FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 615, 620 and 627

RIN 3052–AB58

Organization; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Disclosure to Shareholders; Title V Conservators and Receivers; Capital Provisions

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA or Agency), through the FCA Board (Board), adopts a final rule to amend its capital adequacy and related regulations to address: interest rate risk; the grounds for appointing a conservator or receiver; capital and bylaw requirements for service corporations; and various computational issues and other issues involving the capital regulations. The rule adds safety and soundness requirements deferred from prior rulemakings, provides greater consistency with capital requirements of other financial regulators, and makes technical corrections.

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:
Dennis K. Carpenter, Senior Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4498, TDD (703) 883–4444,
or
Rebecca S. Orlich, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4020, TDD (703) 883–4444.

SUPPLEMENTARY INFORMATION:

I. General

The Agency proposed amendments to its capital regulations on September 23, 1997 (62 FR 49623). The purpose of the proposed regulations was to build on previous regulatory efforts by addressing discrete issues related to capital that were deferred during consideration of the capital adequacy regulations that became effective in March 1997. The issues addressed in the proposed rule were:

- Interest rate risk as it pertains to Farm Credit System (System or FCS) institutions;
- The definition of insolvency and of ''an unsafe or unsound condition to transact business'' for the purpose of appointing a conservator or receiver;
- The establishment of capital and bylaw requirements for System service corporations;
- Changes to risk-weighting categories of assets;
- The retirement of certain allocated equities included in core surplus;
- Deferred-tax assets;
- The treatment of intra-System investments for capital computation purposes;
- Various other computational issues; and
- Other technical issues.

As described more fully below, the FCA Board has made revisions to the proposed regulations on interest rate risk management programs, the enumerated circumstances in which the FCA could consider an institution to be in an unsafe or unsound condition for purposes of appointing a conservator or receiver, and the proposal regarding the treatment of ''other comprehensive income'' in calculating regulatory capital. The remaining regulations are adopted substantially as proposed.

Comments were received on the proposed regulations from the System's Presidents' Finance Committee, which reflected the views of the System's banks and associations (System joint comment); two Farm Credit banks; and a jointly managed production credit association (PCA) and Federal land credit association (FLCA). In addition, a third Farm Credit bank submitted a sample computation of the proposed rule's deferred-tax asset exclusion and asked the Agency to determine whether it had been calculated properly. The respondents did not comment generally on the overall thrust of the proposed rule; rather, their comments addressed specific issues as described below. All of the comments were carefully considered in the formulation of the final rule.

II. Interest Rate Risk

New §§ 615.5180 and 615.5181 are added to the investment regulations to require each System bank to establish an interest rate risk management program and to charge the bank's board of directors and senior management with responsibility for maintaining effective oversight. In addition, new § 615.5182 imposes the same requirements on all other System institutions [1] (excluding the Federal Agricultural Mortgage Corporation) [2] with interest rate risk exposure.

The language in § 615.5182 has been revised from the proposed rule to clarify that the board and management of each System institution have a duty to identify and manage interest rate risk exposure at their institution. The new regulation requires institutions other than banks to establish interest rate risk management programs for all interest rate risk, including risk that is being managed by the bank. The board of directors of an institution is accountable for all interest rate risk exposure of the institution regardless of whether the institution has contracted with the funding bank to manage certain interest rate risks. Although the funding bank may manage the interest rate risk, the institution's board is still accountable for ensuring that risk exposures are appropriately identified and managed. In those cases where an institution has interest rate risk exposure in excess of any exposure covered by the bank, the institution will also be expected to establish additional management requirements commensurate with the level of such exposure.

To supplement these new regulations, which are general in nature, the FCA Board recently adopted and published for comment a proposed interest rate risk management policy. *See* 63 FR 27962, May 21, 1998. The policy statement provides guidance to System institutions on prudent interest rate risk management principles, as well as the criteria the FCA will use to evaluate the adequacy and effectiveness of a System institution's interest rate risk management. The proposed guidelines are similar in approach to the interest rate risk guidelines issued by other Federal financial institution regulatory agencies.[3]

The new interest rate risk regulations and policy statement will improve FCA oversight of the System by supplementing existing capital regulations, which specifically address only credit risk. The regulations and policy statement will better inform System institutions of the Agency's expectations for the management of

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[1] Section 1.2(a) of the Farm Credit Act of 1971, as amended, (Act) identifies System institutions as Farm Credit Banks, banks for cooperatives, production credit associations, Federal land bank associations, and ''such other institutions as may be made a part of the System, all of which shall be chartered by and subject to regulation by the Farm Credit Administration.'' Such additional institutions would include agricultural credit banks, agricultural credit associations, Federal land credit associations, and service corporations chartered under section 4.25 of the Act. For purposes of the requirements of § 615.5182, the Federal Agricultural Mortgage Corporation is not included in the discussion of System institutions.

[2] Regulations affecting the Federal Agricultural Mortgage Corporation will be issued separately.

[3] The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board.

interest rate risk exposure. The potentially adverse effect that interest rate risk may have on net interest income and the market value of an institution's equity is of particular concern to the FCA. Unless properly measured and managed, interest rate changes can have significant adverse effects on System institutions' ability to generate future earnings, build net worth, and maintain liquidity. The combined effect of the final regulation and provisions of the policy statement is to ensure sound interest rate risk management by all System institutions.

With the publication for comment of the proposed interest rate risk management policy, the FCA has addressed the one comment it received on the proposed interest rate provisions. The System joint comment included a request that the Agency continue its practice of following the approaches taken by other Federal financial institution regulatory agencies and that the System be provided with an opportunity to comment on any proposed policy statement prior to final issuance.

III. Definition of Insolvency and ''Unsafe or Unsound Condition to Transact Business''

The FCA Board adopts several changes to § 627.2710, which sets forth the grounds for appointing a conservator or receiver for a System institution. First, the definition of ''insolvency'' as a ground for appointing a conservator or receiver in paragraph (b)(1) is amended to clarify that any stock or allocated equities held by current or former borrowers are not ''obligations to members.'' There is no change in the treatment of obligations to members such as investment bonds and uninsured accounts. Second, the Agency revises paragraph (b)(3), which currently provides that a conservator or receiver may be appointed if ''[t]he institution is in an unsafe or unsound condition to transact business.'' The revision adds that ''having insufficient capital or otherwise'' is a circumstance that the FCA could consider to be an unsafe and unsound condition. The amendment also identifies capital and collateral thresholds below which an institution could be considered to be operating unsafely, as well as other conditions. The thresholds and conditions are:

1. For banks, a net collateral ratio (as defined by § 615.5301(d)) below 102 percent.
2. For associations, a default by the association of one or more terms of its general financing agreement (GFA) with its affiliated bank that the FCA determines to be material.
3. For all institutions, permanent capital (as defined in § 615.5201) of less than one-half the minimum required level for the institution.
4. For all institutions, a total surplus (as defined by § 615.5301(i)) ratio of less than 2 percent.
5. For associations, stock impairment.

The final rule contains a revision in item 2 above, which as proposed pertained to collateral that is insufficient to enable an association to meet the requirements of its GFA with its affiliated bank. The FCA Board changed the provision in response to the System's joint comment that the term ''insufficient collateral'' in the second threshold was too imprecise. The System joint comment stated that some GFAs might have a more ''strident'' collateral test that could result in a technical default that could be cured in a number of ways. The System joint comment recommended instead that a ''continuing and material default under the terms of the association's [GFA]'' be considered to be an unsafe and unsound condition to transact business; it stated that the materiality standard would eliminate minor matters, and the requirement that the default be continuing would eliminate defaults that could be cured. The jointly managed PCA/FLCA commented that it supported the revision proposed in the System joint comment.

The FCA Board agrees in part with the suggestion in the System joint comment. It is appropriate to provide that a material default of the GFA would be considered an unsafe and unsound condition for transacting business and, consequently, a ground for appointing a conservator or receiver. However, a provision that the default must be continuing is too restrictive, since a material default can indicate severe problems even when the default might be cured by, or is waived by action of the affiliated bank. The FCA Board further believes that the Agency, not the bank nor the association, should be responsible for determining, as a ground for appointing a conservator or receiver, what constitutes a material default of the GFA. Therefore, the final rule is revised by removing the reference to ''insufficient collateral'' in the proposed rule and providing instead that an unsafe or unsound condition for transacting business includes an association's default under the terms of its GFA, where such default is determined by the Agency to be material.

While no other comments were received on the remaining standards and conditions, the FCA Board has made some minor adjustments in the final rule for clarity and conformity.

As was noted in the preamble to the proposed regulations, the thresholds and conditions are intended to be examples of what the Agency considers to be an unsafe or unsound condition to transact business for the purpose of appointing a conservator or receiver but are not exclusive. The FCA will continue to have the discretion to determine if an institution is in an unsafe or unsound condition to transact business based on other activities or circumstances that are not enumerated in the regulation. The FCA also retains the discretion to not appoint a conservator or receiver even when any of the enumerated circumstances exists. The Agency will evaluate the totality of circumstances before deciding what action, if any, to take.

The Board notes further that the delineation of the ''unsafe or unsound'' thresholds in this regulation does not mean that an institution is conclusively presumed to be operating safely and soundly if it is above all of the enumerated thresholds. The FCA may still consider an institution operating below minimum capital standards to be operating unsafely and unsoundly, and take appropriate supervisory action accordingly.

IV. Service Corporations

A. Capital Requirements for Service Corporations

The FCA Board amends § 611.1135(c) to provide that minimum capital requirements may be imposed on a service corporation as a condition of approval of the service corporation's charter. The Agency will monitor a service corporation's compliance with individually established capital standards through the examination process. No comments were received on the proposed revision, and the FCA Board adopts the rule as proposed.

B. Application of Bylaw Regulations to Service Corporations

Section 615.5220 is amended by adding a new paragraph (b) requiring each service corporation to have relevant capitalization provisions in its bylaws. A conforming amendment to § 611.1135(b)(4) is also adopted. No comments were received on these provisions, and they are adopted as proposed.

V. Deferred-Tax Assets

The FCA amends § 615.5210 to add a new paragraph (e)(11) establishing a requirement to exclude certain deferred-tax assets in capital calculations. Section 615.5201 is also amended to add new paragraph (d) to define deferred-tax assets that are dependent on future income or future events. These amendments are adopted without change from the proposal.

Under this rule, when an institution computes its required capital ratios, it is not required to exclude deferred-tax assets that can be realized through carrybacks to taxes paid on income earned in prior periods. However, the rule excludes a portion of the deferred-tax assets: (1) That an institution can realize only if it earns sufficient taxable income in the future; or (2) that are dependent on the occurrence of other future events for realization. The portion of deferred-tax assets that must be excluded is the greater of:

(1) The deferred-tax assets in excess of the amount that the institution expects to realize within 1 year of the most recent calendar quarter-end date, based on the institution's financial projections of taxable income and other events for that year; or

(2) The deferred-tax assets in excess of 10 percent of core surplus capital existing before the deduction of any disallowed tax assets.

An institution must deduct the excluded deferred-tax assets from capital and from assets when calculating capital ratios.

The Agency received one comment and a sample computation regarding its proposal. The System joint comment objected to the FCA's statement, in the preamble to the proposed regulation, that the proposed exclusion was consistent with requirements implemented by the other Federal financial institution regulatory agencies. The other agencies provide that commercial banks and thrifts must deduct deferred-tax assets in excess of 10 percent of their Tier 1 capital or in excess of the amount expected to be realized within 1 year (whichever is greater). The System joint comment asserted that the FCA's use of core surplus as the basis for the 10-percent limitation was not consistent with the other agencies' approach. Rather, the System contended, the 10-percent limitation in the calculation should be 10 percent of permanent capital, not core surplus, because permanent capital was ''a conservative equivalent of Tier 1 capital'' for commercial banks and thrifts.

The Agency disagrees with the characterization of permanent capital as a ''conservative equivalent'' of a commercial bank's Tier 1 capital. The components of Tier 1 capital are generally more stable than many components of permanent capital. It is true that common stockholders' equity, which is included in permanent capital but not core surplus, is a component of a commercial bank or thrift's Tier 1 capital. However, a commercial bank or thrift does not routinely retire its common stock. By contrast, most Farm Credit institutions routinely retire common stock and distribute allocated surplus. The Agency implemented a core surplus requirement to ensure that institutions have an amount of stable capital that is not generally subject to routine retirements or distributions for at least the next 3 years.[4] Furthermore, other components of permanent capital such as term stock are not included by commercial banks in Tier 1 capital and may be included in Tier 2 capital only up to an amount that equals the amount of the commercial bank's Tier 1 capital.[5] There are no such restrictions on a Farm Credit institution's permanent capital—nearly all capital is included without limit, except equity holdings between FCS institutions. Because of these significant functional differences, permanent capital and Tier 1 capital are not equivalent. The FCA Board continues to believe that core surplus is a more appropriate basis on which to limit the inclusion of deferred-tax assets and, therefore, adopts the regulation as proposed.

VI. Computational Issues

The FCA Board adopts technical corrections to the existing capital adequacy regulations, primarily involving the computation of the total surplus and core surplus capital requirements, as described below.

A. Average Daily Balance Requirement

The FCA Board adopts § 615.5330(c) to require computation of the total surplus, core surplus, and risk-adjusted asset base using average daily balances for the most recent 3 months, in the same way they are used for the calculation of permanent capital. Under the existing regulations, the total and core surplus ratios have been calculated using month-end balances. The change is made in response to requests from a number of institutions who commented that using month-end balances results in significant variability in the ratios due simply to seasonal lending trends.

One comment was received regarding proposed § 615.5330(c). The commenter supported the change on the ground that basing the calculations on point-in-time assets could lead to a distorted view of the capital position of an institution lending to agriculture due to its cyclical nature.

B. Maintenance of Core Surplus and Total Surplus Ratios

The FCA Board adopts several changes to its requirements that institutions maintain core surplus and total surplus ratios. Paragraphs (a) and (b) of § 615.5330 are amended to add the phrase ''at all times'' to the requirement that institutions must maintain core surplus and total surplus ratios of at least the minimum required level. The amendatory language clarifies that institutions must have the capability to calculate capital ratios every day, so that management decisions relative to loans in excess of the institution's loan limits, stock retirements, and other matters related to capital levels are made with knowledge of the institution's current capital ratios. For example, the institution must be able to calculate capital ratios on any date stock is retired, to ensure that minimum capital levels will be maintained after the retirement.

Section 615.5335 is also amended to expressly require banks to achieve and maintain at all times a net collateral ratio at or above the regulatory minimum, as well as to have the capability to calculate the net collateral ratio at any time using the balances outstanding at the computation date. No comments were received on these revisions, and they are adopted without change from the proposed rule.

C. Treatment of Intra-System Investments and Other Adjustments

1. Reciprocal Investments

The FCA amends § 615.5210(e)(1) to clarify the treatment of reciprocal holdings between two System institutions in the capital calculations. Institutions must eliminate reciprocal holdings before making the other required adjustments relating to intra-System investments. The Agency makes this clarification because some institutions have incorrectly made other required adjustments for intra-System investments before eliminating the reciprocal investments when calculating capital positions. The Agency intended that elimination of investments by one System institution in another institution be applied on a net basis after eliminating reciprocal holdings. *See* 53 FR 16956, May 12, 1988. This ''netting

[4] Associations may include routinely distributed allocated equities in core surplus if such equities are not scheduled for retirement in the next 3 years.

[5] Consequently, a commercial bank or thrift that fails to meet its Tier 1 minimum standard will also fail to meet its overall (Tier 1 plus Tier 2) risk-based standard, no matter how much capital it may have that meets the definition of Tier 2 capital.

effect'' ensures that System institutions eliminate cross-capital investments prior to other adjustments required by the capital regulations.

A System bank, which presently has investments in several of its affiliated associations, recommended that the Agency eliminate the reciprocal investment provisions from the regulations for the following reasons: (1) The FCA currently has prior approval authority over investments by Farm Credit banks in associations and could, therefore, control where the investment counts in the capital calculations; (2) the recently added capital ratios are more comprehensive and preclude the need for the reciprocal investment provisions; and (3) it is illogical for the bank to count its investment in the association in the bank's net collateral ratio, since the bank does not have access to the investment.

The FCA disagrees with the commenter's rationale for how reciprocal investments should be counted. Reciprocal investments must be eliminated from the capital calculations because the exchange of reciprocal stock creates no tangible worth or resources to absorb loss. This is a characteristic of all reciprocal investments, irrespective of the reasons why the reciprocal investment was made. It is not appropriate for any institution to be exempted from this treatment, as the commenter implies. Placing the requirement in the capital regulations ensures that all institutions calculate their capital in the same way, and that the Agency, investors, and others are then able to make meaningful comparisons of one institution's capital ratios with another institution's ratios. The approach suggested by the commenter would add unnecessary and inappropriate inconsistencies in the capital calculations of institutions.

The FCA Board also disagrees with the commenter's assertion that the newly added capital ratios make unnecessary the elimination of reciprocal investments in the permanent capital calculation. On the contrary, the new ratios have not diminished the importance of the permanent capital ratio as a reasonable indication of an institution's available permanent capital. The permanent capital ratio continues to be a key measurement in several important respects. An institution's lending limit is based on its level of permanent capital and specifies how large a loan or loans the institution can make to a single borrower. The institution is statutorily prohibited from retiring stock when its permanent capital is below the required minimum. Finally, with the adoption of this rule, if an institution's permanent capital falls below a level equal to one-half of the required minimum, a regulatory ground for appointing a conservator or receiver exists.

The commenter's assumption that a bank's investment in an association is included in the bank's net collateral is incorrect. Section 615.5301(c) of the regulations provides that net collateral is the value of a bank's collateral as defined by § 615.5050, less an amount equal to the bank's allocations to associations that are not counted as permanent capital by the bank. Section 615.5050 does not include a bank's investment in an association in bank collateral, but does include the following:

- Notes and other obligations representing loans made under the Act;
- Real or personal property acquired in connection with loans made under the Act;
- Obligations of the United States or an agency thereof;
- Other bank assets (including marketable securities) approved by the FCA; and
- Cash or cash equivalents.

The Agency notes that the commenter may have assumed that, because its investments in its associations were approved by the FCA pursuant to § 615.5171, they qualify for inclusion in collateral as ''other bank assets . . . approved by the Farm Credit Administration.'' This is an incorrect interpretation of the collateral definition, which covers only bank assets that have been approved by the Agency specifically for inclusion as collateral. As is clear from the list of assets that may count as collateral, only highly liquid investments qualify. A bank's investment in an affiliated association is not liquid: there is no market for the stock, and—as the commenter points out—the bank does not have access to the investment. Consequently, it would be inappropriate to include the bank's investment in its associations in the net collateral.

2. Computation of Total and Core Surplus Ratios

The FCA Board clarifies the treatment of intra-System equity investments and other deductions in the computations of total and core surplus. For the calculation of total surplus, § 615.5301(i)(7) is amended to more clearly require the same deductions as those made in the computation of permanent capital. In addition, paragraphs (a)(2) and (a)(3) of § 615.5330, which specify how a bank and an association treat an association's investment in its bank in the calculation of total surplus, are eliminated because the treatment is now covered by revised § 615.5301(i)(7). No comments were received on the proposed amendments to the total surplus calculation, and they are adopted without change.

With respect to core surplus, § 615.5301(b)(4) is amended to require the deduction of most intra-System investments in the computation of the core surplus of both the investing and the issuing institutions. However, investments to capitalize loan participations are not deducted from the investing institution's core surplus. In the preamble to the proposed rule, the FCA invited comment on this approach and an alternative approach of eliminating intra-System investments relating to loan participations from the core surplus of the investing institution. No comments were received on this issue, and the FCA Board finds no reason to revise its earlier proposal; thus, the amendment is adopted as proposed.

The core surplus computation in existing § 615.5301(b)(3) is amended to require institutions to make adjustments for loss-sharing agreements and for deferred-tax assets, as well as for investments in the Farm Credit Services Leasing Corporation (Leasing Corporation) and for goodwill. No comments were received on this proposal, and the proposal is adopted without change.

3. Investments in Service Corporations

The FCA Board amends § 615.5210(e)(6) to require an institution to deduct its investments in service corporations from total capital for purposes of computing permanent capital. This is an expansion of the existing regulation, which requires an institution to deduct only its investment in the Leasing Corporation. The change conforms to the Agency's view that such capital investments are committed to support risks at the service corporation level and that such capital investments must be available to meet any capital needs of the service corporation. The investing institution must also deduct the investments when calculating its core and total surplus. The FCA received no comments on the proposed provision and adopts it with only minor technical changes.

D. Farm Credit System Financial Assistance Corporation (FAC) Obligations

The FCA amends 615.5210(a) to provide that Farm Credit institutions shall exclude FAC obligations from their balance sheets only if such obligations were issued to pay capital preservation and loss-sharing agreements. This amendment conforms the regulation to the language of section 6.9(e)(3)(E) of the Act and narrows the existing regulation, which excludes all FAC obligations from institutions' balance sheets. The Agency received no comments on this provision and adopts it as proposed.

E. Risk-Weighting Categories and Credit Conversion Factors for Calculating Risk-Adjusted Assets

The FCA Board adopts modifications to the risk-weighting categories for on- and off-balance-sheet assets in § 615.5210(f) and adds related definitions in § 615.5201. The modifications provide a more accurate weighting of assets relative to their risk and incorporate recent changes to the Basle Accord,[6] as well as provide consistency with the requirements of the other Federal financial institution regulatory agencies. No comments were received on the proposed revisions, and the FCA Board adopts without change the following revisions:

- The elimination of the 10-percent category in § 615.5210(f)(2)(ii);
- The 20-percent risk-weighting category that includes conditional guarantees and Government-sponsored agency securities not backed by the full faith and credit of the U.S. Government;
- Language distinguishing the Organization for Economic Cooperation and Development (OECD)-based group of countries from non-OECD-based countries; and
- Credit conversion factors for derivative transactions.

Additionally, in new § 615.5201(m)(2), which defines ''qualifying bilateral netting contract,'' a definition of the term ''walkaway clause'' has been added.

The FCA Board also adopts an amendment to change the risk weighting for unused commitments with an original maturity of less than 14 months to zero percent. Under the existing regulation, the zero-percent category applies to loan commitments of up to only 12 months. One commenter supported the proposed change but recommended that unused loan commitments with an original maturity of 14 to 25 months be risk-weighted at 10 percent and that those of longer original maturity be risk-weighted at 20 percent; currently, any unused commitments in excess of 12 months are risk-weighted at 50 percent. The commenter stated that such changes would not be material in terms of risk and would allow Farm Credit institutions to offer more timely service at a lower cost to the institutions. The FCA agrees with the commenter that lowering the risk weighting of loans or other assets could potentially lower the costs of institutions that do not presently have capital well in excess of their minimum requirements. However, the Agency disagrees with the commenter's assertion that such changes would not be material in terms of risk. On the contrary, the changes would enable Farm Credit institutions to increase loan commitments by two to five times without a corresponding increase in the amount of capital required to be held. Thus, the final rule does not reduce the 50-percent risk weighting on loan commitments with an original maturity of greater than 14 months.

As stated in the preamble to the proposed regulations, the FCA intends to make the risk-weighting requirements of its regulations consistent with the requirements of the other Federal financial institution regulatory agencies, to the extent appropriate to the System. In this case, the FCA Board believes it is appropriate to extend the zero-percent risk-weighting category to loans with an original maturity of 14 months, even though this is a deviation from the 12-month zero-percent risk-weighting category of the other regulators. Farm Credit institutions are more directly affected by the seasonal cycles of agriculture than are most commercial banks and thrifts because of the System's agriculture-specific charter. Extending the zero-percent category by 2 months will not increase materially the risk in System institutions' portfolios. A 14-month category for zero-percent risk weighting takes into consideration the fact that many Farm Credit institutions make loans on an annual renewal cycle. The practice of these institutions is to perform the credit review and subsequent commitment 30 to 60 days prior to the end of the current loan commitment in order to have loan commitments in place at the beginning of each annual cycle. The revision adopted by the FCA Board will enable institutions to risk-weight these annual loan commitments at zero percent without substantially raising the associated risk.

The System's joint comment recommended that the FCA adopt, as final, a risk-weighting change proposed by the other Federal financial institution regulatory agencies in November 1997. The other agencies proposed to revise the risk-based capital treatment of recourse obligations, direct credit substitutes, and securitized transactions. One proposed revision of the other regulators would lower the risk weighting for AAA-rated asset-backed securities from 100 percent to 20 percent. The System asked in its joint comment that the Agency incorporate this change when it adopts these capital regulations in final form, asserting that it is unlikely that the amendment proposed by the other agencies will be challenged. FCA staff's discussions with the other regulators indicated no final decisions are imminent as to what the other agencies' final rule will address and when it will be adopted. The FCA Board believes that a change to FCA's current risk weighting of such assets is not appropriate at this time. However, the Agency will continue to monitor the efforts of the other regulatory agencies and evaluate the appropriateness of FCA's capital requirements should the other regulatory agencies implement a 20-percent risk weighting for AAA-rated asset-backed securities.

VII. Other Issues

A. Retirement of Certain Allocated Equities Included in Core Surplus

The FCA Board amends § 615.5301(b)(2) to generally disallow certain allocated equities from treatment as association core surplus in the event of partial retirements of similar equities allocated in the same year. However, the revised regulation allows certain allocated equities to remain a part of core surplus when: (1) Partial retirements are required by section 4.14B of the Act, (2) an equityholder has defaulted on a loan, or (3) an equityholder whose loan has been repaid has died, and the institution's capital plan provides for retirement in that circumstance.

Previously, the regulation did not specifically address partial retirements of the type of allocated equities that associations may include in core surplus pursuant to § 615.5301(b)(2). By this change, treatment of such allocated equities is consistent with the treatment in § 615.5301(b)(1)(ii) of nonqualified allocated equities not distributed according to a plan or practice. The Agency had intended to treat partial retirements of all allocated equities in the same way. The change makes the consistent treatment clear for all types of allocated equities. The Agency received no comments on this provision and adopts it as proposed.

[6] Agreed to by the Committee on Banking Regulations and Supervisory Practices, under the auspices of the Bank for International Settlements in Basle, Switzerland. Under this agreement the other Federal financial institution regulatory agencies that are signatories to the Accord are bound to consider such direction and revise their regulations accordingly. The FCA, for consistency purposes, also chooses to consider and revise its regulations, as appropriate to the System.

B. Ensuring Two Nominees for Each Bank Director's Position and Ensuring Representation on the Board of All Types of Agriculture in the District

Pursuant to section 4.15 of the Act, a new § 615.5230(b)(5) is added to require banks to make a good faith effort to locate at least two nominees for each director position and to try to assure representation on the board that is reflective of the bank's territory. The Agency proposed these changes to implement the statutory requirement to adopt regulations assuring a choice for bank director positions and board diversity. The regulation requires written documentation of the effort a bank makes in the event it is unable to find at least two nominees for each position. The bank must also keep a record of the type of agriculture engaged in by each director on its board. In addition, a reference is added in § 611.350, the subpart on director elections, to the cooperative principles set forth in § 615.5230 that apply to such elections.

One commenter asserted that the new regulations should not apply to situations where directors are nominated by shareholders rather than by a nominating committee. (The Act requires only associations to utilize a nominating committee, but other institutions may also choose to do so.) A Farm Credit bank submitted a comment in which it described its nominating process: the bank sends ballots to all eligible shareholders to solicit nominations for director positions, and the two individuals receiving the highest number of votes become the nominees. In the event that one of the nominees withdraws from the election, the bank asks the candidate with the third-highest number of votes to run, but the bank is sometimes unsuccessful. Consequently, only one candidate remains for the office.

The Agency is not persuaded by the Farm Credit bank's assertion that, because the bank uses a shareholder nomination process rather than a nominating committee, it should not have to document in writing its attempts to assure at least two nominees for each director position. Section 4.15 of the Act states in pertinent part that FCA regulations on the election of bank directors shall ''assure a choice of two nominees for each elective office to be filled;'' the Act makes no reference to nominating committees. Institutions must make good faith efforts to assure at least two candidates, but the Agency does not intend or expect the written documentation of these efforts to be burdensome. The bank needs merely to provide a brief but reasonable description of its efforts to seek a second nominee for inclusion in its records. This regulation does not require two nominees for each position. Instead, it requires documentation of the bank's efforts to secure at least two nominees. The FCA Board adopts the regulation without change from the proposal.

C. Statement of Financial Accounting Standards (SFAS) No. 130, Reporting Comprehensive Income

Sections 615.5210(e)(10), 615.5301(b)(5), and 615.5301(i)(4) are amended to extend the exclusion currently applicable to unrealized gains or losses on available-for-sale securities to all transactions covered by the definition of ''accumulated other comprehensive income'' contained in the Financial Accounting Standards Board's (FASB) recently issued SFAS No. 130, Reporting Comprehensive Income. SFAS No. 130 sets forth standards for reporting and displaying comprehensive income in a full set of financial statements for fiscal years beginning after December 15, 1997. Transactions covered by this new statement will be reported as a separate component of the equity (capital) section in the statement of financial position.

The amendments are adopted in response to a suggestion made in the System's joint comment. The Agency did not propose any changes to the regulations in the proposed rule, on the ground that it saw no compelling reasons to limit the impact of SFAS No. 130. But in the preamble to the proposed rule, the FCA Board invited comment on what effect, if any, SFAS No. 130 should have on the current capital standards.

The System, in its joint comment, recommended that the Agency amend the capital regulations to extend the exclusion currently applicable to unrealized gains or losses on available-for-sale securities to all transactions defined by SFAS No. 130 as ''accumulated other comprehensive income.'' The commenter pointed out that the current capital regulations at § 615.5210(e)(10) exclude the net impact of unrealized gains or losses on available-for-sale securities from the computation of permanent capital. The commenter observed that the items included in the category of ''other comprehensive income'' pursuant to SFAS No. 130 are similar in nature to such unrealized gains or losses and that it would be appropriate to treat them in the same way.

The FCA Board is persuaded by the System's joint comment and adopts the System's suggested change. The Agency agrees that it is generally more appropriate to treat components of capital with comparable characteristics and terms in a like manner under the capital standards. However, in the event that the FCA determines that an individual component, entry, or account has characteristics or terms that diminish its contribution to an institution's ability to absorb losses, §§ 615.5301(b)(6) and 615.5301(f)(6) of the current regulations provide the Agency with sufficient flexibility to require the deduction of all or a portion of such a component, entry, or account from core surplus or total surplus.

D. Conforming Amendments

The FCA Board adopts several other clarifying changes to wording of the total surplus and core surplus definitions. Paragraphs (b)(1)(ii) and (iii), (b)(2), and (i)(2) and (3) of § 615.5301 are amended to provide additional clarity to the definitions. Paragraph (b)(1)(ii) is amended to clarify that the term ''allocated equities'' includes allocated stock. The FCA is concerned that some institutions may otherwise interpret the regulation as permitting institutions to treat allocated stock either as allocated equities (as described in paragraphs (b)(1)(ii) and (b)(2)) or as perpetual stock (as described in paragraphs (b)(1)(iii) and (i)(3)) when calculating core and total surplus. In fact, the allocated stock must be treated as allocated equities in the calculations. The FCA is also changing § 615.5301(b)(2) to clarify that, for purposes of the capital ratio calculations, ''revolvement'' of allocated equities means any retirement of those equities, whether or not the institution has a formal revolvement plan. This change is made to avoid the implication that revolvement means something other than retirement.

Furthermore, in § 615.5301(b)(2)(ii), the phrase ''if subject to revolvement, are not scheduled for revolvement during the next 3 years'' is replaced with the phrase ''if subject to a plan or practice of revolvement or retirement, are not scheduled or intended to be revolved or retired during the next 3 years'' in order to parallel more closely the language in paragraphs (b)(1)(ii) and (iii) of § 615.5301. A parallel change is made to § 615.5301(i)(2) by replacing the phrase '' which, if subject to revolvement of retirement, have an original planned revolvement or retirement date of not less than 5 years'' with the phrase ''that are not subject to a plan or practice of revolvement or retirement of 5 years or less.'' These changes clarify that ''subject to revolvement'' has the same meaning as the other references to a plan or practice of revolvement or retirement in the core surplus and total surplus definitions.

The Agency amends § 620.5 to require institutions to disclose information on their surplus and collateral ratios in the annual report to shareholders. Conforming, nonsubstantive changes are also adopted in § 615.5201(h) to replace ''allocation'' with ''allotment'' and in §§ 615.5210(b) and 615.5260(a)(3)(ii) to remove obsolete language. These amendments are adopted without change from the proposed rule.

List of Subjects

12 CFR Part 611

Agriculture, Banks, banking, 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.

12 CFR Part 627

Agriculture, Banks, banking, Claims, Rural areas.

For the reasons stated in the preamble, parts 611, 615, 620, and 627 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 C—Election of Directors

2. Section 611.350 is added to read as follows:

§ 611.350 Application of cooperative principles to the election of directors.

In the election of directors, each System institution shall comply with the applicable cooperative principles set forth in § 615.5230 of this chapter.

Subpart I—Service Organizations

3. Section 611.1135 is amended by revising paragraphs (b)(4) and (c) to read as follows:

§ 611.1135 Incorporation of service organizations.

* * * * *

(b) * * *

(4) The proposed bylaws, which shall include the provisions required by § 615.5220(b) of this chapter.

* * * * *

(c) *Approval.* The Farm Credit Administration may condition the issuance of a charter, including imposing minimum capital requirements, as it deems appropriate. For good cause, the Farm Credit Administration may deny the application. Upon approval by the Farm Credit Administration of a completed application, which shall be kept on file at the Farm Credit Administration, the Agency shall issue a charter for the service corporation which shall thereupon become a corporate body and a Federal instrumentality.

* * * * *

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

4. 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 E—Investment Management

5. Section 615.5135 is amended by removing the first sentence of the introductory paragraph and adding two sentences in its place to read as follows:

§ 615.5135 Management of interest rate risk.

The board of directors of each Farm Credit Bank, bank for cooperatives, and agricultural credit bank shall develop and implement an interest rate risk management program as set forth in subpart G of this part. The board of directors shall adopt an interest rate risk management section of an asset/liability management policy which establishes interest rate risk exposure limits as well as the criteria to determine compliance with these limits. * * *

* * * * *

6. A new subpart G is added to read as follows:

Subpart G—Risk Assessment and Management

Sec.

Subpart G—Risk Assessment and Management

§ 615.5180 Interest rate risk management by banks—general.

The board of directors of each Farm Credit Bank, bank for cooperatives, and agricultural credit bank shall develop and implement an interest rate risk management program tailored to the needs of the institution and consistent with the requirements set forth in § 615.5135 of this part. The program shall establish a risk management process that effectively identifies, measures, monitors, and controls interest rate risk.

§ 615.5181 Bank interest rate risk management program.

(a) The board of directors of each Farm Credit Bank, bank for cooperatives, and agricultural credit bank is responsible for providing effective oversight to the interest rate risk management program and must be knowledgeable of the nature and level of interest rate risk taken by the institution.

(b) Senior management is responsible for ensuring that interest rate risk is properly managed on both a long-range and a day-to-day basis.

§ 615.5182 Interest rate risk management by associations and other Farm Credit System institutions other than banks.

Any association or other Farm Credit System institution other than banks, excluding the Federal Agricultural Mortgage Corporation, with interest rate risk that could lead to significant declines in net income or in the market value of capital shall comply with the requirements of §§ 615.5180 and 615.5181. The interest rate risk management program required under § 615.5181 shall be commensurate with the level of interest rate risk of the institution.

Subpart H—Capital Adequacy

§ 615.5201 [Amended]

7. Section 615.5201 is amended by removing the word ''allocation'' and adding in its place, the word ''allotment'' in paragraph (h); redesignating paragraphs (d), (e), (f), (g),

(h), (i), (j), (k), (l), (m), and (n) as paragraphs (e), (f), (g), (h), (i), (k), (l), (n), (o), (p), and (q) respectively; and adding new paragraphs (d), (j), and (m) to read as follows:

§ 615.5201 Definitions.

* * * * *

(d) *Deferred-tax assets that are dependent on future income or future events* means:

(1) Deferred-tax assets arising from deductible temporary differences dependent upon future income that exceed the amount of taxes previously paid that could be recovered through loss carrybacks if existing temporary differences (both deductible and taxable and regardless of where the related tax-deferred effects are recorded on the institution's balance sheet) fully reverse;

(2) Deferred-tax assets dependent upon future income arising from operating loss and tax carryforwards; or

(3) Deferred-tax assets arising from temporary differences that could be recovered if existing temporary differences that are dependent upon other future events (both deductible and taxable and regardless of where the related tax-deferred effects are recorded on the institution's balance sheet) fully reverse.

* * * * *

(j) *OECD* means the group of countries that are full members of the Organization for Economic Cooperation and Development, regardless of entry date, as well as countries that have concluded special lending arrangements with the International Monetary Fund's General Arrangement to Borrow, excluding any country that has rescheduled its external sovereign debt within the previous 5 years.

* * * * *

(m) *Qualifying bilateral netting contract* means a bilateral netting contract that meets at least the following conditions:

(1) The contract is in writing;

(2) The contract is not subject to a walkaway clause, defined as a provision that permits a non-defaulting counterparty to make lower payments than it would make otherwise under the contract, or no payment at all, to a defaulter or to the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the contract;

(3) The contract creates a single obligation either to pay or to receive the net amount of the sum of positive and negative mark-to-market values for all derivative contracts subject to the qualifying bilateral netting contract;

(4) The institution receives a legal opinion that represents, to a high degree of certainty, that in the event of legal challenge the relevant court and administrative authorities would find the institution's exposure to be the net amount;

(5) The institution establishes a procedure to monitor relevant law and to ensure that the contracts continue to satisfy the requirements of this section; and

(6) The institution maintains in its files adequate documentation to support the netting of a derivatives contract.

* * * * *

8. Section 615.5210 is amended by adding new paragraph (e)(11); removing paragraph (f)(2)(v); and revising paragraphs (a), (b), (e) introductory text, (e)(1), (e)(6), (e)(10), (f)(2)(i), (f)(2)(ii), heading of (f)(2)(iii), (f)(2)(iv), (f)(3)(ii)(A), and (f)(3)(iii) to read as follows:

§ 615.5210 Computation of the permanent capital ratio.

(a) The institution's permanent capital ratio shall be determined on the basis of the financial statements of the institution prepared in accordance with generally accepted accounting principles except that the obligations of the Farm Credit System Financial Assistance Corporation issued to repay banks in connection with the capital preservation and loss-sharing agreements described in section 6.9(e)(1) of the Act shall not be considered obligations of any institution subject to this regulation prior to their maturity.

(b) The institution's asset base and permanent capital shall be computed using average daily balances for the most recent 3 months.

* * * * *

(e) For the purpose of computing the institution's permanent capital ratio, the following adjustments shall be made prior to assigning assets to risk-weight categories and computing the ratio:

(1) Where two Farm Credit System institutions have stock investments in each other, such reciprocal holdings shall be eliminated to the extent of the offset. If the investments are equal in amount, each institution shall deduct from its assets and its total capital an amount equal to the investment. If the investments are not equal in amount, each institution shall deduct from its total capital and its assets an amount equal to the smaller investment. The elimination of reciprocal holdings required by this paragraph shall be made prior to making the other adjustments required by this section.

* * * * *

(6) The double-counting of capital by a service corporation chartered under section 4.25 of the Act and its stockholder institutions shall be eliminated by deducting an amount equal to the institution's investment in the service corporation from its total capital.

* * * * *

(10) The permanent capital of an institution shall exclude the net effect of all transactions covered by the definition of ''accumulated other comprehensive income'' contained in the Statement of Financial Accounting Standards No. 130, as promulgated by the Financial Accounting Standards Board.

(11) For purposes of calculating capital ratios under this part, deferred-tax assets are subject to the conditions, limitations, and restrictions described in this paragraph.

(i) Each institution shall deduct an amount of deferred-tax assets, net of any valuation allowance, from its assets and its total capital that is equal to the greater of:

(A) The amount of deferred-tax assets that are dependent on future income or future events in excess of the amount that is reasonably expected to be realized within 1 year of the most recent calendar quarter-end date, based on financial projections for that year, or

(B) The amount of deferred-tax assets that are dependent on future income or future events in excess of ten (10) percent of the amount of core surplus that exists before the deduction of any deferred-tax assets.

(ii) For purposes of this calculation:

(A) The amount of deferred-tax assets that can be realized from taxes paid in prior carryback years and from the reversal of existing taxable temporary differences shall not be deducted from assets and from equity capital.

(B) All existing temporary differences should be assumed to fully reverse at the calculation date.

(C) Projected future taxable income should not include net operating loss carryforwards to be used within 1 year or the amount of existing temporary differences expected to reverse within that year.

(D) Financial projections shall include the estimated effect of tax-planning strategies that are expected to be implemented to minimize tax liabilities and realize tax benefits. Financial projections for the current fiscal year (adjusted for any significant changes that have occurred or are expected to occur) may be used when applying the capital limit at an interim date within the fiscal year.

(E) The deferred tax effects of any unrealized holding gains and losses on available-for-sale debt securities may be excluded from the determination of the amount of deferred-tax assets that are dependent upon future taxable income and the calculation of the maximum allowable amount of such assets. If these deferred-tax effects are excluded, this treatment must be followed consistently over time.

(f) * * *

(2) * * *

(i) *Category 1: 0 Percent.*

(A) Cash on hand and demand balances held in domestic or foreign banks.

(B) Claims on Federal Reserve Banks.

(C) Goodwill.

(D) Direct claims on and portions of claims unconditionally guaranteed by the United States Treasury, United States Government agencies, or central governments in other OECD countries. A United States Government agency is defined as an instrumentality of the United States Government whose obligations are fully and explicitly guaranteed as to the timely repayment of principal and interest by the full faith and credit of the United States Government.

(ii) *Category 2: 20 Percent.*

(A) Portions of loans and other assets collateralized by United States Government-sponsored agency securities. A United States Government-sponsored agency is defined as an agency originally chartered or established to serve public purposes specified by the United States Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

(B) Portions of loans and other assets conditionally guaranteed by the United States Government or its agencies.

(C) Portions of loans and other assets collateralized by securities issued or guaranteed (fully or partially) by the United States Government or its agencies (but only to the extent guaranteed).

(D) Claims on domestic banks (exclusive of demand balances).

(E) Claims on, or guarantees by, OECD banks.

(F) Claims on non-OECD banks with a remaining maturity of 1 year or less.

(G) Investments in State and local government obligations backed by the ''full faith and credit of State or local government.'' Other claims (including loans) and portions of claims guaranteed by the full faith and credit of a State government (but only to the extent guaranteed).

(H) Claims on official multinational lending institutions or regional development institutions in which the United States Government is a shareholder or contributor.

(I) Loans and other obligations of and investments in Farm Credit institutions.

(J) Local currency claims on foreign central governments to the extent that the Farm Credit institution has local liabilities in that country.

(K) Cash items in the process of collection.

(iii) *Category 3: 50 Percent.*

* * * * *

(iv) *Category 4: 100 Percent.*

(A) All other claims on private obligors.

(B) Claims on non-OECD banks with a remaining maturity greater than 1 year.

(C) All other assets not specified above, including but not limited to, leases, fixed assets, and receivables.

(D) All non-local currency claims on foreign central governments, as well as local currency claims on foreign central governments that are not included in Category 2(J).

(3) * * *

(ii) * * *

(A) *0 Percent.*

(*1*) Unused commitments with an original maturity of 14 months or less; or

(*2*) Unused commitments with an original maturity of greater than 14 months if:

* * * * *

(iii) *Credit equivalents of interest rate contracts and foreign contracts.*

(A) Credit equivalents of interest rate contracts and foreign exchange contracts (except single currency floating/floating interest rate swaps) shall be determined by adding the replacement cost (mark-to-market value, if positive) to the potential future credit exposure, determined by multiplying the notional principal amount by the following credit conversion factors as appropriate.

CONVERSION FACTOR MATRIX

[In Percent]

Remaining maturity	Interest rate	Exchange rate	Commodity
1 year or less	0.0	1.0	10.0
Over 1 to 5 years	0.5	5.0	12.0
Over 5 years	1.5	7.5	15.0

(B) For any derivative contract that does not fall within one of the categories in the above table, the potential future credit exposure shall be calculated using the commodity conversion factors. The net current exposure for multiple derivative contracts with a single counterparty and subject to a qualifying bilateral netting contract shall be the net sum of all positive and negative mark-to-market values for each derivative contract. The positive sum of the net current exposure shall be added to the adjusted potential future credit exposure for the same multiple contracts with a single counterparty. The adjusted potential future credit exposure shall be computed as

$A_{net} = (0.4 \times A_{gross}) + 0.6\ (NGR \times A_{gross})$ where:

(*1*) A_{net} is the adjusted potential future credit exposure;

(*2*) A_{gross} is the sum of potential future credit exposures determined by multiplying the notional principal amount by the appropriate credit conversion factor; and

(*3*) NGR is the ratio of the net current credit exposure divided by the gross current credit exposure determined as the sum of only the positive mark-to-markets for each derivative contract with the single counterparty.

* * * * *

Subpart I—Issuance of Equities

9. Section 615.5220 is amended by redesignating paragraphs (a) through (h) as paragraphs (1) through (8) consecutively; by adding the paragraph designation ''(a)'' to the introductory text; and by adding a new paragraph (b) to read as follows:

§ 615.5220 Capitalization bylaws.

* * * * *

(b) The board of directors of each service corporation (including the Farm Credit Leasing Services Corporation) shall adopt capitalization bylaws, subject to the approval of its voting shareholders, that set forth the requirements of paragraphs (a)(1), (a)(2), and (a)(3) of this section to the extent applicable. Such bylaws shall also set forth the manner in which equities will be retired and the manner in which earnings will be distributed.

10. Section 615.5230 is amended by adding a new paragraph (b)(5) to read as follows:

§ 615.5230 Implementation of cooperative principles.

* * * * *

(b) * * *

(5) Each bank shall endeavor to assure that there is a choice of at least two nominees for each elective office to be filled and that the board represents as nearly as possible all types of agriculture in the district. If fewer than two nominees for each position are named, the efforts of the bank to locate two willing nominees shall be documented in the records of the bank. The bank shall also maintain a list of the type or types of agriculture engaged in by each director on its board.

Subpart J—Retirement of Equities

11. Section 615.5260 is amended by revising paragraph (a)(3)(ii) to read as follows:

§ 615.5260 Retirement of eligible borrower stock.

(a) * * *

(3) * * *

(ii) In the case of participation certificates and other equities, face or equivalent value; or

* * * * *

Subpart K—Surplus and Collateral Requirements

12. Section 615.5301 is amended by revising paragraphs (a), (b)(1)(ii), (b)(1)(iii), (b)(2)(ii), (b)(3), (b)(4), (b)(5), (i)(2), (i)(3), (i)(4), and (i)(7) to read as follows:

§ 615.5301 Definitions.

* * * * *

(a) The terms *deferred-tax assets that are dependent on future income or future events, institution, permanent capital,* and *total capital* shall have the meanings set forth in § 615.5201.

(b) * * *

(1) * * *

(ii) Nonqualified allocated equities (including stock) that are not distributed according to an established plan or practice, *provided that,* in the event that a nonqualified patronage allocation is distributed, other than as required by section 4.14B of the Act, or in connection with a loan default or the death of an equityholder whose loan has been repaid (to the extent provided for in the institution's capital adequacy plan), any remaining nonqualified allocations that were allocated in the same year will be excluded from core surplus.

(iii) Perpetual common or noncumulative perpetual preferred stock (other than allocated stock) that is not retired according to an established plan or practice, *provided that,* in the event that stock held by a borrower is retired, other than as required by section 4.14B of the Act or in connection with a loan default to the extent provided for in the institution's capital plan, the remaining perpetual stock of the same class or series shall be excluded from core surplus;

* * * * *

(2) * * *

(ii) The allocated equities, if subject to a plan or practice of revolvement or retirement, are not scheduled or intended to be revolved or retired during the next 3 years, provided that, in the event that such allocated equities included in core surplus are retired, other than as required by section 4.14B of the Act, or in connection with a loan default or the death of an equityholder whose loan has been repaid (to the extent provided for in the institution's capital adequacy plan), any remaining such allocated equities that were allocated in the same year will be excluded from core surplus.

(3) The deductions required to be made by an institution in the computation of its permanent capital pursuant to § 615.5210(e) (6), (7), (9), and (11) shall also be made in the computation of its core surplus. Deductions required by § 615.5210(e)(1) shall also be made to the extent that they do not duplicate deductions calculated pursuant to this section and required by § 615.5330(b)(2).

(4) Equities issued by System institutions and held by other System institutions shall not be included in the core surplus of the issuing institution or of the holder, unless approved pursuant to paragraph (b)(1)(iv) of this section, except that equities held in connection with a loan participation shall not be excluded by the holder. This paragraph shall not apply to investments by an association in its affiliated bank, which are governed by § 615.5301(b)(1)(i).

(5) The core surplus of an institution shall exclude the net effect of all transactions covered by the definition of ''accumulated other comprehensive income'' contained in the Statement of Financial Accounting Standards No. 130, as promulgated by the Financial Accounting Standards Board.

* * * * *

(i) * * *

(2) Allocated equities, including allocated surplus and stock, that are not subject to a plan or practice of revolvement or retirement of 5 years or less and are eligible to be included in permanent capital pursuant to § 615.5201(j)(4)(iv); and

(3) Stock (other than allocated stock) that is not purchased or held as a condition of obtaining a loan, provided that it is either perpetual stock or term stock with an original maturity of at least 5 years, and provided that the institution has no established plan or practice of retiring such perpetual stock or of retiring such term stock prior to its stated maturity. The amount of term stock that is eligible to be included in total surplus shall be reduced by 20 percent (net of redemptions) at the beginning of each of the last 5 years of the term of the instrument.

(4) The total surplus of an institution shall exclude the net effect of all transactions covered by the definition of ''accumulated other comprehensive income'' contained in the Statement of Financial Accounting Standards No. 130, as promulgated by the Financial Accounting Standards Board.

* * * * *

(7) Any deductions made by an institution in the computation of its permanent capital pursuant to § 615.5210(e) shall also be made in the computation of its total surplus.

13. Section 615.5330 is revised to read as follows:

§ 615.5330 Minimum surplus ratios.

(a) *Total surplus.* (1) Each institution shall achieve and at all times maintain a ratio of a least 7 percent of total surplus to the risk-adjusted asset base.

(2) The risk-adjusted asset base is the total dollar amount of the institution's assets adjusted in accordance with § 615.5301(i)(7) and weighted on the basis of risk in accordance with § 615.5210(f).

(b) *Core surplus.* (1) Each institution shall achieve and at all times maintain a ratio of core surplus to the risk-adjusted asset base of a least 3.5 percent, of which no more than 2 percentage points may consist of allocated equities otherwise includible pursuant to § 615.5301(b).

(2) Each association shall compute its core surplus ratio by deducting an amount equal to the net investment in the bank from its core surplus.

(3) The risk-adjusted asset base is the total dollar amount of the institution's

assets adjusted in accordance with §§ 615.5301(b)(3) and 615.5330(b)(2), and weighted on the basis of risk in accordance with § 615.5210(f).

(c) An institution shall compute its risk-adjusted asset base, total surplus, and core surplus ratios using average daily balances for the most recent 3 months.

14. Section 615.5335 is revised to read as follows:

§ 615.5335 Bank net collateral ratio.

(a) Each bank shall achieve and at all times maintain a net collateral ratio of at least 103 percent.

(b) At a minimum, a bank shall compute its net collateral ratio as of the end of each month. A bank shall have the capability to compute its net collateral ratio a day after the close of a business day using the daily balances outstanding for assets and liabilities for that date.

Subpart L—Establishment of Minimum Capital Ratios for an Individual Institution

15. Section 615.5350 is amended by adding a new paragraph (b)(7) to read as follows:

§ 615.5350 General—Applicability.

* * * * *

(b) * * *

(7) An institution with significant exposures to declines in net income or in the market value of its capital due to a change in interest rates and/or the exercising of embedded or explicit options.

Subpart M—Issuance of a Capital Directive

16. Section 615.5355 is amended by revising paragraph (a)(4) to read as follows:

§ 615.5355 Purpose and scope.

(a) * * *

(4) Take other action, such as reduction of assets or the rate of growth of assets, restrictions on the payment of dividends or patronage, or restrictions on the retirement of stock, to achieve the applicable capital ratios, or reduce levels of interest rate and other risk exposures, or strengthen management expertise, or improve management information and measurement systems; or

* * * * *

PART 620—DISCLOSURE TO SHAREHOLDERS

17. 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 A—General

§ 620.1 [Amended]

18. Section 620.1 is amended by removing the reference ''§ 615.5201(j)'' and adding in its place, the reference ''§ 615.5201(l)'' in paragraph (j).

Subpart B—Annual Report to Shareholders

§ 620.5 [Amended]

19. Section 620.5 is amended by removing the word ''permanent'' from paragraphs (d)(2), (g)(4)(v), and (g)(4)(vi); by revising paragraph (f)(3); and by adding paragraph (f)(4) to read as follows:

§ 620.5 Contents of the annual report to shareholders.

* * * * *

(f) * * *

(3) *For all banks* (on a bank-only basis):

(i) Permanent capital ratio.

(ii) Total surplus ratio.

(iii) Core surplus ratio.

(iv) Net collateral ratio.

(4) *For all associations:*

(i) Permanent capital ratio.

(ii) Total surplus ratio.

(iii) Core surplus ratio.

* * * * *

PART 627—TITLE V CONSERVATORS AND RECEIVERS

20. The authority citation for part 627 continues to read as follows:

Authority: Secs. 4.2, 5.9, 5.10, 5.17, 5.51, 5.58 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2244, 2252, 2277a, 2277a–7).

Subpart A—General

21. Section 627.2710 is amended by revising paragraphs (b)(1) and (b)(3) to read as follows:

§ 627.2710 Grounds for appointment of conservators and receivers.

* * * * *

(b) * * *

(1) The institution is insolvent, in that the assets of the institution are less than its obligations to creditors and others, including its members. For purposes of determining insolvency, ''obligations to members'' shall not include stock or allocated equities held by current or former borrowers.

* * * * *

(3) The institution is in an unsafe or unsound condition to transact business, including having insufficient capital or otherwise. For purposes of this regulation, ''unsafe or unsound condition'' shall include, but shall not be limited to, the following conditions:

(i) For banks, a net collateral ratio below 102 percent.

(ii) For associations, a default by the association of one or more terms of its general financing agreement with its affiliated bank that the Farm Credit Administration determines to be a material default.

(iii) For all institutions, permanent capital of less than one-half the minimum required level for the institution.

(iv) For all institutions, a total surplus ratio of less than 2 percent.

(v) For associations, stock impairment.

* * * * *

Dated: July 15, 1998.

Floyd Fithian,

Secretary, Farm Credit Administration Board.

[FR Doc. 98–19394 Filed 7–21–98; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 98–CE–31–AD; Amendment 39–10671; AD 98–15–20]

RIN 2120–AA64

Airworthiness Directives; Glaser-Dirks Flugzeugbau GmbH Model DG–500M Gliders

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule.

SUMMARY: This amendment adopts a new airworthiness directive (AD) that applies to all Glaser-Dirks Flugzeugbau GmbH (Glaser-Dirks) Model DG–500M gliders. This AD requires inspecting the center of gravity (C.G.) tow release cable pulley for correct positioning, and replacing the C.G. tow release cable pulley with one made of aluminum either immediately or eventually depending on the results of the inspection. This AD is the result of mandatory continuing airworthiness information (MCAI) issued by the airworthiness authority for Germany. The actions specified by this AD are intended to prevent the C.G. tow release cable from coming off the pulley because of incorrect positioning, which could result in the pilot being unable to release from tow operations.

DATES: Effective September 9, 1998.