

# Proposed Rules

Federal Register

Vol. 69, No. 177

Tuesday, September 14, 2004

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## FARM CREDIT ADMINISTRATION

### 12 CFR Part 615

RIN 3052-AC23

#### Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Investments in Farmers' Notes

**AGENCY:** Farm Credit Administration.

**ACTION:** Proposed rule.

**SUMMARY:** The Farm Credit Administration (FCA, agency, us, or we) adopts a proposed rule that amends regulations governing investments in farmers' notes (Farmers' Notes). As a result, it should be easier for Farm Credit System (FCS, Farm Credit, or System) institutions and non-System lenders to work together to finance farmers, ranchers, and aquatic producers or harvesters (farmers). The proposed rule would remove unnecessary regulatory restrictions on Farmers' Notes so this investment program will be able to keep pace with rapid changes in agricultural credit markets. Credit enhancements and a new concentration limit will strengthen the safety and soundness of the Farmers' Notes. The FCA also proposes amendments to its capital regulations.

**DATES:** You may send us comments by October 14, 2004.

**ADDRESSES:** Send us your comments by electronic mail to [reg-comm@fca.gov](mailto:reg-comm@fca.gov), through the Pending Regulations section of our Web site at <http://www.fca.gov>, or through the government-wide Web site <http://www.regulations.gov>. You may also submit your comments in writing (in triplicate) to S. Robert Coleman, Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090, or by facsimile transmission to (703) 734-5785. You may review copies of all comments we receive in the Office of Policy and Analysis, Farm Credit Administration.

**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, TTY (703) 883-4434.

or

Richard A. Katz, Senior Attorney, Office of the General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-2020.

#### SUPPLEMENTARY INFORMATION:

##### I. Objectives

The purpose of this proposed rule is to: (1) Make affordable credit more available to farmers; (2) enable associations to provide additional funding and liquidity to non-System lenders; and (3) increase cooperation between System and non-System financial institutions and merchants that extend credit to agriculture (non-System agricultural lenders). Although there are several different ways for System and non-System agricultural lenders to work together in extending credit to farmers, ranchers, cooperatives, and other eligible rural residents, this proposed rule focuses on investments in Farmers' Notes.

##### II. Overview of the Farmers' Notes Program

The Farmers' Notes program has existed since 1966, when the FCA originally approved it. Under this program, certain FCS direct lender associations invest in notes, contracts, and other obligations that eligible farmers enter into with non-System agricultural lenders. Currently, § 615.5172 authorizes production credit associations (PCAs) and agricultural credit associations (ACAs) to buy Farmers' Notes from private dealers and cooperatives that sell farm machinery, supplies, equipment, home appliances, and other items of a capital nature to eligible farmers and ranchers. As a result, the Farmers' Notes program provides liquidity to certain non-System lenders that extend credit to agriculture.

The authority to purchase Farmers' Notes derives from sections 2.2(10) and 2.12(18) of the Farm Credit Act of 1971, as amended (Act), which permit direct lender associations to invest their funds as may be approved by their funding bank under FCA regulations. Similar to other investments, the regulation places a portfolio cap and a concentration limit

on association investments in Farmers' Notes. Currently, § 615.5172(c) limits investments in Farmers' Notes to 15 percent of each association's total outstanding loans at the end of its preceding fiscal year. Additionally, investments in Farmers' Notes sold by a single creditor cannot exceed 50 percent of the association's capital and surplus. Under current § 615.5172(d), participating dealers and cooperatives must endorse Farmers' Notes that they sell to associations with full recourse. The full recourse requirement is designed as a credit enhancement, which is consistent with the treatment of Farmers' Notes as investments. Finally, the current regulation requires associations to contact those notemakers who meet their credit standards, and encourage them to become FCS borrowers.

##### III. Rulemaking on Farmers' Notes

###### A. Historical Background

This proposed rule is the latest phase of a rulemaking that began 4 years ago. On April 20, 2000, the FCA published an advance notice of proposed rulemaking (ANPRM) that asked the public questions about ways to improve the funding and discount relationship between Farm Credit banks and other financing institutions (OFIs).<sup>1</sup> The commenters responded with a broad array of suggestions on various ways that System and non-System agricultural lenders could cooperate to extend credit to agriculture and rural America. As a result, the FCA decided to hold a public meeting on OFIs and other alternatives for FCS lenders to provide funding to non-System agricultural lenders. The **Federal Register** notice that announced the public meeting asked interested parties for input on both OFIs and "other types of partnering relationships between System and non-System lending institutions that would increase the availability of funds to agriculture and rural America."<sup>2</sup>

On August 3, 2001, we held a public meeting in Des Moines, Iowa, where interested parties offered suggestions on how we could facilitate greater cooperation between System and non-System agricultural lenders. Many System and non-System commenters

<sup>1</sup> See 65 FR 21151 (April 20, 2000).

<sup>2</sup> See 66 FR 35428 (July 5, 2001).

encouraged us to promote other arrangements, in addition to the OFI program, that make it easier for Farm Credit banks and associations to provide funding and liquidity to non-System agricultural lenders. Many commenters expressed their desire for more flexible and informal arrangements between FCS and non-System agricultural lenders.

#### *B. Original Proposed Rule*

On August 11, 2003, the FCA adopted a proposed rule (original proposed rule or proposed rule of August 11, 2003) on OFIs and Farmers' Notes that incorporated many of the comments and suggestions that we received from the ANPRM and at the public meeting.<sup>3</sup> The FCA proposed four major changes to the Farmers' Notes regulation so that this program would be more responsive to the needs of other creditors and their customers. First, the original proposed rule would have expanded this program to all entities that routinely extend agricultural or aquatic credit to eligible farmers and ranchers in the normal course of their business. Whereas this program now is restricted to private dealers and cooperatives, the proposed rule of August 11, 2003, would have allowed all types of creditors, including financial institutions and merchants, to sell Farmers' Notes to FCS associations. Second, the original proposed rule would have expanded this program to long-term loans. Third, the proposed rule of August 11, 2003, would have permitted all FCS direct lenders to invest in Farmers' Notes, whereas this program is now limited to PCAs and ACAs, which have short- and intermediate-term lending authorities. Fourth, the original proposed rule would have allowed FCS associations to invest in notes from aquatic producers or harvesters and farm-related businesses.

Other provisions of the original proposed rule would have ensured that FCS direct lender associations continue to treat Farmers' Notes as investments. Under § 615.5172(b) of the proposed rule of August 11, 2003, for example, FCS associations could have invested in Farmers' Notes that are secured by specified collateral that the underlying debtor pledges to creditors. The original proposed rule would have retained the 15-percent portfolio cap and the 50-percent concentration limit in § 615.5172(c). Current § 615.5172(d) requires the seller to endorse all Farmers' Notes with full recourse. The FCA proposed on August 11, 2003, to update this requirement by allowing other types of credit enhancements,

such as guarantees, insurance, reserves of cash or marketable securities, subordinated interests, or a combination of such credit enhancements that would adequately cover the principal amount of the association's investment in Farmers' Notes.

The proposed rule of August 11, 2003, would have deleted the provision in § 615.5172 that currently requires associations to contact the farmers or ranchers who are indebted on these Farmers' Notes and encourage them to become FCS borrowers.

#### *C. Comment Letters*

The FCA received a total of 111 comments on the proposed rule on OFIs and Farmers' Notes, of which 105 comment letters specifically addressed issues related to Farmers' Notes. Comments on Farmers' Notes came from the Farm Credit Council, two Farm Credit banks, two Farm Credit associations, an agricultural credit cooperative OFI, the Independent Community Bankers of America (ICBA), which is the trade association for community banks, and 98 affiliated commercial banks and their state banking trade associations. System commenters supported the proposed rule while all non-System commenters opposed it.

All commercial bank commenters asked the FCA to withdraw the original proposal on Farmers' Notes. These commenters suggested that the FCA hold a public meeting and solicit congressional input on Farmers' Notes if the agency continues to believe that FCS associations need an expanded Farmers' Notes program. The ICBA and other commercial bank commenters stated that the proposed rule would "reinvent an unused lending program" as "an expansive new consumer and business lending program that has not been authorized by Congress."

Commercial bank commenters also raised safety and soundness concerns about the Farmers' Notes program. The agricultural credit cooperative OFI told the FCA that the proposed revisions to § 615.5172 would not attract non-System agricultural lenders to the Farmers' Notes program or benefit their customers.

System commenters believed that the proposed revisions to the Farmers' Notes regulation will strengthen cooperation between System and non-System lenders and increase the flow of credit to agriculture. Two System commenters, however, asked the FCA to revise the proposed regulation so it would not require that collateral "of a capital nature" secure all Farmers' Notes. One of these commenters

suggested that the final rule should not require that collateral secure all Farmers' Notes. This commenter advised the FCA that the final rule should treat collateralization of Farmers' Notes as a credit enhancement.

#### *D. The Supplemental Proposed Rule*

On April 22, 2004, the FCA Board approved a final rule on OFIs. The preamble informed the public that the FCA was not adopting a final rule on Farmers' Notes because it was still considering the best regulatory approach to this program.<sup>4</sup>

The FCA declines the request of commercial bank commenters to hold another public meeting on this issue. This rulemaking has progressed beyond the point where another public meeting will help the FCA to bring this rulemaking to a successful conclusion. Earlier phases of this rulemaking, such as the ANPRM, the public meeting in Des Moines and the proposed rule have already provided the FCA with the type of basic information that another public meeting will provide. Instead, input from the public on a specific regulatory proposal is the best way to develop a final rule that will improve the flow of funds to agriculture and encourage greater cooperation between the FCS and non-System agricultural lenders.

The FCA also declines the request of commercial bank commenters to consult with Congress about revisions to the Farmers' Note regulation. As discussed below, the FCA has express authority delegated by Congress under sections 2.2(10), 2.12(18), 5.17(a)(9), 7.6(c), and 7.8(b) of the Act to enact investment regulations for FCS associations. In addition, FCA submits all proposed rules to Congress for a 30-day review period under section 5.17 of the Act. FCA welcomes comments from Members of Congress as it does from all members of the public.

#### *E. New Proposed Rule on Farmers' Notes*

The new proposed rule on Farmers' Notes responds to issues and concerns raised by both System and non-System commenters. The FCA proposes to retain the provisions in § 615.5172(a) of the original proposed rule that would: (1) Expand the Farmers' Notes program to all non-System agricultural lenders; (2) allow all FCS direct lender associations to invest in Farmers' Notes; (3) extend this program to long-term mortgages; and (4) include credits to aquatic producers or harvesters, and farm-related businesses in this program. The FCA also proposes, without change,

<sup>3</sup> See 68 FR 47502 (Aug. 11, 2003).

<sup>4</sup> See 69 FR 29852 (May 26, 2004).

§ 615.5172(d), which would authorize other credit enhancements for Farmers' Notes, such as guarantees, insurance, reserves, and subordinated interests. The FCA proposes again to repeal the provision in current § 615.5172(d) that requires associations to contact the farmers or ranchers who are indebted on Farmers' Notes, and encourage them to become FCS borrowers. The new proposal addresses the commenters' concerns by: (1) Limiting investments in Farmers' Notes that are not backed by agricultural credits; (2) lowering the concentration limit for Farmers' Notes; and (3) not requiring collateral of a "capital nature" for Farmers' Notes. As we explain the new proposal in greater detail, we will respond to issues raised by various commenters.

Commercial bank commenters assert that the Farmers' Notes program is really a lending program that is disguised as an investment program. The FCA responds that it has authorized the Farmers' Notes program by exercising its delegated powers under sections 2.2(10), 2.12(18), 5.17(a)(9), 7.6(c), and 7.8(b) of the Act to regulate investments at FCS associations. FCA regulations authorize FCS institutions to hold investments for two fundamental, but distinct, purposes. The regulations in subpart E of part 615 authorize FCS institutions to hold investments for maintaining liquidity and managing market risks.

Separately, the regulations in subpart F of part 615 permit FCS banks and associations to hold investments that advance their public policy mission of financing agriculture. Farmers' Notes are agricultural investments. The Farmers' Notes program enables FCS associations to act as a source of liquidity for non-System agricultural lenders, including small local entities, that sell agricultural supplies, equipment, machinery, other capital goods, and household appliances to farmers and ranchers on credit. Thus, this program benefits farmers, ranchers, and their suppliers.

Under both the existing and proposed regulations, Farmers' Notes are subject to many regulatory criteria that apply to investments. For example, the regulation requires full recourse or other credit enhancements that upgrade the credit quality and reduce the risk of these assets. Additionally, § 615.5172 imposes a portfolio cap on Farmers' Notes, which the Act and FCA lending regulations do not establish for agricultural or aquatic loans. Another distinction between Farmers' Notes and loans is that FCS associations discount Farmers' Notes from other creditors, rather than lending directly to eligible

farmers and ranchers. When all of these factors are taken together, it is clear that Farmers' Notes is an investment, not a lending, program.

Comment letters from commercial banks and their trade associations state that the original proposed rule would reinvent the Farmers' Notes program as an "expansive new consumer and business lending program" that would finance "a vast array of retail merchants" who sell non-agricultural consumer products on credit to rural residents who are not farmers. This has never been the intent of the FCA, and the scope of this regulation does not shift the focus of the Farmers' Notes program away from farmers and agriculture. For example, FCS associations are authorized to invest only in notes from farmers, ranchers, aquatic producers or harvesters, and farm-related businesses that are eligible to borrow from the System. Additionally, the Farmers' Notes program focuses on agricultural, not consumer, credit. Therefore, FCS associations primarily will invest in Farmers' Notes that finance: (1) Agricultural or aquatic operations of farmers, ranchers, aquatic producers or harvesters, or (2) farm-related businesses.

The FCA proposes two major changes to § 615.5172 that should dispel any confusion about the scope of the Farmers' Notes program. First, the FCA proposes to revise § 615.5172(a) to more clearly identify which creditors may sell Farmers' Notes to FCS associations. Second, proposed § 615.5172(b) limits investments in Farmers' Notes that are for consumer goods and services.

Under the proposed rule of August 11, 2003, § 615.5172(a) would have allowed FCS associations to invest in Farmers' Notes given "to entities that routinely extend credit in the normal course of their business." We now propose that § 615.5172(a) require the seller of Farmers' Notes to be either: (1) A financial institution, or (2) an entity whose primary business is selling agricultural supplies, machinery, and equipment to eligible farmers and farm-related businesses, and extends agricultural or aquatic credit to such customers in the normal course of its business. This revision should remove any doubt that the Farmers' Notes program remains geared towards agricultural credit. The primary business of financial institutions is to extend credit. In contrast, merchants primarily sell goods and services, while providing credit to their customers as a supplemental but integral part of their overall business. The proposed rule does not authorize FCS associations to

provide funding and liquidity to businesses that primarily sell consumer goods and services to the general public. The FCA has also added a new provision to § 615.5172(b) that expressly restricts consumer credit.

Proposed § 615.5172(a) and (b)(2) reinforce each other and prevent the Farmers' Notes program from expanding into a general consumer financing program. Proposed § 615.5172(a) authorizes FCS associations to buy Farmers' Notes only from financial institutions and entities whose primary business is selling agricultural supplies, equipment, or machinery to farmers, ranchers, or aquatic producers or harvesters while debt on consumer goods and services from general retail businesses cannot qualify as Farmers' Notes under § 615.5172(b)(2). As a result, no FCS association could invest in notes from merchants whose primary business is selling consumer goods and services to people who are not eligible farmers, ranchers, or aquatic producers or harvesters. However, an association could buy notes that are secured by home appliances and furniture from a farm supply cooperative that sells such consumer goods to its farmer-members.

In addition to these two regulatory revisions, another provision of § 615.5172 ensures that FCS associations invest only in Farmers' Notes to eligible farmers, ranchers, aquatic producers or harvesters, and farm-related businesses. The new proposed regulation continues to require that an FCS association invest in Farmers' Notes only in accordance with policies prescribed by its own board and the board of its funding bank. Thus, each association must operate under policies that ensure it invests only in notes to eligible agricultural and aquatic producers or harvesters, and farm-related businesses. Failure to comply with such policies would violate the regulation.

As requested by two System associations, the FCA has revised § 615.5172(b) so that it no longer requires collateral "of a capital nature" to secure Farmers' Notes for agricultural, aquatic, or farm-related purposes. However, these notes must still be secured by some form of collateral as is appropriate for the type of funding being provided. Instead of limiting the collateral to items "of a capital nature," the new proposal gives FCS associations the flexibility to accept other agricultural collateral such as accounts receivable or inventory, as appropriate.

The FCA declines a System commenter's request to give FCS associations the option of investing in

unsecured Farmers' Notes. This commenter does not believe that the rule should require collateral to secure all Farmers' Notes. Instead, the commenter wants associations to have the option of requiring collateral as a credit enhancement. The FCA responds that securing Farmers' Notes with collateral enhances the safety and soundness of the Farmers' Notes program. From a legal perspective, secured credit is easier to collect if either the seller of these Farmers' Notes fails, or the underlying notemaker defaults. Together, both collateral and credit enhancements improve the quality and liquidity of Farmers' Notes, so they qualify as investments under the regulations.

Commercial bank commenters suggested that the 15-percent portfolio cap and the 50-percent concentration limit in § 615.5172(c) are inherently unsafe and unsound. According to these commenters, Farmers' Notes will not diversify the portfolios of FCS associations, which are already concentrated in agricultural assets. Another criticism of commercial banks is that Farmers' Notes are not liquid assets.

In response, the FCA reiterates that FCA regulations authorize FCS institutions to hold investments for two different purposes. As discussed earlier, FCS institutions hold investments to: (1) Maintain liquidity and manage market risks, or (2) advance their public policy mission of financing agriculture. Farmers' Notes are investments in agriculture. Investing in Farmers' Notes enables FCS associations to provide funding and liquidity to non-System agricultural lenders. Farmers' Notes also increase the flow of affordable, dependable, and stable credit to America's farmers and ranchers, and it fosters cooperation between the FCS and non-System agricultural lenders. In this context, this program achieves the objectives that Congress identified in section 1.1 of the Act.

As agricultural lenders, FCS associations have the expertise that is necessary to understand and manage the risks inherent in Farmers' Notes. Additionally, the regulation upgrades the quality of these assets and minimizes the risks to associations by: (1) Requiring collateral and credit enhancements on all Farmers' Notes, and (2) establishing a portfolio cap and concentration limit on these investments. Thus, this program does not expose FCS associations to significant risks that they cannot manage.

Since 1972, FCA regulations have imposed a 15-percent portfolio cap and

a 50-percent concentration limit on Farmers' Notes. We continue to believe that the 15-percent portfolio cap on Farmers' Notes is appropriate because FCS associations are cooperatives, and loans to their members should always comprise most of the assets in their portfolios. However, the suggestion that we should consider a lower concentration limit on Farmers' Notes has merit. We anticipate that a revised rule will increase investments in Farmers' Notes which, in turn, could expose System associations to greater safety and soundness risk issues from the counterparties in these transactions. For this reason, proposed § 615.5172(c) limits the total amount of Farmers' Notes that an association may invest in from any single seller, guarantor, insurer, or other counterparty to 20 percent of the association's total capital. Although the current regulation and original proposed rule refer to "capital and surplus," the new proposal ties the concentration limit to "total capital," which is consistent with FCA's capital regulations. This limit is compatible with the concentration limits for other investments, and it adequately addresses counterparty risks associated with these investments.

As noted earlier, the agricultural credit cooperative OFI stated that the Farmers' Notes regulation offers no incentives for non-System agricultural lenders. More specifically, this commenter asserted that full recourse and other credit enhancements frustrate the efforts of non-System agricultural lenders to minimize their capital, credit, and portfolio risks by selling notes to FCS associations. If non-System agricultural lenders do not take part in this program, the commenter reasoned that farmers and ranchers would not benefit from it. Although reducing capital, credit, and portfolio limits are important objectives for many agricultural lenders, the Farmers' Notes program bolsters the liquidity and provides an additional source of funds to agricultural businesses and other non-System agricultural lenders.

Commercial bank commenters claimed that § 615.5172, as originally proposed, fails to adhere to statutory restrictions that apply to cross-title lending. The FCA replies that investments are not subject to the same restrictions that apply to loans. Separately, almost all FCS associations are now ACAs, which have authority to make both short- and intermediate-term operating loans, and long-term mortgage loans. No free-standing PCAs are left in the System. There are only 12 stand alone Federal land credit associations (FLCAs) in the FCS, and all are

relatively small. The FCA anticipates that many of these FLCAs will merge into ACAs in the near future. For these reasons, we do not believe that the cross-title concerns presented by the commenters are a serious issue.

#### IV. Capital Risk Weighting

The preamble to the proposed rule of August 11, 2003, explained that we have interpreted FCA's capital adequacy regulations as requiring Farm Credit banks to risk weight investments in Farmers' Notes at 100 percent. The original proposed rule would have amended § 615.5210 so that FCS associations could risk weight Farmers' Notes that exhibit specified risk-mitigating characteristics at 20 or 50 percent. Under the proposed rule of August 11, 2003, System associations would continue to risk weight Farmers' Notes that do not meet these criteria, or otherwise exhibit a higher risk profile at 100 percent. We received no comments about the risk weighting of Farmers' Notes. We now propose the risk-weighting guidelines for Farmers' Notes, as addressed in the original proposed rule, without change.

The proposed rule would establish a 20-percent risk weighting for Farmers' Notes sold by entities that are either: (1) An equivalent to an Organization for Economic Cooperation and Development (OECD)<sup>5</sup> bank (Federal-or state-regulated depository institution); (2) subsidiaries of OECD equivalent banks or bank holding companies and carry full guarantees from such parent entities; or (3) an institution that carries one of the three highest investment-grade ratings from a nationally recognized statistical rating organization (NRSRO).<sup>6</sup> Additional criteria for a 20-percent risk weight is that the obligation must have full recourse or another credit enhancement.

Proposed § 615.5210 would establish a 50-percent risk weight for Farmers' Notes sold by entities that: (1) Are not OECD banks but otherwise meet similar

<sup>5</sup> "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. For purposes of United States banking operations, all federally regulated depository institutions are considered the equivalent of OECD banks.

<sup>6</sup> "Nationally recognized statistical rating organization" means an entity recognized by the Division of Market Regulation (or any successor Division) of the Securities and Exchange Commission (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

capital and operational standards; and (2) carry an investment-grade or higher NRSRO rating, or the investment is guaranteed by a parent company that has such a rating. Again, full recourse or another appropriate credit enhancement is a condition for the 50-percent risk weight.

The proposed rule retains a 100-percent risk weight for all Farmers' Notes that do not qualify for the 20-percent or 50-percent risk-weight categories. Sellers of Farmers' Notes that are well capitalized and well managed expose the System to less risk. Therefore, FCS institutions need less capital to support these investments. This approach is consistent with the direction from the proposed Basel Accord revisions, which are currently under consideration.

## V. Regulatory Flexibility Act

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

### List of Subjects in 12 CFR Part 615

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

For the reasons stated in the preamble, part 615, chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

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

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

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

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

2. Revise § 615.5172 to read as follows:

#### § 615.5172 Investments by associations in Farmers' Notes.

(a) In accordance with policies prescribed by its own board of directors and the board of the Farm Credit bank that funds it, each direct lender association may invest in notes, sales contracts, and other similar obligations (hereafter Farmers' Notes) that eligible farmers, ranchers, producers or harvesters of aquatic products, and farm-related businesses give to:

(1) Financial institutions; and

(2) Any entity whose primary business is selling agricultural supplies, machinery, or equipment to farmers, ranchers, aquatic producers or harvesters, and farm-related businesses, and extends agricultural or aquatic credit to such customers in the normal course of its business.

(b) Farmers' Notes that each direct lender invests in must be secured by collateral pledged by the individual farmer, rancher, aquatic producer or harvester, or farm-related business. In addition, each Farmers' Note must evidence the funding of:

(1) Agricultural assets that eligible farmers, ranchers, or producers or harvesters of aquatic products use in their agricultural or aquatic operations;

(2) Household appliances, furniture, and goods that eligible farmers, ranchers, or producers or harvesters of aquatic products buy for their living needs from entities identified in paragraph (a)(2) of this section; or

(3) Assets that eligible farm-related businesses use in providing farm-related services to eligible farmers and ranchers.

(c) The total amount that an association may invest in Farmers' Notes, at any one time, must not exceed 15 percent of the balance of its loans outstanding at the close of the association's preceding fiscal year. In addition, the total amount that an association may carry as investments in Farmers' Notes from any one entity that sells, guarantees, insures, or provides another credit enhancement listed in paragraph (d) of this section must not exceed 20 percent of the association's total capital.

(d) All Farmers' Notes in which an association invests shall have at least one of the following credit enhancements:

(1) The selling entity must endorse each Farmers' Note with full recourse;

(2) A guarantee by a creditworthy third party covers the entire principal amount of each Farmers' Note;

(3) Insurance covering the entire principal amount of each Farmers' Note;

(4) The selling entity or a third party maintains a reserve of cash or marketable securities of at least 10 percent of the entire principal amount of each Farmers' Note;

(5) The selling entity or a third party holds a subordinated interest of at least 10 percent of the entire principal amount of each Farmers' Note; or

(6) The entire principal amount of each Farmers' Note is covered by a combination of credit enhancements listed in this section.

### Subpart H—Capital Adequacy

3. Amend § 615.5210 by adding new paragraphs (f)(2)(ii)(N), (f)(2)(iii)(D), and (f)(2)(iv)(F) to read as follows:

#### § 615.5210 Computation of the permanent capital ratio.

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(N) Investments in Farmers' Notes that:

(1) Provide the Farm Credit System direct lender association full recourse against a seller or has other acceptable credit enhancements specified in § 615.5172(d) of this part, and

(2) Are guaranteed by an OECD bank or other institution that qualifies for a 20-percent risk weight under this section, or

(3) Are sold by entities that:

(i) Are rated in one of the highest three investment-grade rating categories from a NRSRO or the investment is guaranteed by a parent company with such a rating. If the entity has more than one NRSRO rating the lowest rating shall apply.

(ii) Maintain capital to total assets of at least 9 percent.

(iii) \* \* \*

(D) Investments in Farmers' Notes that:

(1) Provide the Farm Credit System direct lender association full recourse against a seller or has other acceptable credit enhancements specified in § 615.5172(d) of this part, and

(2) The seller is not covered by the provisions of paragraph (f)(2)(ii)(N) (20-percent risk weight) of this section, but otherwise meets similar capital, risk identification and control, and operational standards, or

(3) The credit provider carries an investment-grade or higher NRSRO rating or the investment is guaranteed by a parent company with such a rating. If the entity has more than one NRSRO rating the lowest rating shall apply.

(iv) \* \* \*

(F) Investments in Farmers' Notes that do not otherwise qualify for a lower risk weight under this section.

\* \* \* \* \*

Dated: September 8, 2004.

**Jeanette C. Brinkley,**

*Secretary, Farm Credit Administration Board.*

[FR Doc. 04-20607 Filed 9-13-04; 8:45 am]

**BILLING CODE 6705-01-P**