bred for use in research, for purposes covered by the AWA. (Such entities may include dealers, research facilities, exhibitors, operators of auction sales, and carriers and intermediate handlers of rats and mice covered by the AWA that are sold as pets at the wholesale level, transported in commerce, used in exhibits, or used for research, teaching, testing, or experimentation purposes.)

15. What is the number of each species of rats and mice, except for rats of the genus *Rattus* and mice of the genus *Mus* bred for use in research, that are currently sold as pets at the wholesale level, transported in commerce, used in exhibits, or used for research, teaching, testing, or experimentation purposes?

16. Comments are invited concerning the current physical structures, equipment, staffing, licensing, and paperwork used in the handling, care, treatment, and transportation of rats and mice, except for rats of the genus *Rattus* and mice of the genus *Mus* bred for use in research, for purposes covered by the AWA. If you are submitting suggested standards for rats and mice in response to question 12 or believe that we should establish specific standards for covered rats and mice that are consistent with the *Guide* (see question 13, above), please address how those standards would affect facility operations.

17. What are the potential economic effects, in terms of time and/or money, on entities that may be affected if we were to establish specific standards for rats and mice covered by the AWA? (Such entities may include dealers, research facilities, exhibitors, operators of auction sales, and carriers and intermediate handlers of rats and mice covered by the AWA that are sold as pets at the wholesale level, transported in commerce, used in exhibits, or used for research, teaching, testing, experimentation, or exhibition purposes.)

18. Do you have any other specific concerns or recommendations pertaining to the regulation of rats and mice other than rats of the genus *Rattus* and mice of the genus *Mus* bred for use in research?

Authority: 7 U.S.C. 2131–2159; 7 CFR 2.22, 2.80, and 371.7.

Done in Washington, DC, this 1st day of June 2004.

Bill Hawks,

Under Secretary for Marketing and Regulatory Programs.

[FR Doc. 04–12692 Filed 6–3–04; 8:45 am]

BILLING CODE 3410–34–P

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: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA or agency) proposes to change its regulatory capital treatment for preferred stock issued by Farm Credit System (FCS or System) banks, associations, and service corporations and place certain restrictions on the retirement of preferred stock. Additionally, this proposal would require greater board involvement and oversight in the retirement of preferred stock, enhance the current standards of conduct regulations to specifically address insider preferred stock transactions, and require disclosure of senior officer and director preferred stock transactions. We also propose to modify and streamline our process for reviewing and clearing disclosure for certain issuances of FCS equities. Lastly, we propose to add a new provision to control investments by FCS banks, associations, and service corporations in preferred stock of other FCS institutions, including the Federal Agricultural Mortgage Corporation (Farmer Mac).

DATES: Please send your comments to us by August 3, 2004.

ADDRESSES: You may send comments by electronic mail to *reg-comm@fca.gov,* through the Pending Regulations section of FCA's Web site, *www.fca.gov,* or through the Governmentwide *www.regulations.gov* portal. You may also send comments to S. Robert Coleman, Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102–5090 or by fax to (703) 734–5784. You may review copies of all comments we receive at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

Laurie A. Rea, Senior Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4479; TTY (703) 883–4434;

or

Howard Rubin, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4020, TTY (703) 883–2020.

SUPPLEMENTARY INFORMATION:

I. Objectives

Through this rulemaking we strive to:

- Ensure the stability and quality of capital at FCS institutions by establishing safety and soundness parameters on the issuance of preferred stock;
- Place restrictions on preferred stock issued by FCS institutions that can be continually redeemed and has limited attributes of equity;
- 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 issuances of nonborrower equities; 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. Background

A. Informational Memorandum

FCA recently experienced an increase in requests from FCS institutions to review new preferred stock issuances. In reviewing submissions where associations sought to offer preferred stock to borrowers, we identified a number of policy and safety and soundness issues that led to a review of our capital adequacy regulations. In the fall of 2003, we outlined our concerns in an informational memorandum to all FCS institutions, which indicated that the FCA Board planned to consider modifications to FCA regulations to address these policy and safety and soundness issues.[1]

We noted that questions exist about the stability (''permanency'') and quality of preferred stock that an institution plans to redeem routinely with few limitations or without direct involvement or consideration by the institution's board of directors. In particular, we highlighted our concerns about the risk associated with the capital and earnings volatility that may result from fluctuations in purchases and retirements that may occur daily. Preferred stock programs may be an especially volatile source of capital under adverse credit or interest rate

[1] *See* Informational Memorandum, Roland E. Smith, Issuance of Preferred Stock, September 9, 2003.

conditions when the likelihood of requests for redemption is increased.

Stock that lacks permanence and other attributes of equity may not be available to absorb unforeseen losses, support growth, meet liquidity demands, or build financial strength. Overreliance on such programs as a source of capital may result in unsafe and unsound conditions and lessen incentives to procure more stable forms of capital. Therefore, it is necessary to take appropriate action to ensure that each FCS institution's capital continues to be primarily composed of equities that are likely to be a long-term feature of the institution's capital base. For this reason, we believe additional regulatory parameters and limits on certain types of preferred stock programs are warranted.

In 1997, FCA adopted new surplus and collateral requirements in order to better measure and ensure the adequacy of FCS institution capital.[2] However, many FCS stockholders and others still regard ''permanent capital'' to be a meaningful measure of an FCS institution's financial stability. Therefore, including certain types of preferred stock that lack qualities of ''permanence'' in an institution's permanent capital ratio may give stockholders an inaccurate or misleading impression about the institution's true financial condition. FCS institutions need to ensure that stockholders receive complete information regarding the components of their institution's capital base and the long-term stability of those components. Fair, accurate, and complete disclosure about preferred stock programs in all written materials (including marketing materials, Web page advertisements, and other written information) is another critical issue of concern for FCA. Therefore, we are soliciting public input on what additional disclosures or additional regulatory guidance would be helpful to FCS institutions and benefit potential investors. We are also proposing regulatory changes to help streamline our clearance and review process for certain nonborrower equities. We believe changes can be made to expedite the processing of requests for applications that do not, for example, raise any novel or significant legal, policy or safety and soundness issues.

Lastly, we noted in the informational memorandum that certain preferred stock programs may raise the concern that an institution's board and management may not treat all preferred stockholders equitably regarding stock retirement, or that insiders could become aware of financial difficulties of the FCS institution and retire their stock before other shareholders. Thus, the agency is also proposing additional conflict of interest provisions specifically directed to preferred stock issuances.

B. Mission and Policy

In addition to the safety and soundness concerns outlined above, we are proposing new restrictions to address mission and policy concerns regarding preferred stock issued by FCS institutions that is continually redeemed by the institution or otherwise has limited attributes of equity.

FCS 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. 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, preferred stock issued to borrowers provides FCS associations a mechanism for members to invest and participate in their cooperative beyond minimum borrower stock purchases.

However, we question whether Congress intended FCS institutions to issue equities that have many characteristics of deposit or money market instruments. FCS institutions do not have authority to accept deposits except for limited circumstances specifically authorized by statute. Preferred stock securities that are structured so that a holder can reasonably expect redemption upon request have many features in common with comparably structured demand debt instruments (such as commercial bank deposits) under normal circumstances. Because the holder of such preferred stock can expect to receive principal and interest to the date of redemption, the preferred stock is functionally similar to a deposit or money market instrument under normal circumstances.

On balance, unlike a commercial bank deposit, FCS preferred stock is an ''at-risk'' equity investment and a preferred stockholder ordinarily does not have an enforceable right to demand redemption. The holder of a deposit instrument, such as a demand deposit, time deposit, certificate of deposit, or a ''money market'' deposit has an enforceable legal right to demand payment. By contrast, the holder of preferred stock (a form of equity security) does not have an enforceable right to demand payment. Further, 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 its principal investment) and is, therefore, includable as permanent capital.

Given these competing and dual characteristics that certain types of preferred stock may possess, we have endeavored to carefully craft regulations that appropriately balance mission and policy issues relating to these instruments in addition to addressing safety and soundness concerns.

C. Authority

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 included preferred stock within the meaning of ''stock.'' [4] Congress did not define ''preferred stock'' in the Farm Credit Act of 1971, as amended (Act). Congress defined ''permanent capital'' in the Act to mean:

(A) Current year retained earnings;

(B) Allocated and unallocated earnings (which, in the case of earnings allocated in any form by a System bank to any association or other recipient and retained by the bank, shall be considered, in whole or in part, permanent capital of the bank or of any such association or other recipient as provided under an agreement between the bank and each such association or other recipient);

(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.

When first implementing the new capitalization statutes added by the 1987 amendments to the Act, FCA stated: ''No 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

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

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

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

essential characteristics of permanent capital.'' [5] Therefore, FCA may authorize System institutions to issue preferred stock so long as the stock is at risk and the institution's board retains discretion over stock retirements.

Section 4.3 of the Act [6] requires FCA to ensure that System institutions ''achieve and maintain adequate capital.'' Title V of the Act [7] authorizes FCA to adopt regulations to implement the Act and to take enforcement action in response to, or to prevent, an unsafe or unsound practice. Congress specifically provided that capitalization of System institutions, including the manner in which stock is issued, held, transferred, and retired, is subject to FCA regulation.[8]

III. Section-by-Section Discussion of Proposed Changes

A. Standards of Conduct—§ 612.2165

There is the potential that an insider with access to material confidential information may be able to use that information to make advantageous purchases of preferred stock or request retirement before negative information becomes publicly available. In particular, directors, who are insiders, as well as borrowers and investors, will inevitably possess earlier and more detailed knowledge about the affairs of the institution than other investors. Insiders will know in advance whether a floating or administered dividend rate on preferred stock will change and, if so, by how much and when. They will also know whether the association will have to stop paying dividends due to capital or earnings problems. For these reasons, we believe strong regulatory controls are appropriate.

Currently, System institution (defined to include banks, associations, and service organizations) directors are prohibited by § 612.2140 from making use of non-public information or using their position or inside information to obtain a personal benefit. Section 612.2165 requires the board of directors establish requirements and procedures ''to promote public confidence in the institution and the System * * * and prevent the improper use of official * * * information.'' Employees are prohibited by § 612.2150(b) and (e) from divulging or making use of ''any fact, information, or document not generally available to the public that is acquired by virtue of employment with a System institution'' and from using such information to obtain any personal benefit.

In addition, § 612.2160 requires each institution to ensure that its directors and employees comply with the Standards of Conduct regulations and to ''act promptly to preserve the integrity of and public confidence in the institution in any matter involving a conflict of interest;'' to ''[t]ake appropriate measures to ensure that all directors and employees are informed of the requirements of this regulation'' and the institution's related policies and procedures; and to ''[a]dopt and implement policies and procedures that will preserve the integrity of and public confidence in the institution and the System * * * .'' Under § 612.2170, the institution must designate a Standards of Conduct Official to advise directors, director candidates, and employees on standards of conduct regulations and policies. The Standards of Conduct Official must also report to the board and the FCA any violation that ''may have an adverse impact on continued public confidence in the System or any of its institutions.''

Although the current standards of conduct regulations discussed above are comprehensive, we believe that enhancements to these regulations would strengthen our requirements, reduce the potential for conflicts of interest, and heighten the awareness of this important issue. Thus, we are proposing to add two new provisions. The purposes of these provisions are to help ensure fair and equitable treatment of all stockholders and to address the potential issue that employees and directors could use information regarding changes in dividend rates, regulatory capital ratios, the financial condition of the institution, or other material information that is not available to all investors to their advantage.

Specifically, proposed § 612.2165(b)(14) requires FCS institutions to establish policies and procedures that 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. 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.

We are also proposing other corresponding controls relating to insider transactions and retirement of equities that are discussed later in this preamble.

B. Lending Limits—§ 614.4351

The agency has routinely required FCS institutions that issue preferred stock that does not qualify as total surplus [9] (such as preferred stock with a planned continual redemption feature) to exclude it from their lending limit base calculation (the maximum amount an institution can extend to an individual borrower). This control has been instituted to limit significant fluctuations in an institution's lending base that may occur due to stock purchases and redemptions and to limit the ability of an institution to appreciably increase its lending base with volatile securities. This condition has also been imposed to reduce the possibility that an FCS institution would be in noncompliance with FCA regulations due to routine preferred stock redemptions that caused the institution's capital levels to decline to a level where large loans would exceed the institution's legal lending limit. Lastly, this condition is also an effective safety and soundness control to limit the level of credit risk to a single counterparty or obligor.

For these same reasons, we are now proposing to institute a similar requirement in our regulations by adding a new paragraph (a)(3) to § 614.4351 to the computation of the lending and leasing limit base. 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).

C. Investments in FCS Institution Preferred Stock—§ 615.5175

We believe there is a need to increase our oversight of the flow of capital between FCS institutions through investments in preferred stock. 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).[10] The proposal also requires that an institution's request to purchase preferred stock in another FCS institution, including Farmer Mac, explain the terms and risk characteristics of the investment and the purpose and objectives for making the investment.

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

[6] 12 U.S.C. 2154.

[7] 12 U.S.C. 2241 *et seq.*

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

[9] *See* 12 CFR 615.5301(i).

[10] The FCA is concurrently considering amendments that will address investments by Farmer Mac in other FCS institutions.

As the safety and soundness regulator, we believe that it is important for FCS institutions to build their capital primarily through earnings. Diversified capital sources, however, can be a valuable source of additional financial strength. For example, preferred stock issuances can be a useful method for FCS institutions to build capital to fulfill their ongoing mission to serve agriculture and rural areas. However, for the reasons explained below, we believe that investment by one FCS institution in another FCS institution needs to be closely monitored.

FCS banks and associations have statutory authority to purchase nonvoting equities in other FCS institutions.[11] Historically, investments in preferred stock of other FCS institutions have been made to provide financial assistance. For instance, in the 1980s, several FCS banks purchased preferred stock issued by financially troubled associations. Today, there are a number of FCS institutions that are issuing preferred stock for a variety of other reasons, including meeting long-term capital objectives and supporting growth.

There have not been any recent investments by FCS banks, associations, or service corporations in the preferred stock of other FCS institutions, including Farmer Mac. Nevertheless, certain preferred stock investments of this nature could potentially reduce the perceived quality of FCS and Farmer Mac capital. These investments could be used to improve the regulatory capital ratios of individual FCS institutions without providing additional risk-bearing resources to the System as a whole. For example, if two FCS associations invested in each other's preferred stock, FCA regulations would require each FCS institution to deduct from its assets and total capital an amount equal to the reciprocal investment before computing its regulatory capital.[12] However, if the investment came from a third FCS institution and there were no reciprocal investments, the regulatory capital of the issuing institutions could also increase. Furthermore, an FCS institution's ability to invest unlimited amounts in preferred stock issued by other FCS institutions creates concentration and systemic risks.

D. Capital Adequacy—Definitions—§ 615.5201

We are proposing to modify our definitions in subpart H that apply to our capital adequacy regulations by defining preferred stock by class and maturity. Current § 615.5201 does not specifically define preferred stock, but includes preferred stock within the definition of permanent capital. We are proposing changes to better define and capture the various classes of preferred stock currently offered in the marketplace. We are proposing to use these new definitions to differentiate how each class is treated for permanent capital ratio computation purposes, which we discuss later in this preamble. Also, to the extent appropriate to the activities of the FCS institutions, we are proposing definitions similar to those used by other financial regulatory agencies.[13]

Under the proposal, the reference to term preferred stock is removed from the definition of permanent capital in § 615.5201(1)(5). Instead, preferred stock is more broadly defined under proposed § 615.5201(m) as stock that is ''permanent capital and has dividend and/or liquidation preference over common stock.'' The definition of preferred stock is further described as including, but not limited to, the following instruments:

(1) *Convertible preferred stock*, which means preferred stock that is mandatorily convertible into any other class of equities.

(2) *Intermediate-term preferred stock*, which means term preferred stock with an original maturity of at least 5 years but less than 20 years.

(3) *Limited life preferred stock*, which means preferred stock that has an original maturity of less than 5 years or preferred stock that has an effective maturity of less than 5 years and no stated maturity date.

(4) *Long-term preferred stock*, which means term preferred stock with an original maturity of 20 years or more.

(5) *Perpetual preferred stock*, which means preferred stock that does not have a maturity date and has no other provisions that will require future retirement of the issue.

For consistency with the other financial regulatory agencies and to provide for future use, we reference convertible preferred stock in the proposed rule even though we do not refer to such stock anywhere else in our regulations and no System institution has issued such stock.

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

We are proposing to add new § 615.5203 to address the treatment of preferred stock for permanent capital computational purposes. This provision is similar to current § 615.5201(l)(5), which phases out the amount of term preferred stock that is eligible to be counted as permanent capital as it matures. Also, similar to the rules established by the other financial regulatory agencies, this proposal gives institutions less credit for preferred stock that lacks permanence and other positive characteristics of equity for meeting regulatory capital standards.

We believe revisions to our current regulations are needed to more accurately address the relative levels of ''permanency'' of all classes of preferred stock. FCS institutions can issue classes of preferred stock that possess notably different terms/characteristics and have varying levels of ''permanency.'' As previously discussed, some FCS institutions have offered preferred stock that they intend to redeem at any time with the approval of the institution's board, as long as the institution meets its regulatory capital requirements (*e.g.*, continually redeemed preferred stock). Such stock often lacks characteristics of stable equity because its effective maturity can be very short. Yet, under our current permanent capital regulations, this stock is treated the same as perpetual preferred stock that is not routinely retired, allowing an FCS institution to count the full amount outstanding as permanent capital.

Term preferred stock, however, is treated less favorably during the last 5 years of its term under our current regulations for permanent capital computational purposes. 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). Thus, stock that has a remaining maturity of less than 1 year is no longer eligible to be counted as permanent capital. As a result, certain equity instruments that are outstanding for only a short time period may be counted 100 percent in permanent capital, whereas other equity instruments with an original maturity of more than 5 years, but a similar short remaining maturity, are given less equity credit.

Therefore, we are proposing changes to better align our capital requirements with the true characteristics of an equity instrument and remove inconsistencies.

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

[12] *See* 12 CFR 615.5210(e)(1).

[13] We refer collectively to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision as the ''other financial regulatory agencies.''

These changes also reduce safety and soundness concerns that may result from overreliance on equity that lacks stability and is not expected to remain as a permanent feature of the institution's capital base. Additionally, these amendments would help reduce the volatility in an institution's permanent capital ratio that may result from ongoing purchases and redemptions of the institution's preferred stock.

We believe it is essential that an instrument be available to participate in losses while the institution is operating as a going concern. As an instrument approaches maturity, it begins to take on characteristics of a short-term obligation. For this reason, we are proposing to reduce, or discount, the outstanding amount of preferred stock that is eligible for inclusion in the permanent capital ratio as the instrument nears maturity. More specifically, for the purposes of computing the minimum permanent capital ratio, proposed § 615.5203 would permit a System institution to include preferred stock that it issues based on its ''effective maturity'' as follows:

Effective maturity	Amount includable in the permanent capital ratio (in percent)
5 years or more	100
4 years or more and less than 5 years	80
3 years or more and less than 4 years	60
2 years or more and less than 3 years	40
1 year or more and less than 2 years	20
Less than 1 year	0

For the purpose of this section ''effective maturity'' is the earlier of:

(1) The remaining term to the stated maturity date; or

(2) Either the remaining term to the earliest possible date on which an FCS institution may grant a stockholder's request for stock redemption, or the estimated duration of the weighted average term to maturity of the instrument's expected cash flows as determined under § 615.5202(c) as described below.

To use the estimated duration method, a System institution must adequately document and support its methodology and assumptions using historical redemption rates, appropriate discount rates, and, if applicable, timing of call or other features (*e.g.*, interest rate step-ups or caps). The information must be sufficient for FCA or an independent third party to validate the data and analysis to determine its appropriateness. Additionally, at least quarterly, the System institution must validate and adjust, as needed, its duration estimation and conduct appropriate interest rate stress testing on its estimation. However, in calculating effective maturity, a System institution is not required to include isolated retirements made in unusual or extraordinary circumstances (such as the death of a holder or a merger).

We recognize that at the time a class of stock is first issued, an FCS institution may not have sufficient information regarding potential redemption rates to estimate the duration of the instrument. Therefore, FCS institutions may use data gathered on the duration of preferred stock with similar characteristics issued by other financial institutions (including other FCS institutions) or previously issued by the institution to support their estimation.

The regulation also makes explicit that FCA reserves the right to make the final determination of the appropriate capital treatment for any instrument. The FCA will continue to evaluate the terms and characteristics of each issuance of preferred stock as well as the institution's policy and practice of retirement in making its determination.

We are also proposing to limit the total amount of preferred stock with an effective maturity of less than 5 years that an FCS bank, association, or service corporation may include as permanent capital for computation of the permanent capital ratio. Specifically, proposed § 615.5203(e) limits such stock to 25 percent of the institution's permanent capital (after deductions required in the permanent capital ratio computation). This provision is similar to our regulatory limit on the amount of term preferred stock that may be included as total surplus.[14] We are proposing this limit because we believe it is appropriate and necessary to ensure that each FCS institution's permanent capital continues to be primarily composed of equities that are likely to be a long-term feature of the FCS institution's capital base. Further, it is essential for each FCS institution to maintain a stable capital base to meet the future needs of the institution.

[14] *See* 12 CFR 615.5301(1)(4).

F. Implementation of Cooperative Principles—§ 615.5230

We propose to make a one-word addition to § 615.5230(b)(1) to read: ''each issuance of preferred stock * * * shall be approved by a majority of the shares of each class of equities *adversely* affected by the preference * * *'' (Added word emphasized). This change clarifies our intent. We do not consider this to be a substantive change since the revised language conforms to our current interpretation of this rule.

G. Permanent Capital Requirements—§ 615.5240

We have not made any substantive changes to this section. Current § 615.5240(b) separately enumerates different, yet overlapping, permanent capital requirements for: (1) Common stock and participation certificates; (2) perpetual preferred stock; and (3) term preferred stock. We have made paragraph (b) easier to read and apply by consolidating it into one list for all equities. Additionally, we moved the content of existing paragraph (c), covering retirement of borrower stock, to § 615.5270, Retirement of Other Equities.

H. Limitations on FCS Association Preferred Stock—§ 615.5245

The proposal would limit the amount of preferred stock that a single investor may hold in any one FCS association offering. This limitation is intended to reduce the potential that any one holder of association preferred stock could have undue influence on any one class of stock. Thus, a single investor would be less likely to affect dividend rates or redemptions, or influence a decision

that could affect the institution. Additionally, this is another condition that we have imposed on FCS associations that have issued preferred stock. Specifically, proposed § 615.5245(a) requires an association board of directors to adopt a policy to ensure that no holder at the date of purchase or transfer acquires more than the greater of $2 million or 5 percent of any class of outstanding preferred stock in the association.

Additionally, § 615.5245(b) requires boards of directors of FCS associations offering preferred stock to borrowers to adopt a policy that prohibits the association from extending credit to borrowers to purchase preferred stock in the association. The possibility exists that an FCS association's short-term administered loan rate could be less than the dividend rate on the association's preferred stock, providing an arbitrage opportunity. Generally, we would consider this type of lending a practice that is inconsistent with the mission objectives of the System.

I. Disclosure and Review Requirements for FCS Equities—§§ 615.5250 to 615.5255

Under current rules, FCA has two affirmative responsibilities when an institution seeks to sell preferred stock: (1) We review the proposed disclosure statement for adequacy of disclosure; and (2) we determine whether the stock qualifies as permanent capital. In connection with new stock issuances we also routinely:

- Determine whether the stock issuance qualifies as total surplus or core surplus; and,
- Assess whether the stock issuance may present any legal, policy, operational, or safety and soundness issues.

The proposed rule retains the same basic regulatory framework, 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. We have also created separate regulatory sections for borrower stock and nonborrower equities. The disclosure requirements in proposed § 615.5250 for borrower stock remain fundamentally the same. We have, however, made some organizational and plain language changes. The changes we are proposing to our clearance and review process for equities not purchased as a condition of obtaining a loan are contained in proposed § 615.5255.

We anticipate that the new provisions will expedite processing of offerings that do not present significant supervisory or compliance concerns or raise significant legal or policy issues. For issuances where each purchaser and subsequent transferee must acquire at least $250,000 of the stock and meets the Securities and Exchange Commission definition of ''accredited investor'' or ''qualified institutional buyer,'' a disclosure statement is deemed reviewed and cleared by FCA unless FCA notifies the institution to the contrary within 30 days of receipt of a complete disclosure statement submission (which consists of the proposed disclosure statement and any additional materials requested by FCA).[15]

Under this process, an institution may also conclude that FCA will consider the stock permanent capital unless FCA notifies the institution to the contrary within 30 days. Upon request, FCA will provide written confirmation of its determination on how it will treat the proposed issuance for all other regulatory capital measures. We believe the shorter time period is appropriate for market-driven issuances purchased by sophisticated investors that do not raise novel or safety and soundness issues.

In contrast, FCA has heightened interest about smaller, nonstandard issuances offered to unsophisticated borrowers and other investors who may be unaware of the risks involved with the purchase. Therefore, we are proposing to apply a 60-day time period for these issuances. For issuances offered to unsophisticated borrowers and investors, a disclosure statement is deemed reviewed and cleared and an institution may conclude that FCA will consider the stock permanent capital unless FCA notifies the institution to the contrary within 60 days of receipt of a complete disclosure statement submission.

We believe these proposed changes will clarify our process and expedite FCS institutions' ability to issue preferred stock that does not have unique features or raise significant supervisory, legal, or policy issues. These amendments will also help address the concern that the current process could impede an FCS institution's ability to issue stock to sophisticated investors within a specific time period.

Under our current regulations, a FCS institution must disclose to investors purchasing non-borrower equities: (1) All of the information required by part 620 in the annual report to shareholders as of a date within 135 days of the proposed sale; (2) the institution's capitalization bylaws; and, (3) 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:

- The equity is an at-risk investment and not a compensating balance and the equity is retirable 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;
- Whether the institution presently meets its minimum permanent capital standards;
- Whether the institution knows of any reason the institution may not meet its permanent capital standard on the next earnings distribution date; and,
- The rights, if any, to share in patronage distributions.

In addition to the above disclosures, we are proposing to add a new requirement that FCS institutions establish a method to disclose and make information on insider preferred stock purchases and retirements readily available to the public. Under proposed § 615.5255(h), at a minimum, each FCS institution offering preferred stock must make this information available upon request. A FCS institution can also use other means, such as their Web sites, to make information on insider preferred stock transactions available to the public or provide this information along with the other required disclosures at purchase. We believe making this information available will help increase transparency of insider transactions, reduce the potential for insider abuses, and may provide eligible purchasers useful information regarding their decision on preferred stock purchases and retirements.

At this time, we are not proposing any additional changes to our list of required disclosures. However, we invite comments from the public on whether any additional disclosures would be beneficial for investors to receive regarding the sale of non-borrower FCS equities.

Current § 615.5250(c)(4) provides that ''no officer, director, employee, or agent'' shall make any disclosure in connection with the sale of equities, through the disclosure statement or otherwise, that is inaccurate or misleading, or omit to make any statement needed to prevent other disclosures from being misleading. We are proposing to change this provision

[15] Current rules allow FCA waiver of disclosure requirements for minimum purchases of $100,000 by sophisticated investors. We have updated this threshold to $250,000 (the $100,000 limit has remained the same for more than 15 years) to better reflect the activities of market participants.

in proposed § 615.5255(g) by applying the rule to each ''institution'' in addition to specific individuals. Since this section applies to equities offered by institutions, this amendment places responsibility for accurate and truthful disclosures on the institution itself in addition to individual officers, directors, employees, and agents. We also note that FCA considers this provision applicable to all forms of communication regarding a proposed offering—including marketing materials and Web page advertisements—and not just to the formal disclosure statement submitted to FCA.

We are also proposing to add § 615.5255(j), which provides that in addition to FCA requirements, each institution is responsible for ensuring its compliance with all applicable Federal and State securities laws. This provision reiterates that FCA review and clearance of a disclosure statement does not excuse or replace compliance with any other applicable law and does not replace or supersede oversight by any other governmental entity with authority over a securities issuance.

J. Retirement of Other Equities—§ 615.5270

We are proposing amendments that would restrict the ability of an FCS institution board to retire and delegate to management the retirement of preferred stock under certain conditions. Additionally, these new provisions would increase FCS institution board involvement in the retirement of equities that are at risk. We are proposing these new provisions to address the safety and soundness, mission, and policy concerns discussed earlier in this preamble. These new controls will help ensure that FCS equities are fundamentally composed of equities that are likely to remain a long-term feature of the institution's capital and are available to absorb losses of the institution. Additionally, we believe these measures will help ensure the appropriateness of FCS activities within the context of its Government-sponsored enterprise mission.

We are proposing several new restrictions relating to the retirement of preferred stock in § 615.5270. First, an FCS bank, association, or service corporation would not be able to retire limited life preferred stock, except pursuant to §§ 615.5280 and 615.5290 (which relates to retirement in the event of default or restructuring) and except for stock at the end of its stated maturity, unless the institution's permanent capital ratio would be in excess of 8 percent after any retirements. Second, an FCS bank, association, or service corporation would be prohibited from retiring any preferred stock prior to 12 months after the date of issuance, except pursuant to §§ 615.5280 and 615.5290. These provisions are intended to promote the stability (''permanence'') of capital while restricting the issuance of equities that could function like demand deposits or money market instruments.

The FCA is also considering other regulatory measures to ensure that equities issued by FCS institutions are a stable and permanent feature of an institution's capital base. Specifically, we invite comments on whether FCA should institute a longer prohibition on retirement of preferred stock, such as 5 years (rather than 1 year as currently proposed). We also invite specific comment on whether FCA should only allow FCS institutions to retire preferred stock on a pro rata basis by class and not on an individual basis (except in the case of hardship or death). These provisions are two of many possible measures that could help address both the policy and safety and soundness concerns with stock that is continually redeemable. Thus, we are interested in gathering a broad range of perspectives on this subject.

We are also proposing to move the provisions relating to the delegation of retirement of at-risk borrower stock in § 615.5240(c) to § 615.5270(e) and apply those same revisions to all at-risk stock issued by FCS institutions. Thus, an institution's board of directors would only be able to 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 satisfies 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.

We are further proposing to require FCS institutions to adopt a written policy covering the retirement of preferred stock. Specifically, proposed § 615.5270(f) would require each board of directors of a bank, association, or service corporation that issues preferred stock to adopt a written policy covering 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 all the proposed requirements discussed above).

(2) Contain specific limitations on the amount of stock that may be retired during a single quarter (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.

The proposal would also require the institution's board to 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.

The FCA expects FCS institution boards to fully consider the effect preferred stock retirements have on the institution's capital adequacy, current year earnings, patronage to other shareholders, and future capital needs.

We believe these new regulations are necessary to ensure that FCS institutions fulfill their mission objectives in an appropriate and safe and sound manner, as intended under the Act. We also believe 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.

K. Payment of Dividends—§ 615.5295

This proposal adds a new section to address the payment of dividends. These changes further address our mission and policy concerns relating to the issuance of preferred stock that can be continually redeemed.

Under proposed § 615.5295(a), an FCS institution's board of directors would be required to declare a dividend on a class of stock before any dividends may be paid to stockholders. We are adding this provision to emphasize the distinction between debt and equity securities. We are concerned that payment of accrued dividends before an institution's board has declared them makes the dividend payments perform too much like interest payments on debt instruments.

Proposed § 615.5295(b) prohibits an FCS 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. This provision implements section 4.3A(d) of the Act,[16] which prohibits payments of dividends if such action would cause the institution to fail to meet its permanent capital requirements and extends this safety and soundness measure to include all regulatory capital requirements.

Lastly, proposed § 615.5295(c) would require an FCS institution to exclude any accrued but unpaid dividends from regulatory capital computations. We are proposing this amendment to remove any potential that capital could be inflated through temporary accounts as an additional safety and soundness measure.

L. Disclosure of Insider Preferred Stock Transactions

We are proposing to amend § 620.5(j)(2) relating to the required disclosures of transactions with senior officers and directors in FCS institution annual reports to shareholders. We are proposing to add a new requirement that FCS institutions disclose insider preferred stock transactions and make other organizational changes to this section. We are proposing this new disclosure requirement along with other disclosure amendments previously discussed in an effort to increase the transparency of insider preferred stock transactions.

Specifically, § 620.5(j)(2)(a) would require FCS institutions to 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. A FCS institution may disclose this information in tabular form as follows:

Name of senior officer or director	Amount of preferred stock held	Average dividend rate	Purchases	Retirements

M. Conforming Changes

We propose to make a conforming change to § 611.1135 to update a cross-reference that would be changed by this proposed rule.

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA hereby certifies that the proposed rule 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 RegulatoryFlexibility Act.

List of Subjects

12 CFR Part 611

Agriculture, Banks, Banking, Rural areas.

12 CFR Part 612

Agriculture, Banks, Banking, Conflicts of interest, 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 propose to 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 AND REFERRAL OF KNOWN OR SUSPECTED CRIMINAL VIOLATIONS

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).

Subpart A—Standards of Conduct

4. Amend § 612.2165 by revising paragraphs (b)(12) and (b)(13) and adding new paragraphs (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,

[16] 12 U.S.C. 2154a(d).

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:

a. Removing paragraph (l)(5) and redesignating existing paragraphs (l)(6), (1)(7), and (1)(8) as (l)(5), (1)(6), and (1)(7), respectively.

b. Redesignating existing paragraphs (m), (n), (o), (p), and (q) as paragraphs (n), (o), (p), (q) and (r), respectively and adding a new paragraph (m) to read as follows:

§ 615.5201 Definitions.

* * * * *

(m) *Preferred stock* means stock that is permanent capital and has dividend and/or liquidation preference over common stock. Preferred stock includes, but is not limited to, the following instruments:

(1) *Convertible preferred stock,* which means preferred stock that is mandatorily convertible into any other class of equities.

(2) *Intermediate-term preferred stock,* which means term preferred stock with an original maturity of at least 5 years but less than 20 years;

(3) *Limited life preferred stock,* which means preferred stock that has an original maturity of less than 5 years or preferred stock that has an effective maturity of less than 5 years and no stated maturity date.

(4) *Long-term preferred stock,* which means term preferred stock with an original maturity of 20 years or more; and,

(5) *Perpetual preferred stock,* which means preferred stock that does not have a maturity date and has no other provisions that will require future retirement of the issue.

* * * * *

10. Add new § 615.5203 to read as follows:

§ 615.5203 Treatment of preferred stock in the permanent capital ratio.

(a) For the purposes of computing the minimum permanent capital ratio, a Farm Credit bank, association, or service corporation may include its preferred stock as permanent capital based on its effective maturity as follows:

Effective maturity	Amount includable in the permanent capital ratio (in percent)
5 years or more	100
4 years or more and less than 5 years	80
3 years or more and less than 4 years	60
2 years or more and less than 3 years	40
1 year or more and less than 2 years	20
Less than 1 year	0

(b) For the purpose of this section effective maturity is the earlier of:

(1) The remaining term to the stated maturity date; or

(2) Either the remaining term to the earliest possible date on which an institution may grant a stockholder's request for stock redemption, or the estimated duration of the weighted average term to maturity of the instrument's expected cash flows as determined under paragraph (c) of this section.

(c) To use the estimated duration method, an institution must adequately document and support its methodology and assumptions using historical redemption rates, appropriate discount rates, and, if applicable, timing of call or other features (*e.g.*, interest rate step-ups or caps). Additionally, at least quarterly, the institution must validate and adjust, as needed, its duration estimation and conduct appropriate interest rate stress testing on its estimation.

(d) In calculating effective maturity, an institution is not required to include isolated retirements made in unusual or extraordinary circumstances (such as the death of a holder or merger).

(e) 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).

(f) The Farm Credit Administration reserves the right to make the final determination of the appropriate capital treatment for any instrument.

Subpart I—Issuance of Equities

11. 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;

* * * * *

12. 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 certificate dividends, 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.

13. Add a new § 615.5245 to read as follows:

§ 615.5245 Limitations on FCS association preferred stock.

The board of directors of each association offering preferred stock to eligible borrowers must adopt a policy that:

(a) Includes measures to ensure that no holder acquires more than the greater of $2 million or 5 percent of any class of outstanding preferred stock in the association at the date of purchase or transfer.

(b) Prohibits the association from extending credit for preferred stock purchases in the association.

14. 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 retirable 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.

15. 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.

(4) 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.

(d) For any class of stock where each purchaser and all subsequent transferees acquire 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, 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.

(e) For all other issuances, 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 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.

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

(g) No institution, officer, director, employee, or agent shall make any disclosure, through a disclosure statement or otherwise, in connection with the sale of equities that is inaccurate or misleading, or omit to

make any statement needed to prevent other disclosures from being misleading.

(h) 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.

(i) 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.

(j) 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

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

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

§ 615.5270 Retirement of other equities.

* * * * *

(c) A bank, association, or service corporation may not retire limited life preferred stock at any time, except pursuant to §§ 615.5280 and 615.5290 and except for stock at the end of its stated maturity, unless the institution's permanent capital ratio will be in excess of 8 percent after any retirements.

(d) No preferred stock may be retired prior to 12 months after the date of issuance, except pursuant to §§ 615.5280 and 615.5290.

(e) 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.

(f) 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 (d) of this section.

(2) Contain specific limitations on the amount of stock that may be retired during a single quarter (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. 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.

18. 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

20. 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

21. Revise § 620.5(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: May 27, 2004.

Jeanette C. Brinkley,

Secretary, Farm Credit Administration Board.

[FR Doc. 04–12514 Filed 6–3–04; 8:45 am]

BILLING CODE 6705–01–P