

2093, 2095, 2099, 2111, 2201, 2232, 2233, 2234, 2236, 2237, 2238, 2282); sec. 274, Pub. L. 86–373, 73 Stat. 688, as amended (42 U.S.C. 2021); sec. 201, as amended, 202, 206, 88 Stat. 1242, as amended, 1244, 1246 (42 U.S.C. 5841, 5842, 5846); Pub. L. 95–601, sec. 10, 92 Stat. 2951 as amended by Pub. L. 102–486, sec. 7902, 106 Stat. 3123 (42 U.S.C. 5851); sec. 102, Pub. L. 91–190, 83 Stat. 853 (42 U.S.C. 4332); secs. 131, 132, 133, 135, 137, 141, Pub. L. 97–425, 96 Stat. 2229, 2230, 2232, 2241, sec. 148, Pub. L. 100–203, 101 Stat. 1330–235 (42 U.S.C. 10151, 10152, 10153, 10155, 10157, 10161, 10168); sec. 1704, 112 Stat. 2750 (44 U.S.C. 3504 note); sec. 651(e), Pub. L. 109–58, 119 Stat. 806–810 (42 U.S.C. 2014, 2021, 2021b, 2111).

Section 72.44(g) also issued under secs. 142(b) and 148(c), (d), Pub. L. 100–203, 101 Stat. 1330–232, 1330–236 (42 U.S.C. 10162(b), 10168(c), (d)). Section 72.46 also issued under sec. 189, 68 Stat. 955 (42 U.S.C. 2239); sec. 134, Pub. L. 97–425, 96 Stat. 2230 (42 U.S.C. 10154). Section 72.96(d) also issued under sec. 145(g), Pub. L. 100–203, 101 Stat. 1330–235 (42 U.S.C. 10165(g)). Subpart J also issued under secs. 2(2), 2(15), 2(19), 117(a), 141(h), Pub. L. 97–425, 96 Stat. 2202, 2203, 2204, 2222, 2224 (42 U.S.C. 10101, 10137(a), 10161(h)). Subparts K and L are also issued under sec. 133, 98 Stat. 2230 (42 U.S.C. 10153) and sec. 218(a), 96 Stat. 2252 (42 U.S.C. 10198).

§ 72.10 [Amended]

■ 34. In § 72.10, paragraph (e)(2), remove the telephone number “(301) 415–5877” and add in its place the telephone number “(301) 415–7232”, and remove the e-mail address “forms@nrc.gov” and add in its place the e-mail address “FORMS.Resource@nrc.gov”.

PART 73—PHYSICAL PROTECTION OF PLANTS AND MATERIALS

■ 35. The authority citation for part 73 continues to read as follows:

Authority: Secs. 53, 161, 149, 68 Stat. 930, 948, as amended, sec. 147, 94 Stat. 780 (42 U.S.C. 2073, 2167, 2169, 2201); sec. 201, as amended, 204, 88 Stat. 1242, as amended, 1245, sec. 1701, 106 Stat. 2951, 2952, 2953 (42 U.S.C. 5841, 5844, 2297f); sec. 1704, 112 Stat. 2750 (44 U.S.C. 3504 note); Energy Policy Act of 2005, Pub. L. 109–58, 119 Stat. 594 (2005).

Section 73.1 also issued under secs. 135, 141, Pub. L. 97–425, 96 Stat. 2232, 2241 (42 U.S.C. 10155, 10161). Section 73.37(f) also issued under sec. 301, Pub. L. 96–295, 94 Stat. 789 (42 U.S.C. 5841 note). Section 73.57 is issued under sec. 606, Pub. L. 99–399, 100 Stat. 876 (42 U.S.C. 2169).

§ 73.57 [Amended]

■ 36. In § 73.57, paragraph (d)(1), remove the telephone number “(301) 415–5877” and add in its place the telephone number “(301) 415–7232”, and remove the e-mail address “forms@nrc.gov” and add in its place

the e-mail address “FORMS.Resource@nrc.gov”.

■ 37. In Appendix A to Part 73, first table, second column, and second table, second column, revise the address for Region IV to read as follows:

Appendix A to Part 73—U.S. Nuclear Regulatory Commission Offices and Classified Mailing Addresses

* * * * *
USNRC, Region IV, 612 E. Lamar Blvd., Suite 400, Arlington, TX 76011–4125.

* * * * *
USNRC, Region IV, 612 E. Lamar Blvd., Suite 400, Arlington, TX 76011–4125.
* * * * *

PART 76—CERTIFICATION OF GASEOUS DIFFUSION PLANTS

■ 38. The authority citation for part 76 continues to read as follows:

Authority: Secs. 161, 68 Stat. 948, as amended, secs. 1312, 1701, as amended, 106 Stat. 2932, 2951, 2952, 2953, 110 Stat. 1321–349 (42 U.S.C. 2201, 2297b–11, 2297f); secs. 201, as amended, 204, 206, 88 Stat. 1244, 1245, 1246 (42 U.S.C. 5841, 5842, 5845, 5846). Sec. 234(a), 83 Stat. 444, as amended by Pub. L. 104–134, 110 Stat. 1321, 1321–349 (42 U.S.C. 2243(a)); sec. 1704, 112 Stat. 2750 (44 U.S.C. 3504 note).

Sec. 76.7 also issued under Pub. L. 95–601. Sec. 10, 92 Stat. 2951 as amended by Pub. L. 102–486, sec. 2902, 106 Stat. 3123 (42 U.S.C. 5851). Sec. 76.22 is also issued under sec. 193(f), as amended, 104 Stat. 2835, as amended by Pub. L. 104–134, 110 Stat. 1321, 1321–349 (42 U.S.C. 2243(f)). Sec. 76.35(j) also issued under sec. 122, 68 Stat. 939 (42 U.S.C. 2152).

§ 76.7 [Amended]

■ 39. In § 76.7, paragraph (e)(3), remove the telephone number “(301) 415–5877” and add in its place the telephone number “(301) 415–7232”, and remove the e-mail address “forms@nrc.gov” and add in its place the e-mail address “FORMS.Resource@nrc.gov”.

Dated at Rockville, Maryland, this 20th day of May, 2008.

For the Nuclear Regulatory Commission,
Michael T. Lesar,
Chief, Rulemaking, Directives and Editing Branch, Division of Administrative Services, Office of Administration.

[FR Doc. E8–11751 Filed 5–27–08; 8:45 am]

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FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052–AC33

Eligibility and Scope of Financing; Processing and Marketing

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA or Agency) issues this final rule to amend its regulation governing financing of processing and marketing operations by Farm Credit System (Farm Credit, FCS, or System) institutions under titles I and II of the Farm Credit Act of 1971, as amended (Act). The final rule revises the criteria used to determine the eligibility of legal entities for financing as processing and marketing operations. This revision will enable FCS institutions to better meet the changing needs of their eligible borrowers. The rule further requires System institutions to develop policies and procedures for ensuring that the revised eligibility criteria are met and to include information on all processing and marketing loans in their Reports of Condition and Performance filed with the FCA. The final rule also makes a non-substantive technical correction to the regulation defining the term “person”.

DATES: Effective Date: This regulation will be effective 30 days after publication in the **Federal Register** during which either or both Houses of Congress are in session. We will publish a notice of the effective date in the **Federal Register**.

FOR FURTHER INFORMATION CONTACT: Barry Mardock, Associate Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090, (703) 883–4456, TTY (703) 883–4434; or Michael J. Duffy, Senior Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090, (952) 854–7151, TTY (952) 854–2239; or Howard I. Rubin, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4029, TTY (703) 883–4020.

SUPPLEMENTARY INFORMATION:

I. Background

Sections 1.11(a)(1) and 2.4(a)(1) of the Act authorize Farm Credit banks and associations to finance the processing and marketing operations of bona fide farmers, ranchers, and aquatic producers or harvesters that are “directly related” to the operations of the borrower, provided that the operations of the borrower supply some portion of the raw materials used in the processing or marketing operation (throughput).¹ Current § 613.3010(a)(1)

¹ 12 U.S.C. 2019(a)(1), 2075(a)(1). Each Farm Credit bank has transferred its title I authority to

provides that a borrower is eligible for financing for a processing or marketing operation only if the borrower is eligible to borrow from the System or is a legal entity in which eligible borrowers own more than 50 percent of the voting stock or equity.

We believe that the existing rule, focusing solely on the percentage of eligible borrower ownership in a legal entity, is unnecessarily narrow. Therefore, FCA adds additional specific criteria for determining what legal entities are eligible for financing for processing and marketing operations in accordance with the provisions in sections 1.11(a) and 2.4(a) of the Act. While potentially expanding the pool of eligible legal entities, we believe that the additional criteria properly ensure that there is a sufficiently strong economic link—or identity of interests—between eligible borrowers and the processing or marketing entity so that the financing can be considered made to eligible borrowers and “directly related” to their operations.

On October 16, 2006, we published a proposed rule (71 FR 60678) to amend the regulation governing financing of processing and marketing operations by FCS institutions with the comment period closing on December 15, 2006. On January 11, 2007, we reopened the comment period for the proposed rule (72 FR 1300) after receiving requests from several commercial bank trade organizations. The comment period was reopened for 45 days and ended on February 26, 2007.

II. Purpose of the Rule

FCA believes its amendment to § 613.3010 will permit System associations to more effectively meet the credit needs of eligible borrowers in the face of changing agricultural and economic conditions while remaining consistent with the Act. We recognize the increasing importance of value-added agriculture and aquaculture and the changing ownership structures in processing and marketing operations. As part of these changing agricultural and economic conditions, FCA seeks to ensure that affordable and dependable credit for businesses that add value to farm and aquatic products and commodities remains available for the benefit of agricultural and aquacultural producers (and the rural communities in which they operate).

As farmers, ranchers, and producers or harvesters of aquatic products look for opportunities to increase their

income and diversify income sources, the importance of value-added agriculture and aquaculture has emerged. Producers are pursuing value-added activities to gain more direct access to markets and a greater share of the consumers' food dollar. As such, farmers are increasingly reliant upon vertical integration and coordination of production, processing, and marketing to deliver products that meet consumer needs. These opportunities have stemmed from increased consumer demands regarding health, nutrition, and convenience; efforts by food processors to improve their productivity; and technological advances that enable producers to provide what consumers and processors desire. With continued movement to a global economy, the international market for value-added products is also growing.

Ownership structures within processing and marketing operations are changing as substantial capital investments cannot be fully raised through traditional methods. The farmer-owned sole proprietorships or closely held entities prevalent in the past are often no longer economically viable. Therefore, new forms of cooperatives, limited liability companies, limited liability partnerships, and other ownership structures—requiring outside investment—are being used to address capital needs. For example, many new ethanol plants are only partially owned by farmers; however, these plants are usually directly related to the farmer-owners' operations and provide significant benefits to both producers and the rural communities in which they are located.

Moreover, even where sole proprietorships or closely held entities are economically viable, they are often not advisable from a legal liability, tax, or estate planning perspective. Structuring a processing or marketing operation with prudent legal liability considerations protects borrowers' financial interests and is an appropriate safety and soundness practice. We do not believe that our rules should create a circumstance that forces eligible borrowers to reject prudent legal, business and tax advice if they wish to continue borrowing from their FCS lender.

Processing and marketing agricultural businesses are projected to continue to evolve and grow within rural America. The entrepreneurial spirit of farmers, ranchers, and producers of aquatic products will require a reliable and flexible source of credit and financial services. As value-added agriculture

continues to grow, agricultural producers are challenged by the need to attract substantial capital in order to provide products to an increasing number of consumers and improve the output and efficiency of their operations. The success of value-added agriculture not only directly benefits rural America, but American and international consumers as well.²

FCA recognizes the importance of these value-added enterprises to producers, rural areas and American agriculture and consumers. We believe this regulation will help ensure dependable credit for businesses that add value to farm, ranch and aquatic products and commodities, as well as the communities in which they operate. We also believe that the regulation will provide the FCS with the additional flexibility to meet the existing and future credit needs of processing and marketing entities upon which farmers, ranchers, and producers or harvesters of aquatic products are increasingly dependent for economic survival.

III. Structure of Final Rule

The two criteria contained in existing § 613.3010(a)(1) and (a)(2) for determining the eligibility of processing or marketing operations are retained in paragraphs (a)(1) and (a)(2) of revised § 613.3010. In addition, paragraph (a)(2) clarifies that it only applies to a legal entity that does not qualify for financing under paragraph (a)(1) as a bona fide farmer, rancher, or producer or harvester of aquatic products. However, as discussed above, we believe that a limitation based solely on the percentage of voting stock held by eligible borrowers—representing pure numerical voting “control” of the entity—is an unnecessarily narrow way

² For background on the issues discussed in this section, see, e.g., Klinefelter, D. A., and Penson, J. B., “Growing Complexity of Agricultural Lending Decisions.” *Choices*, 20(1) (1st Quarter 2005); Bowers, D. and Gale, F., “Value-Added Manufacturing—An Important Link to the Larger U.S. Economy,” *Rural Conditions and Trends*, Vol. 8, No. 3 (March 1998); Govindasamy, R., and Thornsbury, S., “Theme Overview: Fresh Produce Marketing: Critical Trends and Issues,” *Choices*, 21(4) (4th Quarter 2006); Gehlhar, M. and Coyle, W., “Global Food Consumption and Impacts on Trade Patterns,” *Agriculture and Trade Report*, Market and Trade Economics Division, Economic Research Service, U.S. Department of Agriculture, WRS-01-1 (May 2001); Holz-Clause, M., “Using Value-added Agriculture to Create a New Rural America,” Economic Development Administration, U.S. Department of Commerce (Summer 2004); Kohl, D. M., and Morris, A. M., “Agri-lending Vision 2020: When Vision and Reality Meet.” *Choices*, (20)1 (1st Quarter 2005); and Innovation & Information Consultants, Inc., “Empirical Approach to Characterize Rural Small Business Growth and Profitability,” Office of Advocacy, Small Business Administration, *Small Business Research Summary* (February 2006).

make long-term real estate mortgage loans to Federal land bank associations pursuant to section 7.6 of the Act (12 U.S.C. 2279b).

of looking through a legal entity to determine whether a loan can be viewed as made to an eligible borrower or "directly related to" an eligible borrower's operation.

The final rule adds new paragraph § 613.3010(a)(3) to provide alternative methods for determining actual eligible borrower "control" over a legal entity where the eligible borrower owns 50 percent or less of the voting stock or equity. New § 613.3010(a)(4) provides eligibility criteria for legal entities where eligible borrowers have a significant equity stake and provide a substantial amount of the throughput for the processing and marketing operation. New § 613.3010(a)(5) provides criteria for financing legal entities that are a direct extension or outgrowth of an eligible borrower's production operation, regardless of the amount of eligible borrower ownership of the legal entity. A legal entity must meet one of the criteria under § 613.3010 to borrow from an FCS association for its processing and marketing activities.

The final rule also adds new paragraph (c), adding new reporting requirements for each System institution making processing or marketing loans and new paragraph (d), requiring the board of directors of each System institution making processing or marketing loans to adopt a policy that, at a minimum, directs institution management to establish procedures for ensuring compliance with the eligibility provisions of § 613.3010.

IV. Comments Received

We received a total of 5,016 comment letters on our proposed rule. We received letters from commenters residing in Puerto Rico, the District of Columbia, and from 48 states. Of the comment letters received, 1,976 letters expressed support for the proposed amendments. The majority of these letters were submitted by System institutions and their member/borrowers, officers, and employees, as well as four comment letters from the Farm Credit Council (FCC) on the behalf of all System institutions and two letters from the 10th District of the FCC. We also received a letter of support from the Empire State Council of Agricultural Organizations, an umbrella organization comprised of 25 farm, commodity and agribusiness organizations in New York.

We received 3,040 comment letters expressing opposition to the proposed rule. Of the opposition comment letters received, 2,945 were submitted by commercial banks, 67 by trade organizations representing commercial banks, and 28 by individuals. The national trade associations that

provided opposition comments included the American Bankers Association of America (ABA), the Independent Bankers Association of America (ICBA), the Financial Services Roundtable, the Conference of State Bank Supervisors, the American Bankers Insurance Association, and America's Community Bankers. The states from which banking chapters and affiliates of their national associations submitted comments included Arizona, Arkansas, Colorado, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Minnesota, Missouri, Montana, Nebraska, New Jersey, Oklahoma, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming.

Although we received opposition letters from commenters throughout the country, almost 75 percent of all opposition comment letters came from the following states located in the central portion of the country: Kansas (429 letters), Oklahoma (325 letters), Minnesota (288 letters), Nebraska (180 letters), Missouri (157 letters), South Dakota (146 letters), Michigan (128 letters), Iowa (125 letters), North Dakota (108 letters), Wisconsin (89 letters), Illinois (80 letters), Colorado (57 letters), Arkansas (55 letters), Wyoming (54 letters), and Tennessee (46 letters). Moreover, commenters in Kansas and Oklahoma submitted approximately 25 percent of all the opposition letters we received.

We received a significant number of letters criticizing the proposal from the three noncontiguous states of Oregon (129 letters), Pennsylvania (109 letters), and Virginia (98 letters). By adding the opposition letters from these three states to those from the 15 states identified above, we note that almost 86 percent of all opposition letters we received in response to the proposed rule came from 18 states.

We also received support letters from commenters located throughout the country. The largest geographic concentration (approximately 27 percent) of letters supporting the proposal came from commenters residing in states located in the South Atlantic section of the country. For example, we received numerous support letters from South Carolina (215 letters), North Carolina (147 letters), Georgia (96 letters), and Virginia (81 letters). In contrast to the opposition letters we received, which were primarily from commenters residing in the middle of the country, we received letters supporting the proposed rule from commenters throughout the United

States. Approximately 40 percent of the letters supporting the proposed rule were submitted by the member/borrowers, officers, and employees of the System from Colorado (120 letters), Minnesota (89 letters), California (88 letters), Pennsylvania (87 letters), Kansas (70 letters), Washington (64 letters), North Dakota (61 letters), Texas (60 letters), Ohio (58 letters), Illinois (49 letters), and Wisconsin (49 letters). Consequently, approximately 67 percent of all supporting comments came from the 15 noncontiguous states identified above.

The vast majority of the 5,016 letters we received in response to our proposed rule—4,683 letters or 93.4 percent of all letters received—were form letters or letters with the same language as numerous other letters with only the names and addresses changed. For example, of the 3,040 responses we received opposing the proposed rule, 3,007 were form letters. Consequently, 98.9 percent of all opposition comments were submitted through form letters by the officers and employees of commercial banks and their trade associations (Bankers). In addition, of the 1,976 responses we received in support of the proposed rule, 1,676 were form letters. Therefore, 84.8 percent of the supporting comments were submitted through form letters by the member/borrowers, officers, and employees of the System. The form letters submitted by System and non-System commenters expressed strong opinions—albeit from very different positions—on the rule.

V. Summary of Supporting Comments

We received 1,976 comments in favor of the proposed rule. Most letters highlighted the changes occurring in the industry and the importance of value-added agriculture, stating:

- The existing regulations no longer fully meet the needs of today's producers and the proposed revisions are necessary to address the changing agricultural conditions farmers currently face;
- Congress recognized the importance of economic diversity for farmers and rural communities and established the FCS to improve the income and well being of agricultural producers who often have limited options for marketing their products;
- The proposed regulatory changes will allow producers to coordinate the production, processing and marketing of their commodities through a financial structure that is conducive to a natural business model;
- Processing and marketing operations are becoming increasingly

important to the success and viability of farmers and rural areas as traditional operations diversify into facilities that support producers with value-added activities;

- FCA should develop a rule that allows System institutions to finance the complex business entities that agricultural producers employ to efficiently and effectively manage their operations; and
- The proposed rule will help rural areas by increasing the level of outside investment in processing and marketing businesses.

The commenters also suggested a number of additional changes to provide further flexibility for financing processing and marketing entities, including:

- Revising proposed § 613.3010(a)(2) to require “at least 50-percent ownership” rather than “more than 50-percent ownership” to allow the financing of hybrid operations that include half eligible producers and half investor owners; and
- Emphasizing “throughput” rather than “ownership” for determining eligibility to better accommodate future changes in the operating structures of agricultural entities.

VI. Summary of Opposing Comments

We received a total of 3,040 comment letters opposing the proposed changes to the rule. The vast majority of the opposition letters—received from commercial bankers and commercial bank lobbyists—requested that the FCA withdraw the proposed rule. We refer to these throughout this preamble as “Bankers’ comments.” Bankers’ comments included:

- FCA lacks the authority to establish new or revised criteria for processing and marketing borrowers;
- The proposal is an attempt to change the mission of the FCS so it can expand into “every sphere of commercial lending”;
- The proposed rule will allow the System to move away from financing farmer-owned businesses and will lead to the direct financing of commercial businesses that may have only marginal farmer involvement, in conflict with Congress’ original intent for the System;
- The proposed expansion of authority could be harmful to rural America due to the unregulated growth of the System and lead to another Federal bailout;
- There is no need for the proposed regulatory changes because there is abundant capital in the marketplace and numerous banks and other lending institutions seeking to make processing and marketing loans;

- FCA should retain its existing rule because it is quantifiable and easy to use when determining eligibility;

- Revisions to the eligibility requirements are not necessary because System institutions can make processing and marketing loans under their similar entity authorities;

- The proposed criteria for determining eligibility is “very subjective and arbitrary”;

- FCA does not provide a transparent process or criteria for determining a borrower’s eligibility;

- The proposed rule will expand the lending authority of the System and is part of the System’s “Horizons” project;

- The proposed rule does not include an explanation of how the FCA would monitor compliance with the new criteria;

- The proposal does not allow for public input, oversight or the ability to challenge a System funding decision; and

- The proposed rule will negatively impact several thousand small banks that compete with the FCS.

VII. Consideration of Comments and Summary of Changes

In response to the concerns raised by the commenters, we made several changes to the proposed rule to: (1) Ensure the language of the regulation conforms to our stated purposes and objectives, (2) increase the objectivity of the eligibility criteria, (3) ensure adequate controls over System processing and marketing lending activities, and (4) add new reporting requirements for processing and marketing loans. We believe the final rule is consistent with the intent of the proposed rule while minimizing or eliminating the potential for unintended consequences or overly broad interpretation of the eligibility criteria. Changes from the proposed to final rule include:

- Revising proposed § 613.3010 (eligibility based on actual management control) by eliminating (a)(3)(iii) and requiring eligible borrowers to constitute a majority of the directors of a corporation, general partners of a limited partnership, or managing members of a limited liability company and exercise actual control;

- Revising proposed § 613.3010(a)(5) (eligibility based on a direct extension or outgrowth of a borrower’s operation) to—

- Require that the processing or marketing entity was created for the primary purpose of processing or marketing the eligible borrower’s throughput and would not exist but for the eligible borrower’s involvement, and

- Add specific throughput requirements;

- Adding new § 613.3010(c) (reporting requirements) to require periodic reporting on processing and marketing loans as part of the quarterly Reports of Condition and Performance required under § 621.12 of this chapter; and

- Adding new § 613.3010(d) (institution policies) to require the board of directors of each System institution making processing or marketing loans to legal entities under authority of this section to adopt a policy, that, at a minimum, directs institution management to establish procedures for ensuring that the eligibility provisions of § 613.3010 are properly adhered to.

VIII. Response to General Comments

A. Legal Authority for Rule

Many Bankers commented that FCA’s proposal violates sections 1.11(a)(1) and 2.4(a)(1) of the Act (authorizing System banks and associations to finance the processing and marketing credit needs of bona fide farmers, ranchers, and aquatic producers and harvesters that are “directly related” to the operations of the borrower) because it allows financing for entities not majority owned by farmers. We disagree.

While the Bankers’ comment letters supported FCA’s existing rule (requiring eligible borrowers to own more than 50 percent of a processing or marketing entity) as a necessary and objective bright line test under the Act, in 1997 the ICBA and ABA filed suit against FCA seeking to invalidate that rule (and other regulatory changes adopted at the same time). The ICBA and ABA argued to the court that the plain language of the statute requires that the applicant be an agricultural producer and therefore only 100-percent farmer-owned operations should be eligible for financing. At the time, FCA argued that the new 50-percent rule was valid because it ensured that the processing or marketing operation was “directly related” to the eligible borrower’s production operation by requiring farmers to “control” the processing or marketing entity.

Even under FCA’s pre-1997 rule, System lenders could make processing or marketing loans to “persons” other than eligible farmers or ranchers. At that time, FCA rules required that eligible borrowers own 100 percent of the processing or marketing entity. Whether a corporation (or most other “legal entities”) is owned 1 percent or 100 percent by farmers, it is considered to be a separate “person” under the law, able

to sue and be sued in its own name. It is a hallmark of the corporate form that shareholders are not liable for the debts of their corporation, and the corporation is not liable for the debts of the shareholders. A loan to a corporation is not the same thing as a loan to its shareholders.

In January 1999, the United States Court of Appeals for the District of Columbia rejected the Bankers' challenge (affirming the district court's decision), holding that under either the old (100-percent ownership) or new (more than 50-percent ownership) rule: legal entities could obtain financing for their processing and marketing operations, provided they were controlled by actual farmers. Appellants' [ICBA and ABA] objection is thus one of degree: how much ownership of the legal entity is enough before the business is no longer farmer-controlled. The statute does not directly address this issue, and appellants fail to demonstrate that the agency's requirement that farmers have a majority ownership of the operation is not a reasonable interpretation.³

Notably, the Court did not say that the 50-percent rule was the only reasonable interpretation or formulation allowed under the Act.

Today, the Banker commenters are making conceptually the same legal argument—and in some cases almost word-for-word the same legal argument—that the Court of Appeals rejected in 1999. There is nothing in the Act that requires 50-percent ownership or any other numerical threshold for farmer ownership for an entity to be eligible for processing or marketing credit. The 50-percent rule is simply a test FCA devised for determining whether a processing or marketing entity has a sufficient identity of interests with an eligible borrower so that it is considered “directly related” to the eligible borrower's operations and therefore eligible for financing under the Act. There are, however, other meaningful ways to make that determination.

While the 50-percent rule does provide a “bright line” test, it excludes many borrowers we believe should be eligible under the Act and is therefore an imperfect test. An example: a processing facility is operated on a day-to-day basis by an eligible farmer and his son, who works full-time in the processing facility. The farmer's equipment and employees are used to operate the facility and the farmer supplies 100 percent of the throughput. However, the processing operation is not eligible for System financing

because the farmer only owns 49.9 percent of the stock in the corporation that owns the facility, with the other 50.1 percent owned by the farmer's son, who is not an eligible farmer because he does not own agricultural land or produce agricultural products.⁴

The Bankers argue that the 50-percent rule is necessary to ensure that legal entities financed by the System are “controlled” by eligible borrowers. Many Banker commenters noted that the proposed rule is “arbitrary” and would “eliminate the quantifiable, easily determined requirement that eligible processing and marketing operations have at least 50-percent farmer or rancher ownership and would replace it with a graduated series of mostly subjective determinations regarding the control, authority, and dependent financial condition of the producers and borrowers.”

However, there are many ways to measure “control” over a legal entity. For example, statutes and regulations applicable to a wide spectrum of activities define “control” several different ways, including use of various numerical thresholds. In some contexts, as little as 5-percent ownership of an entity can be deemed a “controlling” interest.⁵ We believe that each of the new § 613.3010 provisions require substantial control over an entity by an eligible borrower. More importantly, since the concept of “control” is not contained in the Act, control through majority stock ownership is clearly not the only way to determine whether financing a processing or marketing entity is necessary to meet the credit needs of an eligible borrower or whether the operation is “directly related” to the farmer's production operation.

The 50-percent rule was adopted by FCA more than 10 years ago even though nothing in the Act required a 50-percent test for eligibility. As we noted in the preamble to the proposed rule, we believe that our current rule is unnecessarily narrow in focusing solely on percentage of ownership to determine eligibility. However, the Financial Services Roundtable commented that “[h]owever arbitrary these percentage minimums and maximums [in the current rule] may seem, these percentages of eligible

borrower ownership permit an objective application of FCA regulations.” We disagree that a Federal agency should settle for a potentially arbitrary rule just because it permits an “objective” application. Ease of application is not the only criterion to consider when promulgating a rule. There may not be a perfect method available to determine which processing or marketing entities should be eligible and which should not; however, we do believe our current rules are deficient because they exclude entities we believe Congress intended to be eligible under the Act.

As discussed herein, we have made changes to address commenters' concerns over “subjectivity” and the potential for overly broad lending under the rule. Far from being “arbitrary” or unduly “subjective,” we have attempted to carefully target the new provisions of § 613.3010 to ensure that farmers, ranchers, and aquatic producers and harvesters are able to obtain System credit for their value-added activities as they vertically integrate their operations.

B. Prior FCA Interpretations

The Bankers further assert that the new rule contradicts FCA's previous interpretation of legislative history, contradicts the System's mission to serve farmers and ranchers, and contains proposals FCA rejected in prior rulemakings. As discussed below, these assertions are based, in large part, on a misunderstanding of the intended scope of the rule. As Banker commenters noted, “FCA has long held the position that the Act only authorizes titles I and II lenders to lend to processing and marketing operations that are directly related to the borrowers' agricultural or aquatic activities.” We continue to believe this; we also believe that, in today's agricultural economy, processing and marketing operations not 50 percent owned by farmers may also be “directly related” to an eligible borrower's production activities. While the Bankers criticize FCA for “expanding the class” of eligible borrowers under the rule, the new rule, like the prior rule, is intended to ensure that farmers and ranchers can get System financing for their processing and marketing needs, even when legal structures are arranged so that they do not own more than 50 percent of the entity. In adopting the processing and marketing provisions of the Act, we believe Congress intended System lenders to continue to finance their borrowers as they grow their agricultural businesses into value-added activities; our intent with the new rule is to remove artificial constraints

⁴ See 12 CFR 613.3000(a)(1).

⁵ See, e.g., 12 CFR 612.2130(c) (definition of “controlled entity” under FCA Standards of Conduct rule); 12 U.S.C. 1841(a) (statutory presumptions related to determining bank holding company “control”); 7 CFR 59.200 (definition of an affiliate of a packer under United States Department of Agriculture rule); 5 CFR 890.1003 (definition of “control interest” by a health care provider under Office of Personnel Management rule).

³ *Independent Bankers Ass'n v. Farm Credit Admin.*, 164 F.3d 661, 670 (DC Cir. 1999).

impeding System lenders' efforts to fully serve the credit needs of their customers.

With regard to our interpretation of legislative history, FCA is required to implement the Act as adopted by Congress. Legislative history is a tool of statutory interpretation that can help provide insight into Congress's intent. However, it is not the law, and it cannot override the plain words of a statute enacted by Congress. Moreover, as the Court of Appeals stated in the 1999 *Independent Bankers v. FCA* case, "the remarks of a single legislator, even the sponsor, are not controlling in analyzing legislative history."⁶ The ICBA's comment includes lengthy quotes from 1980 Committee Reports that accompanied the legislation establishing a 20-percent minimum throughput requirement. However, Congress changed the law in 1990 to allow financing where there was only "some" farmer-owner throughput, clearly evidencing a Congressional intent to broaden eligibility requirements and clearly limiting the usefulness of the 1980 quotes in determining Congressional intent.

More fundamentally, as the Court of Appeals said in its 1999 decision, an "initial agency interpretation is not instantly carved in stone. On the contrary, the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis."⁷ The Supreme Court has stated that agencies "must be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances.'"⁸ As discussed above, we believe our new rule is necessary to ensure that the regulatory authorities of System lenders keep up with the evolving nature of their customers' businesses.

C. Unmet Credit Needs

Virtually all of the Banker commenters assert that our rule is not necessary because there is not an "unmet need" for processing and marketing credit. The Bankers assert that commercial banks are filling this credit need and therefore this type of financing is generally available in the relevant marketplace. The Bankers support this argument by pointing to the large number of commercial banks operating in rural communities. The

Bankers assert that the System would provide unfair competition for these loans, ultimately driving commercial banks out of the market to the detriment of rural communities.⁹ The Bankers further assert that FCA must be able to demonstrate an unmet credit need for processing and marketing businesses prior to adopting a final rule.

We believe that the Bankers' comments misconstrue both the System's statutory mission and authorities and FCA's role as a Federal regulatory agency. Moreover, many of the Bankers' comments appear to be based on factual misconceptions as well.

Congress established the System to be a nationwide lender to make loans to all creditworthy agricultural borrowers covered by the Act. The preamble to the Act states that the System is intended, among other things, to "provide for an adequate and flexible flow of money into rural areas." Congress further provided in section 1.1(a) of the Act (12 U.S.C. 2001) that:

It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.

Congress did not intend for the System to only serve those agricultural producers "who could not otherwise obtain credit." Congress could have, but did not, limit the System to only those areas and to only those times when credit was otherwise "unavailable." Congress also did not authorize FCA to limit the System's lending authority to only those times and places where there was a lack of available credit. Congress specifically rejected this approach, providing in section 1.1(c) of the Act that the System offer "competitive" credit to borrowers. Further, in response to banker opposition to new System rural housing authority in the 1971 Act, the House Agriculture Committee stated that:

The committee does not agree that those lenders have a vested right to be free from competition and free to make the choice of the areas in which adequate credit is actually available for fully repayable housing loans.

⁹ We note that many of the Banker commenters appear to contradict this assertion by stating that it is "comical" or "nonsense" to believe that the 100 or so direct lenders of the System can have any significant impact on competition in credit markets.

There will be no 'credit elsewhere' requirement.¹⁰

The Act requires the System to provide financing for the processing and marketing credit needs of farmers, ranchers and aquatic producers and harvesters and directs FCA to implement the Act through regulations. Therefore, Congress has already addressed the question of System competition and FCA has an obligation to ensure that its rules enable System lenders to fully meet their statutory obligations. The Bankers generally assert that FCA has exceeded its statutory authority in proposing this rule; however, in the same comment letters they are asking FCA to regulate the System in a manner that would essentially suppress competition for agricultural credit, a result inconsistent with clear statutory intent. Such action by FCA would exceed its Constitutional and statutory authority as an administrative agency.

D. Adequacy of Processing and Marketing Credit

The Act specifically authorizes System lenders to serve the processing and marketing credit needs of farmers, ranchers and aquatic producers and harvesters. Therefore Congress, as expressed through the Act, has decided the 'unmet credit need' policy question for FCA. While we carefully considered and evaluated the Bankers' assertions, we remain convinced that the rule is appropriate to ensure a continuing and "adequate and flexible flow of money into rural areas."

The ICBA supports its contentions, in part, with the results of a poll of its own commercial bank members, in which the poll respondents nearly universally concluded that they are meeting the credit needs of processing and marketing borrowers. We are unaware of any national poll of processing and marketing borrowers gauging their satisfaction with credit providers. However, we note that of the 3,040 people who signed comments in opposition to the rule, only one identified him or herself as a farmer, rancher, or agricultural credit customer. In contrast, we received hundreds of letters from persons who identified themselves as farmers, ranchers and/or

¹⁰ H. Rep. No. 92-593, 92nd Cong., 1st Sess., (Oct. 27, 1971) at 12. See also *Independent Bankers Ass'n v. National Credit Union Admin.*, 936 F. Supp. 605, 612 (W.D. Wis. 1996) (stating "Congress enacted the Farm Credit Act solely for the benefit of farmers and other agricultural entities, not for the benefit of the banks. In fact, Congress seems to have intended that the Act would promote competition for banks by providing farmers with an alternative access to credit").

⁶ *Id.* at 668.

⁷ *Id.* (quoting *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 863-64 (1984)).

⁸ *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29, 42 (1983) (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968)).

System borrowers offering strong support regarding the need for the rule. Moreover, we received a number of letters (19) from farmers in the Northeastern United States stating that commercial banks are not interested in lending to agricultural borrowers in their area. This regional variation in agricultural credit availability also seems to be borne out by the geographic distribution of opposition letters; as discussed above, a large percentage of the opposition letters came from a small number of states. In contrast, we received relatively very few opposition letters from major agricultural states such as California, Texas and Florida (in addition to the Northeast).

Various independent studies on the availability of credit in rural areas have indicated there is the need for additional competition. For example, a recent article in *Choices* magazine, a publication of the American Agricultural Economics Association, explored the need for additional competition in rural credit markets. The authors focused their attention on the competitive forces in rural credit markets in 12 Midwestern states. The authors found that price discrimination and barriers to entry may result in the extension of less credit in rural areas than is optimal. They also concluded that when barriers to entering a market exist, banks that provide agricultural credit engage in credit rationing towards farmers and away from nonfarm borrowers.¹¹ Similarly, an article entitled "Financing the New Rural Economy," presented at a conference on rural policy issues sponsored by the Federal Reserve Bank of Kansas City, noted that borrowers with large debt capital needs, borrowers needing debt capital for start-up businesses, and borrowers needing debt capital for businesses unfamiliar to their lenders can expect difficulties obtaining credit.¹²

A study recently commissioned by the ABA and the Pennsylvania Bankers Association on rural credit markets in Pennsylvania confirmed that the capital needs of rural America require many participants to be involved.¹³ The

study's authors (professors at Pennsylvania State University) stated that "multiple sources of credit will be required" to meet rural Pennsylvania's future needs in order to avoid the possibility of "credit rationing." Most importantly, the professors surveyed farm-related businesses and found those businesses want to work with a lender that has expertise in agriculture, but commercial banks are not replacing their agricultural loan officers who move or retire and some banks are exiting the agricultural market entirely. The study also concluded that the System is "clearly involved in agricultural lending to an extremely high degree while the average commercial bank does comparatively little agricultural lending in Pennsylvania." We also note that we received comments from System customers stating their preference for working with System lenders because of their specialized knowledge and expertise in agricultural lending.

Other independent academic and government sources also indicate that while there may be access to some credit at some price in all parts of rural America today, there is a lack of adequate competition for credit throughout the rural areas of the United States. For example, the 1997 Conference on Rural Development sponsored by the Kansas City Federal Reserve Bank documented shortfalls in financing for rural and agricultural businesses.¹⁴ More recently, a 2005 study of farm level data from the United States Department of Agriculture's (USDA) Agricultural Resource Management Survey (ARMS) looked at competition in farm credit markets and studied farm loans made during the periods of 1991–93 and 2001–02. The study noted the number of counties called "highly competitive" (three or more banks with at least one branch in the county and at least 10-percent agricultural loans or \$50 million of agricultural loans) declined between the two periods and the number that were "uncompetitive" (with no banks meeting the conditions outlined above) increased. The study found FCS lenders were more likely to serve full-time commercial farmers and farmers located in regions with less competitive credit markets.¹⁵ Factors such as distance from

metropolitan areas, economies of scale, and the small number of potential customers in remote areas are market-entry barriers that limit competition. Thus, banks in these markets are in a position to charge higher interest rates, pay lower rates on deposits, offer a narrower range of products, and take on fewer risks than they otherwise would in a more competitive situation. Clearly, the presence of a System institution in these rural credit markets has a moderating influence on what commercial banks offer, and rural customers benefit from the additional competition provided by the System's presence.¹⁶ This benefit may become more significant as commercial banks continue to consolidate, particularly if the acquiring bank chooses to focus more heavily on nonagricultural pursuits. Notably the number of commercial banks classified as agricultural banks by the Federal Deposit Insurance Corporation (*i.e.*, at least 25 percent of a bank's loan portfolio consists of agricultural loans) has declined by about a third (34 percent) over the last 10 years to 1,634 banks at year-end 2006.¹⁷

Additionally, there is significant anecdotal evidence that commercial banks are not interested in providing financing for start-up and other small or potentially risky processing and marketing ventures, which are the primary intended beneficiaries of our rule. Some of the Banker commenters tacitly acknowledge this, asserting that System institutions employ "relaxed underwriting standards that do not meet our safety and soundness requirements." This means that the System is making processing and marketing loans that commercial banks typically do not make. System institutions have a public mission to serve agriculture in good times and bad and therefore we expect them to accept a reasonable degree of risk that commercial banks may not be willing to accept; because System institutions are dedicated agricultural lenders, their expertise and experience in lending to agricultural ventures should enable

¹¹ Kilkenny, M., & Jolly, R., "Are Rural Credit Markets Competitive? Is There Room for Competition in Rural Credit Markets?" *Choices*, 20(1) (1st Quarter 2005).

¹² Markley, D. M., "Financing the New Rural Economy." Federal Reserve Bank of Kansas City Rural Conference: *Exploring Policy Options for a New Rural America*, 69–80 (2001).

¹³ Stokes, J. R. and Moore, H. L., *Rural Credit Conditions in Pennsylvania*. American Bankers Association and Pennsylvania Bankers Association (April 2007). Available on the World Wide Web at: <http://www.aba.com/Press+Room/041007FarmDisputes.htm>.

¹⁴ Federal Reserve Bank of Kansas City, *Financing Rural America* (1997). Available on the World Wide Web: <http://www.kansascityfed.org/publicat/fra/framain.htm>.

¹⁵ Dodson, C. B. and Koenig, S. R., "Competition in Farm Credit Markets: Identifying Market Segments Served by the Farm Credit System and Commercial Banks," *Agricultural Finance Review*, 64, no. 2, 167–186 (2004).

¹⁶ Markley, D. M., "Financing the New Rural Economy." *Exploring Policy Options for a New Rural America*. Federal Reserve Bank of Kansas City (April 30–May 1, 2001). Available on the World Wide Web at: <http://www.kansascityfed.org/PUBLICAT/Exploring/RC01Mark.pdf>.

¹⁷ Economic Research Service, *Ag Income and Finance Outlook* (AIS 80). U.S. Department of Agriculture (March 11, 2003). Available on the World Wide Web at: <http://usda.mannlib.cornell.edu/usda/ers/AIS//2000s/2003/AIS-03-11-2003.pdf>; and Federal Deposit Insurance Corporation (FDIC), *Bank Data & Statistics*. Available on the World Wide Web at: <http://www.fdic.gov/bank/statistical/index.html>.

them to more accurately measure, understand, and adequately address the risks involved.

A good example of this is the ethanol industry. The System appears to have provided financing for the majority of independently owned ethanol plants (excluding ethanol plants owned by large corporate entities) in the start-up phase of the industry. Contrary to Banker assertions about System loan pricing, interest spreads on System ethanol loans would ordinarily be very attractive and, in other industries, draw a great deal of competition for the loans.

E. "Unfair" System Competition

Many bankers commented that the System—because of its Government-sponsored enterprise (GSE) status—provides "unfair" competition for commercial banks, asserting that it is unfair for "private sector" banks to compete against "government," "Federal instrumentality," "taxpayer subsidized" System institutions. This comparison needs careful consideration.

First, each System association—the entity that makes direct loans to farmers, ranchers, and aquatic producers and harvesters—is a cooperative owned and controlled by its member borrowers. The Farm Credit banks—which provide funding to the associations—are in turn owned by their affiliated associations. CoBank, ACB has the authorities of both a Farm Credit bank and a bank for cooperatives and is therefore jointly owned by its affiliated associations and by its cooperative borrowers. FCS institutions are privately owned and in 1985 legislation, Congress expressly referred to "commercial bankers and Farm Credit System" as "private lenders" in contrast to "public lenders."¹⁸ Therefore, similar to their commercial bank competitors, no government capital is invested in System institutions.

Second, Congress established the System to fulfill a public purpose and specifically designated System institutions to be "Federal instrumentalities." Congress also created the national banks to fulfill a public purpose and courts have long recognized that national banks are also "Federal instrumentalities."¹⁹ Congress continues to expect the System and banks to meet public needs; for example, Congress made banks (and not the System) subject to the Community Reinvestment Act, while obligating the System (and not banks) to focus on

lending to "young, beginning, and small farmers and ranchers."

Third, System institutions do not receive any government "subsidy," which directs payments by the government to a private party, such as in various USDA programs providing payments to farmers. Instead, Congress provided that Farm Credit banks and Federal land bank associations, and their long-term mortgage lending business are exempt from Federal and state income taxation. The production credit activities of System associations are taxable. Congress provided similar tax exemptions for a wide variety of privately owned entities that also fulfill public purposes; 26 U.S.C. 501 alone lists some 31 categories of tax-exempt organizations. Moreover, Congress has provided a variety of ways for privately owned businesses to minimize their Federal income taxes. For example, System institutions are organized as cooperatives; to the extent that they return profits to their members in the form of patronage, they are able to minimize their taxes under Subchapter T of the Internal Revenue Code. Similarly, as of December 31, 2006, some 2,356 commercial banks have organized as Subchapter S corporations and are therefore also able to pass their Federal tax burden on to shareholders.²⁰ This number has risen steadily since 1997 when financial institutions were first allowed to elect Subchapter S status.²¹ This trend is particularly pronounced for commercial banks that are classified as agricultural banks by the Federal Deposit Insurance Corporation, with 49 percent electing to be organized as Subchapter S corporations at December 31, 2006, compared to 11 percent in 1997.²²

Fourth, commercial banks also receive government benefits not available to System institutions and are free from statutory restrictions that System lenders must live by. For example, unlike System lenders, commercial banks may accept Federally insured (government-guaranteed) deposits (and earn service fees associated with those deposits). By statute, commercial banks also may lend to a much broader range of customers and provide a much broader range of services to those customers than can System institutions. Moreover, unlike commercial banks,

System lenders must comply with rigid statutory borrower rights provisions, offering their borrowers extensive disclosures and distressed loan restructuring. Additionally, each System borrower must purchase stock in the lending association (with a statutory minimum of the lesser of 2 percent of the loan or \$1,000) before obtaining a loan.

Fifth, Banker commenters assert that "unlike FCS lenders," commercial banks are subject to many safety and soundness regulatory limitations. We invite commenters to review our rules at 12 CFR part 600 *et seq.*, in particular parts 613 (eligibility and scope of financing), 614 (loan policies and operations), 615 (funding and fiscal affairs), 616 (leasing), 618, subpart A (related services), and 621 (accounting and reporting requirements) which demonstrate that FCA's safety and soundness rules are comparable to those of other financial institution regulators.

Lastly, the Bankers assert the System has an "unfair funding advantage" because the financial markets treat the System as having an implicit government guarantee, thereby allowing the System to obtain funds at favorable "agency" interest rates (and thereby allowing System lenders to undercut them on interest rate pricing). However, commercial banks also have access to "agency" or GSE funding through the Federal Home Loan Bank System and have increased those borrowings significantly in recent years.²³ Additionally, we have found that arguments about an unfair funding advantage are not clear cut and are extremely difficult to evaluate and ensure meaningful comparison given the multiple variables impacting various lenders' cost structures and funding strategies. We note that none of the comment letters the Agency received presented any empirical data on this issue.

F. Similar Entity Authorities

Many Bankers suggested that the financing proposed under the revised rule could be accomplished using existing similar entity authorities and that FCA should be encouraging the System to work with commercial banks through the Act's similar entity authority rather than discouraging that cooperation by expanding eligibility for processing and marketing operations. Under section 4.18A of the Act (12 U.S.C. 2206a), System title I and II

²⁰ See U.S. Government Accountability Office letter to Senator Bernard Sanders, April 30, 2007 (GAO-07-593R).

²¹ *Id.*

²² Federal Deposit Insurance Corporation (FDIC), Required Financial Reports, Call and Thrift Financial Reports (December 2006). Available on the World Wide Web at: <http://www.fdic.gov/regulations/required/index.html>.

²³ Federal Deposit Insurance Corporation (FDIC), "FLHB Borrowings Rose Sharply," *Quarterly Banking Profile*, (November 27, 2007). Available on the World Wide Web at: <http://www2.fdic.gov/gbp/2007sep/chart8.html>.

¹⁸ 12 U.S.C. 2001 *note*.

¹⁹ See *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 283 (1896).

lenders may participate with non-System lenders in loans made to entities that are not otherwise eligible to receive a loan from a System bank or association, provided the entities are “functionally similar” to System-eligible borrowers. Among other statutory restrictions, System lenders must hold less than 50 percent of any similar entity loan. System institutions may also participate with non-System lenders in loans to eligible borrowers.

Similar entity authorities are designed to meet the credit needs of (functionally similar) ineligible borrowers while the processing and marketing statutory and regulatory provisions are intended to meet the needs of eligible borrowers. As Congress directed the System in the Act to serve eligible borrower needs directly, a reliance on the more limited similar entity authorities would not be appropriate.

Moreover, the System has been very active in working with commercial banks through participation and similar entity authorities. According to Call Report data (available at <http://www.FCA.gov>), System institutions held \$10 billion (net, *i.e.*, purchases less sales) in participations obtained from non-System lenders, including nearly \$5.8 billion (net of similar entity loans) at December 31, 2006. FCA continues to encourage System lenders to work with their commercial bank counterparts in providing credit to borrowers. However, the Act caps similar entity volume (lending capacity) at 15 percent of total loan volume. Because the capital intensive nature of processing and marketing facilities often results in large loans, some associations that serve these operations are already approaching this cap. Using this capacity for loans to borrowers that should be eligible unnecessarily restricts the System’s ability to work with commercial bankers in the similar entity marketplace for functionally similar ineligible borrowers.

More fundamentally, we believe that this rule will not have a significant effect on similar entity or eligible borrower participations by System lenders with commercial banks. This is because multi-lender transactions are driven by economic considerations, not regulatory fiat. Most System-commercial bank participations involve large credits. Multiple lenders make sense for those transactions because: (1) The lead lender may not have the capacity to make the entire loan, (2) the risk exposure can be spread among multiple lenders, and (3) the costs associated with using multiple lenders makes sense in the context of the loan size. These types of large loans will continue

to be made with multiple lenders. However, this means that the needs of young, beginning and small farmers for start-up processing and marketing credit—intended beneficiaries of this rule—may not be met through participations and are unlikely to be met in the future because of the economics and risks inherent in such loans.

Moreover, where commercial banks have made a business decision to avoid lending (or participating in loans) in a particular industry or to a particular class of borrowers, similar entity authority does not provide any means for the System to provide financing.

G. Scope of Rule—Processing or Marketing Operations

Many of the opposition commenters, without specific reference to any proposed rule language, asserted that the rule will allow System institutions “unlimited opportunities” to finance “investor-owned” businesses that have little or no connection to farmers. Several commenters also expressed concern that the revised regulation would allow System lenders to finance large, publicly traded firms and investor-owned firms. Numerous commenters used Wal-Mart as an example of a large, publicly traded entity that would qualify for System financing as a result of its relationship with farmer-owned suppliers.

It was not an objective of the regulation to expand the System’s authority so that it could lend to businesses that only have a tangential relationship to agricultural or producers’ operations. As we stated in the **Federal Register** notice reopening the comment period, “[s]uch a wide scale expansion of lending authority is not the intent of the proposed rule.”²⁴ As discussed in detail below, we have made significant changes to § 613.3010(a)(5) to allay these concerns and avoid unintended consequences. However, many of the comments appear to be based on a misunderstanding of the scope of the System’s processing and marketing lending authority under the Act and FCA’s prior rule. This is evidenced by this passage appearing in many of the letters:

Another example possible under the proposed rule: A rural town has two farm supply stores. One of the stores is a farmer-owned store (greater than 50 percent of the enterprise is owned by eligible borrowers), and the second one is owned by some investors that do not live in the community. Under the existing regulations, only the farmer-owned supply store would be eligible for total FCS financing because it is majority

owned by eligible farmers. Under the proposed rule the FCS lender would be able to finance both enterprises or either enterprise. If the FCS lender determines that the investor-owned business was a better business deal for them, they could finance it, and deny credit to the farmer-owned store, thus providing taxpayer subsidized credit to an enterprise that was in competition with a farmer owned business.

The problem with this example is that ordinarily neither of these businesses would be eligible for financing under either the old or new version of § 613.3010 because neither of them appears to be a “processing or marketing” operation.²⁵ Sections 1.11(a)(1) and 2.4(a)(1) (12 U.S.C. 2019(a)(1) and 2075(a)(1)) of the Act authorize System institutions to make loans to meet the “processing and marketing” credit needs of eligible borrowers. The Act does not define “processing” or “marketing.” FCA has also not adopted a definition of those terms, primarily because we have not seen significant confusion in the System as to what is a “processing” or “marketing” operation.

Processing and marketing operations are often called “value-added” operations. USDA regulations at 7 CFR 4284.3 define “value-added” this way:

Value-Added. The incremental value that is realized by the producer from an agricultural commodity or product as the result of a change in its physical state, differentiated production or marketing, as demonstrated in a business plan, or product segregation. Also, the economic benefit realized from the production of farm or ranch-based renewable energy. Incremental value may be realized by the producer as a result of either an increase in value to buyers or the expansion of the overall market for the product. Examples include milling wheat into flour, slaughtering livestock or poultry, making strawberries into jam, the marketing of organic products, an identity-preserved marketing system, wind or hydro power produced on land that is farmed and collecting and converting methane from animal waste to generate energy. Identity-preserved marketing systems include labeling that identifies how the product was produced and by whom.

While we are not adopting this as our definition of “processing or marketing,” it provides commenters with a good overview of what kinds of businesses are—and are not—covered. For example, it is unlikely that general retail and other “main street” businesses could qualify for System financing as an agricultural “processing or marketing”

²⁵ Additionally, this and similar examples used by the Bankers set up a false choice. Absent safety and soundness or other regulatory limitations, we would expect a System lender to finance all creditworthy eligible borrowers, not pick and choose among them.

²⁴ See 72 FR 1300 (Jan. 5, 2007).

operation. Contrary to commenters' suggestions otherwise, a farmer selling produce to a grocery store does not turn the grocery store into a "processing or marketing" entity.

The Act and our existing rules do not allow "unlimited" lending in this area. Sections 1.11 and 2.4 of the Act (12 U.S.C. 2019 and 2075) and § 613.3010(b) of our rules—which we did not propose to change—provide specific limits on processing and marketing lending. Under § 613.3010(b), processing or marketing loans to eligible borrowers who regularly supply less than 20 percent of the throughput are subject to the following restrictions:

- *Bank limitation.* The aggregate of such processing and marketing loans made by a Farm Credit bank shall not exceed 15 percent of all its outstanding retail loans at the end of the preceding fiscal year.

- *Association limitation.* The aggregate of such processing and marketing loans made by all direct lender associations affiliated with the same Farm Credit bank shall not exceed 15 percent of the aggregate of their outstanding retail loans at the end of the preceding fiscal year. Each Farm Credit bank, in conjunction with all its affiliated direct lender associations, shall ensure that such processing or marketing loans are equitably allocated among its affiliated direct lender associations.

Our analysis indicates that System institutions appear to have low market penetrations in the agricultural processing and food manufacturing industries. In addition, total FCS association and Farm Credit bank lending to agricultural processing and marketing entities is well below the regulatory limitations previously noted.

Although the proposed regulation does not specifically exclude large, publicly traded entities, the ownership, throughput, control, and functional integration requirements serve to ensure that the System only funds operations that are "directly related" to eligible borrowers and their operations, effectively excluding large publicly traded entities from becoming borrowers. If Wal-Mart could be considered a "processing" or "marketing" operation it would still not meet any of the criteria for eligibility provided for in § 613.3010 and it therefore would not qualify for System processing and marketing funding. We note that numerous commenters provided examples involving large, publicly traded entities such as Wal-Mart to support their opposition to the proposed rule. We believe these examples present unrealistic scenarios

to circumvent regulatory requirements. We also note that these scenarios would be evaluated and addressed through the FCA's examination process.

The ICBA further asserted that a large, publicly traded, multinational entity could qualify for System financing if it owns a few acres of land that are producing an agricultural commodity or could one day produce an agricultural commodity. This hypothetical comment raises a different issue than those implicated by our revisions to § 613.3010; the question of who is a "bona fide farmer" generally eligible for System financing is governed by § 613.3000(a)(1), a rule we are not changing. Therefore the comment is beyond the scope of this rulemaking.

H. The Horizons Project

A number of commenters criticized the rule as being part of the System's "Horizons" project. The Horizons project was undertaken by the System on its own initiative. As part of Horizons, System representatives came up with key findings concerning the evolving financial needs and business trends of farmers, rural businesses and rural communities. It is our understanding that System representatives offered specific legislative changes to Congress. FCA has taken no position on the System's legislative initiatives.

While System representatives provided FCA with the Horizons report,²⁶ we did not receive a formal petition for rulemaking requiring FCA to act. However, FCA is open to constructive suggestions from any source on how the System may better serve its intended customers. The evolution of processing and marketing business eligibility was an area reviewed by the Horizons project. FCA looked at processing and marketing issues independently and determined that our existing rules were excluding certain types of borrowers who we believe were intended to be financed under the Act. We then proposed a rule that would narrowly expand eligibility for certain specific types of entities whose operations were directly related to an agricultural producer's operations.

Moreover, many Banker commenters appear not to have read and/or understood our proposed rule. For example, we received comments such as:

If the rule were adopted, the FCS would be allowed to make commercial loans to any

business that provides any good or service to anyone who may be eligible to borrow from the FCS. Furthermore, it would allow FCS to make residential mortgage loans for high dollar properties and properties in urban and suburban housing markets with populations of up to 50,000.

While these may be items in the System's Horizons agenda, FCA did not propose to authorize loans to goods or services providers and did not make any proposal affecting residential mortgage lending authorities. Many of the more general comments about the sweeping breadth and effect of our proposed rule also seemed unrelated to the actual text of our proposal.

I. Transparency, Public Input, and FCA Oversight of the System

Opposition commenters also asserted that lending under the proposed rule would lack: (1) Transparency, (2) opportunities for the public to provide input and challenge a financing decision, and (3) adequate oversight by FCA. Many commenters criticized the proposed rule for not including procedures on how to make determinations about the control, authority, and dependent financial condition of the producers and borrowers.

Taken as a whole, these comments evidence a concern over the potential for abuse by System lenders under the rule. To address these concerns, we have added paragraphs (c) and (d) to the final rule, establishing new reporting requirements and internal controls. These provisions are more fully discussed in the section-by-section analysis. New paragraph (c) requires each System institution making processing and marketing loans under § 613.3010 to report on its processing and marketing lending in the Reports of Condition and Performance required to be filed with FCA at least quarterly. These reports are publicly available on FCA's Web site. New paragraph (d) requires the board of directors of each System institution making processing and marketing loans under § 613.3010 to adopt a policy and prescribe implementation of procedures on how to properly document and determine eligibility under § 613.3010.

However, it is unreasonable for commenters to argue that the public should have the ability to challenge an individual lending decision made by a System institution. Individual credit decisions made by System institutions on particular borrowers are not public information and are not made by popular public vote. At a minimum, such public involvement would violate any notion of borrower privacy. System

²⁶ The Farm Credit Council, *21st Century Rural America: New Horizons for U.S. Agriculture*. Available on the World Wide Web at: <http://www.fccouncil.com/uploads/Farm%20Credit%20Horizons%20Final%20Report.pdf>.

institutions make credit decisions after carefully considering the borrower's eligibility and creditworthiness as well as compliance with the statute, FCA regulations, board policies, management procedures, and sound business practices. While members of the public are free to (and sometimes do) contact FCA with inquiries about the eligibility or creditworthiness of System loans, it is FCA's role to oversee and ensure regulatory and statutory compliance. Where there is a question, FCA will evaluate the System lending decisions and will take appropriate actions to address safety and soundness concerns or regulatory violations.

Several Banker commenters criticized FCA's effectiveness as a regulatory agency, but provided no evidence to support or substantiate these claims. Many Bankers also raised the specter of "taxpayer risk" if the rule is implemented. However, as noted, the System and FCA operate with no taxpayer funds. The only "risk" to taxpayers the Bankers identify is the potential for Federal assistance if the System is in a financial crisis.

Approximately 22 years ago, at a time when the System was in a financial crisis, Congress transformed FCA into an arms-length regulator and gave it the same enforcement and supervisory authorities held by other financial institution regulators. Congress also created the Farm Credit System Insurance Corporation—which holds an insurance fund collected through premiums charged to System institutions—to ensure the payment of System obligations.

Today, the System is arguably financially healthier and better capitalized than at any time in its history. Since 1985, FCA has adopted many rules and taken many formal and informal supervisory actions to ensure that the System operates in a safe and sound manner. FCA's examination process ensures that each System institution receives the level of regulatory oversight needed on a timely basis so that problems may be identified and proactively addressed. The examination process centers on an ongoing oversight approach, involving both off-site and on-site activities. This ongoing oversight is accomplished through formal and informal contacts with institutions by examiners who monitor and analyze conditions in their assigned institutions. We believe that FCA has demonstrated its ability to effectively regulate the System and

ensure it operates in a safe and sound manner.²⁷

In addition, the Bankers do not explain why the rule—modestly expanding processing and marketing lending eligibility—would lead to more "risky" lending by the System. The rule allows the same type of loans—for agricultural enterprises—that the System already specializes in making. Moreover, the same commenters express concern that the System will take loans that the Bankers want to make; the Bankers do not explain how these loans can, at the same time, be desirable for commercial banks yet "risky" for a System lender.

J. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), the FCA certified in the October 6, 2006, **Federal Register** notice that the proposed rule will not have a significant economic impact on a substantial number of small entities because each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

The Financial Services Roundtable asserted that this certification was "erroneous" because the rule would affect a substantial number of small entities, including small commercial banks that compete against System lenders and small businesses that compete against entities financed by System lenders. However, 12 U.S.C. 603(b)(2) requires an initial regulatory flexibility analysis (RFA) that contains an estimate of the "number of small entities to which the proposed rule will apply." Courts have clearly stated that under the plain language of the statute, the RFA applies only to regulated entities (in this case, System institutions) and not to small entities that may be indirectly affected. In considering a challenge to an Environmental Protection Agency (EPA) rule, the United States Court of Appeals for the District of Columbia stated that the "statute requires that the agency conduct the relevant analysis or certify 'no impact' for those small businesses that are 'subject to' the regulation, that is, those to which the regulation 'will apply.' EPA's rule applies, by its terms,

²⁷ See U.S. General Accounting Office letter to Senator Richard G. Lugar, February 28, 2002, (GAO-02-324R) and Farm Credit System: *Farm Credit Administration Effectively Addresses Identified Problems*, (GAO/GGD-94-14, Jan. 7, 1994).

only to [regulated entities]. The rule will undoubtedly have economic impacts in many sectors of the economy. But to require an agency to assess the impact on all of the nation's small businesses possibly affected by a rule would be to convert every rulemaking process into a massive exercise in economic modeling, an approach that has already been rejected."²⁸ Therefore, FCA's certification was accurate.

IX. Section-by-Section Analysis

A. Section 613.3010(a)(1) and (a)(2)

These criteria are taken directly from FCA's existing rule. The Bankers did, however, argue that keeping the 50-percent provision is meaningless because no entity would ever have to meet this requirement in light of the new, less restrictive eligibility options. However, keeping the existing criteria is necessary because there are many entities that receive financing today under the 50-percent rule that will not qualify under any of the new additional provisions. There are eligible processing and marketing entities in which eligible borrowers own more than 50 percent of the stock but do not hold a majority of seats on the board of directors and therefore can not qualify under new paragraph (a)(3), do not produce at least 20 percent of the throughput and therefore can not qualify under new paragraph (a)(4), or the operation is not a direct extension or outgrowth (no integration of operations) of the eligible borrowers' production operations and therefore cannot qualify under new paragraph (a)(5).

System commenters suggested changing the ownership requirement in paragraph (a)(2) from "more than 50-percent ownership" to "at least 50-percent ownership" to accommodate situations where farmers and nonfarmers are equal owners. However, we believe the existing language provides an objective, bright line ownership test to determine control and do not believe the proposed change is necessary, particularly in light of the new eligibility criteria added by our final rule.

Therefore, we adopt § 613.3010(a)(1) and (a)(2) as proposed.

B. Section 613.3010(a)(3)—Majority Voting, Management, or Actual Control

Under proposed § 613.3010(a)(3), if eligible borrowers own 50 percent or less of the voting stock or equity and one or more of those eligible borrowers/

²⁸ *Cement Kiln Recycling Coalition v. Environmental Protection Agency*, 255 F.3d 855, 869 (DC Cir. 2001) (citing *Mid-Tex Elec. Coop.*, 773 F.2d 327, 342-43 (DC Cir. 1985)).

owners regularly produce some portion of the throughput used in the processing or marketing operation, then an entity would be eligible if it could establish majority voting control, management control, or actual control. Bankers criticized the rule for not setting a minimum percentage floor for ownership. Rather than setting an arbitrary percentage number, the final rule requires either majority voting control or majority control of the board of directors (or similar body), ensuring eligible borrower control. This provision is essentially self-enforcing as to ownership interests; it is highly unlikely that control of an entity will be exercised by a 1-percent owner of a business.

1. Majority Voting Control

Proposed § 613.3010(a)(3)(i) provides that a legal entity is eligible for financing under this paragraph if eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and “exercise majority voting control over the entity.” This is essentially a slight refinement of our existing 50-percent rule. An example of this is a corporation with separate classes of voting stock, where the eligible farmer-owned class of stock exercises actual majority voting control regardless of their overall percentage ownership of stock. Another example would be where holders of a majority of voting stock agree, by contract or otherwise, to allow eligible farmer-owners to exercise voting control.

This provision sets an “objective” standard, very much like the existing 50-percent test praised as essential by Banker commenters. However, the Financial Services Roundtable asserts that it is “excessively vague” and could be abused by an entity by giving majority voting control to a small minority of farmer owners until such time as the entity obtained a System loan, with majority control then reverting back to the majority. Under FCA’s new or existing rule, we would consider an entity that temporarily manipulates its structure in this manner to be an ineligible borrower. To address this potential, new § 613.3010(d) requires each System institution, before making a loan to a legal entity under § 613.3010, to document the legal entity’s plan and intent for maintaining eligible borrower ownership, control, throughput, and integration of operations, as applicable, during the duration of the loan. If the institution has reason to believe that majority

voting control by eligible borrowers—or any other eligibility criteria—is only temporary, the institution is not authorized to make the loan.

2. Management Control and Actual Control

Proposed § 613.3010(a)(3)(ii) would have authorized financing for a legal entity in which eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and “exercise control over management of the legal entity, such as constituting a majority of the directors of a corporation, general partners of a limited partnership, or managing members of a limited liability company.” Proposed § 613.3010(a)(3)(iii) would have authorized financing for a legal entity in which eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and “exercise the documented power and authority to directly determine and implement the policies, business practices, management, and decision-making process of the legal entity.”

Bankers criticized paragraphs (a)(3)(ii) and (a)(3)(iii) for being too subjective and asserted that one farmer on the board of a corporate entity could make an entity eligible for System financing. In response to these concerns, we have eliminated paragraph (a)(3)(iii) from the final rule and made paragraph (a)(3)(ii) a “bright line” test in the nature of the existing 50-percent rule. Final paragraph (a)(3)(ii) provides that the eligible borrowers:

Constitute a majority of the directors of a corporation, general partners of a limited partnership, or managing members of a limited liability company who exercise control over the legal entity by determining and overseeing the policies, business practices, management, and decision-making process of the legal entity.

The provision also requires that the majority of eligible borrowers actually exercise “control,” using a definition derived directly from court decisions and banking statutes and regulations defining “control,” to avoid the concerns raised by the Financial Services Roundtable that the rule could be subverted through supermajority board voting or other manipulative practices.

C. Section 613.3010(a)(4)—Substantial Ownership Interest and Supply of Throughput

Section 613.3010(a)(4) will authorize financing for a legal entity in which eligible borrowers under § 613.3000(b) own at least 25 percent of the voting stock or equity, regularly produce 20 percent or more of the throughput used in the processing or marketing operation and maintain representation on the board of directors or in the applicable management structure. Under this provision, eligible borrower-owners do not need to exercise voting control over the entity because the substantial ownership requirement coupled with the 20-percent throughput requirement ensures that eligible borrowers have both a significant investment in the entity and the operation is “directly related to” eligible borrowers’ operations. To further evidence the importance of farmer involvement and a direct relationship to the eligible borrower’s production operation, the final rule includes a requirement that eligible borrowers be involved in directing the processing or marketing entity.

As a result of this addition, the criteria in proposed paragraph (a)(4) was reordered so that final paragraph (a)(4)(i) addresses ownership requirements; final paragraph (a)(4)(ii) addresses throughput requirements; and final paragraph (a)(4)(iii) addresses eligible borrower representation on the entity’s board or management structure. The reordering of proposed paragraph (a)(4) improves the readability of the rule, but does not change the proposed requirement that eligible borrower-owners regularly produce at least 20 percent of the throughput used in the processing or marketing operation.

As discussed at length above in response to Bankers’ criticisms, allowing an entity to be eligible with less than 50-percent farmer ownership does not violate the Act and we believe that the combining substantial ownership of the entity, substantial throughput, and involvement in overseeing the entity sufficiently evidences a direct relationship to an eligible borrower’s production operation. The 25-percent ownership requirement in final paragraph (a)(4)(i) is consistent with our rules governing attribution of loans; when one entity owns 25 percent of another, System institutions must treat both entities as representing a single credit risk. Section 614.4359 of this chapter provides that “for the purpose of applying the lending and leasing limit to the indebtedness of a borrower, loans to a related borrower

shall be combined with loans outstanding to the borrower and attributed to the borrower” when the conditions set forth in the rule are met. A 25-percent ownership threshold is also used in a number of banking agency statutes and regulations for determining when someone has “control” over a legal entity.²⁹

Moreover, Congress established 20-percent throughput as a meaningful threshold in sections 1.11(a)(2) and 2.4(a)(1) of the Act (12 U.S.C. 2019(a)(2) and 2075(a)(1)), placing a cap on the amount of loans System lenders may make where the applicants supply less than 20 percent of the throughput. Therefore, we believe it appropriate to conclude that Congress viewed loans in which the applicants (farmer-owners of an entity) supplied at least 20 percent of the throughput as clearly related to the applicants’ production operations. For example, the farmer-owners of a typical ethanol plant would need to supply in excess of five million bushels of corn a year to meet the 20-percent throughput requirement.

The Financial Services Roundtable stated that the 20-percent throughput requirement “is a mere fig leaf since the bulk of the entity’s throughput will come from parties who are not eligible borrowers, such as large, stockholder-owned industrial corporations not eligible to borrow from the System.” However, the term “throughput” refers to the raw materials produced in agricultural operations. Anyone (including a small or large corporate entity) engaged in producing agricultural products (the throughput used in processing or marketing operations) is, under FCA rules (and common meaning), a “bona fide farmer” eligible to borrow from the System.³⁰

System commenters suggested that the throughput requirement could be satisfied if the throughput was supplied by any eligible borrower, not just the owners of the entity. However, we reject that suggestion because it would make the throughput requirement meaningless since virtually all “throughput” is produced by eligible borrowers. It is clear under the Act that the operations of the “borrower” (including the owners of a borrowing legal entity) must supply some of the throughput.

As proposed, paragraph (a)(4) required an eligible borrower-owner to “supply” 20 percent or more of the

throughput used by the processing or marketing entity. In paragraph (a)(4)(ii) of the final rule, we changed “supply” to “regularly produce” in order to conform the language to paragraphs (a)(1), (a)(2), and (a)(3).

As noted above, to further strengthen the connection between the legal entity and the farmers’ production operations, we added paragraph (a)(4)(iii) which requires owners that are eligible borrowers to maintain representation on the board of directors or in the applicable management structure of the legal entity. This requirement also addresses concerns from Bankers that System financing will focus on entities that involve large outside investors at the expense of those owned by local farmers and investors.

D. Section 613.3010(a)(5)—Extension or Outgrowth of Production Operations

Section 613.3010(a)(5) will authorize financing for a legal entity that regularly processes or markets some portion of an eligible borrower’s throughput and whose operations are a direct extension or outgrowth of that eligible borrower’s operation. This is intended to cover entities—regardless of ownership—in which an eligible borrower has significant involvement, that fulfill the eligible borrower’s business needs, and that are functionally integrated with the eligible borrower’s production operation. Under paragraph (a)(5), the legal entity’s financial condition is necessarily dependent upon the continued involvement of the eligible borrower. This mutual interdependency in financial performance is further indicia that the processing and marketing operation is part, or an “extension or outgrowth,” of the eligible borrower’s production operation.

We intended proposed paragraph (a)(5) to be a fairly narrow provision to meet the needs of borrowers in limited circumstances (primarily in family farming operations). However, the overwhelming bulk of negative comments focused on this provision. Most of the Banker commenters asserted that this provision would make eligible virtually any entity that did business with a farmer. This was not our intent.

As we discussed in the preamble to the proposed rule, many farming operations are evolving to include value-added processing and marketing operations. In many instances, value-added processing and marketing operations are formed by, and for the direct benefit of, eligible borrowers, their families, or other individuals with direct ties to an eligible borrower’s production activities. In these instances, the processing or marketing operation is

truly part of—or a “direct extension or outgrowth” of—the production operation. However, the ownership structures of these value-added operations are typically crafted to meet tax and liability concerns—rather than System eligibility requirements—and consequently may not satisfy the requirements of our current rule.

In a typical situation, a farmer produces an agricultural commodity and is a System borrower. One of the farmer’s sons operates an integrated processing facility, using the farmer’s resources, to process the commodity. For business, tax, and/or legal reasons, the son is the primary owner of the processing facility; since the son works full time at the processing plant, he is not a “farmer” and the processing entity is therefore not eligible under current FCA rules. New paragraph (a)(5) is intended to ensure that these types of integrated, family operations of System borrowers are eligible for System financing.

In order to avoid the “unintended consequences” suggested by the opposition commenters, we have revised new paragraph (a)(5) so that it more clearly reflects our original intent for this provision. As proposed, paragraph (a)(5) would have provided:

(5) Is a legal entity not eligible under paragraph (a)(1) of this section that is a direct extension or outgrowth of an eligible borrower’s operation. To obtain financing for a legal entity under this paragraph, the eligible borrower must establish that:

- (i) The legal entity was created and operates with the eligible borrower’s active support and involvement,
- (ii) The legal entity fulfills a business need and supports the operation of the eligible borrower through product branding or other value-added business activity directly related to the operations of the eligible borrower,
- (iii) The legal entity and the eligible borrower coordinate to operate in a functionally integrated manner, and
- (iv) The legal entity regularly processes or markets some portion of the eligible borrower’s throughput.

Paragraph (a)(5) of the final rule reads:

(5) Is a legal entity not eligible under paragraph (a)(1) of this section that is a direct extension or outgrowth of an eligible borrower’s operation and meets all of the following criteria:

- (i) The legal entity was created for the primary purpose of processing or marketing the eligible borrower’s throughput and would not exist but for the eligible borrower’s involvement,
- (ii) The legal entity fulfills a business need and supports the operation of the eligible borrower through product

²⁹ See, e.g., 12 U.S.C. 1841(a)(2)(A), 371c(b)(3)(A), 1467a(a)(2)(A); 12 CFR 32.2(g), 40.3(g), 41.3(i), 215.2(c), 223.3(g), 225.2(e), 362.2(e), 574.4(a), 583.7(a).

³⁰ See 12 CFR 613.3000(a)(1).

branding or other value-added business activity directly related to the operations of the eligible borrower,

(iii) The legal entity and the eligible borrower coordinate to operate in a functionally integrated manner, and

(iv) The legal entity regularly receives throughput produced by the eligible borrower representing either:

(A) At least 20 percent of the throughput used by the legal entity in the processing or marketing operation; or

(B) At least 50 percent of the eligible borrower's total output of the commodity processed or marketed.

System commenters suggested that the requirement that "the eligible borrower must establish" eligibility criteria should be changed because it is the System lender's responsibility to "establish" eligibility of a borrower. We agree that it is always the System lender's obligation to establish and document a borrower's eligibility. The proposed language sought to ensure that the eligible borrower is sufficiently involved since the loan will be based on his or her credit need. However, we have now more firmly incorporated that concept into paragraph (a)(5)(i) and therefore are deleting this language to avoid confusion and because it is unnecessary.

Bankers commented that proposed paragraph (a)(5)(i) was vague and could be satisfied if an eligible borrower simply wrote a letter of support or provided other token "support" for the legal entity. However, as we stated in the proposed rule preamble, "active support and involvement" means more than a token investment of money, time, resources, or throughput. In order to satisfy the commenters concerns and to ensure that the rule is not interpreted in the manner suggested, we have clarified the requirements of paragraph (a)(5)(i) to more closely reflect our original intent. As adopted, in order to qualify for financing under paragraph (a)(5), the legal entity must have been created for the primary purpose of processing or marketing the eligible borrower's throughput and would not exist but for the eligible borrower's involvement. This very high threshold ensures that only those entities that are truly an "extension or outgrowth" of a particular eligible borrower's production operation can qualify under paragraph (a)(5).

System commenters also suggested changing the language in paragraph (a)(5)(i) from "the" eligible borrower to "an" eligible borrower so that, for example, when the son takes over the farming operation from the father, it does not destroy eligibility under this section. We believe that the generational

transfer of a family farming operation will not destroy eligibility under new paragraph (a)(5). However, we decline to make the suggested change because of the potentially broad implications of the change. Section 613.3010(a)(5) is designed to provide financing to entities that are an extension or outgrowth of a particular eligible borrower's farming operation, helping him or her vertically integrate operations upward into value added activities.

The Bankers also assert that paragraph (a)(5)(ii)—under which the legal entity must fulfill a business need and support the operation of the eligible borrower through product branding or other value-added business activity directly related to the operations of the eligible borrower—is unduly vague. The Banker commenters suggested that the local hardware store or other main street businesses "fulfill a business need" of an eligible borrower, therefore meaning that all of those businesses would be eligible. First, as discussed above, retail stores such as the local hardware store are not "processing or marketing" operations and are therefore not eligible for financing under this rule. Second, an entity must meet "all" of the criteria of paragraph (a)(5) in order to be eligible; the bankers do not argue how such business would possibly meet the other required criteria. Therefore, we adopt paragraph (a)(5)(ii) as proposed.

Banker commenters made similar vagueness arguments about paragraph (a)(5)(iii), which requires the legal entity and the eligible borrower to coordinate to operate in a "functionally integrated manner." This requires vertical integration of operations; vertical cooperation or other similar marketing agreements are not sufficient to meet this requirement. We also note that other regulators, such as the Department of Labor and the Internal Revenue Service (IRS), have adopted and implemented regulations dealing with "functional integration" or "integration" of businesses which include "subjective" facts and circumstances criteria; therefore, we believe that our rule is not unduly vague in comparison to those rules.³¹ However, in order to address the commenters' concerns on this point, we have added new paragraph (d)(2), which specifically requires each System institution making processing or marketing loans under paragraph (a)(5) to have a procedure for determining functional integration. That procedure requires consideration of all relevant

facts and circumstances, which include the extent to which:

- The operations share resources such as management, employees, facilities, and equipment;
- The operations are conducted in coordination with or reliance upon each other; and
- The eligible borrower and legal entity are dependent upon each other for economic success.

We have changed proposed paragraph (a)(5)(iv) from requiring the eligible borrower to supply "some" throughput (the statutory standard) to requiring that either: (1) The eligible borrower supply at least 20 percent of the throughput used in the processing or marketing operation; or (2) the throughput supplied by the eligible borrower to the processing or marketing operation constitutes at least 50 percent of the eligible borrower's total output of the commodity processed or marketed. Therefore, the throughput must be either significant to the processing or marketing operation or significant to the farmer's production operation (or both). Like the change to paragraph (a)(5)(i), this provision is intended to ensure that only those entities that are truly an "extension or outgrowth" of an eligible borrower's production operation can qualify. Ordinarily, particularly with a start-up operation, we would expect that eligible borrowers would supply most of the throughput for a processing or marketing operation under the criteria of (a)(5) and therefore we believe this change reflects our original intent in proposing the rule.

E. Section 613.3010(c)—Reporting Requirements

To ensure adequate oversight and disclosure of System lending under this section, we adopt a new paragraph (c), which provides:

Reporting requirements. Each System institution shall include information on loans made under authority of this section in the Reports of Condition and Performance required under § 621.12 of this chapter, in the format prescribed by FCA reporting instructions.

FCA makes System "call report" data publicly available through its Web site at <http://www.fca.gov>. Under § 621.13(a) of this chapter, System institutions must prepare Reports of Condition and Performance in accordance with FCA instructions. We anticipate issuing new reporting instructions covering processing and marketing loans made under each of the provisions of § 613.3010 contemporaneously with the effective date of this rule.

³¹ See, e.g., 26 U.S.C. 509(a)(3); 26 CFR 1.469-4T; 29 CFR 776.26, 784.123.

F. Section 613.3010(d)—Institution Policies

In order to address commenters' concerns over the proper application of our eligibility rules, new § 613.3010(d) requires the board of directors of each System institution making processing and marketing loans to legal entities under authority of this section to adopt a policy that addresses eligibility requirements for such legal entities as well as portfolio restrictions and reporting requirements. The final rule also requires each institution to establish procedures for implementing the board policy. Under paragraph (d)(1), the board-adopted policy must provide for procedures on how, at or before the time a loan is made, the institution will document:

- Eligible borrower ownership, control, throughput, integration of operations and other factors, as applicable, sufficient to establish eligibility of legal entities at the time a loan is made under this section; and
- Each legal entity's plan and intent for maintaining eligible borrower ownership, control, throughput, and integration of operations, as applicable, during the duration of the loan.

A number of commenters suggested that continuous monitoring of an entity—after a loan is made—would be necessary in order to ensure that the borrower retained eligibility. However, the Act authorizes System institutions to “make” loans to eligible borrowers. Therefore, eligibility for a System loan is always determined at or before the time the loan is “made,” (*i.e.*, before money is disbursed to a borrower with a legal obligation to repay). If an eligible “farmer” borrower stops farming 5 years into a 10-year term loan, the loan is not immediately due and the System lender is not obligated to immediately divest the loan. Instead, the borrower is not eligible for any new loan (including any refinancing of an existing loan) from the System lender. Similarly, the eligibility of a processing and marketing entity must be established at the time a loan is made; a new eligibility determination must be made every time the entity seeks additional System credit (including refinancing). However, we believe that an entity that intentionally manipulates its structure solely for eligibility purposes—with no intent or plan to meet eligibility criteria on an ongoing basis—is not an eligible borrower under our rules.

Section 613.3010(d)(1)(i) requires the institution to have formal procedures to ensure adequate documentation of the institution's determination that the borrower is eligible at the time a loan is

made. We would expect such procedures to include an independent review of the entity's applicable corporate, organizational, marketing and sales documents that support eligibility conclusions.

Section 613.3010(d)(1)(ii) further requires each institution to document each borrowing entity's plan and intent for maintaining the eligibility conditions throughout the term of the loan. Each lender must be able to reasonably document—again most likely through reference to the entity's applicable corporate, organizational, marketing and sales documents—that the necessary eligible borrower ownership, control or integration is not a temporary or artificially created condition.

To further emphasize that the primary objective of the rule is to help farmers grow into value-added businesses and to address comments that System financing could unduly focus on large entities with limited farmer involvement, we also adopt § 613.3010(d)(2). New § 613.3010(d)(2) requires the board of directors of each System institution making processing and marketing loans to adopt a policy that ensures that the institution develops and implements procedures that encourage financing under paragraph (a)(4) of credit-worthy entities whose operations directly benefit producers, have local community investment support and provide accessible ownership opportunities for local farmers and ranchers. “Accessible ownership opportunities” could include, for example, those that enable participation in the business through minimum investment requirements that are reasonably attainable by individuals in the local community (*e.g.*, a \$25,000 stock purchase minimum rather than \$100,000).

The new procedures required by § 613.3010(d)(2) do not impose any additional eligibility criteria beyond those contained in § 613.3010(a) and cannot be used as a justification for denying credit to otherwise eligible borrowers. Instead, the requirement is intended to ensure that institutions encourage and enable financing opportunities for entities that are primarily owned by farmers and local investors. This encouragement may take a variety of forms, including targeted marketing, community outreach, technical assistance and other related services to assist with business and marketing plans and other strategic or operational needs of local processing or marketing businesses. There are obvious economic benefits of local ownership to rural communities and each

institution's procedures should address how the institution will facilitate lending to those eligible entities.

While not a requirement of this rule, FCA generally encourages System institutions to find ways to help facilitate the creation and continuation of farmer-owned processing and marketing businesses. System institutions can help in a variety of ways, including partnering with industry groups, other lenders and government agencies (such as USDA) to promote farmer ownership and encourage a borrower's use of marketplace and government opportunities, including grants and other programs. System institutions can promote the use of federal, state, county, or local grant programs (such as the USDA's Sustainable Agriculture Research and Education Program, Rural Cooperative Development Grant Program, or Value-Added Producer Grant Program) to develop market research and feasibility studies. System institutions can also provide direct help by giving financial assistance (such as through “matching grants”) to independent organizations that provide grants and other financial assistance to farmers.

As discussed above, many commenters were critical of the lack of guidance in § 613.3010(a)(5) for determining the key element of “functional integration.” After consideration of those comments, we adopt § 613.3010(d)(3), which requires each institution to have procedures for determining functional integration for loans made under paragraph (a)(5). The procedures must require the institution to consider “all relevant facts and circumstances,” which is a standard used in, for example, IRS rules for determining “integration” of corporate entities. The procedures implemented under paragraph (d)(3) must include, at a minimum, consideration of:

- The extent to which the operations share resources such as management, employees, facilities, and equipment;
- The extent to which the operations are conducted in coordination with or reliance upon each other; and
- The extent to which the eligible borrower and legal entity are dependent upon each other for economic success.

While “functional integration” may differ based on the “relevant facts and circumstances” of the operation, we would, at a minimum, expect an institution to find significant resource sharing, operational coordination, and economic interdependence in every “functionally integrated” operation. System lenders must also adequately document their findings supporting a

determination of “functional integration.”

New paragraph (d)(4) requires adoption of portfolio restrictions necessary to comply with paragraph (b) (which caps the number of processing and marketing loans that can be made to borrowers who provide less than 20-percent throughput). Section 614.3010(d)(4) also requires formal adoption of any board-defined limits on financing provided under this section. For example, an institution’s board should consider market, concentration, or other limiting factors on the institution’s processing and marketing lending consistent with the institution’s risk-bearing capacity.

Finally, new paragraph (d)(5) requires adoption of procedures for reporting requirements necessary to comply with new paragraph (c) as well as any internal board-defined reporting on financing provided under this section.

X. Technical Correction

We proposed to correct an omission that inadvertently occurred during the January 30, 1997, regulatory amendments by adding the words “a legal entity or” to the § 613.3000(a)(3) definition of “[p]erson.” This does not provide any additional authority and is in accord with our stated intent published in the 1997 **Federal Register** final rule preamble. We received no comments on this and we adopt the proposed revision as final.

XI. Regulatory Flexibility Act

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

List of Subjects in 12 CFR Part 613

Agriculture, Banks, Banking, Credit, Rural areas.

■ For the reasons stated in the preamble, part 613 of chapter VI, title 12 of the Code of Federal Regulations is amended to read as follows:

PART 613—ELIGIBILITY AND SCOPE OF FINANCING

■ 1. The authority citation for part 613 continues to read as follows:

Authority: Secs. 1.5, 1.7, 1.9, 1.10, 1.11, 2.2, 2.4, 2.12, 3.1, 3.7, 3.8, 3.22, 4.18A, 4.25, 4.26, 4.27, 5.9, 5.17 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2017, 2018, 2019, 2073, 2075, 2093, 2122, 2128, 2129, 2143, 2206a, 2211, 2212, 2213, 2243, 2252).

Subpart A—Financing Under Titles I and II of the Farm Credit Act

§ 613.3000 [Amended]

■ 2. Amend § 613.3000(a)(3) by adding the words “a legal entity or” before the words “an individual”.

■ 3. Amend § 613.3010 by revising paragraph (a) and adding new paragraphs (c) and (d) to read as follows:

§ 613.3010 Financing for processing or marketing operations.

(a) *Eligible borrowers.* A borrower is eligible for financing for a processing or marketing operation under titles I and II of the Act only if the borrower:

(1) Is a bona fide farmer, rancher, or producer or harvester of aquatic products who regularly produces some portion of the throughput used in the processing or marketing operation; or

(2) Is a legal entity not eligible under paragraph (a)(1) of this section in which eligible borrowers under § 613.3000(b) own more than 50 percent of the voting stock or equity and regularly produce some portion of the throughput used in the processing or marketing operation; or

(3) Is a legal entity not eligible under paragraph (a)(1) of this section in which eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and:

(i) Exercise majority voting control over the legal entity; or

(ii) Constitute a majority of the directors of a corporation, general partners of a limited partnership, or managing members of a limited liability company who exercise control over the legal entity by determining and overseeing the policies, business practices, management, and decision-making process of the legal entity; or

(4) Is a legal entity not eligible under paragraph (a)(1) of this section in which eligible borrowers under § 613.3000(b) meet all of the following criteria:

(i) Own at least 25 percent of the voting stock or equity in the processing or marketing operation;

(ii) Regularly produce 20 percent or more of the throughput used in the processing or marketing operation;

(iii) Maintain representation on the board of directors or in the applicable management structure of the entity.

(5) Is a legal entity not eligible under paragraph (a)(1) of this section that is a

direct extension or outgrowth of an eligible borrower’s operation and meets all of the following criteria:

(i) The legal entity was created for the primary purpose of processing or marketing the eligible borrower’s throughput and would not exist but for the eligible borrower’s involvement,

(ii) The legal entity fulfills a business need and supports the operation of the eligible borrower through product branding or other value-added business activity directly related to the operations of the eligible borrower,

(iii) The legal entity and the eligible borrower coordinate to operate in a functionally integrated manner, and

(iv) The legal entity regularly receives throughput produced by the eligible borrower representing either:

(A) At least 20 percent of the throughput used by the legal entity in the processing or marketing operation; or

(B) At least 50 percent of the eligible borrower’s total output of the commodity processed or marketed.

* * * * *

(c) *Reporting requirements.* Each System institution shall include information on loans made under authority of this section in the Reports of Condition and Performance required under § 621.12 of this chapter, in the format prescribed by FCA reporting instructions.

(d) *Institution policies.* The board of directors of each System institution making processing and marketing loans to legal entities under authority of this section must adopt a policy that addresses eligibility requirements for such entities and ensures that the institution, at a minimum, develops and implements:

(1) Procedures on how, at or before the time a loan is made, the institution will document:

(i) Eligible borrower ownership, control, throughput, integration of operations and other factors, as applicable, sufficient to establish eligibility of legal entities at the time a loan is made under this section; and

(ii) Each legal entity’s plan and intent for maintaining eligible borrower ownership, control, throughput, and integration of operations, as applicable, during the duration of the loan;

(2) Procedures that encourage financing under paragraph (a)(4) of this section of credit-worthy entities whose operations directly benefit producers, have local community investment support and provide accessible ownership opportunities for local farmers and ranchers.

(3) Procedures for determining functional integration for loans made

under paragraph (a)(5) of this section that require consideration of all relevant facts and circumstances, which include the extent to which:

- (i) The operations share resources such as management, employees, facilities, and equipment;
 - (ii) The operations are conducted in coordination with or reliance upon each other; and
 - (iii) The eligible borrower and legal entity are dependent upon each other for economic success.
- (4) Portfolio restrictions necessary to comply with paragraph (b) of this section and any board-defined limits on financing provided under this section; and
- (5) Reporting requirements necessary to comply with paragraph (c) of this section and any board-defined reporting on financing provided under this section.

Dated: May 20, 2008.

Roland E. Smith,

Secretary, Farm Credit Administration Board.
[FR Doc. E8-11742 Filed 5-27-08; 8:45 am]

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NATIONAL CREDIT UNION ADMINISTRATION

**12 CFR Parts 700, 704, 705, 707, 708b,
711, 713, 716, 723, 760, and 792**

Technical Amendments

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending a number of its regulations by making minor technical corrections and grammatical changes. The amendments delete duplicate words, add proper punctuations, and make other grammatically necessary corrections. The amendments are intended to provide helpful changes to NCUA's regulations.

DATES: This rule is effective May 28, 2008.

FOR FURTHER INFORMATION CONTACT: Justin M. Anderson, Staff Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428 or telephone: (703) 518-6540.

SUPPLEMENTARY INFORMATION:

A. Background

In 2007, NCUA internally reviewed its regulations as part of a publication process. NCUA used this opportunity to update and clarify existing regulations.

The 2007 review revealed that minor grammatical revisions to certain regulations would be helpful.

B. Regulatory Changes

This rule provides minor grammatical changes and will not cause any regulatory changes.

C. Regulatory Procedures

Final Rule Under the Administrative Procedure Act

Generally, the Administrative Procedure Act (APA) requires a federal agency to provide the public with notice and the opportunity to comment on agency rulemakings. The amendments in this rule are not substantive but technical in that they make minor corrections, merely provide clarification or alert users of the regulations to other legal requirements or limitations. The APA permits an agency to forego the notice and comment period under certain circumstances, such as when a rulemaking is technical and not substantive. NCUA finds good cause that notice and public comment are unnecessary under Section 553(b)(3)(B) of the APA. 5 U.S.C. 553(b)(3)(B). NCUA also finds good cause to dispense with the 30-day delayed effective date requirement under Section 553(d)(3) of the APA. 5 U.S.C. 553(d)(3). The rule will, therefore, be effective immediately upon publication.

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small entities (those credit unions under ten million dollars in assets). This rule provides minor, technical changes to certain sections of NCUA's regulations. This rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that this rule will not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive

order. This rule will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105-277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) (SBREFA) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the APA. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of SBREFA. As required by SBREFA, NCUA will file the appropriate reports with Congress and the Government Accountability Office so this rule may be reviewed.

List of Subjects

12 CFR Part 700

Credit unions.

12 CFR Part 704

Credit unions, Surety bonds.

12 CFR Part 705

Community development, Credit unions, Loan programs—housing and community development.

12 CFR Part 707

Advertising, Consumer protection, Credit unions, Reporting and recordkeeping requirements, Truth in savings.

12 CFR Part 708b

Credit unions, Mergers of credit unions, Reporting and recordkeeping requirements.

12 CFR Part 711

Credit unions.

12 CFR Part 713

Bonds, Credit unions, Insurance.