Rules and Regulations

Federal Register
Vol. 63, No. 129
Tuesday, July 7, 1998

FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 614, 620, and 630

RIN 3052–AB67

Organization; Loan Policies and Operations; Disclosure to Shareholders; Disclosure to Investors in Systemwide and Consolidated Bank Debt Obligations of the Farm Credit System; Other Financing Institutions

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA or Agency), through the FCA Board (Board), issues a final rule amending its regulations that govern the funding and discount relationship between Farm Credit System (Farm Credit, FCS, or System) banks that operate under title I of the Farm Credit Act of 1971, as amended (Act), and non-System other financing institutions (OFIs). The final rule substantially expands access to System funding so OFIs can provide more short- and intermediate-term credit to parties who are eligible to borrow under sections 2.4(a) and (b) of the Act. The FCA has repealed several non-statutory limits on OFI eligibility. The final rule assures access to any creditworthy OFI that is significantly involved in agricultural lending and demonstrates a continuing need for funds to serve its agricultural borrowers. Under certain circumstances, OFIs may seek financing from a Farm Credit Bank (FCB) or agricultural credit bank (ACB) other than the System bank that is chartered to serve its territory. The final rule requires FCBs and ACBs to finance OFIs only on a fully secured basis and to have full recourse to the OFI's capital.

EFFECTIVE DATE: This regulation shall become effective 30 days after publication in the **Federal Register** during which either or both houses of Congress are in session. Notice of the effective date will be published in the **Federal Register**.

FOR FURTHER INFORMATION CONTACT: Eric Howard, Policy Analyst or S. Robert Coleman, Senior Policy Analyst, Regulation and Policy Division, Office of Policy Analysis, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4498,

or

Richard A. Katz, Senior Attorney, Regulatory Enforcement Division, Office of General Counsel, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4020, TDD (703) 883–4444.

SUPPLEMENTARY INFORMATION: This final rule completes a 2-year effort by the FCA to revise these regulations so that farmers, ranchers, and other eligible rural residents have greater access to credit through OFIs that are financed by FCBs and ACBs. On May 17, 1996, the FCA published an Advance Notice of Proposed Rulemaking seeking comments on how these regulations could be more responsive to the credit needs of OFIs and their borrowers. *See* 61 FR 24907. In response to these comments, the FCA proposed a rule that substantially revised the regulations in subpart P of part 614. *See* 62 FR 38223 (July 17, 1997). After considering the comments received, the FCA Board adopts a final rule that provides greater opportunities for OFIs to obtain funding from FCS banks so they can finance agriculture, aquaculture, and other specified rural credit needs.

Sixteen comment letters were received in response to the proposed rule. Of this total, comments were received from 4 trade associations, 5 FCS banks (one comment letter came from 2 FCS banks that are jointly-managed), 4 System direct lender associations, a federation representing System production credit associations (PCAs), a commercial bank, a commercial bank holding company, and an existing OFI. Four trade associations submitted comments on behalf of their members: the American Bankers Association (ABA); the Independent Bankers Association of America (IBAA); the North Dakota Bankers Association (NDBA); and the Farm Credit Council (Council).

The comment letters revealed a diverse range of views about OFI access to System funding. All System direct lender association commenters, except one, opposed any revision to the existing OFI regulation because of their concerns over competition. One commercial bank supported the proposed rule and urged the FCA to adopt it as a final rule without revision. Three commercial bank trade associations recognized the FCA's efforts to improve OFI access to System funding, but they recommended modifications to the rule. The remaining commenters focused on specific issues that were important to their institutions.

Commercial bank trade associations opined that the FCA's regulatory proposal made progress toward granting OFIs more access to System funding. However, these commenters believe that several provisions of the statute discourage many commercial banks from becoming OFIs. The most commonly cited statutory impediments to greater commercial bank participation in this program include: (1) No authority for OFIs to obtain System bank funding [1] for long-term mortgages; (2) lack of OFI representation on the boards of FCS funding banks; and (3) the need to offer borrower rights. For these reasons, the commenters again asked the FCA to support legislative initiatives that would remodel the FCS so it is similar to the Federal Home Loan Bank System. As the commenters acknowledge, the existing statute does not enable the FCA to accommodate some of their requests, and therefore, these issues are not addressed by this rulemaking.

Several PCA commenters expressed concern that expanded OFI access would place them at a competitive disadvantage. These commenters asked the FCA to enact regulations that provide PCAs with more business opportunities before final OFI regulations are adopted. Although several commenters stated that PCAs cannot effectively compete with OFIs until their intermediate-term lending authorities are expanded, section 1.10(b) of the Act establishes the maximum timeframe for intermediate-term loans.

The FCA has considered the concerns of the commenters and adopts a final rule that balances the needs of these parties. The final rule incorporates

[1] As used in this preamble, references to Farm Credit banks apply only to FCBs and ACBs. Although the bank for cooperatives is also a System bank, it lacks statutory authority to finance the OFIs identified in section 1.7(b) of the Act.

many of the commenters' suggestions and promotes a safe and sound lending relationship between System funding banks and their OFIs. The changes increase availability of credit to farmers, ranchers, aquatic producers and harvesters, and other eligible rural borrowers.

I. OFI Access

A. Proposed Rule and Comments

The FCA proposed a two-tier approach for OFIs to establish their eligibility for a funding and discount relationship with a System bank. Under § 614.4540(a), any financial institution that operates under one of the charters specified in section 1.7(b)(1)(B) of the Act may borrow from an FCB or ACB. Additionally, § 614.4540(b) assures access to creditworthy OFIs that have at least 15 percent of their loans to agricultural or aquatic producers and enter into a 2-year funding agreement with an FCB or ACB. The regulations require OFIs to use System funding only to extend short- and intermediate-term credit to eligible persons for authorized purposes under sections 1.10(b) and 2.4(a) and (b) of the Act. This new approach enables more OFIs to borrow from System banks, and as a result, farmers and ranchers should have greater access to affordable and dependable credit.

The FCA proposed to repeal the following eligibility provisions of the existing regulations that are not required by the Act:

- The 60-percent loan-to-deposit ratio for OFIs that are depository institutions;
- The requirement that OFIs primarily use locally generated funds for lending operations;
- The automatic denial of access to any entity that primarily finances the sale of products by its affiliates;
- Consideration of an OFI applicant's relationship with its affiliates and subsidiaries; and
- A mandatory non-use fee for OFIs that fail to maintain a specified average daily loan balance.

The FCA received comments on proposed § 614.4540 from the ABA, IBAA, NDBA, and the Council. These commenters supported the repeal of the non-statutory OFI eligibility criteria that are identified above. The final rule repeals these provisions.

Although all four trade associations supported greater OFI access to System funding, they expressed differing views on the need to modify proposed § 614.4540. The NDBA supported the two-tier approach for OFI access. The Council requested that the FCA amend the regulation so it expressly conveys that System funding banks have discretion to deny the credit application of any OFI that is not covered by § 614.4540(b).

The ABA and IBAA requested amendments that would favor their respective constituencies. The IBAA believes that the regulation should favor small, rural community banks whereas the ABA opined that all banks that provide agricultural credit should be entitled to System funding. The IBAA commented that no lender should be granted access to the FCS unless agricultural loans comprise at least 10 percent of its loan portfolio. Although the IBAA supports the 15-percent threshold for assured access, it believes that OFIs that meet this criterion should be entitled to preferred status and special benefits, such as the lowest cost of funds from System banks and greater flexibility concerning collateral requirements. In contrast, the ABA suggested that any commercial bank should be assured access under final § 614.4540(b) if agricultural loans comprise at least 10 percent of its loan portfolio, or exceed a fixed dollar amount, such as $5,000,000. In the ABA's view, the final rule should include a fixed dollar threshold because agricultural loans often comprise a small percentage of the loan portfolios of large commercial banks that are major providers of agricultural credit. This commenter believes that these large commercial banks deserve assured access to System funding.

The ABA also asked the FCA to reorganize proposed § 614.4540. The commenter suggested that the FCA relocate the provisions in proposed § 614.4540(b) that enable FCBs and ACBs to deny the funding requests of OFIs that are assured access to § 614.4540(c), which governs denials. The ABA stated that this change would clearly communicate the FCA's expectations to System banks and make this regulation more user-friendly.

The IBAA requested that the FCA assume a more active role in collecting and reporting information about the efforts of each System bank to provide agricultural credit through OFIs. Specifically, the commenter suggested that the FCA appoint an Ombudsman to review complaints by OFIs. Additionally, the IBAA recommended that the FCA's Annual Report contain comprehensive information about the number of OFI applications, the number of funding requests that are either approved or denied, a summary of the reasons for denial, and the total amount of funds that System banks advance to OFIs. The IBAA also asked that the final regulations require outside board members to represent OFI interests and establish target goals for the minimum number of new commercial bank OFIs that each System bank will approve every year.

B. Final Rule

Final § 614.4540 retains the two-tier approach to OFI eligibility as proposed. The FCA continues to believe that this regulatory approach best implements the requirements of the Act. Section 1.7(b) of the Act and its legislative history indicate that Congress intended that Farm Credit banks primarily provide financial assistance to small, local OFIs, but it did not exclude other agricultural creditors from this program.[2]

The FCA was not persuaded by the IBAA's request to exclude large financial institutions and the ABA's request to grant most large commercial banks the same assured access to FCS funding as small, local OFIs. Accordingly, the FCA does not adopt the IBAA's recommendation to amend § 614.4540(a) so that OFI applicants are automatically denied access to FCS funding if agricultural loans comprise less than 10 percent of their loan portfolios. In addition, the final regulation does not incorporate the ABA's request that final § 614.4540(b) grant assured access to OFIs that have at least $5,000,000 or 10 percent of their loan portfolio in agricultural loans. The FCA emphasizes that the final regulation allows any institution, including large financial institutions, to fund or discount their agricultural loans with an FCB or ACB, but it does not assure access to creditworthy OFIs unless they have at least 15 percent of their loans in agriculture and enter into a 2-year funding relationship. The FCA continues to believe that the 15-percent threshold is the best measure of whether an OFI is significantly involved in agricultural or aquatic lending, as section 1.7(b)(4)(B)(i) of the Act requires.

The IBAA requested that the final regulation require FCBs and ACBs to provide the lowest cost of funds and other special benefits to OFIs that are entitled to assured access. This request would unnecessarily involve the regulator in the daily business decisions of System banks. Additionally, final § 614.4590 requires Farm Credit banks to treat their OFIs equitably and to determine loan rates through an objective process. The FCA believes that System funding banks should retain

[2] See H.R. 96–1287, 96th Cong., 2d. Sess., (1980), 21, 32–34. *See also* 126 Cong. Rec. H 10960–64 (daily ed. Nov. 19, 1980).

discretion to negotiate the price of funding and other loan terms with OFIs. The final rule fulfills the FCA's responsibility to ensure that FCBs and ACBs abide by their statutory mission to finance creditworthy OFIs in a safe and sound manner.

Many of the ABA's suggestions for reorganizing § 614.4540 have been incorporated into the final rule. The FCA adopts proposed § 614.4540(a) as a final regulation, without revision. This provision allows FCBs and ACBs to fund and discount short- and intermediate-term agricultural, aquatic, processing and marketing, farm-related business, and rural home loans for any financial institution that operates under a charter specified in section 1.7(b)(1)(B) of the Act. As amended, final § 614.4540(b) grants assured access to creditworthy OFIs that maintain at least 15 percent of their loan volume to agricultural and aquatic producers and enter into a 2-year funding or discount relationship with an FCB or ACB. Final § 614.4540(c) retains the requirement in the proposed regulation that FCBs and ACBs establish objective policies and loan underwriting standards for determining the creditworthiness of each OFI applicant. Under final § 614.4540(d), FCBs and ACBs can deny the funding requests of creditworthy OFIs that satisfy the conditions in § 614.4540(b) only if such requests: (1) Adversely affect the Farm Credit bank's ability to achieve and maintain established or projected capital levels or raise funds in the money markets; or (2) otherwise expose the Farm Credit bank to safety and soundness risks. The Council requested that the FCA amend § 614.4540(a) so it expressly conveys that System funding banks have discretion to deny the credit application of any OFI that is not assured access. This revision is unnecessary because § 614.4540(c) requires FCBs and ACBs to develop loan underwriting standards for all OFI applicants. As a result, the framework of this regulation provides FCS banks appropriate discretion, under their policies and loan underwriting standards, to deny the funding requests of OFIs that are not assured access.

Commercial bank trade associations commented that the proposed regulation did not require System funding banks to explain their reason for denying an OFI's application. In response to this concern, the FCA adds § 614.4540(e) that requires System banks to expeditiously process all OFI funding requests and to promptly provide all applicants written notification of the credit decision. Additionally, System banks must provide the applicant with specific reasons for any adverse credit decision.

In response to the IBAA's recommendation about comprehensive reporting on OFIs, the FCA adds new § 614.4540(f), which requires the board of directors of each FCB and ACB to receive annual written reports about the scope of their OFI program activities during the preceding fiscal year. The FCA expects that these annual reports will identify:

- The number of OFI applicants by category (such as commercial banks, credit unions, agricultural credit corporations, etc.);
- The number of approved and denied OFI applications;
- A summary of the reasons for denying OFI applications;
- The total amount of funds advanced to OFIs; and
- Other information necessary to evaluate the success of the System bank's OFI program.

Periodically, the FCA may issue special calls for this information.

The FCA does not adopt the IBAA's request to appoint an OFI Ombudsman because there are more efficient ways for the FCA to address concerns that OFIs may raise. The FCA Board does not accept the IBAA's request that the Agency appoint outside board members to represent OFI interests and to establish target goals for OFI lending. The FCA has no authority under the Act to appoint directors to the boards of Farm Credit banks. In further response to the IBAA, the Agency believes that this rule offers FCS banks sufficient business incentives to extend more credit to OFIs. Additionally, a creditworthy OFI has the option to seek funding from another System funding bank if its designated FCB or ACB denies or fails to approve its application.

II. Place of Discount

Proposed § 614.4550 addresses place of discount for OFIs. Proposed § 614.4550(a) specifies that an FCB or ACB provide funding, discount and other financial assistance to any OFI whose headquarters is located within the funding bank's chartered territory. Under proposed § 614.4550(b), an FCB or ACB could finance an OFI whose headquarters is not located in its chartered territory if the System funding bank identified in § 614.4550(a) consents, denies the OFI's application, or otherwise fails to approve the funding request pursuant to Regulation B of the Board of Governors of the Federal Reserve System, 12 CFR 202.2(f).

The ABA, IBAA, NDBA, three FCBs and two PCAs commented on the place of discount rule. AgFirst FCB supported the FCA's proposal. This commenter believes that the proposal best enables FCS banks to fund OFIs in today's market. The IBAA suggested that the FCA modify its proposal to allow an OFI that is dissatisfied with its System funding bank to seek financing from any other FCB or ACB. The ABA and the NDBA urged the FCA to remove all geographic restrictions on place of discount. These commenters believe that geographic restrictions hamper the success of the OFI program because non-System financial institutions are required to seek funding from a System bank that is owned and controlled by their competitors. The FCB of Texas asserted that the existing regulation governing place of discount is sound and should not be changed. The commenter believes that the FCA's proposal will ultimately lead to unsafe and unsound competition between FCS banks for OFI business. The FCB of Texas opposed the proposal to make an OFI's headquarters the sole factor to determine the place of discount. Finally, two PCAs made the FCA aware of their concerns that associations lack similar opportunities to seek funding from other FCBs or ACBs. After the comment period expired, the FCA received an inquiry from an FCB about whether existing OFIs would be required to change their place of discount once the proposed regulation became final.

The FCA Board believed the proposed rule established a balanced approach concerning the place of discount for OFIs. Traditionally, OFIs have been required to establish a funding or discount relationship with a System bank owned and controlled by their competitors. Several commenters believe that this factor explains why the program has not been widely used by commercial banks and other potential OFIs. The FCA has addressed this concern by proposing a regulation that provides additional flexibility concerning place of discount to OFI applicants.

The FCA believes that some limitations on the place of discount for OFIs are appropriate because FCS charters specify territories that System institutions serve. Direct lender associations do not have the same options to obtain financing from other FCBs and ACBs, and therefore, the recommendations of the three commercial bank trade associations would not treat FCS direct lender associations fairly. Additionally, the ABA's and NDBA's suggestion would deny an FCB or ACB the first

opportunity to finance OFIs operating in its chartered territory. The final rule permits OFIs to apply to any System funding bank after the designated FCS bank rejects or fails to approve the OFI's application. The FCA was not persuaded by the FCB of Texas' argument that changes to the place of discount rule will lead to destructive competition that will ultimately undermine the safety and soundness of the FCS.

In response to the comments, the FCA has modified proposed § 614.4550 to provide additional flexibility regarding an OFI's place of discount. The final regulation continues to require OFIs to apply first to the FCS bank that serves the territory where the OFI operates. The FCA recognizes that some OFIs operate in the chartered territory of two or more FCS banks. Under the final regulation, an OFI may select the FCS funding bank that serves the territory where the OFI is headquartered, or alternatively, where more than 50 percent of the OFI's outstanding loan volume is concentrated.

If the designated funding bank denies, or otherwise fails to approve an OFI's completed application within 60 days, final § 614.4550(b) allows the OFI to apply to any other FCB or ACB. Under final § 614.4550(c), the designated FCS bank may also grant an OFI its consent to seek financing from any other System funding bank. The FCA has redesignated this consent provision as final § 614.4550(c) to enhance the clarity of the regulation. A new provision, § 614.4550(d), states that an OFI is not required to terminate an established funding or discount relationship with its System funding bank if the OFI subsequently relocates its headquarters or experiences a shift in its loan volume concentration.

As mentioned earlier, the FCB of Texas urged the FCA to retain the existing regulation on place of discount. However, the FCB of Texas asked the FCA to consider three alternatives if the final regulation allows OFIs to seek funding from other FCS banks. First, the commenter requested that the FCA modify the regulation to provide the designated FCS bank with the ''right of first refusal'' for any lending agreement that an OFI negotiated with another System bank. Second, the commenter wanted the FCA to determine whether another FCS bank should be permitted to finance each OFI that has been denied credit from the designated System bank for safety and soundness reasons. Finally, the FCB of Texas asked the FCA to clarify that the regulation prohibits an OFI from ''shopping'' FCS banks for funding on a loan-by-loan basis. The commenter sought confirmation that the regulation does not allow an existing OFI to fund or discount individual loans with another System bank if its funding bank rejects those same loans.

The FCA believes a specific ''right of first refusal'' is unnecessary because the designated System bank will have already denied or failed to approve the OFI's initial application. The requirement that an OFI first seek funding from its designated bank is the equivalent of a ''right of first refusal.'' In response to the commenter's second request, the FCA need not determine whether another FCB or ACB can finance an OFI that has been denied credit by its designated funding bank because § 614.4540(c) requires each FCB and ACB to establish its own objective policies and loan underwriting standards for determining an OFI applicant's creditworthiness. The FCA will examine the extension of credit to OFIs in the same context of safety and soundness as it does other risks held in the funding bank's portfolio. The FCA clarifies that the regulation does not permit an OFI to ''shop'' for FCS funding on a loan-by-loan basis because § 614.4560(a)(1) requires all OFIs to execute a general financing agreement (GFA) to establish a funding or discount relationship with a System funding bank. Under the circumstances, § 614.4550(b) applies to the overall relationship between an FCB or ACB and the OFI, not a specific discounted loan.

III. Requirements for OFI Funding Relationships

Proposed § 614.4560 implements several statutory provisions that govern the funding and discount relationship between OFIs and System funding banks. More specifically, each OFI is required to: (1) Execute a GFA with its System funding bank; (2) purchase non-voting stock in the System funding bank pursuant to the bank's bylaws; (3) extend credit only to parties and for purposes that are authorized by sections 1.10(b) and 2.4(a) and (b) of the Act; (4) adhere to portfolio limitations on non-farm rural home loans and certain processing and marketing loans; and (5) comply with statutory and regulatory borrower rights requirements for all agricultural and aquatic loans that an FCB or ACB funds or discounts. Additionally, proposed § 614.4560(e) implements section 5.21 of the Act, which enables the FCA to examine non-depository OFIs and obtain examination reports from the State regulators of commercial banks, trust companies, and savings associations. Under this regulatory provision, OFIs are required to execute the applicable consent forms or releases before they obtain financing from an FCB or ACB. Section 5.22 of the Act enables the FCA to receive examination reports directly from other Federal regulatory agencies.

The FCA proposed to repeal existing § 614.4650, which contains five criteria for a System funding bank to revoke or suspend an OFI's line of credit. The FCA expects each FCS bank to incorporate criteria for revoking or suspending its funding relationship with an OFI into its policies and loan underwriting standards. This issue should also be addressed in the GFA between an OFI and the System funding bank.

The FCA received only one comment about proposed § 614.4560. The IBAA commented that the FCA should establish general guidelines for FCBs and ACBs to follow when they negotiate GFAs with their OFIs. Additionally, the commenter suggested that the FCA consult with OFIs to develop a model GFA.

The FCA recently adopted a GFA rule that eliminated Agency prior-approval of GFAs. See 63 FR 12401, March 13, 1998. The new rule addresses the IBAA's concerns because they provide general guidelines for developing GFAs between System funding banks and OFIs. However, the FCA does not believe it should interfere in the business operations of System banks by negotiating with OFIs to develop a model GFA. The FCA adopts proposed § 614.4560 as a final regulation.

IV. Recourse and Security Requirements

Proposed § 614.4570 would prohibit any FCB or ACB from extending credit to an OFI on an unsecured, limited, or non-recourse basis. Proposed § 614.4570(a) requires an OFI to endorse all obligations that it funds or discounts through an FCB or ACB with full recourse or its unconditional guarantee. Proposed § 614.4570(b)(1) requires each OFI to pledge all notes, drafts, and other obligations that are funded or discounted with the FCB or ACB as collateral for the credit extension. Proposed § 614.4570(b)(2) obligates each FCB or ACB to perfect its security interest in such obligations and the proceeds thereunder in accordance with applicable State law.

A. Full Recourse

An existing OFI, the Council, and two jointly managed FCBs opposed the full recourse requirement in § 614.4570(a). The existing OFI commented that the full recourse requirement would

seriously jeopardize any new opportunities that the new regulation creates for expanded OFI access. One of the jointly managed FCBs expressed concern about how the full recourse requirement in the proposal would affect its relationship with an existing OFI and potential opportunities to finance new OFIs in the future. The Council believes recourse to an OFI's capital should be subject to negotiation between the parties, and each System bank's loan underwriting standards should address this issue.

From a safety and soundness perspective, FCBs and ACBs need full recourse to an OFI's capital in the event of default. Full recourse is necessary because the final rule significantly expands OFI access to the FCS and it repeals many existing regulatory restraints on the funding and discount relationship between System banks and their OFIs. Section 1.7(b)(3)(A) of the Act prohibits a System bank from funding an OFI if its aggregate liabilities exceed ten times its paid-in and unimpaired capital and surplus. In light of this statutory safety and soundness requirement, the FCA believes that it is prudent for FCS banks to have full recourse to an OFI's capital. Additionally, the regulations in 12 CFR part 615, subpart H, require FCS lenders to hold sufficient capital as a cushion against risk in all loans. Full recourse to an OFI's capital strengthens the FCS funding bank's risk-bearing capacity. System funding banks are required to have full recourse to the capital of direct lender associations. Since OFIs have access to other sources of funds, they may expose System funding banks to greater risk of loss than direct lender associations.

B. Security

The FCA received comments from the ABA, IBAA, and the Council about the security OFIs are required to pledge under proposed § 614.4570(b). The ABA and the IBAA requested that the final regulation provide OFIs with additional flexibility to pledge other types of collateral to their FCS funding bank. The ABA opposed § 614.4570(b) because it requires OFIs to pledge all loans that are actually funded by the FCS bank as primary collateral. The commenter believes the requirement is particularly burdensome due to the tracking and recordkeeping that it entails. The ABA recommended that an OFI be allowed to pledge unrelated agricultural loans as collateral. The Council commented that loan perfection should be determined by the FCS funding bank's underwriting standards.

The security requirements of § 614.4570(b) ensure compliance with two sections of the Act. First, section 1.7(b) of the Act requires OFIs to use funds from a title I bank only for the purpose of extending short- and intermediate-term credit to eligible borrowers for authorized purposes under section 2.4(a) and (b) of the Act. Second, OFIs are required to track which loans are funded or discounted through the FCB or ACB funding relationship to ensure compliance with the borrower rights requirements of the Act. In light of these statutory requirements, the FCA does not adopt the ABA's suggestion to allow an OFI to pledge other agricultural loans as primary collateral to a System funding bank. However, § 614.4570(c) permits System funding banks to accept long-term mortgages on agricultural assets as supplemental collateral. Final § 614.4570(b)(2) requires that FCBs and ACBs perfect, in accordance with State law, a senior security interest in any and all obligations that an OFI pledges as collateral.

In summary, the FCA's new regulatory approach for OFI financing affords OFIs greater flexibility and additional access to the FCS. To ensure the safe and sound implementation of the OFI program, the FCA adopts proposed § 614.4570 as a final regulation without revision.

V. Limitation on the Extension of Funding, Discount and Other Similar Financial Assistance to an OFI

Proposed § 614.4580 derives from section 1.7(b)(3) of the Act. This statutory provision prohibits a System funding bank from extending credit to an OFI if its aggregate liabilities exceed ten times its paid-in and unimpaired capital and surplus, or a lesser amount established by the laws of the jurisdiction creating the OFI.

The IBAA commented that the FCA should discourage FCBs and ACBs from establishing less than a 10:1 capital ratio, except under rare circumstances. The commenter expressed concerns that a more stringent capital requirement could raise an OFI's cost of borrowing from the System, and make this program less attractive to potential OFI applicants.

The FCA expects each FCB and ACB to develop loan underwriting standards that address OFI capital requirements. Compliance with these loan underwriting standards are the basis for determining safety and soundness in credit extensions. The FCA believes System banks need the flexibility to tailor underwriting standards to manage the risks from OFIs, based on the banks' risk-bearing capacity. As a safety and soundness regulator, the FCA will not preclude FCBs and ACBs from establishing a capital requirement that is more stringent than the 10:1 ratio in the statute. However, the final rule requires FCS funding banks to treat OFIs equitably in this and other matters. The FCA adopts proposed § 614.4580 as a final regulation.

VI. Lending Limit to a Single OFI Borrower

The FCA proposed to eliminate the existing regulatory lending limit on extensions of credit that OFIs make to their borrowers with FCS funds. The proposal acknowledged that some OFIs will remain subject to the lending limit that their primary regulator imposes under applicable Federal or State law. Additionally, the FCA expects each FCB or ACB to prudently manage the risk exposure caused by concentrations in OFI loan portfolios through its loan underwriting standards and the GFA.

The FCA solicited commenters' views on whether the final rule should contain a lending limit on extensions of credit that an OFI makes to its borrowers with FCS funds. Additionally, the FCA requested suggestions for other approaches to manage and control risks originating through OFI lending relationships.

The ABA, IBAA, and the Council supported the repeal of the existing 50-percent lending limit on OFI borrowers. These commenters advised the FCA that the repeal of the lending limit would enhance the Farm Credit banks' ability to finance OFIs. These trade associations also claimed that the repeal of existing § 614.4565 would not imperil the safety and soundness of System banks that maintain adequate loan underwriting standards. The IBAA requested that the final regulation prohibit FCBs and ACBs from establishing a lending limit *below* 50 percent. The IBAA also expressed concern that the FCA's proposal would impose the Federal or State lending limit on the affiliates and subsidiaries of regulated financial institutions.

As the FCA originally proposed, the final rule repeals the lending limit in existing § 614.4565. In response to the IBAA, the FCA observes that OFIs remain subject to any lending limit imposed by Federal or State law. If the OFI is not subject to a Federal or State lending limit, the funding banks' underwriting standards and the GFA will address single borrower concentration risks in the OFI's portfolio. The FCA rejects the IBAA suggestion that the final rule prohibit FCBs and ACBs from establishing a

lending limit of less than 50 percent because it is inconsistent with safety and soundness. The underwriting standards of each Farm Credit bank should ensure that concentrations in an OFI's loan portfolio do not expose the bank to unacceptable levels of risk.

VII. Equitable Treatment of OFIs and FCS Associations

Proposed § 614.4590 promotes the equitable treatment of OFIs and direct lender associations. Proposed § 614.4590(a) would require FCBs and ACBs to apply objective loan underwriting standards for both types of borrowers. Under proposed § 614.4590(b), the total charges a Farm Credit bank assesses an OFI must be comparable to the charges it imposes on direct lender associations. Furthermore, any variation in funding costs must be attributed to differences in credit risk and administrative costs.

The IBAA and the NDBA commented on proposed § 614.4590. According to the IBAA, references to ''similar'' underwriting standards and ''comparable'' overall cost of funds in the proposed regulation grants System banks too much discretion. The IBAA asserts that the interest rates and the overall cost of funds should be equal for both OFIs and direct lender associations. For this reason, the commenter believes that the final regulation should require System banks to disclose pricing information about their loans to FCS direct lender associations. According to the IBAA, ''equal treatment'' entails lower stock purchase requirements and mandatory dividend payments to OFIs because they are not afforded voting rights and other privileges. The NDBA commented that the final rule should require FCBs and ACBs to adopt ''objective and uniform underwriting standards and pricing requirements.''

The FCA observes that there are fundamental differences between OFIs and direct lender associations. These differences make it difficult to compare the treatment of these two types of financial institutions. The following factors illustrate some of the basic differences between OFIs and direct lender associations that preclude identical treatment:

- OFIs have access to several funding sources whereas direct lender associations are required to borrow from their designated funding bank.
- Direct lender associations have significant amounts of capital invested in their System funding bank, but most OFIs do not.
- As part of a cooperative system, direct lender associations share in System gains and losses. In contrast, OFIs have limited exposure to System losses in the FCS.
- Administrative costs for funding a direct lender association and an OFI differ because OFIs are not required to maintain a long-term commitment with an FCB or ACB.

Under these circumstances, the regulations can only require FCBs and ACBs to treat OFIs and direct lender associations equitably, but not equally. The FCA expects System funding banks to treat similarly situated associations and OFIs comparably. Any variation in the overall amounts that System funding banks charge OFIs and direct lender associations for capitalization requirements, interest rates, and fees shall be attributed to differences in credit risk and administrative costs.

The FCA does not adopt any of the IBAA's suggestions for revising this regulation. The final regulation does not require dividend payments to OFIs, or establish OFI investment levels in System funding banks because the FCA regulations do not impose business practices on FCS institutions in the absence of compelling public policy or safety and soundness reasons. The final regulation does not compel FCS funding banks to charge identical rates to OFIs and FCS direct lender associations, and therefore, it is unnecessary for FCBs and ACBs to disclose pricing information for direct lender associations.

The FCA finds merit in the NDBA's suggestion that § 614.4590(a) should require FCBs and ACBs to establish comparable and objective loan pricing standards for both OFIs and direct lender associations. Accordingly, the FCA has incorporated this revision into final § 614.4590(a). Additionally, the FCA substitutes ''comparable'' for ''similar'' in final § 614.4590(a) so that the language used throughout this regulation is consistent.

VIII. Miscellaneous Issues

A. Association Funding of OFIs

One association asked the FCA to clarify that PCAs and agricultural credit associations can establish and manage OFI relationships on authority delegated by their System banks. The commenter observed that such a program, established under System bank guidelines, would become a natural adjunct to the participation authorities that associations now exercise. Although the Act authorizes only FCBs and ACBs to provide funding to OFIs, the FCA believes that direct lender associations have considerable opportunities for involvement in their funding bank's OFI relationships. Indeed, as funding banks have increasingly become wholesale lenders, associations may be in a position to recruit OFIs, assess the risk in the retail loans or collateral, and service the credit relationship on behalf of the bank. Through their participation authorities, associations may form effective alliances with other agricultural lenders for the benefit of farmers and ranchers.

B. Small Business Investment Companies

A commercial bank holding company commented that the final regulation should permit Small Business Investment Companies (SBICs) to participate in the OFI program. According to the commenter, SBICs and similar state-chartered entities need access to additional stable pools of funds to support their agricultural lending operations. The commenter also suggested that the FCA follow the lead of the Federal Housing Finance Board and permit System banks to invest directly in SBICs.

SBICs do not qualify as OFIs because they do not have one of the charters specified in section 1.7(b)(1)(B) of the Act. Additionally, Federal and State laws effectively preclude SBICs from participating in the OFI program. As a result, the final regulation does not allow SBICs to become OFIs.

The OFI regulations do not implement the investment authorities of FCS banks under sections 1.5(15) and 3.1(13)(A) of the Act. An existing investment regulation, § 615.5140, does not authorize System banks to invest in SBIC equities. However, the FCA recently proposed amendments to § 615.5140, and the Agency will consider the commenter's request when it deliberates on the final investment regulation.

C. Insolvency

The FCA received no comments about proposed § 614.4600, which governs the insolvency of OFIs. The FCA adopts proposed § 614.4600 as a final rule.

List of Subjects

12 CFR Part 611

Agriculture, Banks, Banking, Rural areas.

12 CFR Part 614

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

12 CFR Part 620

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

12 CFR Part 630

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

For the reasons stated in the preamble, parts 611, 614, 620, and 630 of chapter VI, title 12 of the Code of Federal Regulations are amended to read 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, 4.21, 5.9, 5.10, 5.17, 7.0–7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2011, 2021, 2071, 2091, 2121, 2142, 2183, 2203, 2209, 2243, 2244, 2252, 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 P—Termination of Farm Credit Status—Associations

2. Section 611.1205 is amended by revising paragraph (c) to read as follows:

§ 611.1205 Definitions.

* * * * *

(c) *OFI* means an other financing institution that has established a funding and discount relationship with a Farm Credit Bank or an agricultural credit bank pursuant to section 1.7(b)(1) of the Act and the regulations in subpart P of part 614.

* * * * *

PART 614—LOAN POLICIES AND OPERATIONS

3. 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, 4.3A, 4.12, 4.12A, 4.13, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.18A, 4.19, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.7, 7.8, 7.12, 7.13, 8.0, 8.5, 8.9 of the Farm Credit Act (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2096, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2154a, 2183, 2184, 2199, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2206a, 2207, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a–2, 2279b, 2279b–1, 2279b–2, 2279f, 2279f–1, 2279aa, 2279aa–5, 2279aa–9); sec. 413 of Pub. L. 100–233, 101 Stat. 1568, 1639.

Subpart J—Lending Limits

4. Section 614.4350 is amended by revising paragraph (a) to read as follows:

§ 614.4350 Definitions.

* * * * *

(a) *Borrower* means an individual, partnership, joint venture, trust, corporation, or other business entity (except a Farm Credit System association or other financing institution that complies with the criteria in section 1.7(b) of the Act and the regulations in subpart P of this part) to which an institution has made a loan or a commitment to make a loan either directly or indirectly.

* * * * *

5. Subpart P of part 614 is revised to read as follows:

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

Sec.

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

§ 614.4540 Other financing institution access to Farm Credit Banks and agricultural credit banks for funding, discount, and other similar financial assistance.

(a) *Basic criteria for access.* Any national bank, State bank, trust company, agriculture credit corporation, incorporated livestock loan company, savings association, credit union, or any association of agricultural producers engaged in the making of loans to farmers and ranchers, and any corporation engaged in the making of loans to producers or harvesters of aquatic products may become an other financing institution (OFI) that funds, discounts, and obtains other similar financial assistance from a Farm Credit Bank or agricultural credit bank in order to extend short- and intermediate-term credit to eligible borrowers for authorized purposes pursuant to sections 1.10(b) and 2.4(a) and (b) of the Act. Each OFI shall be duly organized and qualified to make loans and leases under the laws of each jurisdiction in which it operates.

(b) *Assured access.* Each Farm Credit Bank or agricultural credit bank must fund, discount, or provide other similar financial assistance to any creditworthy OFI that:

(1) Maintains at least 15 percent of its loan volume at a seasonal peak in loans and leases to farmers, ranchers, aquatic producers and harvesters. The Farm Credit Bank or agricultural credit bank shall not include the loan assets of the OFI's parent, affiliates, or subsidiaries when determining compliance with the requirement of this paragraph; and

(2) Executes a general financing agreement with the Farm Credit Bank or agricultural credit bank that establishes a financing or discount relationship for at least 2 years.

(c) *Underwriting standards.* Each Farm Credit Bank and agricultural credit bank shall establish objective policies and loan underwriting standards for determining the creditworthiness of each OFI applicant.

(d) *Denial of OFI access.* A Farm Credit Bank or an agricultural credit bank may deny the funding request of any creditworthy OFI that meets the conditions in paragraph (b) of this section only when such request would:

(1) Adversely affect a Farm Credit Bank or agricultural credit bank's ability to:

(i) Achieve and maintain established or projected capital levels; or

(ii) Raise funds in the money markets; or

(2) Otherwise expose the Farm Credit Bank or agricultural credit bank to safety and soundness risks.

(e) *Notice to applicants.* Each Farm Credit Bank or agricultural credit bank shall render its decision on an OFI application in as expeditious a manner as is practicable. Upon reaching a decision on an application, the Farm Credit Bank or agricultural credit bank shall provide prompt written notice of its decision to the applicant. When the Farm Credit Bank or agricultural credit bank makes an adverse credit decision on an application, the written notice shall include the specific reason(s) for the decision.

(f) *Reports to the board of directors.* Each Farm Credit Bank and agricultural credit bank shall provide its board of directors with a written annual report regarding the scope of OFI program activities during the preceding fiscal year.

§ 614.4550 Place of discount.

(a) A Farm Credit Bank or agricultural credit bank may provide funding, discounting, or other similar financial assistance to any OFI applicant that:

(1) Maintains its headquarters in such funding bank's chartered territory; or

(2) Has more than 50 percent of its outstanding loan volume to eligible

borrowers who conduct agricultural or aquatic operations in such funding bank's chartered territory.

(b) If the Farm Credit Bank or agricultural credit bank identified in paragraph (a) of this section denies or otherwise fails to approve an OFI's funding request within 60 days of receipt of a ''completed application'' as defined by 12 CFR 202.2(f), the OFI may apply to any other Farm Credit Bank or agricultural credit bank for funding, discounting, or other similar financial assistance.

(c) The Farm Credit Bank or agricultural credit bank may grant its consent for an OFI identified in paragraph (a) of this section to seek financing from another Farm Credit Bank or agricultural credit bank.

(d) No OFI shall be required to terminate its existing funding or discount relationship with a Farm Credit Bank or agricultural credit bank if, at a subsequent time, an OFI relocates its headquarters to the chartered territory of another Farm Credit Bank or agricultural credit bank or the loan volume in the relevant territory falls below 50 percent.

§ 614.4560 Requirements for OFI funding relationships.

(a) As a condition for extending funding, discount and other similar financial assistance to an OFI, each Farm Credit Bank or agricultural credit bank shall require every OFI to:

(1) Execute a general financing agreement pursuant to the regulations in subpart C of part 614; and

(2) Purchase non-voting stock in its Farm Credit Bank or agricultural credit bank pursuant to the bank's bylaws.

(b) A Farm Credit Bank or agricultural credit bank shall extend funding, discount and other similar financial assistance to an OFI only for purposes and terms authorized under sections 1.10(b) and 2.4(a) and (b) of the Act.

(c) Rural home loans to borrowers who are not *bona fide* farmers, ranchers, and aquatic producers and harvesters are subject to the restrictions in § 613.3030 of this chapter. Loans that an OFI makes to processing and marketing operators who supply less than 20 percent of the throughput shall be included in the calculation that § 613.3010(b)(1) of this chapter establishes for Farm Credit Banks and agricultural credit banks.

(d) The borrower rights requirements in part C of title IV of the Act, and section 4.36 of the Act, and the regulations in subparts K, L, and N of part 614 shall apply to all loans that an OFI funds or discounts through a Farm Credit Bank or agricultural credit bank, unless such loans are subject to the Truth-in-Lending Act, 15 U.S.C. 1601 *et seq.*

(e) As a condition for obtaining funding, discount and other similar financial assistance from a Farm Credit Bank or agricultural credit bank, all State banks, trust companies, or State-chartered savings associations shall execute a written consent that authorizes their State regulators to furnish examination reports to the Farm Credit Administration upon its request. Any OFI that is not a depository institution shall consent in writing to examination by the Farm Credit Administration as a condition precedent for obtaining funding, discount and other similar financial assistance from a Farm Credit Bank or agricultural credit bank, and file such consent with its Farm Credit funding bank.

§ 614.4570 Recourse and security.

(a) *Full recourse and guarantee.* All obligations that are funded or discounted through a Farm Credit Bank or agricultural credit bank shall be endorsed with the full recourse or unconditional guarantee of the OFI.

(b) *General collateral.* (1) Each Farm Credit Bank and agricultural credit bank shall take as collateral all notes, drafts, and other obligations that it funds or discounts for each OFI; and

(2) Each Farm Credit Bank and agricultural credit bank shall perfect, in accordance with State law, a senior security interest in any and all obligations and the proceeds thereunder that the OFI pledges as collateral.

(c) *Supplemental collateral.* (1) Each Farm Credit Bank and agricultural credit bank shall develop policies and loan underwriting standards that establish uniform and objective requirements to determine the need and amount of supplemental collateral or other credit enhancements that each OFI shall provide as a condition for obtaining funding, discount and other similar financial assistance from such Farm Credit bank.

(2) The amount, type, and quality of supplemental collateral or other credit enhancements required for each OFI shall be established in the general financing agreement and shall be proportional to the level of risk that the OFI poses to the Farm Credit Bank or agricultural credit bank.

§ 614.4580 Limitation on the extension of funding, discount and other similar financial assistance to an OFI.

(a) No obligation shall be purchased from or discounted for and no loan shall be made or other similar financial assistance extended by a Farm Credit Bank or agricultural credit bank to an OFI if the amount of such obligation added to the aggregate liabilities of such OFI, whether direct or contingent (other than *bona fide* deposit liabilities), exceeds ten times the paid-in and unimpaired capital and surplus of such OFI or the amount of such liabilities permitted under the laws of the jurisdiction creating such OFI, whichever is less.

(b) It shall be unlawful for any national bank that is indebted to any Farm Credit Bank or agricultural credit bank, on paper discounted or purchased, to incur any additional indebtedness, if by virtue of such additional indebtedness its aggregate liabilities, direct or contingent, will exceed the limitation described in paragraph (a) of this section.

§ 614.4590 Equitable treatment of OFIs and Farm Credit System associations.

(a) Each Farm Credit Bank and agricultural credit bank shall apply comparable and objective loan underwriting standards and pricing requirements to both OFIs and Farm Credit System direct lender associations.

(b) The total charges that a Farm Credit Bank or agricultural credit bank assesses an OFI through capitalization requirements, interest rates, and fees shall be comparable to the charges that the same Farm Credit Bank or agricultural credit bank imposes on its direct lender associations. Any variation between the overall funding costs that OFIs and direct lender associations are charged by the same funding bank shall result from differences in credit risk and administrative costs to the Farm Credit Bank or agricultural credit bank.

§ 614.4600 Insolvency of an OFI.

If an OFI that is indebted to a Farm Credit Bank or agricultural credit bank becomes insolvent, is in process of liquidation, or fails to service its loans properly, the Farm Credit Bank or agricultural credit bank may take over such loans and other assets that the OFI pledged as collateral. Once the Farm Credit Bank or agricultural credit bank exercises its remedies, it shall have the authority to make additional advances, to grant renewals and extensions, and to take such other actions as may be necessary to collect and service loans to the OFI's borrower. The funding Farm Credit Bank or agricultural credit bank may also liquidate the OFI's loans and other assets in order to achieve repayment of the debt.

PART 620—DISCLOSURE TO SHAREHOLDERS

6. 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

§ 620.5 [Amended]

7. Section 620.5 is amended by removing the word ''financial'' and adding in its place the word ''financing''; and by removing the words '', as defined in § 614.4540(e) of this chapter'' in paragraph (a)(8).

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

8. The authority citation for part 630 continues to read as follows:

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

Subpart B—Annual Report to Investors

§ 630.20 [Amended]

9. Section 630.20 is amended by removing the words '', as defined in § 614.4540(e) of this chapter'' in paragraph (a)(1)(v).

Dated: June 26, 1998.

Floyd Fithian,

Secretary, Farm Credit Administration Board.

[FR Doc. 98–17844 Filed 7–6–98; 8:45 am]

BILLING CODE 6705–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 98–NM–155–AD; Amendment 39–10643; AD 98–14–10]

RIN 2120–AA64

Airworthiness Directives; Boeing Model 747–400, 757, 767, and 777 Series Airplanes Equipped with AlliedSignal RIA–35B Instrument Landing System Receivers

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule; request for comments.

SUMMARY: This amendment adopts a new airworthiness directive (AD) that is applicable to certain Boeing Model 747–400, 757, 767, and 777 series airplanes. This action requires a revision to the Airplane Flight Manual (AFM) to prohibit certain types of approaches if only one instrument landing system (ILS) receiver is operational. This action also requires repetitive inspections to detect certain faults of all RIA–35B ILS receivers, and replacement of discrepant ILS receivers with new, serviceable, or modified units; or, alternatively, an additional revision to the AFM and installation of a placard to prohibit certain operations. This AD also provides for optional terminating action for the AFM revisions and repetitive inspections. This amendment is prompted by a report of errors in the glide slope deviation provided by an ILS receiver. The actions specified in this AD are intended to detect and correct faulty ILS receivers, and to ensure that the flightcrew is advised of the potential hazard of performing ILS approaches using a localizer deviation from a faulty ILS receiver and also advised of the procedures necessary to address that hazard. Erroneous localizer deviation could result in a landing outside the lateral boundary of the runway.

DATES: Effective July 22, 1998.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of July 22, 1998.

Comments for inclusion in the Rules Docket must be received on or before September 8, 1998.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Transport Airplane Directorate, ANM–114, Attention: Rules Docket No. 98–NM–155–AD, 1601 Lind Avenue, SW., Renton, Washington 98055–4056.

The service information referenced in this AD may be obtained from AlliedSignal Aerospace, Technical Publications, Dept. 65–70, P.O. Box 52170, Phoenix, Arizona 85072–2170. This information may be examined at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Jay Yi, Aerospace Engineer, Systems and Equipment Branch, ANM–130S, FAA, Transport Airplane Directorate, Seattle Aircraft Certification Office, 1601 Lind Avenue, SW., Renton, Washington 98055–4056; telephone (425) 227–1013; fax (425) 227–1181.

SUPPLEMENTARY INFORMATION: The FAA has received a report indicating that, during a test flight of a Boeing airplane, the flightcrew detected discrepancies in the glide slope deviation provided by one of the onboard Instrument Landing System (ILS) receivers. (The glide slope is the flight path that an airplane is to follow when making an ILS landing. The display of the glide slope deviation indicates the position of the airplane relative to the glide slope and indicates to the flightcrew whether the airplane needs to be at a higher or lower altitude to be on the normal approach flight path.) The discrepancies in the glide slope deviation provided by the discrepant ILS receiver resulted in the display showing that the airplane was on the glide slope, when the airplane was approximately one dot low on the glide slope (as determined from the data provided by the ILS receivers that were operating correctly). The flightcrew received no annunciation that there were discrepancies between the glide slope deviations being provided by the ILS receivers.

An investigation conducted by AlliedSignal, the manufacturer of the RIA–35B ILS receivers installed on the airplane, has revealed that the discrepancies in the glide slope deviation were caused by failure of an internal component of the ILS receiver due to that component's sensitivity to temperature. Due to the nature of the failure, that component also could fail on other airplanes.

The same ILS receiver provides localizer deviation. (The display of the localizer deviation indicates the position of the airplane relative to the center line of the runway during an ILS landing.) Faults in the ILS receiver, if not corrected, could result in a landing outside the lateral boundary of the runway. If a faulty ILS receiver provides a localizer deviation that contains errors that are not detected by the flightcrew, use of a single ILS receiver for ILS or localizer approaches could result in the pilot being directed to land the airplane outside the lateral boundary of the runway. If the localizer deviations generated by two of the ILS receivers onboard the airplane contain errors that are not detected by the flightcrew, during category II and III operations, the autopilot system may land the airplane outside the lateral boundary of the runway.

The FAA finds that flightcrews are not currently provided with adequate information necessary to address the potential hazard of performing an ILS or localizer approach using a localizer deviation provided by a faulty ILS receiver. Therefore, the FAA has determined that flightcrews must be provided with such information and must be made aware that certain types