

Congress are in session. We will publish a notice of the effective date in the **Federal Register**.

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of our rule are to:

- Limit the effect of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), on the net collateral ratio;
- Ensure that Farm Credit institutions do not overly rely on term preferred stock to meet regulatory capital requirements;
- Explain how the FCA may include other debt or equity in the definition of permanent capital;
- Clarify the requirements for the FCA to consider waiving disclosure requirements for issuances of stock to more than a single sophisticated investor; and
- Make several nonsubstantive technical changes to our capital regulations.

II. Introduction

The FCA proposed amendments to the capital adequacy regulations on October 22, 2002. (*See* 67 FR 64833.) We now adopt the final amendments without changes from the proposed rule. The amendments will update, modify, and clarify certain capital requirements, as follows:

- Revisions to the net collateral ratio calculation will limit the effect of new accounting requirements for derivatives. This revision is in response to a petition we received in May 2001, from two System banks.
- There will be a limit on the amount of term preferred stock that can be counted in total surplus.
- Term preferred stock will be excluded from liabilities in the calculation of the net collateral ratio for System banks to the extent that the stock is counted as total surplus.
- We also clarify certain requirements and make additional technical corrections.

The amendments are more fully described in the section-by-section analysis below.

III. Comments

We received one comment letter on the proposed rule. The comment was submitted on behalf of two Farm Credit banks. The banks commended the agency for developing the proposed rule, stated their agreement with the objectives set out in the proposed rule, and expressed support for the rule “in its entirety.”

IV. Section-by-Section Analysis

Section 615.5201(e)—Definition of Direct Lender Institution

We amend § 615.5201(e) by removing the phrase “loan of lease” and adding, in its place, the phrase “loan or lease” to correct a typographical error.

Section 615.5201(l)—Definition of Permanent Capital

We add a new paragraph (8) to the definition of permanent capital in § 615.5201(l). This amendment reflects a statutory change to section 4.3A of the Farm Credit Act of 1971, as amended, by the Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 Act). The 1992 Act added section 4.3A(a)(1)(E), which includes in permanent capital any debt or equity instrument or other account that the FCA determines appropriate to be considered as permanent capital. The amendment states that we may include a debt or equity instrument or other account in permanent capital in whole or in part, and on a permanent or temporary basis. The language of this amendment is similar to language in existing § 615.5301(b)(1)(iv) and (i)(5), which states that we may include additional items in core or total surplus when we deem their inclusion to be appropriate. The inclusion of additional items gives institutions more flexibility in meeting their capital requirements.

Section 615.5250(c)(5)—Waiver of Disclosure Requirements

We amend § 615.5250(c)(5) to clarify the circumstances in which we may waive any or all of the disclosures we require institutions to make to potential investors in stock issuances. The existing waiver language was interpreted by some institutions to apply only when a single investor acquires all the equities of an entire class issued by an institution. Our revision clarifies that we may waive disclosure requirements when the following conditions are met: (1) Equities are sold only to sophisticated investors; (2) equities are sold in blocks of \$100,000 or more; and (3) purchasers of equities agree that any subsequent sale or transfer must be in blocks of

\$100,000 or more. Any subsequent sale or transfer of equities that is less than \$100,000 must receive our prior written approval.

We also correct the reference to paragraph (b) in existing paragraph (c)(5). The reference should have been to the disclosure requirements in paragraph (c)(1).

Section 615.5301(i)—Definition of Total Surplus

We add a new paragraph (4) to the definition of total surplus in § 615.5301(i) to limit the amount of term preferred stock that may be included in total surplus to 25 percent of permanent capital. Conforming changes are made to paragraph (3).

Our existing regulations have included term preferred stock in total surplus without limit. The final rule contains a limitation equal to 25 percent of permanent capital, to ensure that System institutions do not overly rely on this type of capital to meet regulatory capital requirements. This limitation is generally comparable to the treatment of intermediate-term preferred stock in the regulatory capital requirements for commercial banks. Commercial banks’ Federal financial regulators exclude term preferred stock from Tier 1 capital and limit the amount of intermediate-term preferred stock that can count as Tier 2 capital to an amount equal to 50 percent of Tier 1 capital.¹ In addition, the amount a commercial bank may count as Tier 2 capital can be no greater than its Tier 1 capital. This means, in effect, that no more than 25 percent of a commercial bank’s minimum total regulatory (Tier 1 + Tier 2) capital may consist of intermediate-term preferred stock.² We believe a similar limit to that imposed on commercial banks is also appropriate for System institutions and, therefore, impose a limitation on the total surplus ratio.

We note that the limitation will not prohibit System institutions from issuing preferred stock in excess of what may be counted as total surplus, but such excess amounts will not qualify as total surplus. The preferred stock will, however, be treated as permanent capital to the extent permitted in the permanent capital calculation.

¹ See 12 CFR Part 325, App. A (I.A.2(d)) (Federal Deposit Insurance Corporation); 12 CFR part 3, App. A (2(b)(4)) (Comptroller of the Currency); and 12 CFR part 208, App. A (II.A.2(iv)) (Board of Governors of the Federal Reserve System).

² This example assumes that a commercial bank has Tier 2 capital equal in amount to its Tier 1 capital.