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| **Title:** | **FINAL RULE--Disclosure of Information on Reports to Shareholders--12 CFR Parts 602, 620, 621** |
| **Date of Issuance:** | **3/13/1986** |
| **Agency:** | **FCA** |
| **Federal Register Cite:** | **51 FR 8644** |

FARM CREDIT ADMINISTRATION

12 CFR Parts 602, 620, 621

Disclosure of Information on Reports to Shareholders

**AGENCY:** Farm Credit Administration.

**ACTION:** Final rule.

**SUMMARY:** The Farm Credit Administration (FCA), by the Acting Chairman of the Farm Credit Administration Board (Board), adopts new regulations under Part 620 that require (1) banks and associations of the Farm Credit System (System) chartered under the Farm Credit Act of 1971, as amended (Act), to issue annual reports to shareholders; (2) Federal land bank associations (FLBAs) and production credit associations (PCAs) to issue an annual information statement to their shareholders prior to meetings at which directors are elected; and (3) all institutions chartered under the Act to file reports of condition and performance in accordance with specified accounting requirements. The FCA also adopts an amendment to 12 CFR 602.250, relating to disclosure under the Freedom of Information Act, that (1) designates as public information, available for a reasonable fee upon request, reports to shareholders filed under the new regulations and items in reports of condition and performance that are of essentially the same character as items disclosed in reports to shareholders; and (2) makes conforming technical changes made necessary by Pub. L. 99-205. The FCA also intends to propose for comment an amendment to the new regulations that would: (1) Require disclosure of the aggregate compensation of senior officers; (2) require System banks and production credit associations to issue quarterly statements to shareholders at the end of each quarter except the one that coincides with the end of the fiscal year; and (3) require financial statements of each Federal intermediate credit bank (FICB) to accompany the annual reports to shareholders of the PCAs who are shareholders of the FICB.

**EFFECTIVE DATE:** The regulations shall become effective upon the expiration of 30 days after this publication during which either or both Houses of Congress are in session.

**FOR FURTHER INFORMATION CONTACT:**

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**TEXT:**

**SUPPLEMENTARY INFORMATION:** On August 27, 1985, the Federal Farm Credit Board (Federal Board) published for comment proposed new regulations that would require (1) banks and associations of the System to issue to shareholders annual reports after the end of each fiscal year; (2) associations to issue annual meeting information statements prior to meetings at which directors are elected; and (3) all institutions chartered under the Act to file reports of condition and performance in accordance with prescribed accounting rules and instructions. At the same time the Federal Board proposed for comment an amendment to its Freedom of Information Act regulations (12 CFR 602.250) that would designate the reports to shareholders required by the new regulation and corresponding items in the reports of condition and performance as public information. The comment period closed on October 23, 1985.

On December 23, 1985, Congress enacted and the President signed into law Pub. L. 99-205, which amended the Farm Credit Act of 1971 (hereinafter 1985 Amendments). This legislation replaced the 13-member part-time Federal Farm Credit Board with a three-member, full-time Farm Credit Administration Board (Board) and replaced the Governor of the Farm Credit Administration with a Chairman of the Board as executive head of the FCA. Congress designated the former Governor of the Farm Credit Administration as Acting Chairman of the Board until a Chairman is appointed by the President and confirmed by the Senate and authorized him to exercise the powers of the Board.

Comments were received from almost every System bank, the Farm Credit System Accounting Standards Committee (ASC), the Farm Credit Corporation of America, and an accounting firm used by some System institutions. The American Institute of Certified Public Accountants (AICPA) requested a 30-day extension of the comment period. The FCA declined to extend the period but agreed to consider any comments submitted by the AICP during that period. No comments were submitted. The comments of the ASC, which is comprised of representatives of System banks, were incorporated by reference, in whole or in part, by almost every bank that commented. The FCA considered every comment that was submitted. A summary of the comments and FCA responses by part and paragraph follows.

**A. Part 620 -- Subpart A -- Annual Reports to Shareholders**

**1. General**

Most of the commentators supported the concept of adequate disclosure to shareholders but differed widely with the FCA and each other on what constitutes adequate disclosure and the degree of regulation required to attain it. One commentator suggested that disclosure to shareholders should be a matter of self-regulation by the System. The FCA disagrees vigorously with this position and, in any case, the 1985 Amendments require the FCA to regulate in this area. Also, one commentator noted that the disclosure required should be limited to the requirements of generally accepted accounting principles (GAAP). The FCA rejected this suggestion because GAAP is limited primarily to accounting disclosures and does not address all disclosures that are material to shareholders' decisions. In addition, the FCA believes that System institution shareholders should have access to at least the level of disclosure made to shareholders of other financial institutions in order to enhance the borrower ownership and control mandated by the Act.

Several commentators commented that the annual report to shareholders required by the proposed regulation contained information that public companies are required to file with the Securities and Exchange Commission (SEC) on Form 10-K, which, while publicly available, is not routinely sent to shareholders. Some of the commentators, including the ASC, recommended that the FCA require a report similar to the 10-K to be filed with the FCA that would be publicly available and required to be sent to shareholders upon request, and a separate, more abbreviated annual report to shareholders focusing on the financial condition of the institution's operations during the preceding fiscal year.

The FCA published the proposed rule with full awareness of its differences from the SEC regulatory format, in the belief that the single annual report filed with the FCA simultaneously with its dissemination to shareholders would impose the least administrative and cost burden upon reporting institutions. The FCA seriously considered the commentators' suggestion, but since the FCA believes that shareholders are entitled to receive all of the information required by the proposed regulation, it concluded that the single multipurpose annual report would be the simplest, least burdensome method of assuring adequate disclosures to shareholders. Institutions would have to print enough copies of annual reports to FCA to make them available upon request to shareholders anyway, and any savings on printing and mailing would appear to be more than offset by the cost of preparing and printing an additional report. In addition, the FCA is considering proposing for comment a regulation that would require certain disclosures to be made to prospective borrowers. One of the options under consideration is a requirement that the most recent shareholder reports be given to prospective borrowers prior to the issuance of stock. Consequently, the FCA declined to accept the suggestion that the regulation require an annual report to be filed with the FCA and a separate, more focused annual report be sent to shareholders.

Several commentators were of the opinion that the disclosure requirements are excessively burdensome and costly. The FCA recognizes that preparation of reports to shareholders is costly but believes that shareholders who assume the risk of ownership of an institution are entitled to receive materially relevant information about the institution's financial condition and results of operations, the directors and officers who manage it, and nominees for directors in order to have a basis for evaluating the stewardship of the directors they have elected and the ability and integrity of the persons from whom they select directors. A few commentators commented that the proposed regulations goes beyond SEC regulations. The disclosure requirements are generally less extensive than those of the SEC and other financial regulators for financial institutions that are public companies. These commentators appeared to overlook the fact that some of the information that is required to be disclosed in the annual report in the FCA proposal but not in the 10-K is required under SEC rules to be sent to shareholders in proxy statements and information statements prior to shareholder meetings. When considered in their entirety, without regard to which shareholder communication the requirement relates to, the FCA requirements are generally less extensive than those of the SEC. Also, while the FCA has drawn upon the experience of other regulators, it is guided in its rulemaking primarily by what it considers appropriate and necessary for System institutions in light of its regulatory experience.

While not all System institutions would meet the test for public companies, many of them have in excess of 500 shareholders and, as the trend toward merger and consolidation continues, the number of associations with less than 500 shareholders continues to decline. In districts in which districtwide mergers or consolidations have occurred, shareholders number in the thousands and the association serves several States. More importantly, the regulations will promote democratic borrower ownership and control, for which Congress has demonstrated such strong concern in the 1985 Amendments, by giving shareholders complete and reliable information on which to base their decision-making.

**2. Section 620.1 Definitions**

Several commentators noted that the definition of "affiliated organization" would cause the disclosure of participations between System institutions. One commentator noted that the definition of "related organization" would, in the case of the Central Bank for Cooperatives, require a description of the business of all of the institutions with which it participates.

The definition of "affiliated organization" has been amended in the final rule to exclude other System institutions, as the FCA did not intend to require disclosure of routine transactions between System institutions in the context of disclosure of transactions of officers, directors, and nominees with the institution they serve. However, the FCA believes that disclosure of the institution's relationships with other System institutions is a material disclosure and does not believe that the requirement to describe the business of related organizations is excessively burdensome. In the case of the Central Bank, the business of the banks for cooperatives with which it participates may be briefly and generically described.

Several commentators requested a definition of the term "executive officer." The final rule substitutes the term "senior officer" for "executive officer" to avoid any confusion the term "executive" may cause, and defines "senior officer" as a person designated by the board of directors as responsible for a major management function.

Several commentators requested a definition of "materiality." The final rule adds a definition of material that makes it clear that material information is information to which there is a substantial likelihood that a reasonable person would attach importance in making a shareholder decision or determining the financial condition of the institution.

Several commentators requested a definition of the term "normal risk of collectibility" as it relates to the requirement to disclose loans to senior officers and directors. A definition of "normal risk of collectibility" has been added to the rule that makes it clear that the reference is to the performance status of the loan as determined in accordance with Part 621. Any loan that falls within any category of "nonperforming loans," as defined in Part 621, is deemed to involve more than a "normal risk of collectibility."

The FCA has reconsidered the proposed definition of "immediate family" and concluded it to be too all encompassing, requiring disclosure of transactions too remote to constitute a substantial risk of a conflict of interest. The final rule has been changed and now restricts "immediate family" to parents, children, and siblings.

The final rule adds a definition of "loan" that is the same as the definition in Part 621 and includes extensions of credit of all types and leases. The final rule also adds a definition of "shareholder" that includes all holders of an equity interest, whether or not they are entitled to vote.

**3. Section 620.2 Preparing, Distributing, and Filing the Report**

Several commentators stated that 90 days is an unreasonably short period within which to prepare and disseminate an annual report to shareholders. One suggested that the 90-day requirement is appropriate for a 10-K type filing but not an annual report to shareholders. The FCA does not agree that the 90-day requirement is unreasonable and notes that it is consistent with the requirements of the SEC and other Federal financial institution regulators.

One commentator suggested that the signing requirement is appropriate for a 10-K type filing but not an annual report to shareholders. Several noted that the SEC requires only a majority of the board rather than the entire board to sign. Also, one commentor expressed concern that the signing requirement may present logistical problems requiring the scheduling of a special board meeting for that purpose. The FCA recognizes that its signing requirements are more stringent than those of the SEC, but believes it necessary to ensure director accountability to require each director to sign or require the institution to disclose the reason for not signing. Also, the FCA believes that directors should be willing to make the same certification to shareholders that they make to FCA. However, to partially alleviate any logistical problems that may result from the requirement, the final rule requires that only the reports to be sent to the FCA be signed by each member of the board of directors and permits the annual reports to be sent to shareholders to be signed by its chief executive officer and the chairman of the board, on behalf of the institution and its board. This change would obviate the need to coordinate the board meeting and the schedule for printing the reports to be mailed to shareholders. However, if any member of the board has not signed the copy of the annual report filed with FCA, the name of the persons who have not signed and the reasons therefore must be disclosed in the annual report to shareholders as well as in the copy sent to the FCA. Also, the final rule has been revised to require the officer who certifies the reports of condition and performance required under Part 621 to also certify the annual report to be sent to FCA.

In the final rule the certification statement that the chief executive officer, the board, and the designated certifying officer are required to sign has been expanded to include a representation that the report has been prepared in accordance with applicable statutory and regulatory requirements.

A new paragraph (h) has been added to this section to clarify that disclosure items required by Part 620 that are of essentially the same character as items required in reports of condition and performance under Part 621 must be prepared in accordance with the rules in Part 621. The purpose of the addition is to assure that financial reporting to shareholders is consistent with disclosure to the FCA in reports of condition and performance. This does not mean that the same format must be used but does mean that the rules and definitions in Part 621 must be consulted in the preparation of the annual report.

Several commentators do not believe it is necessary for the Federal land bank's (FLB) financial statements to accompany the FLBA's annual report. One commentator suggested that such a requirement may make it difficult for the association to fulfill the timing requirements of the regulation. The FCA included this requirement in the proposed rule because all of the loans generated and serviced by the association are carried as assets on the FLB's books and do not appear on the books of the association, since the FLB and not the association is the creditor. When the borrower purchases equity in the FLBA, the FLBA is required to purchase a like amount of equity in the FLB, which equity is specifically identified to the particular borrower's loan. For these reasons, and because of the manner in which capital preservation agreements between the FLB and the FLBA operate, it is the health of the FLB that determines the safety of the borrower's investment. Also, it is the FLB that sets the interest rate on the borrower's loans. For these reasons the requirement is retained in the final rule. The FCA does not believe there is a significant timing problem because preparation of the statements can proceed simultaneously.

Several commentators expressed concern that the disclosures required by § 620.3 (j) and (k) would violate FCA regulation 12 CFR 618.8320, which prohibits the release of borrower data except in certain circumstances. While the FCA intends to make conforming amendments to its regulations concerning release of borrower data in the context of a more comprehensive overhaul of those regulations, the final rule responds to these concerns by adding a new paragraph to § 620.2 to make it clear that disclosure required by this regulation does not violate any other FCA regulation.

A new paragraph has also been added to the final rule requiring the reporting institution to make the annual report to shareholders publicly available at the institution.

**4. Section 620.3. Contents of the Annual Report to Shareholders**

**(a) Description of Business**

Several commentators commented that the requirement to discuss the significant developments for the last 5 years is excessive. One believes that merger is not an important event and one suggested that the seasonal nature of the business is already known by the shareholders. The FCA believes that merger activity is a significant event of the type that should be reported since it is usually designed to effect economies of scale and often results in significant changes in management and operations. The FCA continues to believe that the seasonal nature of the business should be disclosed because it is relevant to an evaluation of earnings performance during the year and it enhances the potential for using shareholder reports as a prospectus for prospective borrowers.

One commentator suggested that Farm Credit service corporations provide banks and associations descriptive information about their businesses for inclusion in their reports. The FCA has no objection to this suggestion but does not believe it appropriate to require it in the regulation.

One commentator suggested that "significant developments" be more specifically defined. The FCA believes it is not in a position to define all events that may be significant to a particular institution's operation and that the types of examples included are sufficient guidance to allow institutions to make a judgment.

It was suggested that the FCA use a percentage of interest revenues test to determine concentrations rather than a percentage of assets test. The FCA declined to accept this suggestion. The suggested disclosures, which are required by GAAP to be disclosed in the footnotes to the financial statements, serve a different purpose. The purpose of requiring disclosure of concentrations in the narrative portion is to enable the reader to evaluate existing risk from concentrations outstanding in the portfolio. For this purpose it is better to use a percentage of assets of the last day of the fiscal year as the test rather than a percentage of revenues earned over the last fiscal year.

Several commentators stated that the information required by paragraph (8) on the dependence on a single customer would violate the FCA release of information regulations, which prohibit the release of borrower data except in limited circumstances. The FCA does not believe that the disclosure required by this paragraph would violate FCA regulations since the regulation does not require any disclosure about a borrower other than the fact of the institution's dependence on the borrower. However, the FCA intends to make this abundantly clear in the comprehensive overhaul of 12 CFR 618.8320 that is planned. Also, the final regulation adds a new paragraph that clarifies that disclosure required by this regulation does not violate any other FCA regulation.

Several commentators believe that the word "few" in the requirement to disclose dependence on a single customer or a few customers is unworkably vague and suggest that it be defined or that the requirement be restricted to a single customer. The FCA rejected this recommendation, believing that "few" cannot be more specifically defined in absolute terms and still elicit meaningful information about asset concentrations. The intent of this item is to require disclosure of dependence on a few large customers, the loss of whose business would have a material impact on the institution's financial condition. The requirement is consistent with the requirements of the SEC and other bank regulators.

**(b) Description of Property**

One commentator noted that this requirement is excessive and another commentator noted that it should be a part of the report to FCA and not the annual report to shareholders. Another commentator requested that the regulation be clarified to indicate that it does not apply to acquired property. The FCA disagrees that the requirement is excessive, since for most institutions the disclosure will require only a brief description of the institution's offices. The FCA recognizes that this disclosure does not ordinarily appear in annual reports to shareholders, but the multipurpose statement approach elected by the FCA requires inclusion of this item. The FCA has clarified the inapplicability of the requirement to acquired property in the final rule.

**(c) Legal Proceedings**

One commentator suggested that the required description of legal proceedings required should be "brief" rather than "full," especially since the items to be disclosed are enumerated, noting that a full description would require an unnecessary amount of detailed information to be included. In the final rule the word "briefly" is substituted for the word "fully," since the FCA concurs that disclosure of the enumerated items is sufficient.

Several commentators noted that the requirement that management render an opinion on the impact of the proceedings on the institution's financial condition would involve management in making a legal judgment that should only be made by the institution's legal counsel. The final rule deletes this requirement because it is unnecessary, since the judgment as to its materiality has already been made before the matter is disclosed. Presumably, however, judgment as to materiality must necessarily be based upon consultations with legal counsel.

The proposed regulation also required disclosure of proceedings to which the institution's officers and directors are parties. Several commentators suggested limiting the proceedings required to be disclosed to those to which officers and directors are parties in their official capacity in order to avoid disclosures of irrelevant personal actions. Another commentator suggested that this disclosure be eliminated except in the context of the footnote disclosure for the financial statements.

The final rule deletes any reference to proceedings to which officers and directors are parties and substitutes a requirement to disclose any proceeding involving claims that the institution may be required, by contract or operation of law, to satisfy. This substitution would reach suits to which officers and directors are parties whose claims the institution would be required to satisfy by virtue of the indemnification provision in the institution's bylaws or under the doctrine of respondeat superior. Certain enumerated proceedings reflecting on the ability or integrity of an officer or director are required to be disclosed under paragraph (k).

The FCA declined to accept the suggestion that the disclosure of material legal proceedings be deleted altogether. Footnote disclosure of legal proceedings as contingent liabilities governed by GAAP is designed to assure that financial statements are not misleading. The standard for disclosure in the narrative portion goes beyond that required by GAAP and requires disclosure of items of importance to shareholder decisions as well as a determination of financial condition. The requirement to disclose such matters in the narrative portion of the statement is consistent with the requirements of other regulators.

During the period in which the FCA was considering the comments, legislation was enacted that gives the FCA new enforcement powers similar to those of other Federal financial institution regulators. The FCA considered whether to add to the regulation a requirement to make similar disclosure with respect to administrative proceedings. This issue is also currently under consideration by other Federal financial institution regulators. The FCA decided not to add such a requirement at this time, but will continue to consider it and will watch closely the experience of other regulators.

**(d) Description of Capital Structure and**

**(e) Description of Securities**

In the proposed regulation these paragraphs were both subsumed under a paragraph entitled "Description of securities." A commentator suggested changing the title of this section to avoid the implication that System stock is a security for the purpose of the Federal securities laws. The same commentator suggested that the only meaningful description is a description of voting stock. Several commentators stated that the number of shares of stock is not a meaningful disclosure in a cooperative institution since each shareholder gets only one vote regardless of the number of shares outstanding.

The FCA believes that, while stock in System institutions is an "at-risk" ownership interest, it lacks some of the attributes needed to make it a security for the purposes of the Federal securities law. Therefore, in the final rule the title of paragraph (d) has been changed to "Description of capital structure" and paragraphs (d) (2) and (3) have been set forth separately as paragraph (e), entitled "Description of liabilities." All subsequent paragraphs have been renumbered accordingly.

The FCA does not agree that the only meaningful description of an institution's capital structure is a description of voting stock and that the number of shares is not a meaningful disclosure. The FCA concurs that such a disclosure is not particularly helpful in the context of an election of directors, but notes that it is materially relevant when preferred shares are proposed to be issued, since a majority of the shares of each class of stock, whether voting or nonvoting, must approve the issuance. Also, a description of the institution's capital structure would be incomplete without a full description of each class of stock and participation certificates, including the number of shares outstanding. Such a description is useful to present to prospective shareholders in evaluating the capital strength of the institution and the relative priority of the shareholders' interest among the institution's equity holders.

**(f) Selected Financial Data**

One commentator noted that the items selected were random and not oriented toward balances and yields and suggested that "income from continuing operations" be defined. The same commentator believes that the analysis of loan losses properly belongs in the footnotes to the financial statements. The ASC recommended that the format be tailored to the particular operating environment of each type of System institution and suggested such a format. Another commentator noted that the time periods for selected financial data are inconsistent with the time periods for the "Management's discussion and analysis of financial condition and results of operations" (MD&A) and the financial statements.

The FCA adopted the format suggested by ASC because it appeared to be more descriptive and meaningful for System institutions than that of the proposed regulation. This change should respond to the concern of the first commentator about the meaningfulness of the required disclosures. The FCA disagrees with the statement that the analysis of loan losses belongs only in the footnotes to the financial statements and notes that the SEC and other financial regulators require such an analysis in the narrative portion. However, the analysis of loan losses has been relocated to the MD&A.

The difference in the time period between that called for in "Selected financial data" and the MD&A is intentional. The two sections serve different purposes. The MD&A is a narrative explanation of the changes in the institution's financial condition and results of operations for the last 2 fiscal years and will facilitate the comparison of the last fiscal year with the prior year. The purpose of the 5-year period for the selected data is to permit the shareholder to spot trends that might not be evident from the discussion presented in the MD&A.

**(g) Management Discussion and Analysis of Financial Condition and Results of Operation**

One commentator stated that the requirements of the paragraph are excessive. The ASC, however, suggested an outline for this section that is more detailed than the proposed regulation and more tailored to the operating environment of System institutions. This outline gives more specific and meaningful guidance regarding the type of information that should be presented. The FCA has incorporated substantially all of the suggestions of the ASC for the content of this item. Since the incorporated ASC format calls for, among other things, a discussion of the loan portfolio, the analysis of loan losses has been relocated to this paragraph.

Another commentator noted the lack of a specific requirement for disclosure of nonperforming loan information in the annual report to shareholders and recommended its addition. This requirement has been added under the discussion of the loan portfolio. Also added to the discussion of the loan portfolio is a requirement to discuss recent PCA loss experience in the aggregate. This information is materially relevant to the other PCAs and other financial institutions (OFIs) who are the FICB shareholders because of the impact these losses may have on the financial condition of the FICB.

**(h) Directors and Senior Officers**

One commentator commented that there is no need to disclose 5 years of business experience or the names of business entities of which the person is a director. Several commentators noted that the requirement to disclose events reflecting on the ability or integrity of directors provides potential for management influence of elections and that the standard for disclosure is too vague and broad.

The FCA disagrees that the 5-year period for describing a director or senior officer's business experience is an inappropriate disclosure. A shareholder or prospective shareholder is entitled to know the qualifications of the individuals who direct and manage the institution's operations. The FCA believes that the disclosure of other business entities in which the officers and directors are directors is useful to shareholders in evaluating actual or potential conflicts of interest. The final rule has been revised to clarify that directors need only disclose business entities on whose boards they also serve as directors.

Several commentators noted that detailed disclosure about officers and directors is inappropriate in the annual report to shareholders but is appropriate for a 10-K form.

Since the final rule retains the multipurpose statement approach, the information required by this section is essentially unchanged, except that the requirement to disclose events that reflect on the ability or integrity of directors and senior officers has been relocated to paragraph (k). The types of events that are required to be disclosed have been specified in response to the concern that management is given too much discretion in determining what should be disclosed and hence given an opportunity to influence elections.

**(i) Director Compensation**

Several commentators suggested that information about director compensation is inappropriate in an annual report to shareholders but would be appropriate in a report to the FCA that would be available to shareholders upon request. One commentator suggested shareholders do not need this information. Two commentators suggested that the number of days served is of doubtful use. Another commentator believes that the disclosure compensation formula is not appropriate and could be misused, and one believes that it is inappropriate in the annual report to shareholders.

The FCA disagrees with all of these comments. The FCA believes that shareholders are entitled to know the manner in which directors whom they elect are compensated and the amount of that compensation. Disclosure of the compensation formula and number of days used in the compensation formula permits the shareholder to evaluate the amount of time a director is devoting to his or her duties and to ascertain the total compensation paid to each director. Accordingly, these requirements have not been changed. However, a requirement to disclose total compensation paid to each director during the year has been added. This requirement makes it unnecessary for the reader to perform the calculation to determine how much a particular director was paid during the last fiscal year. Such a requirement parallels the requirements of the SEC and other regulators. Also, the regulation has been revised to allow noncash compensation that does not exceed the lesser of 10 percent of cash compensation or $25,000 to be excluded from the disclosure.

In the course of considering these comments, the FCA concluded that shareholders are also entitled to disclosure of management compensation as well as director compensation and that its failure to include such a requirement in the proposed regulation was a significant omission. Therefore, the FCA intends to propose an amendment to this regulation that would require disclosure of compensation to senior officers in the aggregate.

**(j) Transactions With Senior Officers and Directors**

Several commentators noted that the captions in this paragraph in the proposed regulation were not properly descriptive. Accordingly, the caption of this paragraph has been changed from "Certain relationships and related transactions" to "Transactions with senior officers and directors." Paragraph (j)(2) continues to be captioned "Transactions other than loans," but paragraph (j)(3) in the final rule is captioned "Loans to senior officers and directors" rather than "Loans to management" as it was captioned in the proposed rule. In the course of reviewing the proposed regulations, FCA discovered an inadvertent omission in paragraph (j)(3) that made its requirements inconsistent with the requirements of paragraph (j)(2). Consequently, paragraph (j)(3) in the final rule has been expanded to require disclosure of loans to members of the officer's or director's immediate family and any organization with which such person is or has been affiliated within the last fiscal year if the loans meet the criteria of paragraph (j)(3). However, the definition of "immediate family" has been restricted to parents, children, and siblings in the final regulation. These additions make paragraph (j)(3) consistent with paragraph (j)(2) and with the requirements of other financial regulators. Also in the final rule, "unfavorable features" has been deleted as a criterion for disclosure from paragraph (j)(3)(I) in response to numerous comments that the term was too broad and unworkably vague. A definition of "normal risk of collectibility" has been added to § 620.2(a).

Several commentators noted that the disclosures of the type required by this part are not usually made in annual reports to shareholders but are usually made in annual meeting information statements.

The FCA agrees that the information required by this paragraph is more appropriate in an annual meeting information statement. However, since district directors are not elected at annual meetings but according to a statutorily prescribed scheme, some mechanism for disseminating such disclosure on district directors to shareholders was needed. The most workable solution appeared to be require such disclosure on officers and incumbent directors in the annual report to shareholders and disclosure with respect to nominees in the context of the FCA-conducted district director elections. The FCA intends to propose for comment in the near future an amendment to its district director election regulations that would impose similar disclosure requirements on nominees for district director. Therefore, in the final rule the requirement to disclose certain transactions between the institution and senior officers and directors is retained in the annual report to shareholders, with an updating requirement and a similar requirement for association director nominees in the association's annual meeting statement required by Subpart C.

**(k) Involvement in Certain Legal Proceedings**

The final rule adds a new paragraph entitled "Involvement in certain legal proceedings" that contains the requirement to disclose events reflecting on the ability and integrity of senior officers and directors that was contained in the paragraph entitled "Directors and executive officers" in the proposed regulation. Events that must be disclosed have been enumerated, in response to the concern of several commentators that the proposed regulation lodged too much discretion in management to determine what events must be disclosed, giving management an opportunity to manipulate elections. These events are bankruptcy or insolvency proceedings, criminal proceedings, and proceedings resulting in a prohibition to engage in a particular type of business activity. Criminal proceedings are deemed to begin at indictment by a grand jury or the filing of a bill of information or similar action by a public prosecutor that formally charges the defendant with a crime. Criminal investigations are not deemed to be "criminal proceedings" as that term is used in these regulations.

**(l) Relationship With Independent Public Accountants**

In the proposed regulation, Part 621 contained a requirement that changes in accountants and disputes with accountants be disclosed in the annual report to shareholders. This requirement has been restated in the final rule as paragraph: (1) In response to a comment that the requirement to disclose disputes with and changes in accountants should be stated in the annual report to shareholders rather than the annual information statement. However, updated disclosure is also required in the annual information statement under Subpart C.

**(m) Financial Statements**

The proposed regulation required financial statements for the last 3 fiscal years. One commentator suggested that 2 years of comparative statements with 5 years of financial highlights are enough. Another noted that 2 years of comparative statements is standard industry practice.

The regulation is designed to provide the financial statements necessary to do a comparative study of the institution's performance during the last 2 fiscal years, which is standard industry practice and required by the SEC. In Form 10-K the SEC requires income statements for the last 3 fiscal years and balance sheets for 2 years. The FCA regulation requires an additional balance sheet, but the FCA does not believe that such a requirement is excessively burdensome and believes it may contain useful comparative information. The final regulation continues to require that the MD&A discuss the results of operations for 2 years on a comparative basis. The FCA believes this is necessary in order to obtain a proper perspective on the fiscal year just ended.

Recent statutory amendments require the independent audit of all System institutions effective for year-end 1986 reports. This change required the deletion of the exception for FLBAs from the audit requirement and the deletion of provisions phasing the audit requirement in over the next 2 years and made comments relative to these provisions moot.

The final regulation adds a requirement that the financial statements be accompanied by a letter signed by the chief executive officer and the chairman of the board representing that in their opinion the financial statements fairly present the financial condition of the institution.

**B. Part 620 -- Subpart C -- Association Annual Meeting Information Statement**

**1. General**

Several commentators suggested that the applicability of Subpart B in the proposed regulation, entitled "Annual Meeting Information Statement," be clarified since the subpart directed each System "institution" to disseminate an annual information statement to shareholders prior to any meeting at which directors are elected. "Institution" was defined to include banks as well as associations, but bank directors (who are also district directors) are not elected at meetings but according to a statutory scheme that provides that district directors serve as ex officio directors of the Federal land bank, the Federal intermediate credit bank, and the bank for cooperatives in the district.

The final regulation clarifies that the annual meeting information statement is applicable only to associations by inserting "Association" in the subpart caption and substituting the word "association" for the word "institution" throughout the regulation. In the final regulation Subpart B -- Association Annual Information Statement has been relettered as Subpart C. Subpart B has been reserved and the FCA intends to publish a new Subpart B for comment in the near future that would require quarterly reporting and prescribe a framework for such interim reporting.

**2. Section 620.20 Preparing, Distributing, and Filing the Information Statement**

A number of comments were received regarding a timing problem created by the interplay of the requirement to include the latest quarterly statements if the annual meeting is held more than 120 days after the end of the fiscal year and the requirement to distribute to shareholders 15 days before the meeting and file with the FCA 30 days prior to dissemination to shareholders.

The final regulation includes a number of changes that are designed to alleviate this problem. First, the final regulation requires the quarterly statement only if the annual meeting is held more than 134 days after the end of the fiscal year. Second, the requirement to distribute to shareholders 15 days prior to the meeting has been changed to 10 days prior to the meeting. Third, the requirement to file with the FCA 30 days prior to dissemination to shareholders has been changed to a requirement that the statement be filed with the FCA (received at FCA offices) on or before the date of its dissemination to shareholders.

A few commentators supported routine quarterly reporting but questioned the wisdom of requiring interim reporting without setting up a framework for such reporting designed to assure that it is not more misleading than helpful. The FCA concluded that the comment had merit and has drafted a regulation that it will propose for comment in the near future that will require a quarterly report to be sent to shareholders for each quarter of the year except the one that coincides with the end of the fiscal year and prescribes rules for presenting the information similar to those of the SEC. Subpart B has been reserved for this regulation. If this regulation were to be adopted, it would eliminate the need to send financial statements with the annual information statement and Subpart C would be amended accordingly.

The signing requirements in the proposed regulation for the annual information statement were subject to the same criticism as those of the annual report and the final regulation reflects the same changes as those made in Subpart A. The final regulation continues to require every member of the board to sign the statement filed with the FCA and the association to disclose in the statement the reason for any director's failure to sign, but permits the chief executive officer and the chairman of the board to sign, on behalf of the board, the statement sent to shareholders.

In addition, the final regulation requires one copy of the statement to be filed with the FCA to be manually signed, to achieve consistency with the signing requirements of Subpart A.

**3. Section 620.21 Contents of Association Annual Meeting Information Statement**

**(a) Section 620.21(b) Voting Shareholders**

One commentator suggested that the requirement to disclose the number of voting shareholders be deleted. The FCA rejected this suggestion because it gives the shareholder the only information available about the potential vote required, even though the actual vote required cannot be determined until the meeting, since the Act requires only a majority of stockholders present and voting for all shareholder decisions except the authorization of preferred stock. It imposes little burden on the association to disclose the number of voting shareholders since a voting list must be compiled for the election. In addition, to provide information about the vote required for the authorization of preferred stock, which requires approval of a majority of the outstanding shares of each class of stock, whether voting or nonvoting, the FCA final regulation adds a requirement that the number of voting shares of each class of stock be disclosed when a vote to authorize preferred stock is to be taken.

**(b) Section 620.21(c) Directors**

The proposed regulation required the reporting institution to disclose policy disagreements when requested by a director who has resigned because of such a dispute. One commentator opined that providing a forum for the airing of policy disagreements between directors is not a good idea. The same commentator noted that information on attendance and compensation policy might be misinterpreted.

The FCA believes that the shareholders who own a business are entitled to know when a director they have elected resigns because of a major policy dispute and the requirement is retained in the final rule. This provision does not require policy disputes to be routinely aired. It only requires disclosure when a director who has resigned because of a policy disagreement requests it. It is unlikely that a director will resign because of a trivial policy dispute and even more unlikely that he or she will attempt to bring it to shareholders unless it is of some importance to the institution. This requirement is consistent with SEC requirements and those of other regulators.

The information required by the proposed regulation on director compensation and other directorships has been deleted, as the same disclosure is required in the annual report to shareholders, which is incorporated by reference.

It was suggested that the information required by this item be given to the nominating committee. The regulation does not address what information, if any, should be given to the nominating committee. Its purpose is to require adequate information be provided to shareholders.

**(c) Section 620.21(d) Nominees**

Two commentators noted that the disclosure requirements for floor nominees are impractical and difficult to implement. One of them believes that 5 years of business experience is excessive and made the same comment on the disclosure of events reflecting on the ability or integrity of nominees as those made on directors.

FCA recognizes that the floor nominee disclosures present an administrative problem but believes that it would be unfair not to require the same disclosures of floor nominees as are required of ballot nominees. The final rule requires that the notice of meeting state that floor nominees must provide such disclosure in writing at the meeting(s) at which the nomination is to be considered. It is incumbent upon the floor nominee to contact the association to ascertain whether his loan requires disclosure, and the notice should so state. In the final rule the paragraph requiring nominee disclosures states that no person may be a nominee for director who has not made the disclosures required by this regulation.

One commentator stated that the requirement to disclose transactions between the institution and the nominees is redundant, since it also appears in the annual report to shareholders. However, the commentator overlooked the fact that the requirement in the annual report to shareholders related only to incumbent directors and senior officers. The final regulation retains the requirement for nominees, but rather than repeating the substance of the requirement, imposes the requirement by cross referencing the requirement in Subpart A. In addition, a paragraph has been added that would require updating of information on incumbent directors and senior officers disclosed in the annual report to shareholders.

The final regulation adds a paragraph requiring nominees to disclose the names of business entities on whose boards of directors they serve, to achieve consistency with disclosure required on incumbent directors and to permit shareholders to evaluate actual or potential conflicts of interest. To respond to the concern that the regulation would cause the association to violate FCA regulations on release of borrower data, a statement has been added to § 620.20 of the final rule to clarify that none of the disclosure required by this subpart shall be deemed to violate any regulations of the FCA.

**(d) Section 620.21(f) Legal Proceedings.**

The same comments were made on the legal proceedings paragraph in this subpart as were made about the legal proceedings paragraph in the annual report to shareholders. In addition, one commentator noted that the requirement is redundant, since the annual report is incorporated by reference. The final regulation deletes this paragraph.

**4. Section 620.22 Prohibition Against Incomplete, Inaccurate, or Misleading Disclosure.**

A new paragraph has been added to the regulation to clarify that any disclosure made in connection with an election, whether pursuant to the subpart or not, which is incomplete, inaccurate, or misleading, is a violation of the regulation and that when such a violation occurs the FCA may require corrective disclosure.

FCA will use its ongoing examination and regulatory mechanisms to enforce compliance with Part 620 and, where appropriate, require corrective action, including restatement of any misleading or erroneous data.

**C. Part 621 -- Accounting and Reporting Requirements**

**1. General**

A large number of comments were received on this part, the most significant and substantive of which related to the definitions of the categories of nonperforming assets. These comments are discussed below according to the topics and definitions to which they relate. One commentator stated that reporting requirements and media specifications should be limited to those that are reasonable and necessary. Another requested that the regulation include a requirement that the FCA give System institutions 90 days' notice before implementing changes in accounting instructions or reporting formats.

The FCA agrees that reporting requirements and media specifications should be reasonable and limited to those that are necessary to fulfill the Agency's responsibility as an examiner and regulator. It is the current practice of the FCA to give 90 days' advance notice of a change in accounting instructions or reporting format when practicable. The FCA intends to continue that practice. However, the FCA declines to add such a requirement to the regulation because of the occasional instance when the information is needed and the 90 days' notice period is not practicable or necessary.

**2. Section 621.1 Purpose and Applicability**

The final rule has been revised to clarify that the Farm Credit System Capital Corporation established by the 1985 Amendments is subject to the accounting and reporting requirements of this part. A Farm Credit System Capital Corporation was in existence prior to the 1985 Amendments, which had been chartered as a service organization under section 4.25 of the Act. The 1985 Amendments required that this organization be dissolved and a new Farm Credit System Capital Corporation be chartered under section 4.28(A) of the Act. The clarification in the regulation is needed to assure that "service organization" is not read narrowly to include only those organizations chartered under section 4.25 of the Act.

The proposed regulation contains two statements that articulated the FCA's motivation for adopting the regulations that have been deleted. These considerations continue to be the key considerations in adopting the regulation but are more appropriately stated in the preamble. The FCA believes these regulations are necessary because accurate and reliable financial information, prepared in accordance with appropriate accounting requirements, is essential to ensuring the accountability of management and directors to stockholders. The accounting requirements are needed to provide a uniform foundation for generating, presenting, and disclosing accurate and reliable information of a material nature to all persons having or contemplating business transactions with System institutions, including investors in consolidated Systemwide bonds.

**3. Section 621.2 Definitions**

This section has been expanded to include all of the definitions applicable to this part, which in the proposed regulation were scattered throughout the part in the sections to which they relate. In addition, certain definitions have been added that respond to comments received or that were made necessary by the FCA response to comments.

The term "nonperforming loans" received by far the most comments and raised the most concern. Eight commentators believed the term as used was misleading because, in their view, not all descriptive categories included in the term "nonperforming" are really nonperforming, and hence the information that would be reported about System institutions is misleading and inaccurate. A majority of the commentators suggested that the FCA requirements parallel those prescribed in SEC Industry Guide 3, "Statistical Disclosure by Bank Holding Companies," so as to provide comparability between System institutions and commercial banks. n1 One commentator stated that "the financial community" uses "nonperforming" assets to refer to nonaccrual loans, restructured loans, and other real estate owned, and suggested disclosing "other high risk" loans separately from the nonperforming category. One commentator suggested that the term "nonperforming" include only nonaccrual loans, and that "performing" should be defined as accruing.

n 1 The SEC formerly used the term "nonperforming" to mean nonaccrual loans; loans that are contractually past due 90 days or more as to interest or principal, but not in nonaccrual status; renegotiated loans that provide a reduction or deferral of interest or principal because of a deterioration in the financial position of the borrower; and loans that are current but there are serious doubts as to the ability of the borrower to comply with present loan repayment terms. Recently, the SEC abandoned the "nonperforming" terminology and adopted a requirement that "risk elements" be disclosed. The reason for the change was to expand the scope of the required disclosure of risk elements to include all assets displaying unusual risks or uncertainties, whether or not they met the formal definition of "nonperforming loans." In addition, the revision further required disclosure of risk elements in cross border outstandings whether or not, at the time, they were in a nonperforming status. As defined in Guide 3, "risk elements" include substantially all assets that previously would have been referred to as "nonperforming" assets plus other types of identified risk, such as concentrations of risk.

The FCA used the term "nonperforming loans" in the proposed rule to serve two purposes. The first purpose was to establish and communicate to readers of the annual report to shareholders that there is risk associated with loans that do not perform in accordance with contractual terms and conditions set forth in loan agreements, and that this risk may reduce the current or prospective value of these loans. The various categories of nonperforming loans differentiate the degree of severity of their "nonperformance," ranging from "nonaccrual loans" at one end of the continuum (in which the threat of reduced value is realized), to "other high risk loans" at the other end (representing the least severe risk), with restructured loans in the middle range. The second purpose to be served by the term "nonperforming loans" was to establish objective standards and ensure consistent application by System institutions, to enable the FCA to monitor the financial condition and performance of System banks and associations and to ensure that accurate and meaningful aggregate data about the System as a whole can be compiled. Also, the concepts and terminology were intended to provide information to be used by shareholders in holding management and directors accountable for the institution's performance and by the FCA in carrying out its examination and regulatory responsibilities. Eliminating the general concept of "nonperforming loans" would eliminate one of the most valuable tools that the proposed regulation established for use in holding management and directors accountable for the institution's condition and performance.

The FCA does not agree that the term "nonperforming" is not routinely used by the financial community or that the FCA use is inconsistent with established usage. The FCA investigated the use of the term "nonperforming loans" by Federal financial institution regulators and, to the extent practicable, the financial press. The FCA concluded that, while not always defined in the regulations, the major Federal bank regulators use the term "nonperforming loans" to refer collectively to loans that have not performed in accordance with contractual terms and conditions specified in loan agreements. Federal bank regulators use the term in their individual monitoring programs and collectively through the Federal Financial Institutions Examination Council. Federal bank regulators use the term "nonperforming loans" for internal examination and regulatory purposes and in standard external communications, such as the Uniform Bank Performance Report.

The FCA definition of the term "nonperforming loans" is substantially the same as the definition used by major Federal bank regulators. The Federal Financial Institutions Examination Council uses the term "nonperforming loans" to refer to the aggregate of: (1) Nonaccrual loans; (2) Loans past due 90 days or more and still accruing; and (3) Renegotiated troubled debt. The three components of "nonperforming loans" used by the Federal Financial Institutions Examination Council correspond to the items failing within the scope of FCA's definition of the term, with two minor exceptions. First, FCA divides "renegotiated troubled debt" into two categories, formally restructured, and other restructured and reduced rate loans. Second, FCA includes loans past due 90 days or more and still accruing in the "other high risk" category rather than as a separate category, and also includes in "other high risk loans" those loans that are current but otherwise in severe default, and loans in bankruptcy or foreclosure.

The FCA believes its extension of the term "nonperforming loans" to include loans that are current but otherwise in severe default and loans in bankruptcy and foreclosure is appropriate because of the risk implied by those conditions. FCA does not believe, however, that by expanding its definitions to specify those items as nonperforming makes FCA's definition of the term "nonperforming loans" materially inconsistent with the definition used by other Federal bank regulators because loans in severe default and loans in bankruptcy and foreclosure that are not already included in another nonperforming category are relatively few in number. However, since these loans exhibit characteristics that could place doubt on their collection in full, the FCA believes they should be classified as nonperforming loans.

In addition, FCA review concluded that the term "nonperforming" is standard terminology used not only by many commercial financial institutions in disclosures contained in their annual reports to shareholders, but also by financial analysts when analyzing a commercial bank's loan portfolio. Generally the terms "nonperforming loans" or "nonperforming assets" are used. There is, however some confusion and no consistency in the components that make up the "nonperforming loans" and "nonperforming assets." The financial industry generally uses the term "nonperforming loans" to mean nonaccrual and restructured or renegotiated loans, and, in some cases, past due but accruing loans (loans delinquent 90 days or more but adequately secured and in the process of collection). The financial industry generally uses "nonperforming assets" to refer to nonperforming loans and acquired property.

After careful consideration of the comments and possible alternatives to the use of the term "nonperforming," the FCA concluded that no other term is as descriptive of the condition common to all individual categories falling within the scope of the term to identify loans that have not performed in accordance with contractual terms and conditions. The FCA acknowledges that the term "nonperforming" is used inconsistently and imprecisely in the financial press. However, the FCA believes it should concern itself primarily with its own regulatory objectives and seek, to the extent possible, consistency with other Federal financial institutions regulators. Therefore the term "nonperforming loans" is retained in the final rule and is defined to include nonaccrual loans, formally restructured loans, other restructured or reduced rate loans, and other high risk loans.

The final rule, however, reflects some changes made for clarity and greater compatibility with other Federal financial institution regulators. The definition of "nonaccrual loan" in the proposed regulation permitted a loan past due 90 days or more (severely past due) to continue to accrue interest if adequately secured. In the final rule, loans that are 90 days or more past due must be adequately secured and in the process of collection in order to remain in an accrual status. A definition of "in the process of collection" is added which states that "a debt is in process of collection if collection of the debt is proceeding in due course either through legal action, including judgment enforcement procedures, or, in appropriate circumstances, through collection efforts not involving legal action that are reasonably expected to result in repayment of the debt or in its restoration to a current status." In addition, the final rule requires any loan that is delinquent for 180 days or more to be classified a nonaccrual loan without regard to whether it is adequately secured and in process of collection.

The final rule also adds a definition of "nonperforming assets" that includes "acquired property" and "nonperforming loans." Acquired property is defined in the final rule as any personal or real property, other than an interest-earning asset, that has been acquired as a result of liquidation of a loan, either full or partial.

While the final rule does not adopt the reporting requirements as exactly provided in SEC Industry Guide 3, as suggested, the types of information required to be disclosed are similar, except that the final rule retains the "nonperforming" nomenclature.

One commentator noted that under the proposed definition of "adequately secured," no loan could ever be adequately secured. Moreover, the commentator noted loan obligations should be paid out of cash flow from the borrower's operations or source of income rather than liquidation of collateral. While the commentator did not adequately explain the basis for the first criticism, FCA concluded that the comment was in response to the requirement that the net realizable value of the collateral or the guarantee of a responsible party, if any, be sufficient to cover the "principal, interest, and collection expenses as may be outstanding, accrued or incurred to the time the debt is discharged in full. . ." and was related to the fact that actual collection expenses may not be known at the time the performance status is determined. In the final rule the requirement has been revised to state that the net realizable value of the collateral must be sufficient to discharge the debt in full, that is, on the principal and interest that will accrue under the contract. Estimated collection expenses would be deducted from the value of the collateral in making the determination of net realizable value.

In response to the second comment, it should be noted that the term "adequately secured" is used in the proposed regulation in the context of deciding whether interest should be accrued on a loan that is not performing in accordance with the contractual terms and conditions. The FCA agrees wholeheartedly that loans should be repaid from the cash flow from the borrower's operations rather than the liquidation of collateral. However, when cash flow from operations does not materialize in amounts sufficient to meet debt obligations, or when borrowers are otherwise unable or unwilling to repay debts, lenders must look to liquidation of collateral or to the guaranteeing party to collect the indebtedness.

Another commentator objected that the definition includes considerations of the guarantor and borrower creditworthiness in the definition of "adequate security" and noted that "adequate security" is commonly understood to refer to loan security itself and not the creditworthiness of the borrower or his or her surety.

In the context of this regulation, the adequacy of security on a nonperforming loan is critical to the determination of whether the loan belongs in nonaccrual status by virtue of its uncollectibility. One of the key tests for determining collectibility is whether the lender can, through legal devices related to the loan, obtain sufficient cash to discharge the debt in full. In this sense, the term "security" must include all potential sources of repayment. If "adequately secured" and "in process of collection," as the terms are used in this regulation, a loan is properly retained in accrual status. If, however, a combination of collateral and guarantors cannot be reasonably expected to yield enough cash to repay a loan in full, then the loan must be identified and reported as nonaccrual.

The proposed regulation defined "bankruptcy" for purposes of identifying and reporting nonperforming loans. Several commentators noted that the portion of the definition governing how long the loan must be reported in that category was confusing and redundant. One commentator opined that once a debt adjustment plan is approved by the court, the loan should no longer be considered "in bankruptcy."

The FCA has substantially revised this section in response to the comments to provide that a loan must continue to be reported as "in bankruptcy" until the court's jurisdiction is terminated unless relief from the automatic stay has been granted that allows the institution to proceed fully with collection or unless the loan has been restructured under a debt adjustment plan. When the court's jurisdiction is terminated or relief from the stay granted, the reporting institution must redetermine the performance status after an analysis of all pertinent factors and documents its determination in the loan file. If the institution proceeds with foreclosure, the loan would remain in "other high risk loans" unless it meets the criteria for nonaccrual. However, if a debt adjustment plan that requires concessions from the lender has been confirmed by the court, the loan must be reported as "formally restructured." Of course, whenever the loan meets the criteria for nonaccrual, it must be placed in nonaccrual without regard to whether any of the events described above have occurred.

One commentator thought that the definition of "contractually past due" in the proposed regulation was too broad in that loans that are only technically past due or past due in small amounts must be reported as nonperforming. Section 621.3(b) of the proposed regulation established acceptable tolerances that should be recognized in the application of definitions. These tolerances were included in the proposed rule to avoid requiring past due loans be reported as nonperforming when their past due status results from insignificant technicalities or involves insignificant amounts. The final rule retains this tolerance but relocates it to § 621.2(b)(1).

The proposed regulation required loans in foreclosure to be reported as "other high risk" loans. Foreclosure was defined to include foreclosure actions initiated by third parties against property in which the reporting institutions have a security interest. One commentator noted that such actions may not affect System institutions and should not be a criterion for identifying loans as "other high risk", especially when foreclosure is brought by a lienholder junior to a lien held by a System lender.

The FCA believes that the risk inherent in one lender's loan increases substantially when the borrower fails to perform on a loan from another lender. Third party foreclosures suggest strongly that either the borrower's ability to pay obligations to all lenders without liquidating collateral is questionable or that the borrower is otherwise unwilling to fulfill contractual obligations. The adequacy of the loan security enhances ultimate collectibility but does not ensure performance. The FCA recognizes, however, that circumstances may arise in which third party foreclosures may not signal abnormal risk on a loan. Therefore, the final rule has been revised to require prompt review of loans in which the security is subject to third party foreclosures to determine the level of risk inherent in the loan and the proper performance status. Such reviews must consider all information pertinent to the borrower's willingness and ability to perform on the loan and conclusions must be well documented in the loan file. If such a review indicates the presence of abnormal risk on a loan, it must be identified and reported in the proper nonperforming category so long as the abnormal risk is present.

The proposed regulation defined "formally restructured loans" to mean those loans on which the contractual terms have been amended or otherwise revised to incorporate concessions made to the borrower that would not otherwise be made by the lender for economic or legal reasons. One commentator suggested that the regulation be revised to include compromise settlements as a legal reason. Another commentator recommended a revision to the definition of concession to clarify whether routine extensions of an installment should be considered a restructured loan. Another commentator does not believe the definition of "formally restructured loans" in § 621.3(a)(5) of the proposed regulation should include renewals or reamortizations provided the financial condition of the borrower supported the renewal and the terms are similar to those made to other borrowers.

The FCA responded to these concerns by defining "formally restructured loans" as those loans described in the statement of Financial Accounting Standards Bulletin (FASB) No. 15 rather than stating the substance of the bulletin. The proposed rule specified, in § 621.3(b)(2), that renewals or amortizations are not considered restructurings as long as the financial condition and performance of the borrower supported the renewal and the renewal or amortization is made under the same terms and conditions as are used to make similar loans to other borrowers whose financial condition and performance are sound. The final rule retains this provision but relocates it to the definition of "formally restructured loans" in § 621.2(a)(8).

One commentator believes that a loan should be divisible for the purpose of classification when determining its performance status. That is, a portion of a loan could be classified nonaccrual and a portion could continue to accrue interest. There is no basis for such a split classification nor is it practical to split a loan for the purpose of determining its accrual or nonaccrual status. Once a loan is estimated to be uncollectible, including principal and interest, acceptable accounting principles would require the entire loan is required to be placed in a nonaccrual status. From a financial reporting perspective, there is no reason to have part of a loan reported as accruing and earning interest and another part reported as nonaccruing.

Performance classifications should be distinguished from loan classifications that are governed by 12 CFR 614.4050. Loan classifications are subjective ratings given to loans during examinations. The final rule does not require disclosure of loan classifications, as they are a part of the confidential FCA examination report. However, it does require the inclusion of loans classified as vulnerable and loss in certain nonperforming categories.

One commentator objected to the inclusion of all loss loans in the definition of a "nonaccrual loan." The commentator believes it may be appropriate to continue accruing interest on a loan classified as loss, since loans are classified as loss as a result of the estimated ultimate uncollectability and loans that may not ultimately be collectible may still be performing at the time of classification and may continue to perform for some time. The commentator further believes that such loans should be adequately reserved for but not automatically placed in a nonaccrual status.

The FCA disagrees with this comment. If an analysis of a loan identifies it as a loss loan, there is no justifiable reason to continue the accrual of interest on such a loan only to have it charged off at a later date. The proposed regulation is consistent with GAAP, which requires loans to be placed in a nonaccrual status if there is doubt as to collectability of principal or interest.

The need to identify past due but well-secured loans as "high risk" and thus "nonperforming loans" was questioned by some commentators.

Performance classifications are designed to measure borrower performance. The FCA believes that the adequacy of the security on a loan does not assure the borrower's performance in fulfilling obligations set forth in the loan agreement. The adequacy of the security is relevant to the collectibility of the loan, which may determine the particular category of nonperforming loans to which it is assigned, but it does not make a nonperforming loan performing. The final regulation retains the requirement that certain past due loans be identified and reported as "other high risk" even though adequately secured.

One commentator questioned whether, when a borrower is 90 days or more past due on one of three notes, the amount outstanding on the other two notes should also be reported as nonperforming. Another commentator believed there was a need to define "loan" and suggested that "loan" should apply to each individual loan of a borrower and not the aggregate credit.

The FCA believes that loan performance is determined primarily by the borrower's willingness and ability to fulfill debt obligations. The structure of indebtedness, whether a single note covering all amounts owed or a series of notes covering the same debt, does not alter the risk underlying the indebtedness. All indebtedness of a borrower should be identified and reported in the appropriate category of nonperforming loans when any portion of the indebtedness meets any of the criteria established for the identification and reporting of nonperforming loans when the underlying risk is the same. Accordingly, the final regulation adds a rule of aggregation that clarifies this point in § 621.2(b)(2). This rule of aggregation is designed to require the institution to consider all loans on which a particular borrower is primarily obligated, including joint loans with other borrowers and partnership or corporate loans, as one loan unless the institution can establish that a particular loan constitutes an independent risk. Minor editorial revisions have been made to the definition of "loan," but the term continues to include all extensions of credit and leases.

One commentator noted that § 621.3(a)(9)(iv) of the proposed rule permitted an implication that all loans classified problem under 12 CFR 614.4050 are to be classified as "other high risk." The FCA agrees that this was a permissible interference, which was unintended. Therefore, the final regulation has been modified to eliminate any such inference by substituting a requirement that institutions report as "other high risk," any loan where information is known to management that causes serious doubts about the ability of the borrower(s) to comply with the loan repayment terms. This modification clarifies that not all problem loans are to be included in high risk but will capture those loans that could result in serious credit problems and loan losses.

One commentator questioned the logic of § 621.3(a) of the proposed rule relating to the definition of "other restructured and reduced rate loans." The commentator could not conceive of concessions that might be offered that would not be incorporated into some formal contractual agreement.

While the FCA believes that it is possible for some loans to be placed in a reduced rate status or restructured internally by the institution without a formal agreement between the borrower and the institution, it agrees with the commentator that, in most cases, a formal agreement would be entered into. However, the fact that the institution has internally modified the accrual and the application of payments to accelerate the repayment of principal does not, unless the loan is formally restructured, relieve the borrower from making full payment in accordance with the original contract terms. This classification is used for financial reporting purposes to preclude the recording of interest in full if collection of the entire principal or interest is doubtful.

One commentator noted that the cash application sequence specified in § 621.3(b)(1)(iii) of the proposed regulation is not consistent with that used by some System banks and associations.

Because of the need to maintain some uniformity by System institution when they prepare financial statements, all System institutions will be expected to apply cash in accordance with the final regulation from its effective date forward.

**4. Section 621.3 Generally Accepted Accounting Principles**

Five commentators stated that the regulation should simply state the institutions should follow GAAP and not duplicate the specific provisions of GAAP in the regulations, noting that restating the specific provisions of GAAP in a regulation would require the regulation to be changed if the specific provisions of GAAP changed. Another suggested that FCA's interpretations of GAAP should not be in the regulations but in guidelines, as has been the practice in the past. Another suggested that the regulations should only define those System accounting practices that are different from GAAP.

The FCA does not intend to restate the requirements of GAAP but to require the System institutions to conform to the applicable provisions of GAAP, unless otherwise modified by statutory or regulatory requirements. FCA is fully supportive of having the System institutions comply with GAAP, but recognizes that there are differences. Currently, there are two such statutory or regulatory requirements that differ from GAAP. These are the requirements for both the FLBs and PCAs to maintain an allowance in accordance with GAAP, subject to minimum specified requirements. GAAP does not specify minimums. Because of the difficulty involved in estimating an adequate allowance for loan losses, the FCA believes it appropriate to maintain these minimum requirements to provide some assurance that the allowance is adequate to cover the potential risk that may be present in the loan portfolio.

In addition, in many situations GAAP provides an option for recording a transaction and the application of any one of the options would result in the transaction's being recorded in accordance with GAAP. Since the FCA prepares combined financial statements for the various bank and association groups and the System prepares a combined Report to Investors, there is a need for consistent application. In those cases, the regulations specify which option to be used, to ensure consistent application by all System institutions.

Notwithstanding the fact that FCA endorses the concepts of GAAP, it may find it necessary from time to time to issue releases on accounting principles and practices with respect to specific accounting areas.

The final regulation has been modified to eliminate any requirement that may be an unnecessary duplication of GAAP and not needed to ensure consistent application among System institutions. For instance, under § 621.3(a)(5) of the proposed regulations the definition of formally restructured loans has been replaced with a reference to the GAAP provisions of FASB No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings."

Minor editorial and clarifying changes have been made to § 621.2 of the proposed regulations (§ 621.3 of the final regulations) to state the requirements more clearly. Section 621.2(c) in the proposed regulation, "Accrual basis of accounting," has been set out as a separate section in the new regulation (§ 621.4) and succeeding sections renumbered.

**5. Section 621.5 Nonperforming Assets**

One commentator stated that § 621.3(c)(1) of the proposed regulations implies that GAAP covers nonperforming loans and the implication should be removed because GAAP does not specifically address nonperforming loans. The FCA agrees that GAAP does not specifically prescribe requirements for nonperforming loans and similar assets. The regulation has been adjusted accordingly.

This section has been further amended to state its requirements more clearly and succinctly by combining paragraphs (a) and (b); stating more directly the requirement to determine the performance status of loans on a quarterly basis, and adding a paragraph to clarify that measures taken to enhance the collectibility of a loan, such as guarantees, do not relieve the institution of the obligation to determine the loan's performance status.

**6. Section 621.6 Uncollectible Interest on Loans and Similar Assets**

One commentator stated that the use of term "chargeoffs" in § 621.4(a) of the proposed regulation (§ 621.6(a) of the final regulation) is not technically correct when referring to earned but uncollected interest. The commentator stated that proper accounting requires interest to be backed out or reversed and suggested the paragraph be changed to read "appropriately account for earned but uncollected interest."

The final regulation has been adjusted to clarify its requirements. The substance of the change requires: (1) Earned but uncollected interest income that was accrued in the current fiscal year and determined to be uncollectible to be reversed from interest income in the current period; and (2) Earned but uncollected interest income that was accrued in prior fiscal years and determined to be uncollectible to be charged off against the allowance for loan losses. In addition, because the requirements mandated by this section are not the only acceptable options under GAAP for the charging off or reversing of accrued but uncollectible interest, the specific reference to GAAP in this section of the proposed regulation has been deleted.

**7. Section 621.7**

**Chargeoffs on Losses on Loans**

Several comments were received relating to § 621.5(c) of the proposed regulation (§ 621.7 of the final regulations) requiring the maintenance of an allowance for losses that, when considered in combination with the ability to make additional provisions for loss, is adequate to absorb loss in the loan portfolio. The commentators noted that this section permits an inference that earnings are needed before additions can be made, which is inconsistent with GAAP. Another commentator suggested that this paragraph be deleted in its entirety.

The FCA agrees that GAAP requires the maintenance of an adequate allowance without regard to the effect on earnings and the final regulation has been adjusted accordingly. The final regulation has also been modified to incorporate the requirement to maintain an allowance for loan losses that is in accordance with minimum statutory and regulatory standards.

One commentator noted that paragraph (d) of this section is open ended, with room for abuse by the FCA, and suggested it be eliminated. Because there is a critical need for each institution to adopt policies and to apply such policies, the FCA believes that paragraph (d) is necessary and it is retained in the final rule. In addition, since the FCA issues releases on accounting principles from time to time, the phrase "such other requirements as may be specified by the Farm Credit Administration" is needed.

**8. Section 621.8 Adjustments to Book Value of Assets**

Section 621.6 of the proposed regulations gave institutions differing with the FCA over the amount that should be charged off the option of charging off the amount specified by the FCA or disclosing the dispute with the FCA over the amount to be charged off in the annual report to shareholders. Section 621.8 of the final regulations requires that the institution charge off the amount directed by the FCA to be charged off. This change requires more directly what the FCA believed would be the usual result of an institution's exercise of the option presented in the proposed regulation.

**9. Section 621.9 Audit by Qualified Public Accountant**

The comments received regarding this section (§ 621.7 of the proposed regulations) were generally supportive of the need for audited financial statements. The commentators recommended the requirement to report FCA changes of accountants and disagreements with accountants be accelerated. One suggested that the institution be required to report to FCA within 15 days of the month-end in which the change takes place and that the certified public accountant (CPA) be required to provide a letter stating whether the CPA concurs with management's response. If the CPA does not concur, the regulation should require the reasons to be stated. Another commentator recommended that § 621.7(c), "Disagreements with accountants," be deleted if the suggested modifications are made to § 621.7(d).

The FCA agrees that any disagreements with the accountant's opinion or changes in accountants should be reported to FCA immediately, in addition to being included in reports to shareholders, and such a requirement has been added to § 621.9 (c) and (d) of the final rule. The requirement that the CPAs be required to provide a letter stating whether they concur with management's response was thought to be implicit in the requirements of § 621.7(c)(3) of the proposed regulations. However, this paragraph (§ 621.9(c)(3) in the final regulation) has been clarified to make the requirement more explicit. The final regulation also requires that all correspondence required by § 621.9(c) be submitted to the FCA simultaneously with its submission by management to the accountant or submission by the accountant to management.

The requirement of § 621.7(c) has not been deleted even though the suggested changes have been made to § 621.7(d) because the FCA believes two separate sections are needed. Section 621.7(d) has, however, been modified to require notification to FCA within 15 days of the month-end when an institution changes its accountant and the reasons therefore.

The comments suggested that each institution be required to establish an audit committee made up of board members, and that the audit committee's activities be a required disclosure in the Annual Meeting Information Statement. One commentator suggested that all System institutions, including service corporations chartered by the FCA in which no equity is owned by any entity not chartered by the FCA, be required to have their financial statements audited by a qualified public accountant.

The FCA supports the use of audit committees but does not believe it appropriate to require them by regulation. The decision to have an audit committee is an internal management decision. The FCA does not think it appropriate to regulate the types of committees each institution should have. The FCA concurs that all institutions chartered by the FCA should have their financial statements audited by a qualified public accountant and the 1985 Amendments require it. The requirement has been restated in the final regulations.

FCA has also eliminated the requirement of § 621.7(b)(3) of the proposed regulation (§ 621.9 of the final regulations) that a copy of the public accountant's opinion of each institution's financial statements be sent to the FCA chief accountant upon receipt, since the annual report to shareholders filed with the FCA will contain the opinion.

**D. Part 602. -- Disclosure Under the Freedom of Information Act**

The proposed amendment to 12 CFR 602.250(a)(8) stated that reports to shareholders required by FCA regulations and certain portions of the reports of condition and performance filed under Part 621 would be publicly available for a reasonable fee upon request. The preamble to the proposal explained that items in the reports of condition that correspond to items in the shareholders reports would be publicly available. One commentator suggested that the regulation specify those portions of the reports of condition and performance that would be made publicly available.

The final amendment states that those items in the reports of condition and performance that are of essentially the same character as items required to be disclosed to shareholders will be publicly available. In addition, technical adjustments made necessary by the 1985 Amendments were made in 12 CFR 602.250(a)(5).

**List of Subjects in 12 CFR Parts 602, 620, and 621**

Archives and records, Freedom of information, Information, Records, Disclosure to shareholders, Annual reports, Quarterly reports, Association annual meeting information statement, Accounting and reporting requirements, Report of condition and performance.

For the reasons set forth in the preamble, Chapter VI, Title 12, of the Code of Federal Regulations is proposed to be amended by amending Part 602 and by adding Parts 620 and 621 as follows:

**PART 602 -- RELEASING INFORMATION**

1. The authority citation for Part 602 is revised to read as follows:

**Authority**: Secs. 5.9 and 5.17, Pub. L. 99-205, 99 Stat. 1678.

2. Section 602.250 is amended by revising the introductory text of paragraph (a) and paragraphs (a)(5) and (8) to read as follows:

**Subpart B -- Availability of Records of the Farm Credit Administration**

**§ 602.250 Official records of the Farm Credit Administration.**

(a) The Farm Credit Administration shall, upon any request for records which reasonably describes them and is made in accordance with the provisions of this subpart, make the records available as promptly as practicable to any person, except exempt records, which include the following:

\* \* \* \* \*

(5) Inter-Agency or intra-Agency memorandums or letters which would not be available by law to a private party in litigation in which the United States, as real party interest on behalf of the Farm Credit Administration, is a party, or from any Farm Credit System institution, including banks, associations, service organizations, or the Capital Corporation, to a private party in litigation with such institution if such memorandums or letters are records of such institution;

\* \* \* \* \*

(8) Records of or related to examination, operation, reports of condition and performance, or reports of or related to Farm Credit institutions that are regulated and examined by the Farm Credit Administration that are prepared by, on behalf of, or for its use; except that reports to shareholders filed with the Farm Credit Administration pursuant to Part 620 of this chapter and those items in reports of condition and performance filed with the Farm Credit Administration pursuant to Part 621 of this chapter that are of essentially the same character as items disclosed in reports to shareholders filed with the Farm Credit Administration pursuant to Part 620 of this chapter, shall be available to the public on request for a reasonable fee.

\* \* \* \* \*

3. A new Part 620 is added to read as follows:

**PART 620 -- DISCLOSURE TO SHAREHOLDERS**

**Subpart A -- Annual Reports to Shareholders**

Sec.

620.1 Definitions.

620.2 Preparing, distributing, and filing the report.

620.3 Contents of the annual report to shareholders.

**Subpart B -- [Reserved]**

**Subpart C -- Association Annual Meeting Information Statement**

620.20 Preparing, distributing, and filing the information statement.

620.21 Contents of the association annual meeting information statement.

620.22 Prohibition against incomplete, inaccurate, or misleading disclosure.

**Authority**: Sec. 5.17(9) and (10), Pub. L. 99-205.

**Subpart A -- Annual Reports to Shareholders**

**§ 620.1 Definitions.**

For the purpose of this part, the following definitions shall apply:

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

(b) "Senior officer" means any person designated by the board of directors as responsible for a major management function.

(c) "Immediate family" shall mean parents, children, and siblings.

(d) "Institution" means any bank or association chartered by the Act.

(e) "Loan" shall have the same meaning as in Part 621 of this chapter.

(f) "Material." The term "material," when used to qualify a requirement to furnish information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable person would attach importance in making shareholder decisions or determining the financial condition of the institution.

(g) "Normal risk of collectibility" means the ordinary risk inherent in the lending operation. Any loans properly identifiable as "nonperforming" as defined in § 621.2(a)(17) of this chapter shall be deemed to have more than a normal risk of collectibility.

(h) "Related organization" means any Farm Credit institution that is a shareholder of the reporting institution or in which the reporting institution has an ownership interest.

(i) "Risk funds" means the allowance for loan losses and all capital accounts exclusive of capital stock, participation certificates, and allocated equities.

(j) "Shareholder" means a holder of any equity interest in an institution.

**§ 620.2 Preparing, distributing, and filing the report.**

(a) Each institution of the Farm Credit System shall prepare and distribute to its shareholders an annual report within 90 days of the end of its fiscal year.

(b) For the purposes of § 620.3(m), a Federal land bank association shall include the financial statements of the Federal land bank in the district in addition to its own. Federal land bank associations shall comply with all other sections of this part except as expressly stated otherwise herein.

(c) The report shall contain, at a minimum, the information required by § 620.3 and, in addition, such other information as is necessary to make the required statements, in light of the circumstances under which they are made, not misleading.

(d) Three complete copies of the report, including financial statements and related schedules, exhibits, and all other papers and documents that are part of the report, shall be filed with the Chief Examiner, Farm Credit Administration, simultaneously with its dissemination to shareholders and shall be available for public inspection at the Farm Credit Administration.

(e) At least one of the reports filed with the Farm Credit Administration shall be dated and manually signed on behalf of the institution by:

(1) the person designated by the board of directors to certify the reports of condition and performance in accordance with § 621.12 of this chapter;

(2) The chief executive officer; and

(3) Each member of the board.

The name and position title of each person signing the report shall be typed or printed beneath his or her signature. The statement to which the signers of the report shall attest shall read as follows:

The undersigned certify that this report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of his or her knowledge.

If any officer or any member of the board is unable to or refuses to sign the report, the institution shall disclose the individual's name and position title and the reasons such individual is unable or refuses to sign the report.

(f) The report sent to shareholders shall be signed and dated by and on behalf of the institution and its board of directors by its chief executive officer and the chairman of the board of directors. If any person required to sign the report submitted to the Farm Credit Administration pursuant to paragraph (e) of this section has not signed the report, the name and position title of the individual and the reasons such individual is unable or refuses to sign shall be disclosed in the report sent to shareholders.

(g) Information in any part of this report may be incorporated by reference in answer or partial answer to any other item of the report.

(h) All items of essentially the same character as items required to be reported in the reports of condition and performance pursuant to Part 621 of this chapter shall be prepared in accordance with the rules set forth in Part 621.

(i) No disclosure required by this subpart shall be deemed to violate any regulation of the Farm Credit Administration.

(j) A copy of the most recent annual report to shareholders shall be publicly available at the institution.

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

The report shall contain the following items in substantially the same order:

(a) Description of Business

The description shall include a brief discussion of the following items:

(1) The territory served;

(2) The persons eligible to borrow;

(3) The types of lending activities engaged in and financial services offered. (Banks shall also briefly describe the lending and financial services offered by the associations that are its shareholders as well as financial services offered to district borrowers by any service organization in which it has an ownership interest.);

(4) Any significant developments within the last 5 years that had or could have a material impact on earnings or interest rates to borrowers, including, but not limited to, mergers or consolidations and financial assistance provided by or to the institution through loss-sharing or capital preservation agreements or from any other source;

(5) Any acquisition or disposition of material assets during the last fiscal year, other than in the ordinary course of business;

(6) Any material change during the last fiscal year in the manner of conducting the business;

(7) Any seasonal characteristics of the institution's business;

(8) Any concentrations of more than 10 percent of its assets in particular commodities or particular types of agricultural activity or business, and the institution's dependence, if any, upon a single customer, or a few customers, including other financial institutions (OFIs), as defined in § 614.4540(e) of this chapter, the loss of any one of which would have a material effect on the institution; and

(9) A brief description of the business of any related Farm Credit organization and the nature of the institution's relationship to such organization.

(b) Description of Property

State the location of and briefly describe the principal offices and other materially important physical properties (other than property acquired in the course of collecting a loan) of the institution. If any such property is not held in fee or is held subject to any major encumbrance, so state and describe briefly the terms and conditions of the agreement under which the property is used or occupied.

(c) Legal Proceedings

Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the institution is a party, of which any of its property is the subject, or which involves claims that the institution may be required, by contract or operation of law, to satisfy. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding, and the relief sought.

(d) Description of Capital Structure

Describe each class of stock and participation certificates the institution is authorized to issue and the rights, duties, and liabilities of each class. The description shall include:

(1) The number of shares of each class outstanding;

(2) The par or face value;

(3) The voting and dividend rights;

(4) The order of priority upon impairment or liquidation;

(5) The institution's retirement policies and restrictions on transfer;

(6) The statutory requirement that a borrower purchase stock as a condition to obtaining a loan;

(7) The manner in which the stock is purchased (i.e., promissory note to the issuer or cash not advanced by issuing institution); and

(8) The statutory authority of the institution to require additional capital contributions, if any.

(e) Description of Liabilities

(1) Describe the institution's debt, indicating the type, amount, maturity, and interest rates of each category of obligations outstanding at the end of the fiscal year just ended. Describe applicable statutory and regulatory restrictions on the institution's ability to incur debt.

(2) Describe fully the institution's rights and obligations under any agreement, formal or informal, between the institution and any other person or entity having to do with capital preservation, loss sharing, or any other financial assistance agreement.

(3) Describe any statutory authorities or obligations to contribute to or on behalf of another institution of the Farm Credit System.

(f) Selected Financial Data.

Furnish in comparative columnar form for each of the last 5 fiscal years the following financial data:

(1) For banks and production credit associations:

(i) Balance sheet

Total assets

Investments

Loans

Allowance for losses

Net loans

Acquired property

Total liabilities

Obligations with maturities longer than 1 year

Obligations with maturities less than 1 year

Total capital

Stock and participation certificates

Surplus

Allocated equities

(ii) Statement of income

Net interest income

Provision for loan losses

Net income

(iii) Key financial ratios

Return on average assets

Return on average capital

Net interest margin as a percentage of average earning assets

Capital-to-asset

Debt-to-capital

Net chargeoffs-to-average loans

Allowance for loan losses-to-average loans

(iv) Net income distributed

Cash

Dividends

Patronage refunds

Stock

Allocated equities

(2) For Federal land bank associations:

(i) Balance sheet

Total assets

Accrued obligation under loss-sharing agreement, if any

Total capital

(ii) Statement of income

Compensation from the Federal land bank

Total operating expense

Provision for obligation under capital preservation or loss-sharing agreements, if any

Net income

(iii) Other

Loans serviced for the Federal land bank

Dividends paid

Patronage refunds paid

Cash

Allocated equities

Payments to the Federal land bank under loss-sharing agreement

(g) Management's Discussion and Analysis of Financial Condition and Results of Operations

Fully discuss the institution's financial condition, changes in financial condition, and results of operations during the last 2 fiscal years, identifying favorable and unfavorable trends and significant events or uncertainties. In addition to the items enumerated below, the discussion shall provide such other information as the institution believes is necessary to an understanding of its financial condition, changes in financial condition, and results of operations.

(1) Loan portfolio.

(i) Describe the types of loans in the portfolio by major category (e.g., agricultural real estate mortgage loans; rural home loans; agriculture production loans by major subcategory; processing and marketing; farm business; and international), indicating the approximate percentage of the total dollar portfolio represented by each major category. For each category, discuss any special features of the loans that may be material to the evaluation of risk and any economic or business conditions that have had or are likely to have a material impact on their collectibility. For Federal intermediate credit banks, disclose separately the aggregate amount of loans outstanding to production credit associations and OFIs.

(ii) Describe the geographic distribution of the loan portfolio by State or other significant geographic division, if any.

(iii) Recent loss experience. For the periods covered by the financial statements provide:

(A) An analysis of nonperforming assets in accordance with the categories delineated in § 621.2 of this chapter;

(B) An analysis of the allowance for loan losses that includes the ratios of the allowance to average loans and net chargeoffs to average loans, and a discussion of the adequacy of the allowance for losses to absorb the risk inherent in the institution's loan portfolio;

(C) Financial assistance given or received under districtwide or Systemwide loss-sharing or capital preservation agreements or otherwise;

(D) For Federal intermediate credit banks, a description in the aggregate of the recent loss experience of the PCAs that are its shareholders, including the items enumerated in paragraphs (g)(1)(iii)(A), (B), and (C) of this section.

(2) Results of operations.

(i) Describe, on a comparative basis, changes in the major components of net income during the last 2 fiscal years, describing significant factors that contributed to the changes and quantifying the amount of the changes due to an increase in volume or the introduction of new services and the amount due to changes in interest rates earned and paid, based on averages for each period.

(ii) Describe any unusual or infrequent events or transactions or any significant economic changes, including, but not limited to, financial assistance from or paid to other Farm Credit institutions, that materially affected reported income. In each case, indicate the extent to which income was so affected.

(iii) Discuss the factors underlying the changes, if any, in the return on average assets and the return on average capital.

(iv) Describe, on a comparative basis, the major components of operating expense, indicating the reasons for significant increases or decreases.

(v) Describe any other significant components of income or expense, including, but not limited to, income from investments, that in the institution's judgment should be described in order to understand the institution's results of operations.

(vi) Describe any known trends or uncertainties that have had, or that the institution reasonably expects will have, a material impact on net interest income or net income. Disclose any events known to management that will cause a material change in the relationship between costs and revenues.

(3) Liquidity and funding sources.

(i) Funding sources.

(A) Describe the average and year-end amounts, maturities, and interest rates on outstanding consolidated Systemwide debt obligations or other bond obligations used to fund the institution's lending operations.

(B) Describe existing lines of credit and their terms.

(C) Describe the institution's capital accounts and other sources of lendable funds.

(ii) Liquidity.

(A) Discuss the institution's liquidity policy and the components of asset liquidity, including, but not limited to, cash, investment securities, and maturing loan repayments. Assess the ability of the institution to generate adequate amounts of cash to fund its operations and meet its obligations.

(B) Discuss any known trends that are likely to result in a liquidity deficiency and the course of action management intends to take to resolve it. Discuss any material increase or decrease in liquidity that is likely to occur.

(iii) Funds management.

(A) Discuss the institution's interest rate programs and the institution's ability to control interest rate margins.

(B) Discuss changes in net interest margin (net interest income as a percentage of average earning assets), explaining the reasons therefore.

(4) Capital resources.

(i) Describe any material commitments to purchase capital assets and the anticipated sources of funding.

(ii) Discuss any material trends or changes in the mix and cost of debt and capital resources.

(iii) Describe any favorable or unfavorable trends in the institution's capital resources.

(iv) Discuss and explain any material changes in capital ratios, noting any material adverse variances from regulatory guidelines.

(v) Discuss any trends, commitments, contingencies, or events that are reasonably likely to have a materially adverse effect upon the adequacy of available risk funds.

(h) Directors and Senior Officers

(1) List the names of all directors and senior officers of the institution, indicating the position title and term of office of each.

(2) Briefly describe the business experience during the past 5 years of each director and senior officer, including each person's principal occupation and employment during the past 5 years.

(3) For each director, list any other business entity on whose board the director serves and state the principal business in which it is engaged.

(i) Compensation of Directors

Describe the arrangements under which directors of the institution are compensated for all services as a director (including total cash compensation and any noncash compensation that exceeds 10 percent of total compensation or $25,000 whichever is less) and state the total cash compensation paid to directors as a group during the last fiscal year. For each director, state:

(1) The number of days served at board meetings;

(2) The total number of days served in other official activities; and

(3) The total compensation paid to each director during the last fiscal year.

(j) Transactions With Senior Officers and Directors

(1) State the institution's policies, if any, on loans to and transactions with officers and directors of the institution.

(2) Transactions other than loans. For each person who served as a senior officer or director on January 1 of the year following the fiscal year for which the report is filed, or at any time during the fiscal year just ended, describe briefly any transaction or series of transactions other than loans that occurred at any time since the last annual meeting between the institution and such person, any member of his or her immediate family, or any organization with which the person or director is affiliated. State the name of the person, his or her relationship to the institution, the nature of his or her interest in the transaction, and the terms of the transaction. No information need be given where the purchase price, fees, or charges involved were determined by competitive bidding or where the amount involved in the transaction (including the total of all periodic payments) does not exceed $5,000, or the interest of the person arises solely as a result of his or her status as a stockholder of the institution and the benefit received is not a special or extra benefit not available to all stockholders.

(3) Loans to senior officers and directors.

(i) If true, state that the institution has had loans outstanding during the last full fiscal year to date to its senior officers and directors that:

(A) Were made in the ordinary course of business;

(B) Were made on the same terms, including interest rate, amortization schedule, and collateral, as those prevailing at the time for comparable transactions with other persons; and

(C) Did not involve more than the normal risk of collectibility.

(ii) If the conditions stated in paragraph (j)(3)(i) of this section do not apply to the loan(s) of any person who served as a senior officer or director on January 1 of the year following the fiscal year for which the report is filed or at any time during the fiscal year just ended, or any member of such person's immediate family or any organization with which such person is or has been affiliated within the last fiscal year, state:

(A) The person's name;

(B) The largest aggregate amount of indebtedness outstanding at any time during the last fiscal year;

(C) The nature of the loan(s);

(D) The amount outstanding as of the end of the last fiscal year;

(E) The rate of interest payable on the loan;

(F) The repayment terms for the loan;

(G) The amount past due, if any;

(H) The performance status of the loan as determined by the institution in accordance with Part 621 of this chapter; and

(I) If applicable, the reason the loan is deemed to involve more than the normal risk of collectibility.

(k) Involvement in Certain Legal Proceedings.

Describe any of the following events that occurred during the past 5 years and that are material to an evaluation of the ability or integrity of any person who served as director or senior officer on January 1 of the year following the fiscal year for which the report is filed or at any time during the fiscal year just ended:

(1) A petition under the Federal bankruptcy laws or any State insolvency law was filed by or against, or a receiver, fiscal agent, or similar officer was appointed by a court for the business or property of such person, or any partnership in which such person was a general partner at or within 2 years before the time of such filing, or any corporation or business association of which such person was a senior officer at or within 2 years before the time of such filing;

(2) Such person was convicted in a criminal proceeding or is a named party in a pending criminal proceeding (excluding traffic violations and other misdemeanors);

(3) Such person was the subject of any order, judgment, or decree, not subsequently reversed, suspended, or vacated, by any court of competent jurisdiction, permanently or temporarily enjoining or otherwise limiting such person from engaging in any type of business practice.

(l) Relationship With Independent Public Accountant

If a change or changes in accountants have taken place since the last annual report to shareholders or if a disagreement with an accountant has occurred that the institution would be required to report to the Farm Credit Administration under Part 621 of this chapter, the information required by § 621.9 (c) and (d) of this chapter shall be disclosed.

(m) Financial Statements

(1) Furnish financial statements and related footnotes that have been prepared in accordance with generally accepted accounting principles and instructions and other requirements of the Farm Credit Administration and that have been audited in accordance with generally accepted auditing standards by a qualified public accountant, as defined in § 621.2(a)(21) of this chapter, and an opinion expressed thereon. The statements shall include the following statements and related footnotes for the last 3 fiscal years: balance sheet, statement of income, statement of changes in capital, and statement of changes in financial position.

(2) The audit requirements of paragraph (m)(1) of this section shall be effective for financial statements issued for the 1986 fiscal year-end.

(3) The financial statements shall be accompanied by a letter signed by the chief executive officer and the chairman of the board representing that the financial statements, in the opinion of management, fairly present the financial condition of the institution, except as otherwise noted.

**Subpart B -- [Reserved]**

**Subpart C -- Association Annual Meeting Information Statement**

**§ 620.20 Preparing, distributing, and filing the information statement.**

(a) Each association of the Farm Credit System shall prepare and distribute to its shareholders at least 10 days prior to any meeting at which directors are to be elected an information statement ("statement").

(b) The statement shall contain, at a minimum, the information specified in § 621.21 and, in addition, such other material information as is necessary to make the required statement, in light of the circumstances under which they are made, not misleading.

(c) The statement shall incorporate by reference the annual report to shareholders required by Subpart A of this part. In addition, if any institution holds a shareholder meeting at which directors are elected more than 134 days after the end of its fiscal year, the statement shall be accompanied by the most recent quarterly statements and statements for the comparable period in the prior fiscal year.

(d) Three complete copies of the statement, including financial statements and all other paper and documents that are part of the statement, shall be filed with the Chief Examiner, Farm Credit Administration (received at Farm Credit Administration offices), on or before the date of its dissemination to shareholders.

(e) At least one of the statements filed with the Chief Examiner, Farm Credit Administration, including any interim financial statements that may be required under paragraph (c) of this section, shall be dated and manually signed on behalf of the institution by:

(1) The person designated by the board to certify reports of condition and performance in accordance with § 621.12 of this chapter;

(2) The chief executive officer; and

(3) Each member of its board of directors.

The name and position title of each person signing the statement shall be typed or printed beneath the signature. The certification to which the signers of the statement shall attest shall read as follows:

The undersigned certify that this statement has been prepared in accordance with all applicable statutory and regulatory requirements and that the information contained herein is true, correct, accurate, and complete to the best of his or her knowledge.

(f) The statement sent to shareholders shall be signed on behalf of the institution and its board of directors by its chief executive officer and the chairman of the board of directors. If any person required to sign the statement submitted to the Farm Credit Administration pursuant to paragraph (e) of this section has not signed it, the name and position title of the individual and the reason such individual is unable or refuses to sign shall be disclosed in the statement sent to shareholders.

(g) Information in any part of the statement may be incorporated by reference in answer, or partial answer, to any other item of the statement.

(h) No disclosure required by this subpart shall be deemed to violate any regulation of the Farm Credit Administration.

**§ 620.21 Contents of the association annual meeting information statement.**

The statement shall address the following items:

(a) Date, Time, and Place of the Meeting(s)

(b) Voting Shareholders

For each class of stock entitled to vote at the meeting, state the number of shareholders entitled to vote, and, when shareholders are asked to vote on preferred stock, the number of shares entitled to vote. State the record date as of which the shareholders entitled to vote will be determined and the voting requirements for each matter to be voted upon.

(c) Directors

(1) State the names and ages of persons currently serving as directors of the institution, their terms of office, and the periods during which such persons have served. No information need be given with respect to any director whose term of office as a director will not continue after the meeting to which the statement relates.

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

(3) If any director resigned or declined to stand for reelection during the last year fiscal year to date because of a policy disagreement with the board, and if the director has furnished a letter requesting disclosure of the nature of the disagreement, state the date of the director's resignation and summarize the director's description of the disagreement contained in the letter. If the institution holds a different view of the disagreement, the institution's view may be summarized.

(4) If any transactions between the institution and its senior officers and directors of the type required to be disclosed in the annual report to shareholders under § 620.3(j), or any of the events required to be disclosed in the annual report to shareholders under § 620.3(k) have occurred since the end of the last fiscal year and were not disclosed in the annual report to shareholders, the disclosures required by § 620.3(j) and (k) shall be made with respect to such transactions or events in the annual information statement. If any material change in the matters disclosed in the annual report to shareholders pursuant to § 620.3(j) and (k) has occurred since the annual report to shareholders was prepared, disclosure shall be made of such change in the annual information statement.

(d) Nominees

(1) If directors are nominated by region, describe the regions and state the number of voting shareholders entitled to vote in each region. If nominations from the floor are restricted by the bylaws to persons from a particular region, so state.

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

(3) If the annual meeting is held in consecutive sectional meetings, the statement shall contain a notice that nominations from the floor must be made at the first sectional meeting.

(4) For each nominee, state the nominee's name, age, and business experience during the last 5 years, including each person's principal occupation and employment during the past 5 years. List any business entities on whose board of directors the director serves and state the principal business in which the entity is engaged.

(5) For each nominee who is not an incumbent director, except nominees from the floor, the disclosures required of senior officers or directors by § 620.3 (j) and (k) shall be made in the annual information statement. Floor nominees must provide the disclosures required by § 620.3 (j) and (k) in writing at the meeting(s) at which the nomination is considered. No person may be a nominee for director who does not make the disclosures required by this subpart.

(6) The statement shall contain a notice that each person nominated from the floor must provide in writing all of the disclosures required by this subpart at the meeting(s) at which the nomination is considered.

(e) Other Shareholder Action

(1) If shareholders are asked to vote on matters not normally required to be submitted to shareholders for approval, describe fully the material circumstances surrounding the matter, the reason shareholders are asked to vote, and the vote required for approval of the proposition.

(2) The statement shall describe any other matter that will be discussed at the meeting upon which shareholder vote is not required.

(f) Relationship With Independent Public Accountant

If an institution of the Farm Credit System has had a change or changes in accountants since the last annual report to shareholders, or if a disagreement with an accountant has occurred, the institution shall disclose the information required by § 621.9 (c) and (d) of this chapter.

**§ 620.22 Prohibition against incomplete, inaccurate, or misleading disclosure.**

No employee or director or nominee for director of the institution shall make any disclosure to shareholders with respect to an election that is incomplete, inaccurate, or misleading. When any such person makes disclosure, that, in the judgment of the Farm Credit Administration, is incomplete, inaccurate, or misleading, whether or not such disclosure is made pursuant to this subpart, such institution or person shall, at the direction of the Farm Credit Administration, make such additional or corrective disclosure as is necessary to provide shareholders with full and fair disclosure.

4. A new Part 621 is added to read as follows:

**PART 621 -- ACCOUNTING AND REPORTING REQUIREMENTS**

**Subpart A -- Accounting Requirements**

Sec.

621.1 Purpose and applicability.

621.2 Definitions.

621.3 Generally accepted accounting principles.

621.4 Accrual basis of accounting.

621.5 Nonperforming assets.

621.6 Uncollectible interest on loans and similar assets -- general rules.

621.7 Chargeoff of losses on loans.

621.8 Adjustments to book value of assets.

621.9 Audit by qualified public accountants.

**Subpart B -- Report of Condition and Performance**

621.10 Applicability and purpose.

621.11 Content and standards -- general rules.

621.12 Certification of correctness.

**Authority**: Sec. 5.17 (9) and (10), Pub. L. 99-205.

**Subpart A -- Accounting Requirements**

**§ 621.1 Purpose and applicability.**

This part sets forth accounting requirements to be followed by all banks, associations, and service organizations chartered under the Act, including the Farm Credit System Capital Corporation and its successors. The requirements set forth in this part include both requirements of general application and specific requirements focusing on particular areas of financial condition and operating performance that are of special importance for generating, presenting, and disclosing accurate and reliable information on lending operations.

**§ 621.2 Definitions.**

(a) For the purposes of this part, the following definitions shall apply, subject to the rules of application in paragraph (b) of this section:

(1) "Accrual basis of accounting" means that accounting method in which expenses are recorded when incurred, whether paid or unpaid, and income is recorded when earned, whether received or not received.

(2) "Acquired property" means any real or personal property, other than an interest-earning asset, that has been acquired as a result of liquidation of a loan, either full or partial.

(3) "Adequately secured." A nonperforming loan shall be considered adequately secured only if:

(i) Collateralized by liens having a net realizable value sufficient to discharge the debt in full.

(ii) Guaranteed by a financially responsible party in an amount sufficient to discharge the debt in full.

(4) "Bankruptcy." A loan shall be considered in bankruptcy if the reporting institution has received notice that a petition has been filed with a court of competent jurisdiction by or against the borrower under any chapter of the Federal Bankruptcy Act or similar State statute. A loan shall remain "in bankruptcy" for the purposes of this part until the court's jurisdiction is terminated or relief from the automatic stay is granted that permits collection to proceed fully, and a detailed analysis of the loan supports a reclassification other than a nonperforming status. Such analysis shall consider all pertinent factors and shall be well documented. If a debt adjustment plan has been confirmed by the court, the loan shall be classified as "formally restructured" unless no concessions are granted by the creditor under the plan.

(5) " Borrowing entity" means the individual(s), partnership, joint venture, trust, corporation, or other business entity, or any combination thereof, which is primarily obligated on the loan agreement.

(6) "Contractually past due." A loan shall be considered contractually past due if any principal repayment or interest payment required by the lending agreement is not received on or before the agreed date. A loan shall remain contractually past due until it is formally restructured, or until the entire amount past due, including principal, accrued interest, and penalty interest incurred by virtue of past due status, is collected or otherwise discharged in full.

(7) "Foreclosure." A loan shall be considered in foreclosure if the lender has authorized initiation of proceedings under State law or deed of trust to terminate the borrower's right in any property in which the lender has a security interest. If the lender has received notice that a third party has initiated proceedings under State law or deed of trust to terminate the borrower's right in any property in which the lender has a security interest, the lender shall promptly review the potential impact of the third party actions and classify the loan accordingly. The review shall consider all pertinent factors and the classification shall be well documented in the loan file.

(8) "Formally restructured loans" means loans that are "troubled debt restructurings," as defined in Statement of Financial Accounting Standards No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings, as promulgated by the Financial Accounting Standards Board. After a loan is classified as "formally restructured," it shall continue to be reported as formally restructured until it is fully paid off or otherwise discharged. A renewal or reamortization of the loan at maturity shall not be considered a restructuring, provided:

(i) The financial condition and loan performance of the borrower support renewal; and

(ii) The renewed or reamortized loan is made under the same terms and conditions as are used to make similar loans to other borrowers whose financial condition and performance are sound and not deteriorating.

(9) "Generally accepted accounting principles" shall mean that body of conventions, rules, and procedures necessary to define accepted accounting practice at a particular time, as promulgated by the Financial Accounting Standards Board and other authoritative sources recognized as setting standards for the accounting profession in the United States. Generally accepted accounting principles shall include not only broad guidelines of general application but also detailed practices and procedures that constitute standards against which financial presentations are evaluated.

(10) "Generally accepted auditing standards" shall mean the standards and guidelines adopted by the Auditing Standards Board of the American Institute of Certified Public Accountants to govern the overall quality of audit performance.

(11) "In process of collection." A debt is in process of collection if collection of the debt is proceeding in due course either through legal action, including judgment enforcement procedures, or, in appropriate circumstances, through collection efforts not involving legal action that are reasonably expected to result in repayment of the debt or in its restoration to current status.

(12) "Institution" means any bank, association, or service organization chartered under the Farm Credit Act of 1971, as amended, including the Farm Credit System Capital Corporation and its successors.

(13) "Loan" means any extension of credit or lease resulting from direct negotiations between a lender and a borrowing entity that is recorded as an asset of a reporting institution. The term "loan" includes loans, contracts of sale, notes receivable, and other similar obligations and lease financings. The term "loan" includes loans originated through direct negotiations between the reporting institution and a borrowing entity and loans or interests in loans purchased from another lender.

(14) "Material." The term "material," when used to qualify a requirement to furnish information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable person would attach importance in making shareholder decisions or determining the financial condition of the institution.

(15) "Nonaccrual loans." A loan shall be considered nonaccrual if and so long as:

(i) Any amount of outstanding principal and all past and future interest accruals, considered over the full term of the asset, are determined to be uncollectible for any reason; or

(ii) It has been classified "loss" as a result of a periodic credit evaluation; or

(iii) It is severely past due and not adequately secured, in process of collection, and fully collectible with respect to all principal and interest; or

(iv) It is past due for 180 days or more, without regard to whether it is adequately secured or in process of collection.

(16) "Nonperforming assets" means nonperforming loans and acquired property as defined in this part.

(17) "Nonperforming loans" means nonaccrual, formally restructured, other restructured and reduced rate and other high risk loans, as defined in this part.

(18) "Other high risk loans" means all loans that:

(i) Have been classified "vulnerable" as a result of a periodic credit evaluation; or

(ii) Are past due 90 days or more but less than 180 days, but adequately secured and in process of collection; or

(iii) Are in process of collection, bankruptcy, or foreclosure; or

(iv) Are in severe default; or

(v) Do not meet the other criteria of this paragraph for classification as other high risk loans, but management has information that causes serious doubt as to the borrower's willingness or ability to perform in accordance with the terms and conditions of the loan agreement.

(19) "Other restructured and reduced rate loans" shall have the same meaning as formally restructured loans except that the concessions granted to the borrower have not been incorporated into the contractual terms and conditions of the loan by amendment or other revision. A loan shall continue to be classified as other restructured or reduced rate until the reporting institution, after a well-documented analysis of all pertinent factors, determines that it should be reclassified.

(20) "Performing loans" means all loans not identified as nonperforming under the definitions and standards established in this part.

(21) "Qualified public accountant" shall mean a person who:

(i) Holds a valid and unrevoked certificate, issued to such person by a legally constituted State authority, identifying such person as a certified public accountant; and

(ii) Is licensed to practice as a public accountant by an appropriate regulatory authority of a State or other political subdivision of the United States; and

(iii) Is in good standing as a certified and licensed public accountant under the laws of the State or other political subdivision of the United States in which is located the home office or corporate office of the institution that is to be audited; and

(iv) Is not suspended or otherwise barred from practice as an accountant or public accountant before the U.S. Securities and Exchange Commission or any other appropriate Federal or State regulatory authority; and

(v) Is independent of the institution that is to be audited. For the purposes of this definition the term "independent" shall have the same meaning as under the rules and interpretations of the American Institute of Certified Public Accountants.

(22) "Severe default." A loan shall be considered in severe default if:

(i) The borrower does not perform in accordance with any term(s) or condition(s) or other obligation(s) set forth or incorporated by reference into the loan agreement; and

(ii) The borrower's failure to perform in accordance with the loan agreement increases the lender's risk exposure on the loan to a level that reduces or threatens to reduce the current or prospective value of the loan as a financial asset.

(23) "Severely past due loans." A loan shall be considered severely past due if any portion thereof is contractually due and uncollected for a period of 90 days or more with respect to principal, interest, or both.

(24) "Vulnerable" shall have the same meaning as under § 614.4051(a)(4(iii) of this chapter.

(b) Rules for applying definitions.

(1) Acceptable tolerances in determining amounts contractually past due. For purposes of this part, earned and contractually due but uncollected amounts may be considered paid in full if:

(i) At least 90 percent of all contractually due principal and interest has been collected; and

(ii) No more than a combined total of $100 of contractually due principal and interest remains uncollected.

However, amounts collected in successive partial payments or other credits shall be applied to the oldest contractually past due amount until it is paid in full, then to the next oldest past due amount until it is paid in full, and so on until the total amount of the partial collection(s) is exhausted.

(2) Rule of aggregation. For the purposes of determining performance status under this part, all loans on which a borrowing entity, or a component of a borrowing entity, is primarily obligated to the reporting institution shall be considered as one loan unless a review of all pertinent facts supports a reasonable determination that a particular loan constitutes an independent credit risk and such determination is adequately documented in the loan file.

**§ 621.3 Generally accepted accounting principles.**

Each institution of the Farm Credit System shall:

(a) Prepare and maintain accurate and complete records of its business transactions as necessary to prepare financial statements and reports, including reports to the Farm Credit Administration, in accordance with generally accepted accounting principles, except as otherwise directed by statutory and regulatory requirements;

(b) Prepare its financial statements and reports, including reports to the Farm Credit Administration , in accordance with generally accepted accounting principles, except as otherwise directed by statutory and regulatory requirements or otherwise required by the Farm Credit Administration ; and

(c) Prepare and maintain its books and records in such a manner as to facilitate reconciliation with financial statements and reports prepared from them.

**§ 621.4 Accrual basis of accounting.**

Each institution of the Farm Credit System shall use the accrual basis of accounting in the preparation and maintenance of its accounting records, and in the preparation of its financial statements, including interim statements that are;

(a) Used for internal management purposes;

(b) Used by the board of directors;

(c) Prepared to meet Farm Credit Administration reporting requirements; and

(d) Prepared for shareholders and investors.

**§ 621.5 Nonperforming assets.**

(a) Each institution of the Farm Credit System shall:

(1) Account for, report, and disclose to shareholders, investors, board of directors, and the Farm Credit Administration all material items with respect to nonperforming assets, in accordance with the rules and definitions set forth in this part and such other requirements as may be prescribed by the Farm Credit Administration ;

(2) Develop, adopt, and apply policies governing nonperforming assets, which, at a minimum, conform to the definitions, rules, and standards set forth in this part and such other requirements and procedures as may be required by the Farm Credit Administration ;

(3) Review at least quarterly all loans to:

(i) Determine their performance status in accordance with the definitions in this part; and

(ii) Determine the collectibility of accrued but uncollected income, if any.

(4) Recognize interest income from informally restructured loans and similar assets on its books and records and on its financial statements when received in cash or cash equivalents, or at a rate of accrual lower than the contractual rate and consistent with amounts that the institution may reasonably expect to collect given the material facts of the borrower's situation.

(b) Measures taken to enhance the collectibility of a loan shall not be deemed to relieve an institution of the requirement to monitor and evaluate the loan for the purpose of determining its performance status.

**§ 621.6 Uncollectible interest on loans and similar assets -- general rules.**

(a) Each institution of the Farm Credit System shall employ the following practices with respect to charging off earned but uncollected interest income on loans, leases, contracts, and similar assets:

(1) Earned but uncollected interest income that was accrued in the current fiscal year and is determined to be uncollectible shall be reversed from interest income.

(2) Earned but uncollected interest income that was accrued in prior fiscal years and is determined to be uncollectible shall be charged off against the allowance for loan losses.

(b) Notwithstanding the above, the following types of income shall, at a minimum, be classified as uncollectible:

(1) Earned but uncollected interest on any loan, if any portion thereof is severely past due and the loan is not adequately secured;

(2) Earned but uncollected interest on any loan, lease, or similar investment that is not adequately secured and on which the institution has commenced legal action to acquire title to, secure possession of, or force liquidation of the underlying collateral security, or to otherwise enforce performance on the loan by the borrower;

(3) Earned but uncollected interest on any loan that is not adequately secured on which the institution has received notice that the borrower's bankruptcy petition, or similar pleading, has been filed with a court of competent jurisdiction; and

(4) Earned but uncollected interest on loans that are being or have been restructured, but such interest is not explicitly included in the principal amount of the restructured loan.

**§ 621.7 Chargeoff of losses on loans.**

Each institution of the Farm Credit System shall:

(a) Charge off loans, wholly or partially as appropriate, at the time they are determined to be uncollectible; and

(b) Apply generally accepted accounting principles, or regulatory requirements where appropriate, consistently in all material aspects of recognizing, estimating, and recording chargeoffs; and

(c) Maintain at all times an allowance for loan losses that is in accordance with statutory and regulatory requirements and, at a minimum, is adequate to absorb all loses that may be reasonably expected to exist in the loan portfolio; and

(d) Develop, adopt, and apply policies governing the establishment and maintenance of the allowance for loan losses which, at a minimum, conform to the rules and definitions, and standards set forth in this part and such other requirements as may be prescribed by the Farm Credit Administration.

**§ 621.8 Adjustments to book value of assets.**

When an institution, or the district bank in which it is a shareholder, if any, or the Farm Credit Administration determines that the value of a loan or other asset recorded on its books and records exceeds the amount that can be reasonably expected to be collectible, or that the documentation supporting the recorded asset value is inadequate:

(a) The institution shall immediately charge off the asset in the amount determined to be uncollectible.

(b) If the amount determined to be uncollectible by the institution or its district bank in which it is a shareholder, if any, is different from the amount determined to be uncollectible by the Farm Credit Administration, the institution shall charge off such amount as the Farm Credit Administration shall direct.

**§ 621.9 Audit by qualified public accountant.**

(a) Each institution of the Farm Credit System shall, at least annually, have its financial statements audited by a qualified public accountant in accordance with generally accepted auditing standards.

(b) The qualified public accountant's opinion of each institution's financial statements shall be included as a part of each annual report to shareholders.

(c) Disagreements with accountant's opinion. If an institution of the Farm Credit System disagrees with the opinion of a qualified public accountant provided under the requirements of paragraph (b) of this section, the following actions shall be taken immediately:

(1) The institution shall prepare a brief but thorough written description of the scope and content of the disagreement, noting each point of disagreement and citing, in all cases, the specific provisions of generally accepted accounting principles and generally accepted auditing standards upon which the institution's position in the disagreement is based;

(2) A copy of the institution's final description of the disagreement shall be given to the accountant who provided the opinion with which the institution disagrees;

(3) The accountant shall have 10 business days to develop and provide a brief but thorough final response to the institution's description of the disagreement, including all items believed to be incorrect or incomplete, and citing, in all cases, the specific provisions of generally accepted accounting principles and generally accepted auditing standards upon which the accountant's position in the disagreement is based;

(4) Both the institution's final description of the disagreement and the accountant's final response to it shall be included in the institution's annual report to shareholders directly following the accountant's opinion of the institution's financial statements; and

(5) The institution shall immediately notify the Chief Examiner, Farm Credit Administration, of any disagreement with its accountant and shall furnish the Farm Credit Administration the written documentation required by paragraphs (c)(1) through (4) of this section.

(d) Changes in qualified public accountants. If an institution of the Farm Credit System selects a qualified public accountant to audit its financial statements and provide an opinion thereon for its annual report who is different from the accountant whose opinion appeared in the institution's most recent annual report, the following items shall be sent to the Farm Credit Administration no later than 15 days after the end of the month in which the change took place and shall be included in the institution's annual meeting information statement and annual report to shareholders for the year in which the change of accountants took place:

(1) The name and address of the accountant whose opinion appeared in the institution's most recent annual report to shareholders;

(2) A brief but thorough statement of the reasons the accountant selected for the most recent annual report was not selected for the current annual report. If the change resulted from a disagreement with the accountant, the statement shall describe the institution's disagreement with the accountant's opinion and the accountant's final response to the institution's disagreement prepared pursuant to paragraph (c) of this section; and

(3) The identification of the highest ranking officer, committee of officers, or board of directors, as appropriate, that recommended, approved, or otherwise made the decision to change qualified public accountants.

**Subpart B -- Reports of Condition and Performance**

**§ 621.10 Applicability and purpose.**

(a) Each institution of the Farm Credit System shall prepare and file such reports of condition and performance as may be required by the Farm Credit Administration.

(b) Reports of condition and performance shall be filed four times each year, and at such other times as the Farm Credit Administration may require. The reports shall be prepared on the accrual basis of accounting and shall fairly represent the financial condition and performance of each institution at the end of, and over the period of, each calendar quarter, provided that such additional reports as may be necessary to ensure timely, complete, and accurate monitoring and evaluation of the affairs, condition, and performance of Farm Credit institutions may be required, as determined by the Chief Examiner, Farm Credit Administration.

(c) All reports of condition and performance shall be filed with the Farm Credit Administration, Office of Administration, Management Information Division, 1501 Farm Credit Drive, McLean, Virginia, 22102-5090.

**§ 621.11 Content and standards -- general rules.**

Each institution of the Farm Credit System shall prepare reports of condition and performance:

(a) In accordance with all applicable laws, regulations, standards, and such instructions and specifications and on such media as may be prescribed by the Farm Credit Administration;

(b) In accordance with generally accepted accounting principles and such other accounting requirements, standards, and procedures as may be prescribed by the Farm Credit Administration; and

(c) In such manner as to facilitate their reconciliation with the books and records of reporting institutions.

**§ 621.12 Certification of correctness.**

Each report of financial condition and performance filed with the Farm Credit Administration shall be certified as having been prepared in accordance with all applicable regulations and instructions and to be a true and accurate representation of the financial condition and performance of the institution to which it applies. The reports shall be certified by the officer of the reporting institution named for that purpose by action of the reporting institution's board of directors. If the board of directors of the institution has not acted to name an officer to certify the correctness of its reports of condition and performance, then the reports shall be certified by the president or chief executive officer of the reporting institution.

**Marvin Duncan,**

Acting Chairman.

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