

# Proposed Rules

Federal Register

Vol. 70, No. 12

Wednesday, January 19, 2005

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 Parts 611, 612, 614, 615, 618, 619, 620, and 630

RIN 3052-AC19

**Organization; Standards of Conduct; Loan Policies and Operations; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; General Provisions; Definitions; Disclosure to Shareholders; Disclosure to Investors in Systemwide and Consolidated Bank Debt Obligations of the Farm Credit System**

**AGENCY:** Farm Credit Administration.

**ACTION:** Proposed rule.

**SUMMARY:** The Farm Credit Administration (FCA, we, or our) is proposing to amend our regulations affecting the governance of the Farm Credit System. The proposed rule does not affect the governance of the Federal Agricultural Mortgage Corporation. The proposed rule provides guidance on director qualifications; requires Farm Credit System institution boards of directors to complete training on corporate governance topics and conduct evaluations of their own performance; and addresses the number, selection, terms of service, and removal of outside directors. The proposed rule also addresses board committees, providing requirements for nominating committees, establishing compensation committees, and extending audit committee requirements to all Farm Credit System institutions. Finally, the proposed rule clarifies and expands the current rule on disclosure of conflicts of interest and compensation.

**DATES:** You may send comments on or before March 21, 2005.

**ADDRESSES:** Comments may be sent by electronic mail to [reg-comm@fca.gov](mailto:reg-comm@fca.gov), through the Pending Regulations section of our Web site at [www.fca.gov](http://www.fca.gov), or through the Government-wide [www.regulations.gov](http://www.regulations.gov) portal. You may also send written comments to S. Robert Coleman, Director, Regulation and

Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090, or by facsimile transmission to (703) 734-5784. You may review copies of all comments we receive at our office in McLean, Virginia.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove electronic-mail addresses to help reduce Internet spam.

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### SUPPLEMENTARY INFORMATION:

#### I. Objectives

The objectives of this proposed rule are to:

- Strengthen the safety and soundness of Farm Credit System institutions;
- Strengthen the independence of Farm Credit System institution boards;
- Incorporate many of the best corporate governance practices for Farm Credit System institutions; and
- Improve disclosures to stockholders and investors in the Farm Credit System.

#### II. Background

The Farm Credit Act of 1971, as amended (Act),<sup>1</sup> authorizes FCA to issue regulations implementing the provisions of the Act. FCA regulations ensure the safe and sound operations of Farm Credit System institutions and govern disclosure of financial information to stockholders and investors in the Farm

Credit System.<sup>2</sup> Congress explained in section 514 of the Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 Act)<sup>3</sup> that disclosure of financial information and reporting of potential conflicts of interest by Farm Credit System directors, officers, and employees helps ensure the financial viability of the Farm Credit System. In the 1992 Act, Congress required that we review our regulations to ensure that Farm Credit System institutions provide adequate disclosures to stockholders and other interested parties. We completed this review in 1993, making appropriate amendments to our Standards of Conduct regulation (59 FR 24889, May 13, 1994) and Disclosure to Stockholders regulation (59 FR 37406, July 22, 1994). In keeping with today's business environment and the findings of Congress under the 1992 Act, we believe it is prudent and timely to update our regulatory guidance on corporate governance.

The structure of the Farm Credit System and its individual institutions has undergone significant change as a result of the Agricultural Credit Act of 1987 (1987 Act).<sup>4</sup> Since 1988, Farm Credit banks have transferred their direct lending authority to their affiliated associations, thereby becoming wholesale lenders. Most of the 13 banks for cooperatives (BCs) merged and then, along with the remaining BCs, consolidated with a Farm Credit bank to create an agricultural credit bank. Overall, 37 banks and 377 associations have consolidated into 5 banks and 97 associations, creating fewer, but larger and more sophisticated, institutions.<sup>5</sup> During this same time, agricultural credit associations with subsidiary structures have become the dominant Farm Credit System direct lending structure. The continued growth and increasing complexity of Farm Credit System institutions places additional demands on their boards of directors. Further, the recent troubles of a number of publicly held companies resulting from poor governance practices amplifies the need to ensure Farm Credit System institutions have

<sup>2</sup> Section 5.17(a)(8) to (10) of the Act. 12 U.S.C. 2001, *et seq.*

<sup>3</sup> Pub. L. 102-552, 106 Stat. 4131.

<sup>4</sup> Pub. L. 100-233, 101 Stat. 1568.

<sup>5</sup> As of September 9, 2004.

<sup>1</sup> Pub. L. 92-181, 85 Stat. 583.

qualified boards and transparency in reporting to stockholders and investors.

Public attention on corporate governance issues resulted in a series of investigations, public hearings, and legislative and regulatory changes for public companies. The predominant legislative action was passage of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).<sup>6</sup> Sarbanes-Oxley establishes stronger reporting requirements and enhanced oversight for publicly held companies by increasing the responsibility and independence of corporate boards. The Securities and Exchange Commission (SEC) issued, and continues to issue, regulations implementing the provisions of Sarbanes-Oxley. Self-regulating organizations (SROs) such as the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX) and the NASDAQ Stock Exchange (NASDAQ) have also issued requirements designed to enhance the accountability and transparency of business operations. Likewise, the Conference Board's Commission on Public Trust and Private Enterprise, the Business Roundtable, and large institutional investors and insurance companies issuing director and officer liability insurance recommended changes to corporate policies and procedures to improve corporate governance.

Although Farm Credit banks and associations are not subject to the governance requirements of Sarbanes-Oxley, we considered its components, the actions of other regulators, and recent governance enhancements by the Farm Credit System when developing this proposed rule. As noted in a Moody's Corporate Governance Assessment in 2003, the Farm Credit System initiated an extensive review of its governance practices, intending to adopt best practices and follow relevant provisions of Sarbanes-Oxley. We have also considered these self-initiated governance enhancements by the Farm Credit System in developing this proposed rule. We also sought to balance regulatory requirements with informal guidance. Regulations ensure an element of consistency, while informal guidance provides flexibility for management to adopt practices suitable to the unique needs of individual Farm Credit System institutions. Our efforts to achieve this balance are reflected in this proposed rule. The proposed rule also gives full consideration to our examination of Farm Credit System institutions and the

role examinations play in ensuring safe and sound operations.

The proposed rule considers the current state of the Farm Credit System, the increasingly complex market environment within which it operates, and current best governance practices. Specifically, the proposed rule addresses five governance areas: (1) Director training, experience, and performance, (2) board composition, (3) nominating committees, (4) conflict of interest and compensation disclosures, and (5) audit and compensation committees. This proposed rule will ensure timely and accurate System-wide disclosure in a manner consistent with our regulatory policy.<sup>7</sup>

### III. Section-by-Section Analysis

#### A. Definitions

##### 1. Agent and Entity (§ 612.2130)

The proposed rule amends existing § 612.2130 to clarify that the term "agent" applies to current, not past, relationships with Farm Credit System institutions. It also proposes to remove the Farm Credit System institutions exception from the list of business institutions and organizations included in the Standards of Conduct definition of "entity." We believe the interactions between Farm Credit System institutions should be included in the Standards of Conduct reporting requirements, providing complete and full disclosure of potential conflicts of interest. We also propose redesignating paragraph numbers as a conforming change.

##### 2. Outside Director (§§ 611.320, 615.5230, and New § 619.9235)

We propose adding a definition of outside director to the general definitions in part 619. The proposed § 619.9235 would define an outside director as a director elected or appointed by the board and independent of the Farm Credit System. The proposed definition includes agents in the list of ineligible candidates. Currently Farm Credit banks, but not associations, may have agents as outside directors. The proposed definition would remove that option, making requirements between Farm Credit banks and associations consistent.

We propose using the opportunity created by the introduction of the term outside director into the regulations to clarify §§ 611.320(b) and 615.5230(a). We clarify that each voting stockholder's right to elect directors does not include outside directors.

##### 3. Senior Officer (§§ 611.1223, 612.2155, 620.1, and New § 619.9265)

We propose removing the existing definition of senior officer from § 620.1 and adding a definition to part 619 that expands the § 620.1 definition to include policy makers. The proposed § 619.9265 would apply the definition of senior officer to all our regulations, unless otherwise noted. In conformance with this proposed change, we propose removing the § 620.1 definition reference in §§ 611.1223(d)(9) and 612.2155(a).

##### 4. Affiliated Organization (§ 620.1)

We propose amending the definition of an affiliated organization at § 620.1(a) by adding the position of director to the list of positions within an affiliated organization. This change will correct an inadvertent omission in the existing rule.

#### B. Bank and Association Boards of Directors

##### 1. Director Qualifications and Training (New § 611.210)

The proposed rule adds a new § 611.210, requiring each Farm Credit bank and association to establish standards for evaluating the knowledge and experience of director candidates. Farm Credit bank and association boards are responsible for providing management oversight, planning, and policy direction. In addition, they have certain fiduciary responsibilities to stockholders, which may require some accounting and financial experience. It is important to identify well-qualified directors and strengthen the collective knowledge of each board. Therefore, we propose that Farm Credit System institutions identify specific board member qualifications to enhance the collective knowledge of the board in a variety of areas, such as risk management, agricultural economics, and financial reporting.

The proposed rule requires that new directors receive orientation training within 1 year of assuming a board position and that incumbent directors receive periodic training. We recognize that the Farm Credit System offers some training for directors and seeks increased opportunities for FCA and the Farm Credit System to jointly offer director training. We believe our proposed training requirement will provide these opportunities, as well as improve board performance, facilitate implementation of best governance practices, and promote stockholder confidence. Continuing education and training assists directors in keeping abreast of current issues and

<sup>6</sup>Pub. L. 107-204, July 30, 2002.

<sup>7</sup>FCA Board Policy Statement on Regulatory Philosophy, 59 FR 32189, June 22, 1994.

developments affecting agriculture, banking, and corporate governance. While we propose some training topics, we expect each Farm Credit System institution to add others that fit its needs and circumstances.

The rule does not propose requiring Farm Credit bank and association boards be culturally diverse, but we believe each board should be representative of its current and potential borrowers. We believe a board should reflect the age, race, gender, and other cultural factors of producers within its territory. As such, we encourage Farm Credit System institutions to consider diversity when conducting director recruitment.

## 2. Board Evaluations (§§ 615.5200 and 618.8440)

We propose adding a director evaluation requirement to §§ 615.5200 and 618.8440. We believe each board needs a systematic approach for evaluating its performance. Annual board performance evaluations are acknowledged as a best governance practice and have been endorsed by the NYSE, prominent trade groups, consulting firms, and leading schools of management. As such, we are proposing amendments to §§ 615.5200(b) and 618.8440(b) to require that every Farm Credit System institution board of directors conduct an annual evaluation of its performance as part of the 3-year operational and strategic business plan (3-year business plan). Our proposal leaves the method of conducting this evaluation to the board's discretion. Whatever method is selected, the goal of this evaluation is to help the board identify its strengths and weaknesses.

In proposing this requirement, we recognize that we currently monitor director performance through our examination process. Section EM-510 of the FCA Examination Manual requires our examiners to assist each Farm Credit System institution board in understanding our view of a director's role and responsibilities through an evaluation of a board's effectiveness in achieving safe and sound operations and operating within applicable law and regulations. We will continue to offer this assessment during examinations, but believe its usefulness would be increased if each Farm Credit System institution board also conducted a similar evaluation.

A companion to board evaluations is a Code of Ethics. A written Code of Ethics is intended to reasonably assure customers that a business offers services in an objective and impartial manner. Section 406 of Sarbanes-Oxley encourages companies to adopt a Code

of Ethics and the SEC, to implement section 406, requires publicly traded companies to disclose if they have a Code of Ethics or the reason why no code has been adopted. This rule does not propose requiring Farm Credit bank and association boards to adopt a Code of Ethics. We believe the proposed enhancements to our regulations offer sufficient assurances to customers that the Farm Credit System functions in a fair manner. However, we are encouraging each board to follow the current best practice of establishing a Code of Ethics for itself, management and employees. We believe a voluntary action by the individual institutions to adopt and publish a Code of Ethics will increase stockholder and investor goodwill and confidence.

## 3. Outside Directors (New § 611.220)

The proposed rule adds a new § 611.220 addressing outside director expertise, number, terms of service, and removal.

a. *Expertise and Number.* The Act requires each Farm Credit bank and association board to have at least one director who is independent of the Farm Credit System and elected or appointed by stockholder-elected board members. The legislative history of the Act explains that Congress intended the outside director to provide an independent perspective and some expertise in appropriate areas. We believe the current business environment requires financial expertise within each board of directors and are proposing that all Farm Credit banks and associations have at least one outside director who is a financial expert.<sup>8</sup> This outside director will broaden the board's collective knowledge, enhance its independence, and improve its ability to carry out its fiduciary responsibilities on behalf of Farm Credit System stockholders and investors. We define financial expertise to include education or experience in accounting, internal accounting controls, and preparing or reviewing financial statements for financial institutions or large corporations. We relied on Sarbanes-Oxley when defining financial expertise, which was also used as a basis for the Office of the Comptroller of the Currency (OCC) governance rules for national banks and the proposed amendments to the Office of Federal Housing Enterprise Oversight (OFHEO) rules.

The proposed rule would further require Farm Credit banks and

associations with total assets of more than \$150 million to have at least two outside directors. We feel the growth in individual institution asset size, the increasing complexity in the financial services sector and related operating risk exposure, as well as the increasing scrutiny of Government-sponsored enterprises justify our proposal. We propose exempting Farm Credit System institutions with total assets of \$150 million or less because we believe these institutions are generally less complex and pose less risk. Although we propose exempting these smaller institutions, we are not precluding them from having more than one outside director. However, shareholder-elected directors must remain the majority presence on a board.

We note that in today's business climate, outside directors provide a valuable independent voice of experience to Farm Credit System institutions facing a changing business environment. As such, we believe outside directors should not be discouraged from serving in leadership positions on the board. We further encourage Farm Credit System institutions to select board leaders and committee members based on their qualifications and not on the manner of their selection to the board.

b. *Terms of Service and Removal.* We propose that outside directors have the same terms of office as directors elected by all voting stockholders. We believe that a similar term for all directors is consistent with best governance practices and current Farm Credit System practices. We also propose that outside directors only be removed for cause or a change in eligibility status. Although the removal of outside directors is currently governed by Farm Credit System institution bylaws, we believe regulating removal improves Farm Credit System institution governance, provides better System-wide accountability, and enhances safety and soundness operations.

We consider "cause" to include a breach of fiduciary duties, willful or criminal misconduct, and creating a risk to the Farm Credit System institution. Removal for cause does not include offering opposing viewpoints during board deliberations, identifying weaknesses in the institution's operations, or exercising appropriate authorities while serving on a committee of the board. We believe permitting removal for other than a causal basis may have a chilling effect on the outside director's independence, inhibiting the outside director's willingness to take controversial positions while serving on the board.

<sup>8</sup> Section 4.9 of the Act requires the Federal Farm Credit Banks Funding Corporation to have two expert outside directors. 12 U.S.C. 2160(d)(1)(C)(ii).

Further, we are proposing that outside director removal for cause be achieved only with a majority vote of all voting stockholders. Our proposal follows our past practice of encouraging stockholder consent when removing an outside director from office and recognizes the cooperative principles of the Farm Credit System structure.

We are also proposing regulations requiring the removal of an outside director when the director no longer meets the definition of an outside director. The Act requires outside directors to have no affiliation with the Farm Credit System, and as such, they should not acquire any prohibited relation with the Farm Credit System while serving as an outside director. We recognize that an anomaly in the Act permits Farm Credit bank and association outside directors to serve as the Federal Farm Credit Banks Funding Corporation's (Funding Corporation) outside directors, thereby becoming ineligible to continue as the underlying bank or association outside director.<sup>9</sup> We believe the proposed rule remedies this situation. Although we are proposing that an outside director be removed from the position of outside director if he or she acquires prohibited affiliations with the Farm Credit System, we are not restricting a Farm Credit System institution from converting that director to the proposed board-selected inside director.

#### 4. Board-Selected Inside Directors (New § 611.230)

We strongly believe that stockholders have the right to vote for directors, except in limited situations.

Our proposed rule adds a new § 611.230 permitting no more than two board-selected inside director positions, subject to the majority consent of all voting stockholders of a Farm Credit System institution. We believe allowing a bylaw provision authorizing Farm Credit bank and association boards of directors to elect or appoint stockholder-directors does not adversely impact corporate democracy or a bank or association's status as a cooperative, provided the stockholders have agreed to implement this through the institution's bylaws to create the position. In further preservation of cooperative principles, we are proposing a "cooling off" period, preventing selection of anyone who was a candidate in the past 5 years for a stockholder-elected position. We believe permitting board-selected inside directors may serve as a tool for boards to achieve diversity or acquire needed

skills. However, we are limiting the number of board-selected inside directors to preserve the cooperative principles of the Farm Credit System. In addition, shareholder-elected directors must constitute the majority of a board. We note that the board-selected inside director may run for election at the next available opportunity.

We are also proposing clarifying amendments addressing this unique director position in §§ 611.320 and 615.5230.

#### C. Election of Directors

##### 1. Director Candidate Campaign Material (§§ 611.320 and 618.8310)

The proposed rule amends § 618.8310 to clarify that Farm Credit System institutions may provide a list of stockholders to other stockholders in relation to an election to the board of directors or to the nominating committee. In addition, we have added the distribution of campaign materials in board and nominating committee elections to the permissible purpose list of examples.

In making this clarification, we further propose amending § 618.8310 to prohibit Farm Credit banks and associations from distributing this same campaign material in lieu of providing a list of stockholders. We make this change to reconcile the provisions of § 618.8310 with those of § 611.320, which prohibits a Farm Credit System institution from distributing campaign material. We also clarify § 611.320 to emphasize that Farm Credit System institutions may not distribute director candidate campaign material. The amendments we are proposing to §§ 618.8310 and 611.320 are essential to preserve impartiality in the election of directors, while allowing for candidate communication with stockholders.

We are also proposing a clarifying amendment to § 618.8310(b)(1) to specify that a "list of stockholders" consists of each stockholder's name, address, and classes of stock held. This amendment is consistent with our past interpretations and comports with the Model Business Corporation Act.<sup>10</sup> We also clarify that Farm Credit banks and associations may not add conditions to releasing the list, such as indemnification or "hold-harmless" agreements, other than those named in section 4.12A of the Act and our regulation. We believe the existing certification provision adequately addresses an institution's legitimate confidentiality concerns.

As a technical change, we propose replacing "agricultural credit bank, bank for cooperatives, Federal land bank association, production credit association, merged association, or Farm Credit Bank" in § 618.8310(b)(1) with "Farm Credit bank or association" pursuant to the definitions contained in §§ 619.9140 and 619.9050.

##### 2. Director Candidate Disclosure (§§ 615.5230, 620.20, 620.21, 620.30, and 620.31)

We propose consolidating the provisions of subpart F, *Bank Director Disclosure Requirements* (§§ 620.30 and 620.31), with subpart E, *Association Annual Meeting Information Statement* (§§ 620.20 and 620.21) into § 620.21 of subpart E, and renaming subpart E "Annual Meeting Information Statement (AMIS)." The proposed change would establish a uniform set of election disclosure guidelines for Farm Credit banks and associations.

Our proposed changes to the AMIS would require associations to include nominee residential and business addresses and for candidates to disclose any family relationships that would be reportable under part 612 if elected to the institution's board. These requirements currently exist for Farm Credit banks. Farm Credit banks would be required to provide an AMIS to stockholders at least 10 days prior to director elections, listing the day, time, and place of the meetings. These changes should encourage further participation of stockholders in Farm Credit bank and association elections, consistent with cooperative principles, and establish a uniform set of election disclosure guidelines. We also propose changing the "and" to "or" in § 620.21(c)(2), while removing the "total of" phrase to provide more information to stockholders on director attendance.

As part of the proposed consolidation, we propose amending § 615.5230 to require that Farm Credit banks report their efforts to locate nominees for director positions in the AMIS.

##### 3. Nominating Committees (New § 611.325)

The proposed rule adds a new § 611.325 on nominating committees. After reviewing surveys on the practices in many Farm Credit System institutions, we decided to propose regulations addressing the duties and composition of nominating committees. Although we issued informal guidance in the past, the Farm Credit System continues to request additional information on permissible nominating committee activities. We believe this

<sup>9</sup> Section 4.9(d)(1)(C)(i) of the Act.

<sup>10</sup> 1984 Model Business Corporation Act, § 7.20 (3rd Ed. 2002).

guidance should be formalized in our regulations.

We are proposing that each Farm Credit bank and association have a nominating committee of at least three members. We believe a minimum of three members is consistent with best governance practices for balancing outreach and diversity against potential committees of one. The proposed rule specifies that committee members may not be director candidates. We propose this restriction because some Farm Credit banks and associations have permitted a stockholder to run for the nominating committee and a directorship position in the same year. We believe requiring committee members to be free from an interest in a directorship at the time of service and selection preserves impartiality.

Our existing rule requires Farm Credit banks and associations to assure a choice of at least two nominees for each elected office or document why there are not two nominees. Currently, only associations are required to disclose this documentation to stockholders. We believe that Farm Credit bank disclosure of the efforts to locate two qualified and willing nominees will lead to greater openness in the nomination process, increase the number of candidates, and provide regulatory consistency between Farm Credit banks and associations in director nominations. Therefore, the proposed rule requires Farm Credit bank and association nominating committees to document and maintain a record of their efforts to nominate two or more suitable candidates when only one can be found and for the Farm Credit banks and associations to include the nominating committee's report in the AMIS.

We further propose requiring Farm Credit banks and associations to provide all necessary resources to the nominating committee, including a list of stockholders. We believe these resources are necessary for a nominating committee to conduct an independent and thorough search for, and evaluation of, director candidates.

#### *D. Conflict of Interest and Compensation Disclosure (§ 620.5)*

The proposed rule would increase the level of disclosure for potential conflicts of interest and executive compensation. Taken together, these proposed changes will improve the transparency of Farm Credit System institution governance and operation, strengthen its safety and soundness, maintain the cooperative principles upon which the Farm Credit System is based, and improve information flow to stockholders and

investors, consistent with the purposes and objectives of the Act.

#### 1. Disclosure of Other Business Interests

The proposed rule would amend § 620.5(h) to require disclosure of director and senior officer business relationships with other business interests. The existing provision only requires directors to disclose those business interests where he or she serves on the board of another entity. We are proposing to expand the coverage of disclosure reporting to include all senior officers. We also propose increasing the level of disclosure to include all business interests where a director or senior officer serves on the board or is employed as a senior officer.

In proposing these changes, we considered the reporting requirements of part 612 and the specific business interests that could create a real or potential conflict of interest. We also looked to the reporting requirements of other regulators. At a minimum, we believe it is essential to disclose the individual's relationships with other Farm Credit System institutions, including the Federal Agricultural Mortgage Corporation. We considered limiting disclosure to lending institutions but ultimately chose to retain the existing disclosure requirement of all other business interests.

#### 2. Disclosure of Compensation

We are proposing to clarify the meaning of compensation in § 620.5(i)(1)(iv) and (i)(2). We are clarifying that compensation for serving as a Farm Credit System institution director or senior officer includes both cash and noncash compensation from all sources. For example, if a senior officer attends an out-of-town meeting in his or her Farm Credit System official capacity, any expenses paid by a third party would be reportable.

a. *Director Noncash Compensation.* We are proposing that all noncash compensation be disclosed. Existing § 620.5(i)(1) excludes the reporting of noncash compensation that does not exceed 10 percent of total compensation. We believe tying a disclosure provision to a percentage of compensation results in a disparity of reporting. For example, a director in association A may have compensation of \$30,000, reporting noncash compensation that exceeds \$3,000. Conversely, a director in association B may have compensation of \$300,000 and only have to report noncash compensation that exceeds \$30,000. We also propose reporting any special

compensation for serving on a board committee.

b. *Senior Officer Compensation.* The proposed rule would amend § 620.5(i)(2) to expand the current compensation disclosure requirement for senior officers of Farm Credit banks and associations. Our existing regulation provides for disclosure by Farm Credit System institutions of compensation to senior officers on an aggregated basis subject to certain limits. We are proposing that senior officer cash and noncash compensation be individually disclosed.

We believe that the interests of Farm Credit System stockholders and investors require full disclosure, as evidenced by congressional statements on disclosure in the 1992 Act. Further, it is generally considered a best practice to publicly disclose executive compensation (both cash and noncash) on an individual basis. We further clarify in the proposed rule that noncash compensation includes stock and stock options. The proposed rule also removes the option for associations to disclose senior officer compensation in the AMIS as an alternative to the annual report. Farm Credit banks do not currently have this option; therefore, we are removing the option for the associations in order to improve disclosure to stockholders and provide consistency in reporting requirements.

As a conforming change, we propose removing the provision at § 620.5(i)(2), which provides for the disclosure of individual senior officer compensation when requested.

c. *CEO Compensation Threshold.* We propose removing the reporting exclusion for Chief Executive Officer (CEO) salaries below \$150,000, as adjusted for the Consumer Price Index. We reviewed the existing CEO disclosure requirement and the associated limit of that disclosure. Our review found no basis for retaining the \$150,000 minimum reporting limit. Further, in the course of our review, we noted that the SEC and OCC require CEO compensation disclosure regardless of the amount. In light of the stockholders' right to know and the events leading up to the passage of Sarbanes-Oxley, we believe the existing provision can no longer be supported. Therefore, we propose that every Farm Credit System institution report the full amount of CEO compensation.

d. *Senior Officer Perquisites.* The existing rule at § 620.5(i)(2) requires reporting perquisites over \$25,000 or 10 percent of a senior officer's salary. The proposed rule would reduce this amount to \$5,000. The reduced amount is the same as the reportable loan

transaction threshold at § 620.5(k). Perquisites, by their nature, are nominal privileges and benefits. However, amounts of \$25,000 are not nominal. As such, we believe the same disclosure level for loan transactions is a reasonable level.

#### *E. Audit and Compensation Committees*

##### *1. Audit Committees (§§ 620.30 and 630.6)*

An audit committee is the guardian of a corporation's financial integrity. The events outside of the Farm Credit System involving alleged misdeeds by corporate executives and independent auditors damaged stockholder confidence in the financial markets. These events highlight the need for strong, competent, and vigilant audit committees. As such, we believe it is important for all Farm Credit System institutions to have audit committees. Therefore, we are proposing that each Farm Credit System association have an audit committee. Currently, the Funding Corporation and Farm Credit banks are the only Farm Credit System institutions required to have audit committees under § 630.6.

In conjunction with the proposed expansion, we propose moving the Farm Credit bank audit committee provisions from § 630.6(b) to § 620.30 for organizational purposes and adding a requirement for association audit committees to § 620.30. This section and § 620.31 currently contain provisions on Farm Credit bank disclosure statements. As discussed earlier, we propose consolidating Farm Credit bank disclosures with association disclosure in § 620.21.

We are also proposing changes in the structure, responsibilities, and authority of audit committees. Audit committees recommend actions needed to ensure full and accurate disclosure of an institution's operations and financial well being. We believe an audit committee must be comprised of at least three well-qualified board members. This view is shared by Sarbanes-Oxley, which also requires audit committees to be composed of directors. Therefore, the proposed rule requires each audit committee to be composed solely of board members, including at least one outside director.

Audit committee independence is essential to stockholder confidence in the transparency of audited financial statements and the integrity of the audit committee. By effectively carrying out its responsibilities, an independent audit committee helps to ensure that management properly develops and adheres to a sound system of internal

controls, that procedures are in place to objectively assess management's practices, and that the outside auditors objectively assess the institution's financial reporting practices. In furtherance of these objectives, we propose that a director with financial expertise serve on the audit committee as its chair.

We are also proposing that audit committees approve the engagement or discharge of an institution's outside auditor. We believe it is appropriate that the audit committee hire the outside auditor to minimize potential or perceived undue management influence in the review of financial reports and accounting procedures. The audit committee's oversight will provide auditors with a knowledgeable authority other than management with which to discuss controversial matters.

We propose authorizing each audit committee to hire experts and legal counsel, when necessary. Access to outside experts and legal counsel provides an independent source of information or advice. Other resources are also to be made available and, as part of the proposed rule, we require a supermajority board vote to deny resources to an audit committee. We propose requiring this level of control to increase the independence of the audit committee and to act as a check on both the audit committee and management expectations for the Farm Credit System institution's financial resources. The proposed rule would also add a 3-year recordkeeping requirement similar to the voting record retention timeframe contained in § 611.340.

In conjunction with the enhanced role of audit committees, we are proposing to amend §§ 618.8430, 620.5(m), 620.11(d) and (e), 630.20(l), and 630.40(d) to include a reference to the oversight responsibility of audit committees.

##### *2. Compensation Committees (§§ 620.31 and 630.6)*

The proposed rule would add a requirement that each Farm Credit bank and association have a compensation committee comprised of at least three board members. We also propose that compensation committees have approval authority for senior officer compensation. We are proposing this provision to ensure that senior officer salaries are commensurate with the duties and responsibilities of their positions.

In drafting our proposal, we reviewed the regulations issued by OFHEO, several compensation committee charters of publicly traded companies, and published studies of best

governance practices. These emphasized the importance of a well-defined compensation program, a qualified, objective compensation committee to oversee the program, and the importance of transparency in administering the program.

We propose placing compensation committee provisions in § 620.31 for Farm Credit banks and associations and § 630.6(b) for the Funding Corporation.

#### **IV. Miscellaneous**

##### *1. Technical Changes (§§ 611.1030, 612.2130, 614.4511, and 630.20)*

Our proposed amendments require additional conforming technical changes to other regulatory provisions. We propose removing § 611.1030 as it contains provisions rendered obsolete by the 1988 technical amendments to section 7.1 of the Act and is redundant of statutory language. We also propose amending § 612.2130(d) to remove the definition of "director" because it is unnecessary, resulting in redesignated paragraphs. We propose removing § 614.4511 as it has been rendered obsolete. We also propose changing the management reference in § 630.20 to "senior officer" for consistency. The change to § 630.20 would include incorporating the proposed changes of § 620.5(i) regarding senior officer disclosures.

##### *2. Bank Director Compensation (§ 611.400)*

We recognize that the proposed rule may increase the responsibilities of some Farm Credit System directors, such as those serving on board committees. We further appreciate that some Farm Credit banks have reported director recruitment difficulties, due in part to the statutory compensation limit for Farm Credit bank directors. In addition, prior to this rulemaking we received several requests from Farm Credit banks to revise our rules on director compensation waivers.

The Act at section 4.21 establishes the compensation for Farm Credit bank directors at \$20,000, adjusted annually to reflect changes in the Consumer Price Index. The Act, however, gives FCA the authority to waive this compensation level under exceptional circumstances. Use of the waiver authority is designed to provide a higher level of compensation for the duration of the exceptional circumstances. We have exercised this authority in existing § 611.400, which authorizes Farm Credit banks to pay directors up to 30 percent more than the statutory compensation limit in documented exceptional circumstances and without prior

submission to FCA. Farm Credit banks are required to document the need for the additional compensation before exercising this authority and report its use, and the associated exceptional circumstances, in the annual report to stockholders.

We are inviting comment on whether we should retain, reduce, increase, or remove the current regulatory 30-percent waiver amount and at what level we should remove the authority of Farm Credit banks to exercise the waiver without prior submission to FCA. We request that comments suggesting an appropriate percentage be accompanied by independent data. We are seeking separate comment on what constitutes an appropriate exceptional circumstance. Example of exceptional circumstances might include taking a leadership role on the board or one of its committees, serving as a recognized financial expert, or addressing one-time unusual bank business, such as a merger. In addition, we would like to receive comments identifying objective criteria. The criteria should address the special knowledge, skills, and abilities required by the exceptional circumstances.

### 3. Implementation Date

We recognize that some Farm Credit System institutions may have to recruit outside directors who have financial expertise or hire an additional outside director to satisfy certain provisions of the proposed rule. Therefore, we are proposing a 1-year delay in the implementation of these two requirements, beginning after publication of the final rule. Full compliance with all other provisions must be achieved beginning on the day following the effective date of the final rule.

## V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), 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 Farm Credit 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, Farm Credit System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

## List of Subjects

### 12 CFR Part 611

Agriculture, Banks, banking, Rural areas.

### 12 CFR Part 612

Agriculture, Banks, banking, Conflict of interests, Crime, Investigations, Rural areas.

### 12 CFR Part 614

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

### 12 CFR Part 615

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

### 12 CFR Part 618

Agriculture, Archives and records, Banks, banking, Insurance, Reporting and recordkeeping requirements, Rural areas, Technical assistance.

### 12 CFR Part 619

Agriculture, Banks, banking, Rural areas.

### 12 CFR Part 620

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

### 12 CFR Part 630

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

For the reasons stated in the preamble, parts 611, 612, 614, 615, 618, 619, 620, and 630 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

## PART 611—ORGANIZATION

1. The authority citation for part 611 is amended to read as follows:

**Authority:** Secs. 1.3, 1.4, 1.13, 2.0, 2.1, 2.10, 2.11, 3.0, 3.2, 3.21, 4.12, 4.15, 4.20, 4.21, 5.9, 5.10, 5.17, 6.9, 6.26, 7.0–7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2011, 2013, 2021, 2071, 2072, 2091, 2092, 2121, 2123, 2142, 2183, 2203, 2208, 2209, 2243, 2244, 2252, 2278a–9, 2278b–6, 2279a–2279f–1, 2279aa–5(e)); secs. 411 and 412 of Pub. L. 100–233, 101 Stat. 1568, 1638; secs. 409 and 414 of Pub. L. 100–399, 102 Stat. 989, 1003, and 1004.

2. Add a new subpart B, consisting of §§ 611.210, 611.220, and 611.230, to read as follows:

### Subpart B—Bank and Association Board of Directors

Sec.

611.210 Director qualifications and training.

611.220 Outside directors.

611.230 Board-selected inside directors.

## Subpart B—Bank and Association Board of Directors

### § 611.210 Director qualifications and training.

(a) Each bank and association must establish standards for director candidates that consider the knowledge and experience of individual candidates in risk management, agricultural economics, financial reporting, agricultural production and marketing, or other appropriate areas.

(b) At a minimum, banks and associations must require newly elected or appointed directors to complete director orientation training within 1 year of assuming their position and require incumbent directors to attend training periodically to advance their skills. Orientation and advanced training courses should address corporate governance, strategic planning, financial reporting, electronic banking, and other areas deemed appropriate by the Farm Credit bank or association.

### § 611.220 Outside directors.

(a) *Eligibility, number and term.* (1) No candidate for an outside director position may be a director, officer, employee, agent, or stockholder of an institution in the Farm Credit System. Farm Credit banks and associations must make a reasonable effort to recruit outside directors possessing a level of financial knowledge, but must have at least one outside director with financial expertise. Financial expertise includes, but is not limited to, education or experience in: accounting, preparing or reviewing financial statements for financial institution or large corporations, or internal accounting controls.

(2) Each bank and association with total assets exceeding \$150 million as of January 1 of each year must have no fewer than two outside directors on the board. Banks and associations with \$150 million or less in total assets as of January 1 of each year must have one outside director. Nothing in this section prohibits a bank or association board from exceeding the minimum number of outside directors. Stockholder-elected directors must constitute a majority of the board at all times.

(3) Banks and associations may not establish a different term of office for outside directors than that established for directors elected by the majority vote of all voting stockholders.

(b) *Removal.* When the majority of the board determines the removal of an outside director is necessary before the

expiration of the outside director's term, the board must document the reason for removal. Outside directors may only be removed when the director no longer meets the definition of an outside director or for cause. Removal for cause includes, but is not limited to, risk to the institution's operations, breach of fiduciary duties, willful or criminal misconduct, or violations of law. Removal for cause requires a majority vote of all voting stockholders.

**§ 611.230 Board-selected inside directors.**

A board-selected inside director is a stockholder who has been elected to a Farm Credit bank or association board of directors by the other board members. Board-selected inside directors are not elected by a general or regional vote of all voting stockholders. Board-selected inside directors are not outside directors as defined in part 619 of this chapter.

(a) *Creation of the position.* A Farm Credit bank or association may only establish a board-selected inside director position with the majority consent of all voting stockholders. The position must be established in the bank or association bylaws. The qualifications, training and disclosure requirements of directors elected by voting stockholders apply to board-selected inside directors. Board-selected inside director candidates are not subject to the nominating committee process of § 611.325.

(b) *Eligibility and number.* A board-selected inside director may not be a stockholder in any institution of the Farm Credit System, except the Farm Credit bank or association on whose board he or she will serve. No board-selected inside director may have been a candidate for a stockholder-elected director position in the Farm Credit bank or association in the 5 years prior to accepting the board-selected inside director position. No Farm Credit bank or association may have more than two board-selected inside directors serving on the board at any one time. Stockholder-elected directors must constitute a majority of the board at all times.

(c) *Duration of term.* The term of office for board-selected inside directors must be the same as for directors elected by the majority vote of all voting shareholders.

**Subpart C—Election of Directors and Other Voting Procedures**

3. Amend § 611.320 by revising paragraphs (b) and (e) to read as follows:

**§ 611.320 Impartiality in the election of directors.**

\* \* \* \* \*

(b) No employee or agent of a Farm Credit institution shall take any part, directly or indirectly, in the nomination or election of members to the board of directors of a Farm Credit institution, or make any statement, either orally or in writing, which may be construed as intended to influence any vote in such nominations, or elections. This paragraph shall not prohibit employees or agents from providing biographical and other similar information or engaging in other activities pursuant to policies and procedures for nominations and elections. This paragraph does not affect the right of an employee or agent to nominate or vote for shareholder-elected directors of an institution in which the employee or agent is a voting member.

\* \* \* \* \*

(e) No Farm Credit institution may in any way distribute or mail, whether at the expense of the institution or another, any campaign materials for director candidates. Institutions may request biographical, as well as the disclosure information required under § 620.21(d) of this chapter, from all declared candidates who certify that they are eligible, restate such information in a standard format, and distribute or mail it with ballots or proxy ballots.

4. Add a new § 611.325 to read as follows:

**§ 611.325 Bank and association nominating committees.**

Nominating committees must conduct themselves in the impartial manner prescribed by the policies and procedures adopted by their institution under § 611.320.

(a) *Composition.* The voting stockholders of each bank and association must elect at their annual meeting a nominating committee of no fewer than three members who will serve for the following year. No individual may serve on a nominating committee who, at the time of selection to a nominating committee, is an employee, director, or agent of that bank or association. A nominating committee member may not be a candidate for election to the board in the same election for which the committee is identifying nominees.

(b) *Responsibilities.* It is the responsibility of each nominating committee to identify, evaluate, and nominate candidates for stockholder election to a bank or association board of directors.

(1) Each nominating committee must seek individuals whom the committee determines meet the eligibility requirements to run for director

positions. The committee must endeavor to assure representation from all areas of the institution's territory and as nearly as possible all types of agriculture practiced within the territory.

(2) The nominating committee must perform an independent critical evaluation of the qualifications and suitability of the director candidates. The evaluation process must consider whether each candidate has a level of training and experience to perform the duties required by the position and whether there are any known obstacles that would prevent a candidate from performing the duties of the position.

(3) Each committee must nominate at least two candidates for each director position being voted on by stockholders. If two nominees cannot be identified, the nominating committee must provide written explanation to the existing board of the efforts to locate candidates or the reasons for disqualifying any other candidate that resulted in fewer than two nominees.

(c) *Resources.* Bank and association bylaws must provide that nominating committees have reasonable access to administrative resources in order to perform the nominating committee duties. Each bank and association must, at a minimum, provide their nominating committees with a current list of stockholders, the most recent bylaws, and a copy of the policies and procedures that the bank or the association has adopted pursuant to § 611.320(a) to assure impartial elections. On the request of the nominating committee, the bank or association must also provide a copy of the current operational and strategic business plan prepared pursuant to § 618.8440 of this chapter, including the board self-evaluation. The bank or association may require a pledge of confidentiality by committee members prior to releasing business plan or evaluation documents.

**Subpart F—Bank Mergers, Consolidations and Charter Amendments**

**§ 611.1030 [Removed and reserved]**

5. Remove and reserve § 611.1030.

**Subpart P—Termination of System Institution Status**

6. Amend § 611.1223 by revising paragraph (d)(9) to read as follows:

**§ 611.1223 Information statement—contents.**

\* \* \* \* \*

(d) \* \* \*

(9) *Employment, retirement, and severance agreements.* Describe any employment agreement or arrangement between the successor institution and any of your senior officers or directors. Describe any severance and retirement plans that cover your employees or directors and state the costs you expect to incur under the plans in connection with the termination.

\* \* \* \* \*

## PART 612—STANDARDS OF CONDUCT AND REFERRAL OF KNOWN OR SUSPECTED CRIMINAL VIOLATIONS

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

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

### Subpart A—Standards of Conduct

8. Amend § 612.2130 as follows:

a. Add the word “currently” after the word “who” each time it appears in paragraph (a);

b. Remove paragraph (d);

c. Redesignate existing paragraphs (e) through (u) as paragraphs (d) through (t), consecutively; and

d. Revise newly designated paragraph (e) to read as follows:

#### § 612.2130 Definitions.

\* \* \* \* \*

(e) *Entity* means a corporation, company, association, firm, joint venture, partnership (general or limited), society, joint stock company, trust (business or otherwise), fund, or other organization or institution.

\* \* \* \* \*

9. Amend § 612.2155 by revising paragraph (a) introductory text to read as follows:

#### § 612.2155 Employee reporting.

(a) Annually, as of the institution’s fiscal yearend, and at such other times as may be required to comply with paragraph (c) of this section, each senior officer must file a written and signed statement with the Standards of Conduct Official that fully discloses:

\* \* \* \* \*

## PART 614—LOAN POLICIES AND OPERATIONS

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

**Authority:** 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128; Secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 1.11, 2.0, 2.2, 2.3, 2.4, 2.10, 2.12, 2.13, 2.15, 3.0, 3.1, 3.3, 3.7, 3.8, 3.10, 3.20, 3.28, 4.12, 4.12A, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.18A, 4.19, 4.25, 4.26, 4.27, 4.28, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6,

7.8, 7.12, 7.13, 8.0, 8.5 of the Farm Credit Act (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2097, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2206a, 2207, 2211, 2212, 2213, 2214, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a–2, 2279b, 2279c–1, 2279f, 2279f–1, 2279aa, 2279aa–5); sec. 413 of Pub. L. 100–233, 101 Stat. 1568, 1639.

## Subpart N—Loan Servicing Requirements; State Agricultural Loan Mediation Programs; Right of First Refusal

### § 614.4511 [Removed and reserved]

11. Remove and reserve § 614.4511.

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

12. 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 H—Capital Adequacy

13. Amend § 615.5200 by revising paragraph (b)(1) to read as follows:

#### § 615.5200 General.

\* \* \* \* \*

(b) \* \* \*

(1) Capability of management and the board of directors;

\* \* \* \* \*

### Subpart I—Issuance of Equities

14. Amend § 615.5230 by revising paragraphs (a)(1) introductory text, (a)(1)(ii), (a)(2) introductory text, (a)(2)(ii), (a)(3) introductory text, and (b)(5) to read as follows:

#### § 615.5230 Implementation of cooperative principles.

(a) \* \* \*

(1) Each voting shareholder of an association or bank for cooperatives must:

(i) \* \* \*

(ii) Have the right to vote in the election of each director, except outside directors, unless the regional election of directors is provided for in the bylaws pursuant to § 615.5230(a)(3) or the bylaws provide for the board selection

of an inside director pursuant to § 611.230 of this chapter;

\* \* \* \* \*

(2) Each voting shareholder of a Farm Credit Bank must:

(i) \* \* \*

(ii) Have the right to vote in the election of each director, except outside directors and board-selected inside directors, and be allowed to cumulate such votes and distribute them among the candidates in the shareholder’s discretion, except that cumulative voting for the directors may be eliminated if 75 percent of the associations that are shareholders of the Farm Credit Bank vote in favor of elimination. In a vote to eliminate cumulative voting, each association must be accorded one vote.

(3) The regional election of stockholder-elected directors is permitted under the following conditions:

\* \* \* \* \*

(b) \* \* \*

(5) Each bank must 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 to locate two willing nominees must be documented in the records of the bank and provided as part of the Annual Meeting Information Statement of part 620, subpart E of this chapter. The bank must also maintain a list of the type or types of agriculture engaged in by each director on its board.

## PART 618—GENERAL PROVISIONS

15. The authority citation for part 618 continues to read as follows:

**Authority:** Secs. 1.5, 1.11, 1.12, 2.2, 2.4, 2.5, 2.12, 3.1, 3.7, 4.12, 4.13A, 4.25, 4.29, 5.9, 5.10, 5.17 of the Farm Credit Act (12 U.S.C. 2013, 2019, 2020, 2073, 2075, 2076, 2093, 2122, 2128, 2183, 2200, 2211, 2218, 2243, 2244, 2252).

### Subpart G—Releasing Information

16. Amend § 618.8310 by revising paragraph (b) to read as follows:

#### § 618.8310 Lists of borrowers and stockholders.

\* \* \* \* \*

(b)(1) Within 7 days after receipt of a written request by a stockholder, each Farm Credit bank or association must provide a current list of its stockholders’ names, addresses, and classes of stock held to such requesting stockholder. As a condition to providing the list, the bank or association may only require

that the stockholder agree and certify in writing that the stockholder will:

- (i) Utilize the list exclusively for communicating with stockholders for permissible purposes; and
- (ii) Not make the list available to any person, other than the stockholder's attorney or accountant, without first obtaining the written consent of the institution.

(2) As an alternative to receiving a list of stockholders, a stockholder may request the institution mail or otherwise furnish to each stockholder a communication for a permissible purpose on behalf of the requesting stockholder. This alternative may be used at the discretion of the requesting stockholder, provided that the requester agrees to defray the reasonable costs of the communication. In the event the requester decides to exercise this option, the institution must provide the requester with a written estimate of the costs of handling and mailing the communication as soon as practicable after receipt of the stockholder's request to furnish a communication. However, a stockholder may not exercise this option when requesting the list to distribute campaign material for election to the institution board or board committees. Farm Credit banks and associations are prohibited from distributing or mailing campaign material under § 611.320(e) of this chapter.

(3) For purposes of this paragraph (b), "permissible purpose" is defined to mean matters relating to the business operations of the institutions. This includes matters relating to the effectiveness of management, the use of institution assets, the distribution by stockholder candidates of campaign material for election to the institution board or board committees, and the performance of directors and officers. This does not include communications involving commercial, social, political, or charitable causes, communications relating to the enforcement of a personal claim or the redress of a personal grievance, or proposals advocating that the bank or association violate any Federal, State, or local law or regulation.

**Subpart J—Internal Controls**

17. Amend § 618.8430 by revising the introductory text and adding a new paragraph (d) to read as follows:

**§ 618.8430 Internal controls.**

Each Farm Credit institution's board of directors must adopt an internal control policy, providing adequate direction to the institution in establishing effective control over, and accountability for, operations, programs,

and resources. The policy must include, at a minimum, the following:

- \* \* \* \* \*
- (d) The role of the audit committee in providing oversight and review of the institution's internal controls.

18. Amend § 618.8440 by revising paragraphs (b) introductory text and (b)(2) to read as follows:

**§ 618.8440 Planning.**

- \* \* \* \* \*
- (b) The plan must include, at a minimum, the following:
  - (1) \* \* \*
  - (2) An annual review of the internal and external factors likely to affect the institution during the planning period. The review must include:
    - (i) An assessment of management capabilities;
    - (ii) A self-evaluation of the board's performance; and
    - (iii) Strategies for correcting identified weaknesses.
- \* \* \* \* \*

**PART 619—DEFINITIONS**

19. The authority citation for part 619 is revised to read as follows:

**Authority:** Secs. 1.4, 1.7, 2.1, 2.4, 2.11, 3.2, 3.21, 4.9, 5.9, 5.12, 5.17, 5.18, 6.22, 7.0, 7.1, 7.6, 7.7, 7.8, 7.12 of the Farm Credit Act (12 U.S.C. 2011, 2015, 2072, 2075, 2092, 2123, 2142, 2160, 2243, 2244, 2252, 2253, 2278b-2, 2279a, 2279a-1, 2279b, 2279b-1, 2279b-2, 2279f).

20. Amend part 619 by adding new §§ 619.9235 and 619.9265, to read as follows:

**§ 619.9235 Outside director.**

A member of a board of directors selected or appointed by the board, who is not a director, officer, employee, agent, or stockholder of any Farm Credit System institution.

**§ 619.9265 Senior officer.**

The Chief Executive Officer, the Chief Operations Officer, the Chief Financial Officer, the Chief Credit Officer, and the General Counsel, or persons in similar positions; and any other person responsible for a major policy-making function.

**PART 620—DISCLOSURE TO SHAREHOLDERS**

21. 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**

22. Amend § 620.1 as follows:

- a. Remove paragraph (p);
- b. Redesignate existing paragraphs (q) through (s) as paragraphs (p) through (r), consecutively; and
- c. Revise paragraph (a).

**§ 620.1 Definitions.**

\* \* \* \* \*

(a) *Affiliated organization* means any organization, other than a Farm Credit organization, of which a director, senior officer or nominee for director of the reporting institution is a partner, director, officer, or majority shareholder.

\* \* \* \* \*

**Subpart B—Annual Report to Shareholders**

23. Amend § 620.5 as follows:
- a. Revise paragraphs (h)(3), (i)(1), (i)(2) and (i)(2)(i) introductory text;
  - b. Remove paragraph (i)(2)(iii); and
  - c. Add new paragraph (m)(3).

**§ 620.5 Contents of the annual report to shareholders.**

\* \* \* \* \*

(h) \* \* \*

(3) For each director and senior officer, list any other business interest where the director or senior officer serves on the board or as a senior officer. Name the position held and state the principal business in which the business is engaged.

\* \* \* \* \*

(i) \* \* \*

(1) *Director compensation.* Describe the arrangements under which directors of the institution are compensated for all services as a director (including total cash compensation and noncash compensation) and state the total cash compensation and total value of noncash compensation paid to all directors as a group during the last fiscal year. If applicable, describe any exceptional circumstances justifying the additional director compensation as authorized by § 611.400(c) of this chapter. For each director, state:

- (i) The number of days served at board meetings;
- (ii) The total number of days served in other official activities, including any board committee(s);
- (iii) Any additional compensation paid for service on a board committee, naming the committee; and
- (iv) The total cash and noncash compensation paid to each director during the last fiscal year.

Compensation reported must include the amount of cash, or value of noncash items, provided by anyone to a director for services rendered by the director on behalf of the reporting Farm Credit institution.

(2) *Senior officer compensation.* Disclose the information on senior officer compensation and compensation plans as required by this paragraph. Compensation reported must include the amount of cash and the value of

noncash items provided by anyone to a senior officer for services rendered by the senior officer on behalf of the reporting Farm Credit institution.  
(i) The institution must disclose the total amount of cash and noncash

compensation, including stock and stock options, paid to each senior officer in substantially the same manner as the tabular form specified in the following Summary Compensation Table (table):

SUMMARY COMPENSATION TABLE

Name, position of senior officer (a)	Annual					
	Year (b)	Salary (c)	Bonus (d)	Deferred/perquisite (e)	Other (f)	Total (g)
(X), CEO .....	20XX					
	20XX					
(X) .....	20XX					
	20XX					
(X) .....	20XX					
	20XX					
(X) .....	20XX					
	20XX					
	20XX					

(A) Report the total amount of cash and noncash compensation paid and the amount of each component of compensation paid to the institution's chief executive officer (CEO) and each senior officer for each of the last 3 completed fiscal years, naming the individuals. If more than one person served in the capacity of CEO during any given fiscal year, individual compensation disclosures must be provided for each CEO.

(B) Amounts shown as "Salary" (column (c)) and "Bonus" (column (d)) must reflect the dollar value of salary and bonus earned by the senior officer during the fiscal year. Amounts contributed during the fiscal year by the senior officer pursuant to a plan established under section 401(k) of the Internal Revenue Code, or similar plan, must be included in the salary column or bonus column, as appropriate. If the amount of salary or bonus earned during the fiscal year is not calculable by the time the report is prepared, the reporting institution must provide its best estimate of the compensation amount(s) and disclose that fact in a footnote to the table.

(C) Amounts shown as "deferred/perquisites" (column (e)) must reflect the dollar value of other annual compensation not properly categorized as salary or bonus, including but not limited to:

(1) Deferred compensation earned during the fiscal year, whether or not paid in cash; or

(2) Perquisites and other personal benefits, unless the aggregate value of such compensation is less than \$5,000.

(D) Compensation amounts reported under the category "Other" (column (f)) shall reflect the dollar value of all other compensation not properly reportable in any other column. Items reported in this column shall be specifically identified and described in a footnote to the table. Such compensation includes, but is not limited to:

(1) The amount paid to the senior officer pursuant to a plan or arrangement in connection with the resignation, retirement, or termination of such officer's employment with the institution; or

(2) The amount of contributions by the institution on behalf of the senior officer to a vested or unvested defined contribution plan unless the plan is made available to all employees on the same basis.

(E) Amounts displayed under "Total" (column (g)) shall reflect the sum total of amounts reported in columns (c), (d), (e), and (f).

\* \* \* \* \*

(m) \* \* \*

(3) State that the financial statements were prepared under the oversight of the audit committee, identifying the members of the audit committee.

\* \* \* \* \*

**Subpart C—Quarterly Report**

24. Amend § 620.11 by adding a new paragraph (d)(5) and revising paragraphs (d) introductory text and (e) to read as follows:

**§ 620.11 Content of quarterly report to shareholders.**

\* \* \* \* \*

(d) *Financial statements.* The following financial statements must be provided:

\* \* \* \* \*

(5) State that the financial statements were prepared under the oversight of the audit committee.

(e) *Review by independent public accountant.* The interim financial information need not be audited or reviewed by an independent public accountant prior to filing. If, however, a review of the data is made in accordance with the established professional standards and procedures for such a review, the institution may state that the independent accountant has performed such a review under the supervision of the institution's audit committee. If such a statement is made, the report of the independent accountant on such review must accompany the interim financial information.

\* \* \* \* \*

**Subpart E—Annual Meeting Information Statement**

25. Revise the heading of subpart E to read as set forth above.

**§ 620.20 [Removed and reserved]**

26. Remove and reserve § 620.20.

27. Amend § 620.21 by revising the introductory paragraph, paragraphs (c)(2) and (d) to read as follows:

**§ 620.21 Contents of the information statement and other information to be furnished in connection with the annual meeting.**

Each bank or association of the Farm Credit System must provide an information statement (“statement” or “AMIS”) to its stockholders at least 10 days prior to any meeting at which directors are to be elected. The AMIS must reference the annual report required by subpart B of this part and such other material information as is necessary to make the required statement, in light of the circumstances under which it is made, not misleading. The AMIS must address the following items:

\* \* \* \* \*

(c) \* \* \*

(2) State the name of any incumbent director who attended fewer than 75 percent of the board meetings or any meetings of board committees on which he or she served during the last fiscal year.

\* \* \* \* \*

(d) *Nominees.* (1) For each nominee, state the nominee’s name, residential address, business address if any, age, and business experience during the last 5 years, including each nominee’s principal occupation and employment during the last 5 years. List all business interests on whose board of directors the nominee serves or is otherwise employed in a position of authority, and state the principal business in which the business interest is engaged. Identify any family relationship of the nominee that would be reportable under part 612 of this chapter if elected to the institution’s board.

(2) If fewer than two nominees for each position are named, describe the efforts of the nominating committee to locate two willing nominees.

(3) State that nominations shall be accepted from the floor.

(4) For each nominee who is not an incumbent director, except a nominee from the floor, provide the information referred to in § 620.5(j) and (k) and paragraph (d)(1) of this section. If stockholders will vote by paper mail or electronic mail ballot upon conclusion of all sessions, each floor nominee must provide the information referred to in § 620.5(j) and (k) and paragraph (d)(1) of this section in paper or electronic form to the Farm Credit institution within the time period prescribed by the institution’s bylaws. If the institution’s bylaws do not prescribe a time period, state that each floor nominee must provide the disclosure to the institution within 5 business days of the nomination. The institution must ensure

that the information is provided to the voting stockholders by delivering the ballots for the election of directors in the same format as the comparable information contained in the annual meeting information statement. If stockholders will not vote by paper mail or electronic mail ballot upon conclusion of all sessions, each floor nominee must provide the information referred to in § 620.5(j) and (k) and paragraph (d)(1) of this section in paper or electronic form at the first session at which voting is held.

(5) If association directors are nominated or elected by region, describe the regions and state the number of voting stockholders entitled to vote in each region. Any association director nominee from the floor must be an eligible candidate for the association director position for which the person has been nominated.

(i) If association directors are not elected by region, the following must apply:

(A) If the annual meeting is to be held in more than one session and paper mail or electronic mail balloting will be conducted upon the conclusion of all sessions, state that nominations from the floor may be made at any session or, if the association’s bylaws so provide, state that nominations from the floor shall be accepted only at the first session.

(B) If stockholders will not vote solely by paper mail or electronic mail ballot upon conclusion of all sessions, state that nominations from the floor may be made only at the first session.

(ii) If association directors are elected by region, the following must apply:

(A) If more than one session of an annual meeting is held in a region, and if paper mail or electronic mail balloting will be conducted at the end of all sessions in a region, state that nominations from the floor may be made at any session in the region or, if the association’s bylaws so provide, state that nominations from the floor shall be accepted only at the first session held in the region.

(B) If stockholders will not vote solely by paper mail or electronic mail ballot upon conclusion of all sessions in a region, state that nominations from the floor may be made only at the first session held in the region.

(6) Each bank and association must adopt policies and procedures that assure a disclosure statement is prepared by each director candidate. Copies of completed and signed disclosure statements must be provided to voting stockholders with the election ballots. No person may be a nominee for

director who does not make the disclosures required by this subpart.

\* \* \* \* \*

28. Revise subpart F to read as follows:

**Subpart F—Bank and Association Audit and Compensation Committees**

Sec.

620.30 Audit committees.

620.31 Compensation committees.

**Subpart F—Bank and Association Audit and Compensation Committees**

**§ 620.30 Audit committees.**

Each Farm Credit bank and association must establish and maintain an audit committee. An audit committee is established by adopting a written charter describing the committee’s composition, authorities, and responsibilities in accordance with this section. All audit committees must maintain records of meetings, including attendance, for at least 3 fiscal years.

(a) *Composition.* Each member of an audit committee must be a member of the Farm Credit institution’s board of directors. An audit committee may not consist of less than three members and at least one member must be an outside director. All audit committee members should be knowledgeable in at least one of the following: public and corporate finance, financial reporting and disclosure, or accounting procedures. The chair of an audit committee must be a financial expert. A financial expert is one who either has experience with internal controls and procedures for financial reporting or experience in preparing or auditing financial statements.

(b) *Independence.* Every audit committee member must be free from any relationship that, in the opinion of the board, would interfere with the exercise of independent judgment as a committee member.

(c) *Resources.* Farm Credit institutions must permit their audit committees to contract for independent legal counsel and expert advisors. Each institution is responsible for providing monetary and nonmonetary resources to enable its audit committee to contract for independent auditors, outside advisors, and ordinary administrative expenses. A two-thirds majority vote of the full board of directors is required to deny an audit committee’s request for resources.

(d) *Duties.* Each audit committee must report only to the board of directors. In its capacity as a committee of the board, the audit committee is responsible for the following:

(1) *Financial reports.* Each audit committee must oversee management’s preparation of the report to

stockholders; review the impact of any significant accounting and auditing developments; review accounting policy changes relating to preparation of financial statements; and review annual and quarterly reports prior to release. After the audit committee reviews a financial policy, procedure, or report, it must record in its minutes its agreement or disagreement with the item(s) under review.

(2) *Independent (external) auditors.* Each audit committee must determine the appointment, compensation, and retention of independent auditors to issue audit reports of the institution. The audit committee must review the independent auditor's work. The independent auditor reports directly to the audit committee.

(3) *Internal controls.* Each audit committee must oversee the institution's system of internal controls relating to preparation of the report, including controls relating to the institution's compliance with applicable laws and regulations. Any internal audit functions of the institution must also be subject to audit committee review and supervision.

#### **§ 620.31 Compensation committees.**

Each Farm Credit bank and association must establish and maintain a compensation committee by adopting a written charter describing the committee's composition, authorities, and responsibilities in accordance with this section. All compensation committees will be required to maintain records of meetings, including attendance, for at least 3 fiscal years.

(a) *Composition.* Each compensation committee must consist of at least three members. Each committee member must be a member of the institution's board of directors. Every member must be free from any relationship that, in the opinion of the board, would interfere with the exercise of independent judgment as a committee member.

(b) *Duties.* Each compensation committee must report only to the board of directors. In its capacity as a committee of the board, the compensation committee is responsible for reviewing the compensation policies and plans for senior officers and employees. Each compensation committee must approve the cash and non-cash compensation of senior officers.

(c) *Resources.* Each institution must provide monetary and nonmonetary resources to enable its compensation committee to function.

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

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

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

#### **Subpart A—General**

30. Revise § 630.6 to read as follows:

#### **§ 630.6 Funding Corporation committees.**

(a) *Farm Credit System audit committee.* The Funding Corporation must establish and maintain a Farm Credit System Audit Committee by adopting a written charter describing the committee's composition, authorities, and responsibilities in accordance with this section. The Farm Credit System Audit Committee must maintain records of meetings, including attendance, for at least 3 fiscal years.

(1) *Composition.* Each member of the Farm Credit System Audit Committee must be a member of the Funding Corporation's board of directors. The Farm Credit System Audit Committee may not consist of less than three members and at least one member must be an outside director. All audit committee members should be knowledgeable in at least one of the following: Public and corporate finance, financial reporting and disclosure, or accounting procedures. The chair of an audit committee must be a financial expert. A financial expert is one who either has experience with internal controls and procedures for financial reporting or experience in preparing or auditing financial statements.

(2) *Independence.* Every audit committee member must be free from any relationship that, in the opinion of the board, would interfere with the exercise of independent judgment as a committee member.

(3) *Resources.* The Funding Corporation must permit the Farm Credit System Audit Committee to contract for independent legal counsel and expert advisors. The Funding Corporation is responsible for providing monetary and nonmonetary resources to enable the Farm Credit System Audit Committee to contract for independent auditors, outside advisors, and ordinary administrative expenses. A two-thirds majority vote of the full board of directors is required to deny the Farm Credit System Audit Committee's request for resources.

(4) *Duties.* The Farm Credit System Audit Committee reports only to the board of directors. In its capacity as a

committee of the board, the audit committee is responsible for the following:

(i) *Financial reports.* The Farm Credit System Audit Committee must oversee the Funding Corporation management's preparation of the report to stockholders and investors; review the impact of any significant accounting and auditing developments; review accounting policy changes relating to preparation of the System-wide combined financial statements; and review annual and quarterly reports prior to release. After the Farm Credit System Audit Committee reviews a financial policy, procedure, or report, it must record in its minutes its agreement or disagreement with the item(s) under review.

(ii) *Independent (external) auditors.* The Farm Credit System Audit Committee must determine the appointment, compensation, and retention of independent auditors to issue audit reports of the Farm Credit System. The audit committee must review the independent auditor's work. The independent auditor reports directly to the Farm Credit System Audit Committee.

(iii) *Internal controls.* The Farm Credit System Audit Committee must oversee the Funding Corporation's system of internal controls relating to preparation of the report, including controls relating to the Farm Credit System's compliance with applicable laws and regulations. Any internal audit functions of the Funding Corporation must also be subject to the Farm Credit System Audit Committee's review and supervision.

(b) *Compensation committee.* The Funding Corporation must establish and maintain a compensation committee by adopting a written charter describing the committee's composition, authorities, and responsibilities in accordance with this section. The compensation committee will be required to maintain records of meetings, including attendance, for at least 3 fiscal years.

(1) *Composition.* The committee must consist of at least three members. Each committee member must be a member of the Funding Corporation's board of directors. Every member must be free from any relationship that, in the opinion of the board, would interfere with the exercise of independent judgment as a committee member.

(2) *Duties.* The compensation committee must report only to the board of directors. In its capacity as a committee of the board, the compensation committee is responsible for reviewing the compensation policies and plans for senior officers and

employees. Each compensation committee must approve the cash and non-cash compensation of senior officers.

(3) *Resources*. The Funding Corporation must provide monetary and nonmonetary resources to enable its compensation committee to function.

### Subpart B—Annual Report to Investors

31. Amend § 630.20 by revising the introductory heading for paragraph (h), paragraphs (h)(2) and (l) introductory text to read as follows:

#### § 630.20 Contents of the annual report to investors.

\* \* \* \* \*

(h) *Directors and senior officers*.

\* \* \* \* \*

(2) *Senior officers*. List the names of all senior officers employed by the disclosure entities, including position title and length of service at current position.

\* \* \* \* \*

(l) *Financial statements*. Furnish System-wide combined financial statements and related footnotes prepared in accordance with GAAP, and accompanied by supplemental information prepared in accordance with the requirements of § 630.20(m). The System-wide combined financial statements must provide investors and potential investors in FCS debt obligations with the most meaningful presentation pertaining to the financial condition and results of operations of the Farm Credit System. The System-wide combined financial statement and accompanying supplemental information must be audited in accordance with generally accepted auditing standards by a qualified public accountant (as defined in § 621.2(i) of this chapter) and indicate that the financial statements were prepared under the oversight of the Farm Credit System Audit Committee, identifying the members of this audit committee. The System-wide combined financial statements must include the following:

\* \* \* \* \*

### Subpart C—Quarterly Reports to Investors

32. Amend § 630.40 by revising paragraph (d) introductory text to read as follows:

#### § 630.40 Contents of the quarterly report to investors.

\* \* \* \* \*

(d) *Financial statements*. Interim combined financial statements must be provided in the quarterly report to investors as set forth in paragraphs

(d)(1) through (4). Indicate that the financial statements were prepared under the oversight of the Farm Credit System Audit Committee.

\* \* \* \* \*

Dated: January 12, 2005.

**Jeanette C. Brinkley**,  
Secretary, Farm Credit Administration Board.  
[FR Doc. 05-913 Filed 1-18-05; 8:45 am]

BILLING CODE 6705-01-P

## SMALL BUSINESS ADMINISTRATION

### 13 CFR Part 121

RIN 3245-AF22

#### Small Business Size Standards; Selected Size Standards Issues

**AGENCY:** Small Business Administration.

**ACTION:** Advance notice of proposed rulemaking; extension of comment period.

**SUMMARY:** The U.S. Small Business Administration (SBA) is extending the deadline for comments on the Advanced Notice of Proposed Rulemaking (ANPRM), which requested comments on issues related to SBA's effort to restructure its small business size standards, for 60 days because SBA agrees with the public's view that an extension is necessary to afford interested parties more time to thoroughly review the issues described in the ANPRM and prepare their comments. The previous deadline of February 1, 2005 is extended to April 3, 2005.

**DATES:** Comments must be received on or before April 3, 2005.

**ADDRESSES:** You may submit comments, identified by RIN 3245-AF22, by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

- E-mail: [restructure.sizestandards@sba.gov](mailto:restructure.sizestandards@sba.gov). Include RIN 3245-AF22 in the subject line of the message.

- Fax: (202) 205-6390.
- Mail: Gary M. Jackson, Assistant Administrator for Size Standards, 409 Third Street, SW., Washington, DC 20416.

- Hand Delivery/Courier: Gary M. Jackson, Assistant Administrator for Size Standards, 409 Third Street, SW., Washington, DC 20416.

Upon receipt of a written request, SBA will make available public comments to the requestor, subject to the Freedom of Information Act.

**FOR FURTHER INFORMATION CONTACT:** SBA's Office of Size Standards, (202) 205-6618, or [sizestandards@sba.gov](mailto:sizestandards@sba.gov).

**SUPPLEMENTARY INFORMATION:** On March 19, 2004, SBA published a proposed rule to restructure its small business size standards by establishing them based primarily on the number of employees of a business concern and by limiting to 10 the number of different size standard levels (69 FR 13130). Although a majority of the more than 4,000 comments on the proposed changes expressed support for the proposal, SBA also received a large number of comments opposing various aspects of SBA's approach to simplifying size standards. As a result, SBA withdrew the proposal on July 1, 2004 (69 FR 39874).

On December 3, 2004, SBA published an ANPRM seeking comments from the public on several issues that were raised during the public comment period for the proposed rule (69 FR 70197). Specifically, the ANPRM sought comments on the approach to simplify size standards, the calculation of number of employees (including how SBA defines an employee for size purposes), the use of receipts-based size standards, the designation of size standards for Federal procurements, the establishment of size standards for use solely in Federal procurement programs, the establishment of tiered size standards, the simplification of affiliation regulations, the simplification of small business joint venture eligibility regulations, the grandfathering of small business eligibility, and the impact of SBA size standards on the regulations of other Federal agencies. The deadline for comments on the ANPRM was February 1, 2005.

SBA has received hundreds of comments on these issues. SBA has also received requests from the public for an extension of the comment period to afford interested parties more time to thoroughly review the issues described in the ANPRM and prepare their comments. Given the scope and nature of size standard issues, SBA agrees that it is in the public interest to provide additional time for preparation of comments, which SBA will consider as part of its deliberations on restructuring size standards. Therefore, SBA is extending the comment period for 60 days, from February 1, 2005 to April 3, 2005.