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| **Title:** | **PROPOSED RULE--Loan Policies and Operations; Definitions; Lending Authorities, Appraisal Standards, Participations, and Lending Limits--12 CFR Parts 614 and 619** |
| **Date of Issuance:** | **1/23/1991** |
| **Agency:** | **FCA** |
| **Federal Register Cite:** | **56 FR 2452** |

FARM CREDIT ADMINISTRATION

12 CFR Parts 614 and 619

RIN 3052-AB13

Loan Policies and Operations; Definitions; Lending Authorities, Appraisal Standards, Participations, and Lending Limits

**ACTION:** Proposed rule.

**SUMMARY:** The Farm Credit Administration (FCA), by the Farm Credit Administration Board, republishes for comment proposed amendments (reproposed regulations) to 12 CFR part 614 relating to lending limits, appraisals, and loan participations previously proposed on November 3, 1988, [53 FR 44438](file://fcahome/DavWWWRoot/readingrm/fedreg/Federal%20Register%20Documents/53%20FR%2044438.docx) (proposed regulations). The proposed amendments would have implemented the Agricultural Credit Act of 1987 (1987 Act) (Pub. L. 100-233) (which authorized the creation of new corporate entities) established appraisal standards for Farm Credit System (FCS) lending institutions, and established lending limits for new entities.

The effect of the reproposed regulations on lending limits would be to lower the existing and previously proposed lending limits to 20 percent of capital for all FCS direct lender institutions except banks for cooperatives (BCs), provide for exceptions to the lending limitation, provide rules for the attribution of loans to separate but related borrowers and address "single borrower" determinations. The effect of the reproposed regulations establishing appraisal standards would be to bring FCA appraisal standards more in line with appraisal standards adopted by other bank regulatory agencies under the Financial Institutions Recovery, Reform, and Enforcement Act of 1989 (FIRREA). The effect of the reproposed loan participation regulations would be to alter certain regulatory constraints on participation authorities contained in existing and proposed regulations, including the deletion of certain FCA prior approval requirements, and to adopt implementing regulations for the authority to purchase and sell interests in loans other than participation interests. The reproposed regulations address the sale of loans to a pooler certified by the Federal Agricultural Mortgage Corporation (Farmer Mac) and the sale of interests in loans to other institutional lenders that are not FCS institutions.

**DATES:** Written comments must be received on or before March 25, 1991.

**ADDRESSES:** Submit any comments in writing (in triplicate) to Anne E. Dewey, General Counsel, Farm Credit Administration, McLean, Virginia 22102-5090. Copies of all communications received will be available for examination by interested parties in the Office of General Counsel, Farm Credit Administration.

**FOR FURTHER INFORMATION CONTACT:**

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or

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**SUPPLEMENTARY INFORMATION:**

**I. General**

On November 3, 1988, the FCA published a proposed rule ([53 FR 44438](file://fcahome/DavWWWRoot/readingrm/fedreg/Federal%20Register%20Documents/53%20FR%2044438.docx)) implementing changes resulting from the amendment of the Farm Credit Act of 1971 (1971 Act) by the 1987 Act relating to borrower eligibility and the lending authorities of FCS institutions. The 1987 Act authorized the creation of new corporate entities from mandatory and voluntary mergers and the transfer of long-term real estate lending authorities from Farm Credit Banks (FCBs) to certain associations and directed the FCA to reconcile the authorities of the resulting institutions. These changes required amendments to FCA regulations to reflect the structural changes and the lending authorities of new entities. Other provisions of parts 613, 614, 615, 618 and 619 were proposed to be amended to make conforming changes and to eliminate a number of FCA prior approvals, including provisions relating to lending limits, appraisals, and loan participations.

Many of the amendments proposed on November 3, 1988, were adopted as final regulations on June 19, 1990. Among the proposed amendments that were not adopted at that time were those related to lending limits, appraisals and loan participations. As a result of its consideration of comments received on those proposals and related issues, the FCA concluded that more substantive adjustments requiring additional comment should be proposed. Therefore, the FCA today reproposes amendments to its regulations relating to appraisal standards, sale and purchase of loans (including loan participations), and lending limits. Amendments proposed on November 3, 1988, ("proposed regulations") comments received on the proposed regulations, and the regulations reproposed today ("reproposed regulations") are described below.

**II. Subpart F -- Appraisal Standards**

**A. General**

Existing regulations require primary real estate security to be valued on the basis of appraised value and primary chattel security or additional security to be valued on the basis of recovery value, but do not prescribe how or by whom such appraisals must be done. The proposed regulations would have required FCS banks and associations to develop a more structured and uniform collateral appraisal process that would conform to the uniform standards of the appraisal industry, be independent of the loan-making decision, and utilize three valuation approaches (cost, income, and comparable sales). The proposed regulations would have required each bank and association board to develop policies governing appraisal standards and standards for the qualification of staff and fee appraisers, but did not prescribe such standards in the regulations.

A number of comments were received on the proposed regulations, the majority of which related to the requirement that the appraisal process be independent of the loan-making process. An appraisal industry group expressed unqualified support for the independence of the appraisal process from the credit decision. Other respondents agreed in theory, but specific concerns relating to efficiency of operations and the potential increase in costs to borrowers were expressed by all respondents but one.

BCs expressed opposition to the proposed application of the requirements to BCs, contending that their commercial bank competitors are not subject to such requirements and the additional cost would be a competitive disadvantage. Also BCs asserted that book value is more reliable than appraised value because of the limited availability of appraisers with the necessary expertise to evaluate the complex and sometimes unique operations financed by the BCs.

While the comments were under consideration, Congressional interest in accurate appraisals was elevated by extensive losses in the thrift industry, which Congress addressed in FIRREA. FIRREA prescribed appraisal standards and appraiser qualifications for all Federally related real estate loans and required bank regulatory agencies to prescribe regulations implementing these provisions. Although not subject to these requirements, the FCA supports the Congressional policy reflected in FIRREA, and now proposes to adopt, in lieu of the proposed regulations, amendments to subpart F of part 614 relating to appraisals. The reproposed amendments closely parallel in most respects the appraisal regulations adopted by other Federal financial institution regulatory agencies.

Although the appraisal is but one of several components of a sound credit judgment and should not alone dictate the credit decision, appraisals that accurately reflect the value of the collateral are essential to the safe and sound exercise of the lending authorities vested in FCS institutions. The soundness of loans and investments collateralized by real estate, personal, and intangible property depends in large degree upon the adequacy and accuracy of the analysis used in support of the appraisal. The amendments are reproposed to ensure that real estate, personal, and intangible property appraisals are performed in accordance with uniform standards by individuals with relevant training and experience whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. The amendments are reproposed in the interest of improving the quality of appraisals supporting the credit decisions of FCS institutions.

The reproposed amendments to subpart F would expand the requirements of existing regulations and the proposed regulations, in that they would prescribe minimum appraisal standards and standards for appraiser qualifications, but take into account the comments on the earlier proposal to the extent possible. The reproposed amendments, like the proposed regulation, would require the appraisal process to be independent of the credit decision, but would make some adjustments to the previous proposal in response to the practical concerns of some of the smaller associations. (See discussion below under "C. Appraiser Independence and Objectivity"). The reproposed regulations would not prescribe when collateral must be required. The institution's board would be required to adopt policies prescribing collateral requirements, consistent with statutory and regulatory requirements and prudent lending standards.

The requirements of the reproposed regulation would apply to all FCS direct lenders, including BCs, in any instance in which real estate, personal property, and/or intangibles are used as collateral for a loan, except that certain requirements would not apply when such collateral is taken solely out of an abundance of caution. "Abundance of caution" is intended to describe those circumstances in which the institution takes the collateral when collateral is not required by statute and a prudent lender would make the loan without requiring such types of collateral, after evaluating the application on each of the five credit factors relevant to a sound loan, as set forth in 12 CFR 614.4160. In order to qualify for the abundance of caution exceptions, the institution would be required to document in the loan file the approval of the application on the strength of the five credit factors without considering the collateral.

The FCA believes that BCs should be subject to the same requirements as other direct lenders. The FCA considers the accuracy of appraisals to be an essential component of prudent lending and vital to the institution's safety and soundness. Accurate appraisals are even more important for large, complex loans than for smaller loans. The FCA does not agree with the assertion that the availability of appraisers with relevant experience is so limited that book value would be a more reliable indicator of value than appraised value. The production credit associations (PCAs) and FCBs have historically provided credit, supported by collateral appraisals, to large, highly complex operations that have facilities and seasonal collateral similar to the types encountered in lending to cooperatives. Furthermore, contrary to the respondent's assertion, commercial banks that compete with BCs have been and will continue to be subject to similar appraisal requirements for the types of loans that BCs make. Consequently, the reproposed regulation should result in no competitive disadvantage to the BCs.

***B. Appraisal Standards***

The reproposed regulation would require that all appraisals used to support credit decisions of FCS institutions engaged in lending or leasing be performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) adopted by the Appraisal Foundation and that any departures from the standards be in accordance with the departure provisions of USPAP. However, under the reproposed regulation the departure provisions could only be used for: (1) Appraisals for loans with transaction values of $50,000 or less; (2) for collateral taken out of an abundance of caution; or (3) for subsequent transactions resulting from a maturing extension of credit when no new funds are advanced, the borrower has performed satisfactorily, and there has been no deterioration in the borrower's credit standing or the property or market conditions that would threaten the institution's collateral position. The reproposed regulation would require the board of directors of each institution to adopt policies and standards governing appraisals of real, personal, and intangible property and qualifications of appraisers that are consistent with USPAP and the requirements of the regulation. Federal land bank associations (FLBAs) would be required to adopt appraisal policies in compliance with the policies of their respective Farm Credit Banks. Definitions used in the reproposed regulations are consistent with USPAP, which is becoming an industry standard as a result of FIRREA.

The reproposed regulation would set forth specifically the following basic requirements of USPAP that are applicable to appraisals of real, personal, and intangible property. All appraisals would be required to:

(1) Conform to the USPAP standards adopted by the Appraisal Foundation except where departure is allowed under the regulation and warranted under the departure provision of USPAP, which permits departure only if it is clearly and accurately set forth in the appraisal and would not result in confusing or misleading results.

(2) Disclose the steps taken to comply with the competency provision of the USPAP, which requires that an appraiser have the knowledge and experience necessary to complete an assignment or disclose the lack of knowledge and experience and take steps to complete the appraisal in a competent manner;

(3) Value the subject property in its "as is" condition based upon "market value," as defined;

(4) Be written and presented in a format that satisfies the requirements of this subpart; be sufficiently descriptive to enable the reader to ascertain the estimated market value and the rationale used to support the estimate; provide sufficient detail and depth of analysis to reflect the complexity of the property appraised; deduct and discount applicable adjustments to the subject property for conditions that would have a negative impact on the value of the property, including but not limited to condition of the facilities and property, specialization of the operation, and potential environmental impact concerns;

(5) Address the purpose for which the property will be used and the property's highest and best use if different from the intended use;

(6) Include in the certification required by the USPAP an additional statement that the appraisal assignment was not based on a requested minimum valuation or specific valuation or approval of a loan; and

(7) Contain sufficient supporting documents with all pertinent information reported so that the appraiser's logic, reasoning, judgment and analysis in arriving at a conclusion indicate to the reader the reasonableness of the market value reported. The reproposed regulation would require the legal description of the real property to be included in the appraisal in addition to, and not in lieu of, the description required in USPAP.

***C. Appraiser Independence and Objectivity***

The reproposed amendments would require all appraisals of property that serves as the collateral for a loan to be performed by a "qualified appraiser" who is not engaged in the marketing, lending, collections, or credit decision processes of the institution or an institution under common management, and who has no direct or indirect interest in the transaction of the property that is the subject of the appraisal (subject property). The independence restriction would apply to any officers and directors of an institution who participate in the marketing, lending, collection, or credit decision processes as well to other employees of the institution. The regulation would also not allow the appraisal to be performed by any employee involved in the credit decision process of a FCS institution to which an interest in the loan is to be sold. Reproposed subpart H of part 614 would prohibit an employee of a FCS institution from participating in the decision to purchase an interest in a loan for which the employee has performed an appraisal.

In response to some of the practical concerns of smaller associations that it would be difficult to find sufficient qualified appraisers if independence of the loan-making function were to be required, the reproposed regulation would allow an exception for transactions with values of $50,000 or less where the only qualified persons available to perform an appraisal are involved in the marketing, lending, collections, or credit decision processes of the institution. In these circumstances the reproposed regulation would allow such individuals to perform the appraisal if the institution takes appropriate steps to ensure that the appraiser exercises independent judgment and that the appraisal is objective. Under the reproposed regulation, such steps must include, at a minimum, adopting procedures for ensuring that an individual does not perform appraisals in connection with transactions in which the appraiser is otherwise involved, professionally or personally, and prohibiting directors, officers, and employees from participating in any vote or approval involving assets on which they have performed an appraisal.

This exception is proposed because the FCA recognizes that in some smaller associations it may not be economically feasible to maintain a separate appraisal staff, and that a loan officer or other official of the institution maybe the best qualified individual to perform appraisals in some circumstances. However, because of the importance of an independent and objective appraisal to a sound credit decision, the exception is limited to smaller transaction values with less risk. Appraisals involving transaction values in excess of $50,000 would require strict adherence to the independence requirements. The FCA believes that adequate appraisal services are available to satisfy these requirements without significant economic or operational hardships if institutions avail themselves of the services of fee appraisers, regional appraisers, and staff appraisers from other FCS institutions (including bank staff appraisers). Although these requirements may increase costs to borrowers in the short term, the FCA believes that prudent lending requires that the inherent conflict that is present when appraisals are performed by individuals involved in the credit decisions be minimized or eliminated. However, it is not the intention of the FCA in proposing the independence requirement to remove the loan officer from the review of collateral, since farm visits and collateral inspections are considered an integral part of proper credit administration.

The reproposed regulation would also prohibit the performance of an appraisal by any individual having any direct or indirect interest in the property, financial or otherwise. The purpose of this requirement is to ensure that the objectivity of the appraiser is not compromised because of a personal interest in the transaction or the subject property. Owning all or part of the subject property is an obvious example of a direct financial interest. Owning property adjacent to the subject property or other property whose value is likely to be affected by the appraisal is an example of an indirect financial interest. The prohibition would also extend to nonpecuniary interests, such as a relationship with the applicant that would undermine the objectivity of the appraiser.

In addition to the reproposed regulations addressing appraiser independence in subpart F of part 614, the reproposed regulations also provide a definition for an "independent appraiser" as the term is used in subpart L of part 614 "Actions on Applications; Review of Credit Decisions." As described in § 614.4443-Review process an applicant for a loan, or a borrower who has applied for a restructuring, may, as part of the request for a review, request an independent appraisal, by an independent appraiser, of any interests in property securing the loan (other than the stock or participation certificates of the lender held by the borrower).

For the purposes of subpart L, an "independent appraiser" would be defined as an appraiser who is a State-certified, State-licensed, designated, or an accredited appraiser, and who qualifies under the standards established by the FCS institution for the type of property to be appraised. Such an appraiser may not be a FCS institution employee or have a relationship with the institution or any of its officers or directors that contravenes the provisions of part 612, subpart B. In addition, § 614.4443 is proposed to be amended to further clarify requirements for use of an "independent appraiser" and the role of the independent appraiser for the purposes of subpart L of part 614. The proposed regulation would also require appraisals completed pursuant to subpart L to be performed in compliance with the requirements of subpart F of part 614 relative to appraisal standards, appraiser independence and appraiser qualifications.

***D. Appraiser Qualifications***

The reproposed regulation would impose the following minimum qualification requirements:

(1) All appraisals would be required to be performed by a "qualified appraiser" who meets the independence requirements. A "qualified appraiser" is defined as one who is competent, reputable, impartial and has sufficient training and experience in appraising property of the type that is the subject of the appraisal to perform a competent appraisal.

(2) For transactions with "transaction values" of $50,000 or less, there would be no additional requirements.

(3) For transactions with "transaction values" of over $50,000 and up to and including $250,000, the appraisal would be required to be performed by a State-certified appraiser, a "designated appraiser" or a State-licensed appraiser.

(4) For transactions with "transaction values" of over $250,000 and less than $1,000,000, the appraisal would be required to be performed by a designated appraiser or a State-certified appraiser.

(5) For transactions with "transaction values" of $1,000,000 or more, the appraisal would be required to be performed by a State-certified appraiser.

(6) Regardless of the transaction value, where the property is not the primary security but is taken as collateral solely out of an abundance of caution and the terms of the transaction as a consequence have not been made more favorable than they would have been in the absence of the lien, the appraiser must only be qualified and meet the institution's standards and the independence requirement.

(7) For subsequent transactions resulting from a maturing extension of credit, regardless of transaction value, the appraiser must only be qualified and meet the independence requirement, provided: (1) The borrower has performed satisfactorily; (2) no new funds are advanced except as originally agreed; (3) the credit standing of the borrower has not deteriorated; and (4) there has been no material deterioration in market conditions of the physical aspects of the property that would threaten the institution's collateral position.

These requirements are summarized in Table 1:

**Table 1. -- Appraiser Qualifications and Independence**

|  |  |  |
| --- | --- | --- |
| Transaction levels | Qualifications  (minimum) 1 | Independence  required |
| All appraisals -- real, personal, and intangible property. | Qualified........................................ | Yes. |
| Real property -- $1,000,000 and over. | Qualified and state-certified | Yes. |
| Real property -- over $250,000 and less than $1,000,000. | Qualified and state-certified or designated 2 | Yes. |
| Real property -- over $50,000 to $250,000. | Qualified and state-certified designated, 2 or state-licensed. | Yes. |
| Real property -- $50,000 and less. | Qualified....................................... | Objectivity procedure. |
| Abundance of caution. | Qualified....................................... | Objectivity procedures. |
| Personal property and intangibles | Qualified....................................... | Objectivity procedures. |

1 Minimum Qualification requirements would become effective January 1, 1992.

2 "Designated appraiser" satisfies the "State-Certified" requirement only until January 1, 1994.

"Designated appraiser" would be defined as a qualified appraiser who has successfully completed at least the minimum educational and experience requirements to be State licensed and, in addition, 60 course hours of agricultural real estate appraisal training in specified subjects, which courses must be recognized by the State-licensing authority for licensing or accreditation. A "State-certified appraiser" would be defined as an individual who has been certified as having met the requirements for certification by any State or territory whose certification criteria meet or exceed the minimum criteria for certification issued by the Appraiser Qualification Board of the Appraisal Foundation. A "State-licensed appraiser" would be defined as any individual who has satisfied the requirements for licensing and has been licensed as a real estate appraiser by a State or territory in which the licensing procedures comply with the licensing criteria of the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (FFIEC). For loans, "transaction value" would be defined as the amount of the loan and/or any unfunded commitment; for leases, sales, purchases, and investments in or exchanges of real property, "transaction value" would be defined as the market value of the real property. Where loans are purchased or sold in a group, the transaction would be the individual credit transaction rather than the aggregate value of the sale transaction.

Exceptions to the requirements for State-licensed, designated or State-certified appraisers for transaction values of $50,000 or less are proposed in recognition of the lower degree of risk associated with smaller loans and in response to the concerns over cost and availability of appraisers. Such an exception is consistent with the position taken in recently adopted regulations on appraisal standards by the Federal Reserve Board, the Office of the Comptroller's (OCC), and the Federal Deposit Insurance Corporation's (FDIC) (55 FR 27762, July 5, 1990; 55 FR 34684, August 24, 1990; and 55 FR 33879, August 20, 1990 respectively). However, for transaction values of $50,000 or less, appraisers must be "qualified appraisers" and meet the institution's standards for appraiser qualifications.

Unlike the regulations of the other Federal bank regulatory agencies, the FCA's reproposed regulation would allow appraisals for transaction values of over $50,000 and up to and including $250,000 to be performed by a "designated appraiser." This term is not used in the regulations of other agencies and is proposed as a temporary relaxation of the requirement that appraisals for transactions with values of over $250,000 be performed by a State-certified appraiser, in recognition of the practical difficulty institutions may have in securing the services of State-certified appraisers during the implementation of FIRREA appraisal requirements and the adoption of State-certification programs. The "designated appraiser" option is proposed as an interim step and would cease to be effective January 1, 1994. At that time all real estate appraisals of $250,000 or more would be required to be performed by a State-certified appraiser.

It is anticipated that the requirement that all appraisers be both qualified and licensed or certified would result in certified appraisers and licensed appraisers that are competent to perform commercial appraisals and also possess sufficient unique agricultural appraisal experience as necessary to satisfy an institution's requirements for competent appraisers to meet the institution's appraisal needs.

Although these requirements may result in increased costs to the institution, the FCA believes that these costs will be offset by savings realized through better risk identification and control.

***D. Valuation Methods***

Existing regulations require real estate collateral to be valued on the basis of appraised value and personal property to be valued on the basis of "recovery value." The proposed regulation would have required both real and personal property to be valued on the basis of market value. The reproposed regulation would also require real, personal, and intangible property to be valued on the basis of market value, but would impose standards and use definitions more consistent with uniform industry standards and terminology than existing regulations or than the previously proposed regulations.

**(1) *Real Property***

For appraisals of real property, the previously proposed amendments would have required the appraiser to consider the cost, income, and comparable sales approaches to valuation and to explain in the appraisal why any of the three approaches not used were not completed. The reproposed regulation would require the appraiser to document two approaches -- the income capitalization approach and either the cost approach or the comparable sales approach.

Respondents to the previous proposal objected to having to perform more than one approach because of the increased cost to the institution. Although the FCA recognizes that this requirement may result in some additional cost, this cost should be more than offset by the benefits of better identification of risk and control of potential losses. This requirement is contained in the standards of USPAP, which will become an industry standard as a result of FIRREA.

In responding to the previously proposed amendments, some associations expressed considerable support for the benchmark system (a form of sales comparison approach where the comparable is a single property rather than several properties and adjustments are made for the differences in the subject property from the comparable, or benchmark) based on their past experience. A benchmark system could be recognized as a form of the comparable sales approach, which is one of the three permitted approaches, provided the institution maintains a current market evaluation of the benchmark properties supplemented with sales data developed from ongoing sales comparisons.

**(2) *Appraisal of Personal Property and Intangibles***

Existing regulations require the use of recovery value for personal property collateral. Recovery value is defined as the amount the lender should realize from a sale of the property on reasonable terms less estimated maintenance, selling costs, and prior liens and encumbrances, at the date of inspection or appraisal. While the recovery value may be a more accurate reflection of what will actually be realized on the collateral, the FCA has concluded there is merit in making the basis for valuation consistent for real, personal, and intangible property and consistent with industry standards. Therefore, the reproposed regulation would require personal property, as well as intangibles, to be valued on the basis of a market value. Under USPAP standards the "market value" of certain types of personal property, involving transportation costs or related expenses normally associated with the marketing of such products includes consideration for such factors and costs as part of the "market value." While the reproposed regulations would discontinue the use of recovery value as the required basis for valuing personal property, the FCA believes that institutions still need to consider what can actually be recovered (as a net realizable value) in making their credit decisions.

The term personal property is intended to include movable chattels, except that collateral closely aligned with, an integral part of, and normally sold with real estate (fixtures) may be included in the value of the real estate. All other collateral associated with real estate but designated as personal property must be appraised as personal property. Such appraisals must describe the property, including its location, and must include a review and description of the legal documents supporting the property interests and marketability of the intangible property.

**III. Subpart H -- Purchase and Sale of Interests in Loans**

Proposed changes to Subpart H -- Participations where published for comment on November 3, 1988, largely to reflect structural changes made by the 1987 Act. Comments were received urging additional amendments not proposed for comment. As a result of these comments and the need to address issues related to the authority to purchase and sell interests in loans and the authority to pool and securitize loans under title VIII of the 1971 act, the FCA is reproposing amendments to subpart H that would result in a more extensive revision than previously proposed. The reproposed revision would address, in addition to loan participations, the purchase and sale of interests in loans other than participation interests and issues related to subordinated participation interests and cash reserves required under title VIII of the 1971 Act when loans are sold into the Farmer Mac program. These reproposed regulations take into consideration comments on the previously proposed regulations by the former Farm Credit Corporation of America (FCCA) as well as two Farm Credit Banks, a bank for cooperatives and an individual.

The reproposed regulations address sales and purchases of interests in loans generally and treat loan participations as a subcategory of interests in loans. It is necessary to make a distinction because the authority to sell and purchase interests in loans is granted separately from the authority to enter into loan participations and is more restricted. The authority to purchase and sell interests in loans is also granted separately and predates the authority to pool and securitize loans and sell loans to a pooler certified by Farmer Mac, which was granted by the 1987 Act.

***A. Authorities***

While the 1971 Act authorizes all direct lender FCS institutions to sell loan participations to, and purchase loan participations from lending institutions that are not FCS institutions, it only authorizes FCBs and direct lender associations to purchase interests in loans other than participation interests from institutions that are not FCS institutions and only for the purpose of conducting a pooling operation under title VIII of the 1971 Act. BCs are not authorized to purchase or sell interests in loans other than participation interests from non-FCS institutions. While the 1971 Act authorizes all FCS direct lenders except BCs to sell loans to poolers certified by Farmer Mac that are not FCS institutions, only the FCB has statutory authority to sell interests in loans to lending institutions that are neither FCS institutions nor poolers certified by Farmer Mac. The statutory authority of production credit associations to purchase and sell interests in loans other than participation interests is restricted to engaging in such transactions with banks of the FCS when authorized by their respective funding banks. However, the 1971 Act directs the FCA to reconcile authorities between the FCB and transferee associations (namely Federal land credit associations (FLCAs) and agricultural credit associations (ACAs)).

The reproposed regulation would amend part 614, subpart A of existing regulations to set forth the authorities of FCS institutions to sell and purchase interests in loans other than participation interests and would reconcile authorities between the FCB and an association to which it transfers direct long-term lending authority under § 7.6 of the 1971 Act. The FCA proposes to reconcile these authorities in the following manner:

Transferee FLCAs and ACAs would receive loan-related authorities such as participation authority and authority to sell interests in long-term real estate loans to lending institutions other than FCS institutions and Farmer Mac poolers. However, a transfer of loan-related authorities would be not deemed to deplete the FCBs loan-related authorities. Even where FCBs have transferred all direct lending authority to associations, the FCB continues to have residual authority to make loans in areas where there is no active association and needs to retain its loan-related authorities. Furthermore, it is necessary to reconcile the participation authorities in this way to give full effect to the purpose for which the powers were granted, to allow broad participation among FCS institutions and non-FCS lenders so that the credit needs of farmers might be adequately met. Also, allowing associations receiving long-term lending authority to exercise the same loan-related authorities the FCB has with respect to the loans it is authorized to make is needed to accomplish a full and complete transfer of lending authority. Under the proposed reconciliation the authority received by the transferee association to sell interests in loans other than participation interests to institutions other than FCS institutions and Farmer Mac poolers would relate only to long-term real estate loans and could not be used to sell interests in short-term loans.

***B. Definitions***

The reproposed regulation would amend the definition of "loan participation" in part 619 of the existing regulations to distinguish it from other interests in loans that may be bought or sold. The reproposed definition would clarify that a loan participation is a fractional undivided interest, which necessarily must be less than 100 percent, in the principal amount of the loan. "Interests in loans" would be defined more broadly as ownership interests in the principal amount, interest payments, or any other aspect of a loan transaction, including servicing rights. The reproposed regulation would permit transactions in which interest and other revenues are shared differently from the principal amount to qualify as a participation interest, as long as the interest in the principal is an undivided interest. However, in order to qualify for exclusion from lending limits and capital requirements, sales of interests in loans, including participation interests, would be required to be structured within more narrow parameters, as discussed more fully below under "D. *Exclusion from lending limits and capital requirements."* Loan participations, as a subcategory of interests in loans, would be subject to the provisions in reproposed § 614.4325 relating to sales and purchases of interests in loans generally and the more specific requirements of reproposed § 614.4330.

The reproposed regulations would define the term "loan" broadly for the purposes of subpart H, to include all direct or indirect extensions of credit and similar financial assistance, such as leases and off-balance sheet items such as guarantees and standby letters of credit. The definition would include subordinated participation interests and interests in pools of subordinated interests, as well as any contributions to a cash reserve made for the purpose of satisfying the requirements of title VIII of the 1971 Act when a loan is sold to a Farmer Mac-certified pooler.

The reproposed regulation also includes a definition for the term "subordinated participation interest," as that term is used in title VIII of the 1971 Act. The subordinated participation interest is not a participation interest as defined in the reproposed regulation, inasmuch as it bears the first risk of loss and is hence not an undivided interest in the principal. Consequently, it would not be subject to the requirements of § 614.4330 of the reproposed regulation, but, like other interests in loans, would be subject to the requirements of § 614.4325. The term "subordinated participation interest" would include an interest in a pool of subordinated interests that includes the subordinated portion of a loan the institution has sold to a Farmer Mac-certified pooler or into other similarly structured programs. The effect of this inclusion is to authorize FCs institutions to purchase such interests and to require them to be characterized as loans rather than investments. The authority to purchase such interests is limited, however, to those necessary to permit the institution to pool and securitize loans through the Farmer Mac program.

Additionally, the reproposed regulations would define "sales with recourse," for the purpose of determining when interests in loans sold may be excluded for lending limit and capital purposes. This definition does not control the accounting issue of whether a transaction must be recorded as a sale or a financing. For all other regulatory purposes, however, "recourse" would be defined to include the retention of any risk of loss on any portion of the loans sold or an obligation to make principal or interest payments to any party as a result of the borrower's default, a change in market value, any contractual arrangement that by its terms could continue after final payment, default or other termination of the loan contract, or any other cause (except breach of usual and customary representations and warranties designed to prevent misrepresentation and fraud).

***C. Independent Credit Judgment***

Both existing regulations and previously proposed regulations require an independent credit judgment on each purchased interest by the purchasing institution. Among the comments on the previously proposed amendments to the regulation were assertions by certain respondents that such a requirement is unnecessary. The FCCA contended that FCS institutions should be permitted to purchase an interest in a pool of loans, for which the only loan analysis is performed by the institution originating the loans in the pool.

Like existing and previously proposed regulations, the reproposed regulation reflects the judgment of the FCA that the purchase of participations or other interests in loans without adequate independent analysis to make an independent, objective, and informed decision by the purchasing institution on the borrower's creditworthiness and the quality of the asset is an unsafe and unsound practice. In addition to the credit risk assumed in the purchase of an interest in a loan, an institution that purchases an interest in a loan without also purchasing the servicing rights incurs considerable risk in the necessary reliance on the lead lender to discharge its responsibilities under the agreement, particularly servicing. The purchasing institution is required to have sufficient capital to absorb these risks, which capital is exposed to any risk associated with the purchased interest. Fraudulent activity, ineffective servicing, or the insolvency of the lead lender can result in loss to the participant adversely affecting its capital position. Because of this exposure, the reproposed regulation would require that the analysis consider the financial stability and the servicing capacity of the lead lender.

Therefore, the reproposed regulation would require that the participating institution perform an independent credit analysis and judgment with respect to each interest purchased, to provide reasonable assurance that assets are purchased and recorded at their proper value and that imprudent risks are not accepted. The reproposed regulation would also make explicit the implicit requirements of existing regulations that the credit judgment and analysis be independent of the originating or lead lender and any intermediary seller or broker and that the analysis and judgment be performed by employees of the participating institution, who are accountable to the participating institution's board of directors. In addition, the reproposed regulation would prohibit an employee from participating in the decision to purchase a loan for which the employee had performed the appraisal.

The reproposed regulation would require the independent credit judgment to be made prior to the purchase of the interest and prior to each servicing action that changes the terms of the original agreement with the borrower or the terms of the contract under which the asset was purchased. The reproposed regulation would require that the independent credit judgment be supported by a similarly independent credit analysis that considers such credit and other borrower information as would be required by a prudent lender and evaluates the capacity and financial condition of the servicing institution.

The requirement for an independent analysis does not mean that the participating institution could not consider the analysis performed by the originating or lead lender or that it must gather information independently, if the information provided by the originating or selling institution meets the prudent lender standard. Nor is it necessary for the analysis to be lengthy or even totally separate in its documentation. However, the purchasing institution's records must document that an objective, independent, and thorough analysis was done prior to the making of a loan decision, and the credit judgment must be more than a mere rubber stamp of the analysis and judgment of the originating or selling institution. The reproposed regulation contemplates that FCS institutions would ensure through their participation agreements that the originating or selling institution is obligated to provide them, in a timely manner and on a continuing basis, all financial and other information critical to assessing and monitoring risk in the purchased asset.

Although the reproposed regulation would permit the board to delegate to institution employees the functional responsibilities necessary to discharge its fiduciary responsibility, the fiduciary responsibility itself cannot be delegated, and the board must exercise appropriate oversight of the performance of delegated responsibilities. Also, while the practice of employing an agent to perform certain administrative and operational functions involved in the credit analysis would continue to be permissible under the reproposed regulations, such relationships must be structured to preserve the institution's responsibility to conduct an independent analysis and to reach an independent, objective credit decision. Where a funding bank is the agent, this would require that the association have the ability to disagree with the bank's analysis and cancel that contract without fear of repercussion.

The FCA believes that these requirements are necessary to the effective discharge of the board's fiduciary responsibility to the institution's stockholders to ensure that adequate internal controls are in place to safeguard its assets. Although a properly written participation agreement can result in the imposition on the lead lender of fiduciary duties owed to the participant, judicial interpretations have not been sufficiently consistent to allay safety and soundness concerns. In any case, even if such duties are found to exist, when the lead lender is bankrupt, there may be insufficient assets to satisfy any judgments the participant may be successful in obtaining for breach of such duties. Therefore, even if the lead lender owes a fiduciary duty of the participants, the FCA believes that there should be an independent judgment made by persons who are accountable to the institution's shareholders.

***D. Exclusion From Lending Limits and Capital Requirements***

The reproposed regulation would require that interests in loans sold have the following three characteristics in order to be excluded from the institution's assets for the purpose of determining whether lending limits have been exceeded and capital requirements have been met: (1) If less than a 100 percent interest in principal is sold, the interest must be an undivided interest in the principal amount of the loan; (2) risk, including collection costs and collateral proceeds, must be shared on a pro rata basis (as defined); and (3) the sale must be without recourse.

**(1) Undivided interest**

Neither existing nor previously proposed regulations, both of which only address loan participations, permit an institution to purchase or sell a divided interest in a loan. A loan participation is by definition an undivided interest in a loan (See 12 CFR 619.9195). However, existing regulations permit collateral to be shared on a divided basis with FCA approval. That is, instead of the participant owning a fractional interest in all of the collateral upon foreclosure, which is the normal consequence of owning an undivided interest in the loan, the agreement may provide for the division of collateral, so that the lead lender might have a 100 percent ownership interest in a particular part of the collateral and the participating institution a 100 percent ownership interest in another part of the collateral.

Although the reproposed regulation would continue to define "loan participation" as a fractional undivided interest in a loan, the reproposed regulation would allow institutions to purchase interests in loans other than participation interests that are divided interests (except BCs, which have only participation authority) without FCA approval, provided the requirement for an independent credit judgment is met. The reproposed regulation would also permit institutions to divide collateral without FCA approval. However, such interests would not be excluded from the selling institution's lending limits or capital computations. Similarly, under the reproposed regulation, all FCS institutions (including BCs) could purchase a participation interest (i.e., an undivided interest in the principal amount of the loan) but agree to take a divided interest in the collateral. However, in order to exclude such participations sold from lending limits and capital computations, it would be necessary under the reproposed regulation for the selling institution to have disposed of all risk associated with the portion sold. Therefore, the reproposed regulation would not allow sales in which the interest in the principal or the collateral is divided interest, to be excluded from the lending limits and capital requirements. Requiring an undivided interest in the loan *and* the collateral ensures that the portion of the loan that is retained does not retain a disproportionate share of the risk.

The reproposed regulations do not address loan syndications, whereby a borrower has a direct contractual relationship with more than one lender but the loan negotiations with the borrower are coordinated under the auspices of a lead bank(s). Such loans can be made through the exercise of the institution's direct lending authority provided the institution's underwriting standards and other statutory and regulatory requirements, including eligibility requirements, are met. Loans provided under this type of arrangement would not be subject to the requirements of the reproposed regulations unless they constitute the purchase of a divided interest in a loan. However, since such loans are an exercise of the institution's direct lending authority, an independent credit judgment is required just as it is for other direct loans.

**(2) *Pro Rata Risk Sharing***

The second requirement for exclusion from lending limits and capital computations under the reproposed regulations is that risk of loss, including collection expenses and collateral proceeds, be shared on a pro rata basis according to the percentage of the principal owned by the parties. Existing regulations permit risk to be shared on a basis other than pro rata only where approved by the FCA. The proposed regulation would have deleted this exception to the pro rata risk sharing requirement. The reproposed regulation would allow institutions to share risk on a basis other than pro rata without FCA approval but would require pro rata risk sharing for exclusion of the portion of the loan sold from lending limits and capital computations.

Like the proposed regulation, the reproposed regulation would allow agreements providing for other than pro rata sharing of payments prior to the time of default or comparable event to qualify as pro rata risk sharing agreements, provided the agreement requires repayments and collections to be shared pro rata at the time of default by the borrower under the loan agreement or other comparable event, as defined in the participation agreement. This position, which allows a last-in-first-out distribution of payments and advances prior to default, closely parallels that reflected in regulations of the OCC, 12 CFR 32.107, and will make it easier for FCS institutions to participate with national banks and other commercial banks. However, the FCA would require that this arrangement be clearly specified in the agreement.

In order to protect its interests, the participant should seek to ensure that default or the comparable event is defined in the agreement in such a manner that the pro rata requirement attaches when credit risk in the loan has become evident and events have transpired that indicate that some potential for loss exists. Should the reproposed regulation be adopted, institutions that are party to participation agreements should have information systems in place to identify any interests in loans sold subject to agreements that share risk on any basis other than a pro rata, as defined in § 614.4325(g)(3), including their amount and the nature of the conditions that would move them to a pro rata basis.

**(3) *Recourse***

The third requirement for exclusion from the lending limits and capital computations under the reproposed regulation is that the interest be sold without recourse. Recourse is defined as the retention of some risk of loss from a transferred asset for any cause except breach of usual and customary warranties or representations designed to protect the purchaser against fraud or misrepresentation, or any obligation to make payments of principal or interest to any party resulting from: (a) Default by the borrower; (b) changes in the market value of the asset; (c) any contractual relationship between the seller and purchaser incident to the transfer that, by its terms, continue even after final payment, default, or other termination of the assets transferred; or (d) any other cause.

Interests in loans sold subject to agreements that share risk on other than a pro rata basis, as defined in § 614.4325(g)(3), would be considered to be loans sold with recourse and would not be afforded favorable capital and lending limit treatment. For this reason, retained subordinated participation interests and loans for which a contribution to a cash reserve is made in order to satisfy the requirements of title VIII of the 1971 Act for a loan sold into the Farmer Mac program would not be excluded from lending limits and capital computations.

An interest in a pool of subordinated participation interests would not be excluded from capital computations, but would be excluded from lending limit computations, provided the institution shares risk in the pool on a pro rata basis with all other holders of interests in the pool. Interests in pools of subordinated interests are excluded from lending limit computations because the risk of lending to a single borrower that is present when the subordinated interest is retained is exchanged for a more diversified risk. They are not excluded from capital computations because the credit risk, although diversified, is still present and the interest is still in a first loss position. Although the institution may be less likely to lose the entire amount of the interest than if it had retained the subordinated interest in the loan it originated, it is more likely to sustain some loss on the interest and has increased the risk that loss will occur because of the negligent underwriting or servicing of other parties over which it has no control.

***E. Removal of FCA Prior Approvals***

The proposed regulations would have deleted requirements of existing regulations for FCA prior approval for district policies governing the making of participation loans within a district, the sharing of risk on other than a pro rata basis, the making of any loans subject to prior approval, the use if differential rates by originating institutions, and the requirement for FCA prior approval of participation agreements between regional banks for cooperatives and the Central Bank for Cooperatives (a constituent entity of the National Bank for Cooperatives). The reproposed regulations would also delete these prior approval requirements.

***F. Purchase of Participation Interests From Nonfarm Credit System Lenders***

The reproposed regulations would ease the restrictions under which FCBs, agricultural credit banks (ACBs), PCAs, FLCAs, and ACAs may purchase participation interests from lenders that are not FCS institutions. For all banks and associations except BCs, existing regulations restrict participations purchased from institutions that are not FCS institutions to those in which the selling institution retains 50 percent of the loan or retains 10 percent and does not materially reduce its ratio of agricultural loans to total loans from the ratio maintained during the preceding 3 years, or retains the maximum amount permitted by its regulatory authority. The restriction was imposed when the authority to participate with non-FCS lenders was first granted, to ensure that FCS institutions did not become merely warehouses of participation interests and neglect their statutory mission.

The FCA has received comments from FCS institutions suggesting that this restriction is a serious obstacle to participation with commercial banks. Commentors have also noted that these conditions are difficult to enforce and that the participant often has difficulty determining whether the originating lender is in compliance with these conditions.

The FCA continues to believe that some limitation in this area is needed, but for a purpose related to safety and soundness. Such a requirement, if tied to servicing rights, can help to contain the risk attendant to relying on another institution to service the loan. The FCA believes that if the servicing institution has a vested interest in the loan, servicing is likely to be more prompt and effective. However, the FCA believes that a 50 percent retention requirement is not needed to achieve the safety and soundness purpose and believes that the warehousing concern can be addressed by requiring the institution itself to set appropriate limits on purchased participations in its board policies.

Therefore, the reproposed regulation would lower the retention amount to 10 percent and extend the requirement to BCs, but would require that the retained interest be tied to the servicing rights. That is, the reproposed regulations would limit the purchase of participation interests from non-FCS lenders to those in which at least a 10 percent participation interest in the principal amount of the loan is retained by the institution servicing the loan, which interest could not be assignable separately from the servicing rights. Such a requirement is necessary to ensure that the purpose of the requirement could not be defeated by the sale of the servicing rights. In cases where the servicing lender has a lending limit of less than 10 percent, the reproposed regulation would require only that the servicing lender retain the amount permitted by its lending limit. The requirement would apply across the board without considering whether the lender is decreasing its ratio of agricultural loans to other loans, as existing regulations do, but would not apply at all if the FCS institution acquires the servicing rights with the interest. This requirement would also not apply to participations between FCS institutions because the loan servicing by FCS institutions is subject to FCA regulatory oversight.

To ensure that these requirements can be enforced, the FCS institution would need to ensure that appropriate provisions are included in the participation agreement restricting the assignability of the retained amount separately from the servicing rights. Failure to do so would be deemed by the FCA to be a violation of the requirement of the proposed regulation for the institution to include in the agreement any provisions necessary to protect its interests.

***G. Institution Policies***

The reproposed regulations would make some adjustments in the requirements for policies in existing and previously proposed regulations. The proposed regulations would have substituted a requirement for individual institution participation policies for the requirement of existing regulations that institutions comply with district and bank policies. As noted above, the proposed regulation would also have deleted the requirement for FCA prior approval. The reproposed regulations would make a similar substitution, delete the prior approval requirement, and require the policy to address all interests in loans, including loan participations.

In addition to matters required to be addressed in the policy by existing regulations, the reproposed regulation would incorporate certain factors formerly considered by the FCA in its evaluation of district policies prior to giving its approval. Also, certain additions to the policy would be required by the reproposed regulation to ensure that the authority to purchase and sell interests in loans are prudently exercised. Both existing and previously proposed regulations require district policies to contain a limit on the aggregate amount of loan participations that an institution could purchase. Under existing regulations these limits are subject to the FCA prior approval of participation policies. The reproposed regulation would remove the existing FCA prior approval for loan participation policies and would provide more flexibility to institutions in establishing institution limits for loan participations purchased. However, the reproposed regulations would require that institution policies specify limits on the aggregate amount of interests in loans that may be purchased, including participation interests, sufficient to ensure that the primary mission of the institution to provide credit directly to agriculture is not compromised. In addition, the reproposed regulation would require each institution to set limits on the aggregate amount of purchased interests in loans, including participation interests, that it does not service, so that the risks from the lead lender's fraud, insolvency or ineffective servicing is sufficiently diversified.

The board of each institution should ensure that risks inherent in purchasing or selling interests in loans are considered in the policy limits it establishes, and should monitor these exposures periodically to ensure such exposures are appropriate in view of potential risks. The reproposed regulation would require each FCS bank and association board of directors to ensure the institution stays within the limits established in its policy.

The reproposed regulations incorporate a requirement that participation policies address the need to obtain financial and other borrower information on a timely and ongoing basis. Adequate and timely information is essential in order to make a sound credit judgment in the purchase of a loan, as well as to monitor any change in risks in that loan, and boards should ensure that policies require information sufficient to accomplish these objectives.

Other subjects not included in existing regulations that the reproposed regulations would require are: (1) Types of interests in loans which may be purchased or sold; (2) types of loans in which an institution may purchase or sell interests; (3) the types of institutions with which an institution may agree to purchase or sell interests in loans; and (4) underwriting standards.

***H. Purchase and Sale Agreements***

Existing and proposed regulations set forth certain requirements that must be met in any loan participation agreement executed by a FCS institution. The reproposed regulations set forth general requirements for agreements under which interests in loans are sold or purchased as well as more specific additional requirements for agreements governing the sale or purchase of loan participations.

Section 614.4325 of the reproposed regulations sets forth requirements for agreements governing the purchase or sale of any interest in a loan, including participation interests. These requirements include: (1) Identification of the loan or loans covered by the contract; (2) description of the nature of the interest in loans being purchased or sold; (3) provisions requiring the transfer of credit and other borrower information on a timely and continuous basis; (4) the terms and conditions of the sale and rights and obligations of the parties; (5) provisions for sharing, dividing, or assigning of collateral; and (6) any other terms needed for the appropriate administration of the loan or the protection of the interests of the FCS institution.

The reproposed regulation would require loan participation agreements to meet additional requirements, which reflect some slight adjustments to the requirements contained in both existing and proposed regulations governing loan participations. For example, the reproposed regulations would require that the participation agreement provide for the monitoring of the servicer. The participation agreement should establish the authority of the participating institution to review the loan files and records of the servicing institution to ensure that timely and pertinent information is being provided and that the responsibilities of the servicing institution are being adequately discharged.

More rigorous requirements are placed on participation agreements, because the originating institution normally has maintained responsibility for servicing the loan and properly written agreements can serve to contain the risks arising from insolvency or fraudulent activity of the servicer or negligent or ineffective servicing. The reproposed regulations would also require that the agreement provide for the issuance of a participation certificate evidencing an equitable interest in the loan, as a safeguard against losses that can be incurred if the servicing institution becomes insolvent.

The reproposed regulations would delete certain requirements of existing regulations for loan participation agreements, such as the provision for capitalization of the participation interest. Although the agreement may include an agreement for the participant to purchase stock in the lead lender, the FCA believes that this no longer need be required by regulation. Each institution is responsible for meeting its minimum permanent capital standards and maintaining in addition a level of capital adequate to reflect the risk in its particular assets. However, the reproposed regulation would permit institutions to provide for adequate capitalization in whatever way it deems appropriate. For the purpose of determining whether capital standards are met, interests in loans purchased, as well as subordinated participation interests or any equivalent thereof used to satisfy the requirements of title VIII of the 1971 Act, must be considered as loan assets.

***I. Borrower Rights***

The reproposed regulations would address the impact of the sale of an interest in a loan on the borrower's rights under title IV of the 1971 Act and would require that impact to be clearly disclosed to the borrower. An institution selling an interest in a loan would be required to either obtain from the borrower a waiver of his or her statutory rights, or ensure that the borrower's statutory rights will not be defeated by the sale by incorporating the rights in the loan contract, to ensure that such rights would continue to be afforded by the purchaser. Under the reproposed regulation, the waiver would take effect at the time the loan is sold and would remain in effect only so long as the loan is not reflected on a FCS institution's books. If the originating institution or another FCS direct lender should repurchase the loan, the statutory borrower rights would reattach under the reproposed regulation.

Prior to obtaining a waiver of borrower rights for any loan sales, the reproposed regulation would require institutions to make the disclosures required when a waiver is obtained for the purpose of selling a loan to a Farmer Mac pooler by 12 CFR 614.4367(b).

***J. Borrower Stock***

The reproposed regulations reflect the statutory requirement that a borrower, as a condition of obtaining a loan by or through a Farm Credit bank or association, purchase an amount of stock not less than the lower of $1,000 or 2 percent of the loan amount. In addition, the 1971 Act contemplates the individual institutions may need to require a higher minimum stock purchase requirement to capitalize the institution adequately. The reproposed regulations would require a FCS institution to impose the institution's minimum stock purchase requirement upon all borrowers, whether or not the loan is made for the purpose of sale. However, the FCA does not believe that the borrower should be required to hold stock in the institution when the entire loan is sold without recourse and the institution does not retain a subordinated participation interest, take an interest in a pool of subordinated interests, or make a contribution to a cash reserve to satisfy the requirements of title VIII of the 1971 Act. However, where a subordinated participation interest is retained or an interest in a pool of subordinated participation interests is purchased or a contribution to a cash reserve is made to satisfy the requirements of title VIII of the 1971 Act, the reproposed regulation would not allow the retirement of stock below the institution's minimum stock purchase requirement for the entire loan.

The FCA believes that so long as the institution retains the first loss position on a loan in any form, the borrower should be required to hold stock in the institution the same as any other borrower and that the requirement should be calculated on the basis of the entire loan amount. To allow stock retirement for such loans would be inequitable to stockholders whose loans are not sold, because they would bear a disproportionate share of the burden of capitalizing the institution, a situation which would conflict with cooperative principles. For this reason, the reproposed regulation would also require the borrower to repurchase stock or participation certificates equal to the institution's minimum stock purchase requirement if the institution were to repurchase the loan. However, if the institution sells a fractional interest in the principal amount of a loan that qualifies for exclusion from capital computations under the reproposed regulation, the institution could under the reproposed regulation retire a proportionate share of the borrower stock, provided that after the retirement minimum permanent capital standards would continue to be met and the institution's capital would continue to be adequate in light of the risk in its portfolio. The reproposed regulation would not require stock to be retired in such circumstances, however, and the FCA encourage institutions to evaluate future as well as present capital needs carefully before deciding to make such retirements.

Institutions should be careful that any disclosures made to borrowers about the possibility of stock retirements if the loan is sold also include disclosure that stock cannot be retired if minimum permanent capital standards are not met or if the institution's capital is not adequate to support the risk in its loan portfolio.

***K. Disclosure to Borrowers***

The reproposed regulation would add a requirement that certain disclosures be made to a borrower at least 10 days prior to the borrower's next payment date when his or her loan is sold. These disclosures include the name, address and telephone number of the purchasing institution, the name and address of the party to whom payment is to be made; the effect of the sale upon the borrower's exercise of statutory borrower rights; the impact of the sale on the borrower's stock purchase requirement; and any authority under the borrower's contract that would allow the purchaser to change the terms of the borrower's loan. The reproposed regulation would also prohibit any servicing action by the purchasing institution that would adversely affect the borrower until the purchasing institution ensures that disclosure has been made to the borrower of the name, address and telephone number of the purchasing institution and the address where the borrower's payment should be sent. These provisions address concerns over damage to borrowers caused by the transfer of the servicing rights which prompted a recent General Accounting Office (GAO) study on the transfer of servicing rights.

***L. Loan Participations Originated by Banks for Cooperatives***

Existing regulations require district BCs to first offer participations to the Central Bank for Cooperatives (CBC), one of the constituent entities of the National Bank for Cooperatives (CoBank), and set forth a Systemwide lending limit for borrowers of the BCs. Existing regulations also require the prior approval of the FCA of the participation agreement between the CBC and district BCs and any modifications of that agreement.

The proposed regulations did not allow BCs to offer participations to FCBs that operated in the same district. These proposed restrictions were prompted by the FCA's concern that when institutions have common management or operations so interlocked that the viability of one institution is severely affected by the viability of the other, the independence of the loan decision process may be compromised. This concern is heightened when loans are of such substantial size that a BC would need to offer a participation, as the impact on earnings and assets resulting from the participation decision can be substantial.

The FCA received two sets of comments on the proposed amendments to § 614.4334. The FCCA and a BC noted that the proposed regulations seemed to envision only the origination of participation loans by the district BCs rather than the origination of such loans by the CoBank and participation by the district BCs. In addition, the FCCA asserted that there should be no limitation on the other FCS institutions with which a BC could enter into a participation relationship, and that associations should be identified as participants for loans originated by BCs. A FCB opined that a BC within the district should be authorized to participate a loan to the FCB within the same district, stating that setting a lending limit for the System would be preferable to a restriction on participation within a district as a method of containing risk.

After considering the comments and reflecting on alternative means of containing risk, the FCA has concluded that there are ways of containing the concentration of risk that are less restrictive than prescribing the parties to whom such participations could be offered or prohibiting intradistrict participation altogether. Consequently, the reproposed regulations would not require FCS institutions to offer loan participations to any particular FCS institution or types of institutions in any particular order and would not prohibit intradistrict participations. Thus, under the reproposed regulations, BCs could sell loan participations to any FCS institution with direct lending authority, including FCS institutions within their respective districts.

The FCA has concluded that the requirements for an independent loan analysis and credit judgment, the proposed lower limits on loans to a single borrower and the limitations required by the reproposed regulation in each institution's policies would be sufficient to contain the concentration of risk in a single district. When a BC sells loan participations to institutions within the same district, the participant's board of directors has a fiduciary responsibility to ensure that an independent, objective, and informed decision has been made on the participation purchased, based on an independent analysis of the risks by the participating institution. As long as the institution can provide sufficient evidence to establish that the decision and its supporting analysis were independent, the participation by a district institution in a loan originated by the BC headquartered within the district would be permitted under the reproposed regulations. Since these institutions possess separate boards of directors, independence of the analysis and decision can be achieved despite the fact that the respective institutions may maintain common managerial staff and employees. However, like existing regulations, the reproposed regulation would require that boards of jointly managed institutions develop procedures for ensuring that the respective interests of their shareholders is protected when they participate in each other's loans. FCA also considers the disciplines required by the independence in the analysis and decision process on participation loans, along with the proposed lower lending limits for individual institutions and the elimination of double counting of capital in the computation of those lending limits, to be sufficient to eliminate the need for any Systemwide lending limit other than that imposed on each individual FCS institution.

**IV. Lending Limits**

***A. General***

Existing regulations limit the amount of indebtedness an institution can have outstanding to a single borrower to a certain percentage of capital and surplus. These limits are currently set separately for Federal land banks (FLBs), Federal intermediate credit banks (FICBs), PCAs, and BCs. For FLBs, extensions of credit to one borrower are limited to 20 percent of capital and surplus; for FICBs, participations purchased from other FCS institutions representing loans to a single borrower are limited to 20 percent; and for PCAs, 50 percent if not party to an approved loss-sharing agreement and 100 percent if party to such an agreement. Existing regulations set lending limits for BCs according to the type of loan, with an overall limit of 50 percent of net worth. In addition, existing regulations limit total extensions of credit by all BCs to the same percentages applied to the combined net worth of all BCs and the CBC.

The proposed regulations reflected the restructuring required and authorized by the 1987 Act, namely the mandatory merger of the Federal land bank and the Federal intermediate credit bank to form the FCB in each district; the authorized merger of FLBAs and PCAs (creating an ACA); the authorized merger of the banks for cooperatives, including the CBC, to form the CoBank; the authorized merger of the FCB and a district BC (creating an ACB); and the authorized transfer of direct long-term lending authority from a FCB to a FLBA (creating an FLCA) or an ACA. The proposed regulation would have set lending limits for the FCBs, ACBs and the ACAs at the level applicable to the individual banks or associations prior to the mergers. For ACAs an overall lending limit of 50 percent was proposed in addition to the separate limits for short- and long-term loans. Lending limits for FLCAs would have been set at 20 percent of the FLBA's capital and surplus. PCAs and ACAs that were parties to an approved loss-sharing agreement would have been permitted to lend up to 100 percent of capital and surplus.

Some respondents to the proposed regulations expressed support for lowering the lending limits. While four FCS institutions supported a lending limit of up to 100 percent if an approved loss-sharing agreement were in place for FLCAs, the FCCA and an FCB commented that lending limits should be equalized for all institutions and brought in line with industry standards, and that the loss-sharing exception should be eliminated.

At the time the proposed regulations were published for comment, final capital adequacy regulations had not yet been adopted and FCS banks and associations were in the process of considering various merger and reorganization proposals. The FCA recognized that the final capital adequacy regulations, as well as the resulting structure of the institutions, would have a major impact on the individual bank and association lending limits by affecting the manner in which the capital and assets are adjusted between the banks and associations. The FCA has now reconsidered the proposed regulations on the lending limits in light of the capital adequacy regulations and the considerable amount of restructuring that has taken place in the interim and reproposes amendments to existing lending limit regulations.

Although the FCA recognizes that it is important for the institutions to serve the credit needs of all creditworthy, eligible borrowers, safety and soundness is a necessary prerequisite to continuation of such service. The FCA believes that limiting the amount that can be lent to one borrower or a group of related borrowers is an effective way to control risk in a lending institution. The limits currently in effect for FCS institutions have been in place for many years and are generally higher than lending limits for other Federally chartered lending institutions. Studies have shown that failed banks have a higher percentage of unwarranted concentrations of credit than healthy banks. A concentration of credit is generally defined as more than 25 percent of total capital and can include concentrations of loans to one industry, loans to one group of companies or affiliated businesses, and loans secured by the same type of collateral.

The FCA believes that single industry lending is inherently more risky than the more diversified lending of commercial banks. However, lending limits for FCS institutions have traditionally been higher than those of commercial banks, partly because of the existence of loss-sharing agreements between the associations in each district and between associations and their supervisory banks. The loss-sharing agreements were instituted to deal with the increase in loan size during the late 1960's. During that time there was no mechanism to protect the associations from excessive losses on individual loans. Prior to the passage of the 1971 Act, there was no legal limit on the total amount a PCA could commit to a single credit risk. "Risk sharing" was organized to minimize the damaging cumulative effects of large losses on PCAs and reduce the capitalization burden on individual borrowers. It was believed that all associations would work to prevent any single organization from going bankrupt because the harm resulting from serious financial difficulties in one PCA would affect the operations of neighboring associations. Although some of these loss-sharing agreements are still in place, the recent crisis in the FCS demonstrated that these agreements do not operate effectively and are not a satisfactory substitute for effective lending limits. Risk is not minimized because a loss-sharing agreement is in place and the agreements have proven difficult to control and enforce.

In the interest of safety and soundness, the FCA now proposes to establish more stringent and comprehensive lending limits on loans to any one borrower. The reproposed regulation would lower the limit on loans to a single borrower for all institutions except BCs to 20 percent of capital. (Although the reproposed regulation would not change the lending limit percentages for BCs, other provisions of the reproposed regulation would apply to BCs.) The reproposed regulation would require all extensions of credit on which a borrower is primarily liable and all extensions of credit attributable to such borrowers under rules of attribution to be aggregated for the purpose of applying the lending limit. The FCA proposes to delete the provision of existing regulations for a 100 percent lending limit when a loss-sharing agreement is in place. This proposed change reflects the FCA's judgment that it is imprudent to lend up to 50 or 100 percent of capital and surplus to one borrower and to allow concentrations of risk in one association to endanger the solvency of itself and others.

Some FLBAs have entered into loss-sharing agreements with their respective FCBs. These agreements stipulate that losses incurred in any manner on loans endorsed by the FLBA shall be shared equally by the FLBA and the FCB. Because loans originated or serviced by an FLBA are subject to the FCB's lending limit, these FLBAs are exposed to potential loan losses for a single borrower that far exceed 20 percent of their capital. While the agreement between an FLBA and the FCB may contain provisions protecting FLBA capital in the event of such losses, the FCA believes that the FLBAs could be subjected to excessive risk from any one borrower. Therefore, to diversify risk created by concentrations of credit to one borrower, the reproposed regulation would limit the risk an FLBA may assume through loss-sharing agreements for a single borrower by limiting the amount of liability an FLBA may assume for the indebtedness of any one borrower to the FCB, including loans attributed to that borrower, to 20 percent of its capital. Based on information available to the FCA, the FCA does not believe this restriction would have a material impact on those FLBAs that share losses with the FCB. However, the FCA invites comments on the impact of this proposed limitation and other means for protecting the capital of FLBAs that share losses with the FCB.

Existing regulations relate lending limits to net worth for BCs and to capital and surplus for other institutions. They do not specify when the capital and surplus of the institutions must be calculated, but require BCs to establish net worth on an ongoing basis. The reproposed regulation would relate lending limits to permanent capital, after elimination of any double counting, and would require permanent capital to be computed monthly for lending limit purposes. However, for lending limit purposes only, the reproposed regulation would permit stock protected under section 4.9A of the 1971 Act to be included as capital for 7 years, until January 1, 1998. A transition period would be allowed because of the FCA's recognition that it would be unrealistic and unfair to exclude borrower stock that would have been considered in lending limit computations but for the statutory protection while institutions still have considerable amounts of such stock outstanding. To exclude it at the same time lending limits are lowered could severely limit the size of loans some institutions could make. Since the average lives of long-term real estate loans and BC term loans have historically been 7 years, it seems likely that after 7 years most "protected" stock will have been retired or converted to "at-risk" stock. Any protected stock still on the books after 7 years from the effective date of the regulations would be excluded from capital for calculation of the lending limitation.

The reproposed regulation would bring lending limits for FCS institutions more in line with those applicable to other Federally chartered lending institutions. National banks are generally limited to 15 percent of capital and surplus. However, there are many exceptions to the general 15-percent limitation, which either allow an additional percent of capital and surplus to be loaned on certain secured loans or impose no limitation on certain guaranteed loans. Some of these exceptions are not relevant to the operations of FCS institutions, but some of them are, such as loans fully secured by livestock or by bills of lading, warehouse receipts, or similar documents transferring or securing title to readily marketable staples. Rather than incorporating numerous exceptions that may be difficult to apply and administer, the FCA proposes to adopt a lending limit that is somewhat higher than that to which national banks are subject to but allow few exceptions. See "D. *Exclusions from the lending limit"* below.

The reproposed regulation would impose uniform lending limits for all FCS direct lenders, except banks for cooperatives, and for all types of loans. Although it may be argued that long-term real estate loans are less risky than operating loans because they are secured by a first lien, it can also be argued that operating loans are less risky because of their shorter maturities. Also, long-term real estate and seasonal operating loans are usually repaid from the same source, and prudent lenders should not rely on the forced liquidation of collateral as a primary source of repayment or lend simply on the basis of collateral. Therefore, the FCA believes that all types of loans should be subject to the same limit.

***B. Loans Subject to Limitations.***

In order to limit total exposure to a borrower, the term "loan" would be broadly defined in the reproposed regulation to include any extension of credit or similar financial assistance of the type authorized under the 1971 Act. All types of loans, sales contracts, notes receivable, and other similar obligations and lease financing outstanding, directly or indirectly, to a borrower would be included. This would include loans purchased from or discounted for another lender, including other financing institutions (OFIs), interests in loans to a borrower purchased from another institution, including loan participations; loans sold to another lender under certain circumstances; and loans in which the borrower obligation to repay directs the institution to advance funds to a third party.

Under the reproposed regulations "loans" would be deemed to be outstanding to a borrower for lending limit purposes, unless they are legally unenforceable. Hence, the reproposed regulation would require the lending limit computation to include the balances of loans that have been charged-off or forgiven due to restructuring and not subsequently collected, unless such amounts are uncollectible because they have been discharged in bankruptcy or are unenforceable because of the expiration of the statute of limitations or judicial decision. The inclusion of these amounts is deemed to be appropriate because the existence of charge-offs or debt forgiveness evidences excessive risk from a borrower due to inadequate performance or condition, and the failure to include previously charged-off or forgiven balances could result in excessive levels of exposure to a borrower with exhibited weaknesses. Such exposure would be inconsistent with the underlying purpose of these regulations.

***C. Interests in Loans Purchased and Sold.***

Like existing regulations, the reproposed regulation would require purchased interests in loans, including participation interests, to be counted against the institution's lending limit. Unlike existing regulations, the proposed regulation would include in the lend limit calculation any commitments to participate in or purchase interests in loans, regardless of whether the commitment is fully utilized.

The reproposed regulation would require interests in loans sold to other institutions, including participation interests, to be included if they are sold with recourse, as defined in reproposed § 614.4325, or if they are sold pursuant to an agreement that provides for a divided interest in principal or collateral or an agreement that provides for sharing of risk on a basis other than pro rata, as that term is used in § 614.4325(g)(3). If the agreement provides for recourse to the selling institution for all initial losses on a loan up to a stated percentage, the full amount of the loan sold would be required to be counted against the selling institution's lending limit, since the repayment risk, has not been transferred from the selling institution. For that reason, loans sold to a pooler certified by Farmer Mac would continue to be counted against the selling institution's lending limit if the selling institution retains a subordinated participation interest in the loan or contributes to a cash reserve for the loan. However, the loan would not be included if the loan is sold without recourse to a pooler and an interest in a pool of subordinated interests is taken to satisfy the requirements to title VIII of the 1971 Act, unless the interest in the pool is a divided interest or the risk of loss on the pool is shared on other than a pro rata basis. Interests in pools of subordinated interests are excluded because the risk is more diversified than a retained subordinated participation interest in a single loan.

The fact that a loan sold with recourse is counted against the selling institution's lending limit does not mean that the purchasing institution would not be required to count the purchased portion against its lending limit under the reproposed regulation. While this may appear to constitute double counting of the same risk, the purchasing institution is also subject to the risk that the seller may not be able to repurchase. Furthermore, counting the loan toward the lending limits of both institutions would serve to limit System exposure to a single borrower.

***D. Exclusions From the Lending Limits***

Existing regulations make no provision for the exclusion of certain types of loans from the lending limits except: (1) Loans on which a borrower is secondarily liable if the institution certifies that the party with primary liability can be depended on to repay the obligation; and (2) loans guaranteed by FCS institutions, which are counted as obligations of the guaranteeing institution. Previously proposed regulations would have allowed banks for cooperatives to eliminate from the lending limit computation a loan that is guaranteed by the United States Government.

The reproposed regulation would not allow any for the exclusion of existing regulation, but would allow all FCS institutions to exclude loans guaranteed by the United States Government. However, the reproposed regulation would alter the language of the previously proposed regulation to make it clear that only that portion of the loan that is guaranteed is exempt from any limitation.

While the FCA recognizes that some agencies guarantee late payment of principal and interest and others guarantee payment upon default or receipt of a judgment against the borrower, the reproposed regulations do not make a distinction between the types of guarantees but treat them all equally. Rather, the reproposed regulation assumes proper enforcement of the guarantee through strict adherence to the requirements of the guarantee, and the institution's enforcement of the guarantee will be examined as part of the institution's credit administration practices. However, if a lender wants to make additional loans to a borrower that would be above the legal lending limit if the guaranteed loans were not excluded from the calculation, there must be no external evidence that the guarantor will be unable to pay and the institution must be prepared to demonstrate that it is in compliance with the terms and conditions of the guarantee. If the guaranty becomes unenforceable, the entire loan would be counted against the institution's lending limit. If all loans and commitments, including the loan or portion of the loan that is not longer guaranteed, are above the lending limit, the loan(s) would become nonconforming and no further advances could be made until all loans and commitments are within the lending limit.

The reproposed regulation would also exclude from the lending limit computation loans that are fully secured by obligations of the United States, such as Treasury bonds, notes and bills, provided the loans are fully secured by the current market value of the obligations. If the market value of the collateral were to decline so the loan is not fully secured, and the balance of the loan exceeds the 20-percent limitation, the loan would be required to be brought into conformance within 5 business days. If the institution could not obtain additional collateral so the loan is fully secured again, or the loan could not be paid down to within the 20-percent limitation, the loans to the borrower would become "nonconforming." No additional credit could be extended to the borrower until the borrower's indebtedness is within the lending limit. The basis for any exceptions to the lending limits must be documented in the loan files.

The reproposed regulation would also exclude: (1) Loans that have been discharged in bankruptcy or that have become legally unenforceable because of judicial decision or the expiration of the applicable statute of limitations; (2) undivided interests in loans (including collateral), including participation interests, sold without recourse on which risk is shared on a pro rata basis, as defined in reproposed § 614.4325(g)(3); and (3) loans sold to a pooler certified by Farmer Mac in which no subordinated participation interest is retained and no contribution is made to a cash reserve to satisfy the requirements of title VIII of the 1971 Act. As noted above, loans sold to a Farmer Mac pooler may be excluded if the requirements of title VIII are met by the purchase of an interest in a pool of subordinated participation interests, provided the interest is an undivided interest and risk is shared on a pro rata basis, as defined in reproposed § 614.4325(g)(3).

***E. Aggregation and Attribution***

The term "borrower" would be defined to include any individual, partnership, joint venture, trust, corporation, or any other business entity (except a FCS institution), with which an institution has a lending relationship either through direct negotiations or by means of a purchase of a loan or interest in a loan participation from another lending institution. Historically, there has been a strong correlation between problem commercial banks and the volume of loans concentrated in related entities, or borrowers. Hence, the reproposed regulation contains rules of attribution that are designed to achieve diversity and alleviate risk posed by loan concentrations to a single borrower or a group of interdependent borrowers.

Under the reproposed regulation, loans to other borrowers may be attributed to a borrower for the purpose of applying the lending limit if certain conditions are present. In addition, under the reproposed regulation, all loans on which a borrower is primarily or secondarily liable must be aggregated for the purpose of determining whether loans to that borrower exceed the lending limit. The reproposed regulation also requires loans and commitments to other borrowers ("named borrowers") that are attributed to the borrower ("subject borrower") under rules of attribution to be aggregated with loans and commitments to the subject borrower for the purpose of determining whether a loan or commitment exceeds the lending limit. However, attribution of a loan to someone other than the named borrower would not remove the loan from the named borrower's total of loans used to compute the lending limits. The named borrower is still primarily liable on the loan, leaving the institution with credit risk exposure. The attributed loan would remain in the named borrower's total of loans and would also be included in the subject borrower's total.

Under the reproposed regulations, "primarily liability" would be defined as an obligation to repay that is not conditioned on unsuccessful demand on another party. Thus, any signatory to a loan contract or note is primarily liable for repayment of the obligation, even if he or she signs as an accommodation to the maker. In this situation, the primary repayment obligation of the other party would be the same as the named borrower's and a "loan" would be deemed to have been made to the other party for purposes of determining lending limits. An institution's intention to proceed first against one party rather than another with primarily liability does not affect the determination of lending limits. "Secondary liability" would be defined as an obligation to repay that arises only after the unsuccessful resort to another party.

***F. Rules of Attribution***

Under the rules of attribution in the reproposed regulation, loans to a borrower (named borrower) will be attributed to another borrower (subject borrower) when: (1) The subject borrower is primarily or secondarily liable on a loan to a named borrower; (2) when the proceeds of a loan to a named borrower are to be used by or for the direct benefit of the subject borrower; (3) when the named borrower is controlled by or under common control with the subject borrower; (4) when the subject borrower is deemed to be the source of repayment on the loan to the named borrower; or (5) when the operations of a named borrower are so intertwined with the subject borrower's operations that the visibility of the named borrower's operations will affect the viability of the subject borrower's operations.

Under the reproposed regulation, the subject borrower would be deemed to be the source of repayment, except in the case of integrated operations, on the loan to the named borrower if the subject borrower contributes 30 percent or more of the named borrower's gross receipts, which for the purpose of this provision includes gross revenues, intercompany loans, dividends, and capital contributions. However, loans to an integrated operation (e.g., poultry processor) would not be attributed to all contract growers if, in the event of the demise of the current integrator, the contract grower would have other sources of repayment and other intergrators or means with which to market. Each loan must be analyzed individually to identify expected as well as alternative sources of repayment and income, and determinations that attribution is not required must be supported by analyses documented in the loan file. If contract growers do not have other sources of repayment and other integrators or means with which to market in the event of the integrator's demise, loans to contract growers would be attributed to the integrator, as they are likely to depend on the integrator as the source of repayment. Under the reproposed regulation, proceeds of a loan to a named borrower would be deemed to be for the use or direct benefit of a subject borrower if the proceeds of loan or an asset purchased with the proceeds of a loan to a named borrower are transferred to a subject borrower without the exchange of equivalent value.

Under the reproposed regulation a subject borrower would be deemed to control or be under common control with a named borrower if the subject borrower: (1) Owns, controls, or has the power to vote 25 percent or more of the named borrower's voting securities; (2) controls or has the power to control the election of a majority of the named borrower's board of directors; (3) exercises or has power to exercise a controlling influence over the management of the named borrower's operations; or (4) shares a common directorate or management with the named borrower.

It is not necessary for both borrowers to have identical boards of directors for a common directorate to exist. A common directorate would be deemed to exist when borrower A effectively controls or has the power to effectively control decisions of the board of directors of borrower B. It is not even necessary for the members of the board of the subject borrower to be members of the board of the named borrower for common management to exist. Common management would be deemed to exist if any employee of one borrower holds the position of chief executive officer, chief operating officer, or chief financial officer of another.

The rules of attribution can be illustrated by the following example. Borrower Smith has two loans; loan A and loan B. Jones is the named borrower on three loans, loans X, Y, and Z. Loan documentation evidences that Smith is primarily liable on X, which is in the name of Jones, but not on loans Y and Z. When a loan made to Jones is attributed to Smith, that loan is added to Smith's other loans to determine total loans. Thus, when determining Smith's total loans for determining lending limit conformance, loan X would be attributed to Smith. Therefore, loans A, B, and X would be totaled, or aggregated, to determine the total loans to Smith. Borrower Jones' total obligation includes loans X, Y and Z. Even though loan X is being combined with Smith's loans for the purpose of computing Smith's total obligation, it is not removed from the named borrower (Jones') total of loans used to compute whether Jones's total exceeds the institution's lending limit. If, however, Smith and Jones are partners and rely on the same primary source of repayment for all loans, then all loans to both partners would be aggregated together. For example, assume loans B, X, and Y are partnership loans. Loan A is an additional operating loan to Smith. Loan Z is a rural housing loan to Jones. The partnership operation is the primary source of income and repayment for both Smith and Jones. Thus, for the purposes of determining lending limits, all loans to Smith, Jones and the partnership would be combined, or aggregated, to determine total loans.

The reproposed regulation would require each institution to designate loans that are required to be attributed to and aggregated with the loans of another borrower, in order to monitor and ensure compliance with the lending limits. If the institution does not have the capability to combine loans through a data base, the loan files should have a manual flag to ensure that all loans are included when determining whether additional loans can be extended.

***G. Timing of Determinations***

Under the reproposed regulation, the determination of whether a borrower's indebtedness exceeds the lending limit would be made at the time the loan or commitment is made. An institution would be allowed to fund a loan commitment if the commitment, when combined with all other loans and commitments outstanding or attributed to the borrower, is within the lending limit when made, even if the institution experiences a decline in capital, and thus its lending limit. However, such loans would become nonconforming and would require action by the institution, as more fully discussed below under "H. *Decline in lending limits.*"

Similarly, the determination of whether to attribute a loan made to a named borrower to a subject borrower would be made at the time a new loan is made, prior to advancing funds. For purposes of these lending limit regulations, new loans are not meant to include renewals and restructurings, as defined in § 614.4440(h), unless new funds are advanced to the borrower, a different borrower is substituted for an original borrower who is subsequently released, or another borrower who is primarily liable is added to the loan contract. The restructuring of a loan that results in extended repayment terms, additional security or adjusted interest rates is not considered a new loan as long as new monies are not advanced or a new obligor created or added.

Loan renewals that result in the advancement of new funds (e.g., PCA operating lines, additional advances) will be considered new loans for purposes of determining lending limits. This determination of when a loan renewal represents a new loan is consistent with other regulators, as well as with the FCA's position on the issue of converting protected stock to eligible borrower stock when renewing PCA operating loans. Only the principal balance of the loan is considered in lending limit calculations, but in the case of renewals or restructurings that involve the capitalization of interest, the interest amount that has been capitalized is considered loan principal. Therefore, for the purposes of this subpart, the capitalization of accrued but uncollected interest would be considered the extension of new monies.

***H. Decline in Lending Limits***

A reduction in capital resulting in a lower lending limit may cause a loan or commitment that was previously within the lending limit to exceed it. Although this would cause the loan or commitment to because nonconforming, it would not result in a violation of lending limits. All loans or commitments must be within the lending limit at the time the loan or commitment is made; loans or commitments that if fully funded would exceed the lending limit on the day the loan or commitment is made would violate the regulation. Although the institution would not violate the regulation if it fully funds a loan commitment that was within the lending limit when it was made even if it exceeds the lending limit on the date of funding, the amount of credit to the borrower in excess of the lending limit would be nonconforming and no additional credit could be granted to the borrower until the borrower's indebtedness is within the institution's new lending limit. Therefore, it is in the institution's best interest to participate the loan if it anticipates a decline in capital or a request for additional credit from a borrower whose obligations are nearing the lending limit.

When an institution is requested to enter into a commitment that it anticipates may exceed its lending limit in the future, prudent lending practice would dictate the institution take precautions to permit the escape from such a dilemma by either entering into a participation with another institution or including a protective clause in the commitment that would release the institution from its obligation to fund the commitment if doing so would exceed the lending limit. To ensure that institutions make every attempt to bring loans into conformance, the reproposed regulations would require the institutions to have, for each nonconforming loan, a written plan that documents the specific actions that will be taken to make the loan conform, whether through participation with another lender or pay downs by the borrower. The level of nonconforming loans and the length of time a nonconforming loan remains on the books will be monitored through the examination process to ensure that institutions are not purposefully entering into loans or commitments when capital declines are anticipated.

Violations of lending limits, including extensions of credit when a loan has become nonconforming as a result of a decline in the lending limit, would be subject to possible enforcement actions when the violation is knowing and willful. The entire range of enforcement options and remedial measures would be considered, including requiring the entire loan that caused the violation to be repaid before any new credit could be extended.

***I. Transition Period***

The reproposed regulation would provide for a transition period that would allow all nonconforming loans to be brought into conformance with the new regulations by the earlier of the next maturity date or the next loan servicing action, but no later than 18 months from the effective date of the regulation. An institution would not be considered in violation of the regulation during the transition period if a loan was made prior to any change in the regulation if the loan conformed with the existing regulations.

Under the reproposed regulation, if an institution enters into a binding commitment prior to the effective date of the regulations that does not conform to the new regulations, advances under the commitment would be allowed provided the lender has documentation that demonstrates that the commitment represents a legal obligation to fund incurred before the effective date of the change. However, if the funding of the commitment results in a nonconforming loan, no new extensions of credit could be made except pursuant to the commitment or except for the purpose of protecting the institution's interest or collateral.

Every effort should be made to bring loans into conformance with the new lending limit. A loan servicing action, where the institution has the opportunity to change the contractual terms, such as an extension or reamortization, presents an opportunity to bring loans into conformance. Loans that cannot be brought into conformance by the end of the transition period would be allowed to be retired or liquidated in an orderly fashion. No further advances to the borrower would be permitted, except those that are necessary to protect the institution's interest and/or collateral position. As discussed earlier, all nonconforming loans would be required to have a documented plan of action on how the loan will be brought into conformance.

***J. Other Financing Institutions (OFIs)***

The reproposed regulation would require an institution to aggregate loans to a borrower purchased from or discounted for another lender with any direct loans to that borrower for the purpose of applying the lending limit. This requirement would be in addition to the requirement of § 614.4565, which limits OFI extensions of credit to a single borrower to the lesser of 50 percent of the OFI's capital and surplus or any regulatory or statutory lending limit. The FCA does not propose to amend § 614.4565 at this time, but intends to consider whether concentrations of risk in OFIs discounting with the FCB could be more effectively addressed in the general financing agreement. In the interim the FCA expects institutions that have a discounting relationship with OFIs to examine further their own procedures for limiting loss exposure from these loans and to consider imposition of more restrictive limits, if necessary.

***K. Bank for Cooperatives***

The proposed regulation would have made several changes to existing regulations delineating lending limits for the BCs. The proposed regulations would have deleted the requirement that BC loans be reduced to established lending limits over a reasonable period of time if the BC experiences a decline in its lending limit that causes the lending limit to be exceeded.

While the FCCA commented that this subpart should be retained, the FCA continues to believe this paragraph should be deleted. The reproposed regulation would allow each institution maximum of 18 months to bring loans into conformance with the lending limits and would prescribe the proper treatment of loans and commitments that have become excessive due to a decline in the lending limits.

Existing regulations establish a Systemwide BC lending limit, which limits loans to one borrower by one or more BCs to the lending limits for individual BCs applied to their combined net worth of the individual BCs. The reproposed regulation would delete this limitation. With the merger of 10 of the district BCs and the CBC to form CoBank, the capital base of the merged entity will result in a lending limit that will permit a loan to one borrower that is much larger than any individual bank could previously lend. Therefore, the FCA believes this regulation is unnecessary since the percentages applied to the merged entity alone are nearly as large as the percentages applied to the combined net worth of the 13 banks for cooperatives. Also, with the disappearance of the CBC, the Systemwide limitation for BCs would be no different than the combined limitation for the CoBank and the district banks.

Existing regulations set forth requirements for determining lending limits for the purpose of purchasing participations in loans of other banks for cooperatives. Because of changes made to other sections of the lending limit regulations, this section is redundant and the reproposed regulation would delete it. The reproposed regulation would require purchased loan participations to be aggregated with direct loans before the lending limit is applied.

Unlike existing regulations, which relate the lending limit to net worth, the reproposed regulation would also require lending limit percentages to be applied against permanent capital, computed on a monthly basis and in accordance with subpart H of part 615, except that protected stock could be included until January 1, 1998. Since this computation eliminates double counting of capital, the requirement of existing regulations to subtract investments in the purchasing bank owned by the originating bank for cooperatives prior to computation is redundant and would be deleted in the reproposed regulation.

**List of Subjects in 12 CFR Parts 614 and 619**

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

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

**PART 614 -- LOAN POLICIES AND OPERATIONS**

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

**Authority:** Secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 2.0, 2.2, 2.3, 2.4, 2.10, 2.12, 2.13, 2.15, 3.0, 3.1, 3.3, 3.7, 3.8, 3.10, 3.20, 3.28, 4.12, 4.12A, 4.13, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.19, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.7, 7.8, 7.12, 7.13, 8.0, 8.5; 12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2096, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2199, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2207, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a-2, 2279b, 2279b-1, 2279b-2, 2279f, 2279f-1, 2279aa, 2279aa-5; sec. 413 of Pub. L. 100-233.

**Subpart A -- Lending Authorities**

2. Section 614.4000 is amended by adding a new paragraph (e) to read as follows:

**§ 614.4000 Farm Credit Banks.**

\* \* \* \* \*

(e) *Other interests in loans.* (1) Subject to the requirements of subpart H of this part, Farm Credit Banks may sell interests in loans to Farm Credit System institutions authorized to purchase such interests and to other lending institutions that are not Farm Credit System institutions.

(2) Subject to the requirements of subpart H of this part, Farm Credit Banks may purchase interests other than participation interests in loans and nonvoting stock from other Farm Credit System institutions.

(3) Farm Credit Banks may purchase interests in loans (other than participation interests authorized in paragraph (d) of this section) from institutions other than Farm Credit System institutions only for the purpose of pooling and securitizing such loans under title VIII of the Act.

(4) Farm Credit Banks may purchase an interests in a pool of subordinated participation interests that contains a subordinated participation interest in a loan it has originated, to satisfy the requirements of title VIII of the Act with respect to such loan.

3. Section 614.4010 is amended by adding a new paragraph (f) to read as follows:

**§ 614.4010 Agricultural credit banks.**

\* \* \* \* \*

(f) *Other interests in loans.* (1) Subject to the requirements of subpart H of this part, agricultural credit banks may sell interests in loans originated under paragraphs (a) and (b) of this section to other Farm Credit System institutions authorized to purchase such interests and to other lending institutions that are not Farm Credit System institutions.

(2) Subject to the requirements of subpart H of this part, agricultural credit banks may purchase interests in loans and nonvoting stock from other Farm Credit System institutions.

(3) Agricultural credit banks may purchase interests in loans (other than participation interests authorized in paragraph (e) of this section) from institutions other than Farm Credit System institutions only for the purpose of pooling and securitizing such loans under title VIII of the Act.

(4) Agricultural credit banks may purchase an interest in a pool of subordinated participation interests that contains a subordinated participation interest in a loan it has originated, to satisfy the requirements of title VIII of the Act.

4. Section 614.4030 is amended by adding a new paragraph (c) to read as follows:

**§ 614.4030 Federal land credit associations.**

\* \* \* \* \*

(c) *Other interests in loans.* (1) Subject to the requirements of subpart H of this part, Federal land credit associations may sell interests in loans made under paragraph (a) of this section to Farm Credit banks, as authorized by their respective funding Farm Credit Banks, and to other lending institutions that are not Farm Credit System institutions.

(2) Subject to the requirements of subpart H of this part, Federal land credit associations may purchase interests in loans and nonvoting stock from Farm Credit banks, as authorized by their respective funding Farm Credit Banks.

(3) Federal land credit associations may purchase interests in loans (other than participation interests authorized in paragraph (b) of this section) from institutions other than Farm Credit System institutions *only* for the purpose of pooling and securitizing such loans under title VIII of the Act.

(4) Federal land credit associations may purchase an interest in a pool of subordinated participation interests that contains a subordinated participation interest in a loan it has originated, to satisfy the requirements of title VIII of the Act.

5. Section 614.4040 is amended by adding a new paragraph (d) to read as follows:

**§ 614.4040 Production credit associations.**

\* \* \* \* \*

(d) *Other interests in loans.* (1) Subject to the requirements of subpart H of this part, production credit associations may sell to and purchase from Farm Credit banks, interest in loans, as authorized by their respective funding Farm Credit Banks.

(2) Production credit associations may purchase interests in loans (other than participation interests authorized by paragraph (c) of this section) from institutions other than Farm Credit banks only for the purpose of pooling and securitizing such loans under title VIII of the Act.

(3) Production credit associations may purchase an interest in a pool of subordinated participation interests that contains a subordinated participation interest in a loan it has originated, to satisfy the requirements of title VIII of the Act.

(6) Section 614.4050 is amended by adding a new paragraph (d) to read as follows:

**§ 614.4050 Agricultural credit associations.**

\* \* \* \* \*

(d) *Other interests in loans.* (1) Subject to the requirements of subpart H of this part, agricultural credit associations may sell interests in loans made under paragraph (a) of this section to Farm Credit banks, as authorized by their respective funding Farm Credit Banks, and to other lending institutions that are not Farm Credit System institutions.

(2) Subject to the requirements of subpart H of this part, agricultural credit associations may purchase interests in loans and nonvoting stock from Farm Credit banks, as authorized by their respective funding Farm Credit banks.

(3) Agricultural credit associations may purchase interests in loans (other than participation interests authorized by paragraph (c) of this section) from institutions other than Farm Credit System institutions *only* for the purpose of pooling and securitizing such loans under title VIII of the Act.

(4) Agricultural credit associations may purchase an interest in a pool of subordinated participation interests that contains a subordinated participation interest in a loan it has originated, to satisfy the requirements of title VIII of the Act.

7. Subpart F is revised to read as follows:

**Subpart F -- Appraisal Requirements**

Sec.

614.4240 Appraisal definitions.

614.4245 Appraisal policies.

614.4250 Appraisal standards.

614.4255 Appraiser independence.

614.4260 Appraiser qualifications.

614.4265 Real property appraisals.

614.4266 Appraisals of personal property and intangibles.

**Subpart F -- Appraisal Requirements**

**§ 614.4240 Appraisal definitions.**

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

(a) *Abundance of caution,* when used to describe decisions to require collateral, means that the collateral is required in circumstances in which it is not required by statute, regulation or the institution's policies, and it would not be required by a prudent lender to support the credit decision. To qualify for the abundance of caution exception to the requirements of this subpart, the institution must document in the loan file that the application, when evaluated on the credit factors set forth in § 614.4160 without considering the collateral that is the subject of the appraisal, would support the credit decision.

(b) *Appraisal* means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

(c) *Appraisal Foundation* means the Appraisal Foundation established on November 30, 1987, by professional appraisal organizations, as a not-for-profit corporation under the laws of Illinois, in order to enhance the quality of professional appraisals.

(d) *Appraisal Subcommittee* means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(e) *Cost approach* means the valuation process by which an appraiser establishes an indicated value by measuring the current cost to construct a reproduction or replacement for the improvements minus the amount of depreciation (physical deterioration, or functional and/or economic obsolescence) evident in the structure from all causes plus the market value of the land.

(f) *Designated appraiser* means a qualified appraiser that has successfully completed at least 60 course hours of agricultural real estate appraisal training (of a type recognized by a State certification authority) and the minimum appraisal educational and experience requirements to be licensed by such State as a real estate appraiser. Such minimum appraisal educational requirements shall include courses on real estate economic theories and principles, income and discounted cash, and appraisal standards and ethics.

(g) *Fee appraiser* means a qualified appraiser who is not an employee of the contracting institution and performs an appraisal on a fee basis. For purposes of this subpart, a fee appraiser may include a "qualified" staff appraiser from another Farm Credit institution only if the employing institution is not operating under joint management with the contracting institution.

(h) *Highest and best use* means the reasonable and most probable use of the property that would result in the highest market value of vacant land or improved property, as of the date of valuation.

(i) *Income capitalization approach* means the procedure that values property by measuring the present value of the expected future benefits of property ownership. The income capitalization approach requires that the present value discount rate (or capitalization rate) be derived by the investigation of acceptable rates of return to owners of similar properties. Favorable or unfavorable features of the subject property such as commodity markets, roads, transportation, community facilities, dwelling value, and other amenities must be considered in the valuation.

(j) *Market value* means the most probable price in cash, in terms of financial arrangements equivalent to cash, or in other precisely revealed terms, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale (including exposure on the open market for a reasonable time), with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under duress.

(k) *Personal property* for purposes of this subpart, means all tangible and moveable property not considered real property or fixtures.

(l) *Qualified appraiser* means an individual, who is competent, reputable, impartial and has sufficient training and experience in appraising property of the type that is the subject of the appraisal (subject property) to perform a competent appraisal and meets the institution's standards for appraiser qualifications.

(m) *Real estate-related financial transactions* means any transaction involving:

(1) The sale, lease, purchase, investment in or exchange of real property, including interest in property or the financing thereof; or

(2) The refinancing of real property or interests in real property; or

(3) The use of real property or interests in real property as security for a loan or investment, including mortgage-backed securities.

(n) *Sales comparison approach* means the procedure that values property by comparing the subject property to similar properties located in relatively close proximity, having similar size and utility, and having been recently sold in arms-length transactions (comparable sales). The sales comparison approach requires the appraiser to estimate the degree of similarity and difference between the subject property and comparable sales. Such comparison shall be made on the basis of conditions of sale, financing terms, market conditions, location, physical characteristics, and income characteristics. Appropriate adjustments shall be made to the comparable property based on the identified deficiencies or superiorities to arrive at a probable price for which the subject property could be sold on the date of the appraisal.

(o) *State-certified appraiser* means any individual who has satisfied the requirements for and been certified as a real estate appraiser by a State or territory whose requirements for certification currently meet or exceed the minimum criteria for certification issued by the Appraiser Qualification Board of the Appraisal Foundation.

(p) *State-licensed appraiser* means any individual who has satisfied the requirements for licensing and has been licensed as a real estate appraiser by a State or territory in which the licensing procedures comply with the licensing criteria of the Appraisal Subcommittee.

(q) *Transaction value* means:

(1) For loans or other extensions of credit, the amount of the loan, loan commitment, or other extensions of credit;

(2) For sales, leases, purchases, and investments in or exchanges of real property, the market value of the property interest involved; and

(3) For the pools of loans or interests in real property, the transaction value of the individual loans or the market value of the real property interests comprising the pool.

(r) *USPAP* means the Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Foundation.

**§ 614.4245 Appraisal policies.**

(a) The board of directors of each Farm Credit institution that extends credit or engages in leasing shall adopt well-defined and effective appraisal policies and standards that are formulated to insure that appraisals are completed by persons that have the knowledge and experience to perform the assigned work competently and in an unbiased manner. The policies and standards shall, at a minimum:

(1) Incorporate the requirements of and be consistent with this subpart;

(2) Be consistent with the Uniform Standards of Professional Appraisal Practice (USPAP);

(3) Establish standards for the qualifications, education, and competence of appraisers who perform appraisals for the institution, which standards shall be consistent with USPAP; and

(4) Establish criteria for determining the circumstances under which collateral appraisals will be required and when they will be required, which criteria must, at a minimum, take into account such factors as market trends, market volatility, and various types of credit, loan, servicing, collection, and liquidation actions.

(b) Federal land bank associations shall, with the approval of their respective Farm Credit banks, adopt appraisal policies that reflect bank policies and standards.

**§ 614.4250 Appraisal standards.**

(a) When real, personal, or intangible property is required as security pursuant to subparts D and E of part 614 or is relied upon in making the credit decision, all appraisals shall be performed in conformance with the USPAP standards as adopted by the Appraisal Foundation except as provided in paragraph (b) of this section. Specifically, the appraisal must:

(1) Disclose any steps taken to comply with the USPAP "Competency Provision," as appropriate;

(2) Value the subject property in its "as is" condition based upon market value as defined in § 614.4240 of this subpart;

(3) Be presented in a written format and satisfy the requirements of this subpart;

(4) Consider the purpose for which the property will be used and the property's highest and best use, if different from the intended use;

(5) Be sufficiently descriptive to enable the reader to ascertain the estimated market value and the rationale for the estimate;

(6) Provide sufficient detail and depth analysis to reflect the relevant characteristics and complexity of the property appraised;

(7) Analyze and report, as appropriate, on --

(i) The current income-producing capacity of the property;

(ii) A reasonable marketing period for the property;

(iii) The current market conditions and trends that will affect projected income, to the extent such conditions will affect the value of the property; and

(iv) The appropriate deductions and discounts as they would apply to the property, including but not limited to condition of the facilities and property, specialization of the operation and property, and other potential liabilities including those associated with any hazardous waste;

(8) Include in the certification required by the USPAP an additional statement that the appraisal assignment was not based on a requested minimum valuation or specific valuation or approval of a loan; and

(9) Contain sufficient supporting documentation (including a legal description of real-property) with all pertinent information reported so that the appraiser's reasoning, judgment, and analysis in arriving at a conclusion indicate to the reader the reasonableness of the market value reported.

(b) Appraisals of real, personal, and intangible property may be performed using the "Departure Provisions" of USPAP only under one of the following conditions:

(1) The transaction value is $50,000 or less;

(2) A lien on the property has been taken as collateral solely through an abundance of caution and the terms of the transaction as a consequence have not been made more favorable than they would have been in the absence of the lien;

(3) There is a subsequent transaction resulting from the maturing extension of credit, provided that:

(i) The borrower has performed satisfactorily according to the original terms;

(ii) No new monies have been advanced other than as previously agreed;

(iii) The credit standing of the borrower has not deteriorated; and

(iv) There has been no material deterioration in market conditions or physical aspects of the property that would threaten the institution's collateral position; or

(4) An institution purchases a loan or interest in a loan, pooled loans, or interests in real property, including mortgage-backed securities, provided that the appraisal prepared for each pooled loan or real property interest, when originated, met the appraisal standards of this regulation, other Federal regulations adopted pursuant to the Financial Institutions Recovery, Reform, and Enforcement Act of 1989, or the requirements of the government-sponsored secondary market intermediaries under whose auspices the interest is sold.

**§ 614.4255 Appraiser independence.**

(a) Except as provided for in paragraph (c) of this section, all appraisals of real, personal, and intangible property that serve as the primary security for a loan shall be performed by a qualified appraiser who has no direct or indirect interest, financial or otherwise, in the loan or subject property and is not engaged in the marketing, lending, collections, or credit decision processes of any of the following:

(1) A Farm Credit institution making or originating the loan;

(2) A Farm Credit institution operating under common management with the institution making or originating the loan; or

(3) A Farm Credit institution purchasing an interest in the loan. In those cases where an appraisal has been performed by an individual from another Farm Credit institution for a loan in which such institution subsequently purchases an interest, the appraiser shall not participate in any decision related to the loan purchase.

(b) Fee appraisers shall be engaged directly by the institution or its agent, and shall have no direct or indirect interest, financial or otherwise, in the property or transaction.

(c) For transaction values of $50,000 or less, if the only "qualified" persons available to perform an appraisal are involved in the marketing, lending, collections, or credit decision processes of the institution, the institution may use such persons as appraisers provided it takes appropriate steps to ensure that the appraiser exercises independent judgment and that the appraisal is adequate. Such steps shall include, but are not limited to:

(1) Procedures for ensuring that an individual shall not perform appraisals in connection with transactions in which the appraiser is otherwise involved, professionally or individually; and

(2) Prohibiting directors, officers, and employees from participating in any vote or approval involving assets on which they performed an appraisal.

**§ 614.4260 Appraiser qualifications.**

(a) *Real, personal, and intangible property.* All appraisals shall be performed by a qualified appraiser who meets the established standards of the Farm Credit institution obtaining the appraisal.

(b) *Real estate.* For all appraisals completed after January 1, 1992, the following requirements shall apply:

(1) Appraisals for real estate-related financial transactions with transaction values of $1,000,000 or more shall be performed by a qualified appraiser who is a State-certified real estate appraiser.

(2) Appraisals for all real estate-related financial transactions with transaction values of less than $1,000,000 but in excess of $250,000 shall be performed by a qualified appraiser who is a State-certified real estate appraiser. For appraisers completed prior to January 1, 1994, the requirements of this paragraph may be met by appraisals performed by a designated appraiser.

(3) Appraisals for real estate-related financial transactions with transaction values of $250,000 or less but in excess of $50,000 shall be performed by a qualified appraiser who is a State-certified real estate appraiser or a State-licensed appraiser. For appraisals completed prior to January 1, 1994, the requirements of this paragraph may be met by appraisals performed by a designated appraiser.

(4) Appraisals of real property securing a loan shall not be required to be completed by a State-certified, designated, or State-licensed appraiser for transactions in which:

(i) The transaction value is $50,000 or less;

(ii) A lien on real property has been taken as collateral solely out of an abundance of caution and the terms of the transaction as a consequence have not been made more favorable than they would have been in the absence of the lien;

(iii) There is a subsequent transaction resulting from the maturing extension of credit, provided that:

(A) The borrower has performed satisfactorily according to the original terms;

(B) No new monies have been advanced other than as previously agreed;

(C) The credit standing of the borrower has not deteriorated; and

(D) There has been no material deterioration in market conditions or physical aspects of the property that would threaten the institution's collateral position; or

(iv) An institution purchases a loan or an interest in a loan, pool of loans (real property), or mortgage-backed securities, provided that the appraisal prepared for each pooled loan or real property interest, when originated, met the appraisal standards of this regulation, other Federal regulations adopted pursuant to the Financial Institutions Recovery, Reform, and Enforcement Act of 1989, or the requirements of the government-sponsored secondary market intermediaries under whose auspices the interest is sold.

**§ 614.4265 Real property appraisals.**

(a) Real estate shall be valued on the basis of market value.

(b) Real estate shall be valued by a reasonable valuation method that considers the income capitalization approach, the sales comparison approach, and/or the cost approach, as appropriate under the provisions of USPAP.

(c) At a minimum, where the real estate is an integral part of and supports the principal source of loan repayment, the appraiser shall develop and document in the appraisal, in accordance with USPAP, the income capitalization approach (establishing a production earnings capacity for the property) and at least one of the other two approaches to valuing real estate, whichever is appropriate. The earnings capacity established on such properties shall be documented as part of the credit analysis for any related loan action whether the income approach value is used as the market value or not.

(d) Collateral closely aligned with, an integral part of, and normally sold with real estate (fixtures), may be included in the value of the real estate. All other collateral associated with the real estate, but designated as personal property, shall be appraised as personal property in accordance with paragraph (b) of this section.

(e) The appraisal shall properly identify all nonagricultural influences, including but not limited to, urban influence, mineral deposits, and commercial building development value.

(f) The "Departure Provisions" of USPAP may not be used for real estate appraisals unless such appraisals meet the conditions of § 614.4250(b).

**§ 614.4266 Appraisals of personal property and intangibles.**

(a) Personal property and intangibles shall be valued on the basis of market value in accordance with the USPAP and the institution's appraisal standards and policies.

(b) The "Departure Provisions" of USPAP may not be used for personal property and intangible appraisals unless such appraisals meet the conditions of § 614.4250(b).

(c) Personal property appraisals shall include a description of the property being appraised, including location of the property.

(d) Appraisals of intangibles shall include a review and description of the legal documents supporting the property interests and marketability of the intangible property, including applicable terms, conditions, and restrictions contained in the document that would affect the value of the property.

8. Subpart H is revised to read as follows:

**Subpart H -- Loan Purchases and Sales**

Sec.

614.4325 Purchase and sale of interests in loans.

614.4330 Loan participations.

614.4335 Borrower stock requirements.

614.4336 Borrower rights

.

614.4337 Disclosure to borrowers.

**Subpart H -- Loan Purchases and Sales**

**§ 614.4325 Purchase and sale of interests in loans.**

(a) For the purposes of this subpart, the following definitions shall apply:

(1) *Interests in loans* means ownership interests in the principal amount, interest payments or any aspect of a loan transaction, including servicing rights.

(2) *Lead lender* means a lending institution having a direct contractual relationship with a borrower to advance funds, which institution sells or assigns an interest or interests in such loan to one or more other lenders.

(3) *Loan* means any extension of credit or similar financial assistance of the type authorized under the Act, such as leases, guarantees, letters of credit, and other similar transactions.

(4) *Loan participation* means a fractional undivided interest in the principal amount of a loan that is sold by a lead lender to a participating institution in accordance with the requirements of § 614.4330. The term "loan participation" does not include a subordinated participation interest.

(5) *Participating institution* means an institution that purchases a fractional undivided interest in the principal amount of a loan originated by another lender.

(6) *Sale with recourse* means a sale of a loan or an interest in a loan in which the seller:

(i) Retains some risk of loss from the transferred asset for any cause except the seller's breach of usual and customary warranties or representations designed to protect the purchaser against fraud or misrepresentation; or

(ii) Has an obligation to make payments of principal or interest to any party resulting from:

(A) Default on principal or interest on the loan by the borrower or any other deficiencies in the obligor's performance;

(B) Changes in the market value of the assets after transfer;

(C) Any contractual relationship between the seller and purchaser incident to the transfer that, by its terms, could continue even after final payment, default, or other termination of the assets transferred; or

(D) Any other cause.

(7) *Subordinated participation interest* means an interest in a loan that bears the first risk of loss, including the retention of such an interest when a loan is sold to a pooler certified by the Federal Agricultural Mortgage Corporation pursuant to title VIII of the Act, or an interest in a pool of subordinated participation interests purchased to satisfy the requirements of title VIII of the Act with respect to a loan sold to such a certified pooler.

(b) *Authority to purchase and sell interests in loans.* Loans and interests in loans may only be sold in accordance with each institution's lending authorities, as set forth in subpart A of this part. No Farm Credit institution may purchase from an institution that is not a Farm Credit institution any interest in a loan, except for the purpose of pooling and securitizing such loans under title VIII of the Act, unless such an interest is a participation interest that qualifies under the institution's lending authority, as set forth in subpart A of this part, and meets the requirements of § 614.4330.

(c) *Policies.* Each Farm Credit institution that is authorized to sell or purchase interests in loans under subpart A of this part shall exercise that authority in accordance with a policy adopted by its board of directors that addresses the following matters:

(1) The types of institutions to which the institution is authorized to sell interests in loans;

(2) The types of loans in which the institution may purchase or sell an interest, and the types of interests which may be purchased or sold;

(3) The underwriting standards to be applied in the purchase of interest;

(4) Such limitations on the aggregate principal amount of interests in loans that the institution may purchase from a single institution as are necessary to diversify risk and such limitations on the aggregate amount the institution may purchase from all institutions as are necessary to assure that service to the territory is not impeded;

(5) Provision for the identification and reporting of loans in which interests are sold or purchased;

(6) Requirements for providing and securing in a timely manner adequate credit and other information needed to make an independent credit judgment; and

(7) Any limitations or conditions to which sales or purchases are subject that the board deems appropriate, including arbitration.

(d) *Purchase and sale agreements.* Agreements to purchase or sell an interest in a loan shall, at a minimum:

(1) Identify the particular loan(s) to be covered by the agreement;

(2) Provide for the transfer of credit and other borrower information on a timely and continuing basis;

(3) Provide for sharing, dividing, or assigning collateral;

(4) Identify the nature of the interest(s) sold or purchased;

(5) Set forth the rights and obligations of the parties and the terms and conditions of the sale; and

(6) Contain any term necessary for the appropriate administration of the loan and the protection of the interests of the Farm Credit institution.

(e) *Independent credit judgment.* Each institution that purchases an interest in a loan shall make a judgment on the creditworthiness of the borrower that is independent of the originating or lead lender and any intermediary seller or broker prior to the purchase of the interest and prior to any servicing action that alters the terms of the original agreement, which judgment shall not be delegated to any person(s) not employed by the institution. No employee who performed an appraisal on any collateral supporting a loan shall participate in the decision to purchase that loan. The independent credit judgment shall be documented by a credit analysis that considers factors set forth in § 614.4160 and is independent of the originating institution and any intermediary seller or broker. The credit analysis shall consider such credit and other borrower information as would be required by a prudent lender and shall include an evaluation of the capacity and reliability of the servicer. Boards of directors of jointly managed institutions shall adopt procedures to ensure that the interests of their respective shareholders are protected in participations between such institutions.

(f) *Limitations.* The aggregate principal amount of interests in loans purchased from a single lead lender and the aggregate principal amount of interests in loans purchased from other institutions shall not exceed the limits set in the institution's policy.

(g) *Lending limits.* In order to exclude the principal amount of interests sold from the principal amount of the loan for the purpose of determining compliance with the lending limits set forth in subpart J of this part, sale agreements must meet the following requirements:

(1) The interest sold must be an undivided interest in the principal amount of the loan and all collateral securing the loan;

(2) The interest must be sold without recourse; and

(3) The agreement under which the interest is sold must provide for the sharing of all payments of principal, collection expenses, collateral proceeds and risk of loss on a pro rata basis according to the percentage interest in the principal amount of the loan. Agreements that provide for the pro rata sharing to commerce at the time of default or similar event, as defined in the agreement under which the interest, is sold, shall be considered to be pro rata agreements, notwithstanding the fact that advances are made and payments are distributed on a basis other than pro rata prior to that time.

(h) *Sales with recourse.* When a loan or interest in a loan is sold with recourse, it shall be accorded the following treatment:

(1) The loan shall be considered, to the extent of the recourse, an extension of credit by the purchaser to the seller, as well as an extension of credit, from the seller to the borrower(s), for the purpose of determining whether credit extensions to a borrower are within the lending limits established in subpart J of this part.

(2) The amount of the loan subject to the recourse agreement shall be considered a loan sold with recourse for the purpose of computing permanent capital ratios.

**§ 614.4330 Loan participations.**

Agreements to purchase or sell a participation interest shall be subject to the provisions of § 614.4325, and, in addition, shall satisfy the requirements of this section.

(a) *Participation agreements.* Agreements to purchase or sell a participation interest in a loan shall, in addition to meeting the requirements of § 614.4325(d), at a minimum:

(1) Define the duties and responsibilities of the participating institution and the lead lender, and/or the servicing institution, if different from the lead lender;

(2) Provide for loan servicing and monitoring of the servicer;

(3) Set forth authorization and conditions for action in the event of borrower distress or default;

(4) Provide for sharing of risk;

(5) Set forth conditions for the offering and acceptance of the loan participation and termination of the agreement;

(6) Provide for sharing of fees, interest charges, and costs between participating institutions;

(7) Provide for a method of resolution of disagreements arising under the agreement between two or more Farm Credit System institutions;

(8) Specify whether the contract is assignable by either party; and

(9) Provide for the issuance of participation certificates to the participants evidencing an undivided interest in a loan.

(b) *Retention requirement.* No participation interest may be purchased from an institution that is not a Farm Credit institution unless the servicing institution has an ownership interest in the principal amount of the loan of at least 10 percent, or the amount permitted by the institution's lending limit, which ownership interest cannot be assigned separately from the servicing rights.

(c) *Intrasystem participations.* Loans participated between or among Farm Credit System institutions shall meet the borrower eligibility, membership, loan term, loan amount, loan security, and stock purchase requirement of the originating lender.

**§ 614.4335 Borrower stock requirements.**

(a) As a condition of obtaining a loan by or through a Farm Credit institution, including loans originated for sale to other lenders, a borrower shall meet the institution's minimum stock purchase requirements. Such stock may be retired only if the institution meets its minimum permanent capital standards and only in accordance with paragraphs (a)(1), (a)(2), or (a)(3) of this section.

(1) If the loan or a portion of the loan is sold with recourse (including a sale of a portion of the loan with a retained subordinated interest), or if the entire loan is sold without recourse but an interest in a pool of subordinated participation interests is purchased or a contribution to a cash reserve is made to satisfy the requirements of title VIII of the Act with respect to the loan, borrower stock may not be retired below the institution's minimum stock purchase requirement for the entire loan.

(2) If a portion of the loan is sold without recourse and a portion is retained that is not a subordinated interest, a proportionate amount of borrower stock may be retired provided minimum regulatory capital requirements are met, but in no event may stock be retired below the institution's minimum stock purchase requirement for the portion retained.

(3) If the entire loan is sold without recourse and no interest in a pool of subordinated participation interests is taken and no contribution to a cash reserve is made to satisfy the requirements of title VIII of the Act with respect to the loan, the stock may be retired, provided regulatory capital requirements are met.

(b) If an institution repurchases a loan on which the stock has been retired, the borrower shall be required to repurchase stock in the amount of the minimum stock purchase requirement.

**§ 614.4336 Borrower rights.**

(a) Each institution that contemplates selling an interest in a loan subject to the borrower rights provisions of title IV of the Act shall either:

(1) Include provisions in the contract with the borrower that ensure that the purchaser of the loan will be obligated to accord the borrower the same rights "qualified lenders" must provide under the Act; or

(2) Obtain a waiver of the statutory borrower rights from the borrower. A waiver of borrower rights shall have no effect until the loan is sold and shall have no effect if the loan or a portion thereof is repurchased.

(b) Before obtaining a waiver of borrower rights for the purpose of selling a loan, the lending institution shall disclose to the borrower:

(1) A full and complete description of the statutory rights the borrower is asked to waive;

(2) Any changes in loan terms or conditions that will occur if the loan is not sold; and

(3) The fact that the waiver will not apply unless the loan is sold and will not apply if the loan is repurchased.

(c) The making of a loan may not be conditioned on a waiver of statutory borrower rights.

**§ 614.4337 Disclosure to borrowers.**

When an interest other than a participation interest in a borrower's loan is sold without servicing rights, the following disclosure shall be made to the borrower:

(a) The selling institution shall disclose to the borrower at least 10 days prior to the borrower's next payment date;

(1) The name, address and telephone number of the purchasing institution;

(2) The name and address of the party to whom payment is to be made;

(3) The effect of the sale upon the exercise of statutory borrower rights; and

(4) Any terms in the agreement that would permit a purchaser to change the terms or conditions of the loan.

(b) A purchasing institution shall not take any servicing action that adversely affects the borrower until it ensures that disclosure has been made to the borrower of:

(1) The name, address and telephone number of the purchasing institution; and

(2) The address where the payment should be sent.

**Subpart J -- Lending Limits**

9. Sections 614.4350, 614.4351, 614.4352, and 614.4353 are revised to read as follows:

**§ 614.4350 Definitions.**

For purposes of this subpart, the following definitions shall apply:

(a) *Borrower* means an individual, partnership, joint venture, trust, corporation, or other business entity (except a Farm Credit association or other financing institution, as defined in § 614.4540), to which an institution has made a loan or a commitment to make a loan either directly or indirectly.

(b) *Capital* means permanent capital as defined in § 615.5201(h), with adjustments required by § 615.5210(d) (1) through (4), except that stock protected under section 4.9A of the Act may be included in capital until January 1, 1998.

(c) *Commitment* means a legally binding, written obligation to extend credit, enter into lease financing, purchase or participate in loans or leases, or pay the obligation of another.

(d) *Control* means exercising a controlling influence on the affairs of another borrower or operating under common control with another borrower. A borrower is deemed to control another when the borrower:

(1) Owns, controls, or has power to vote 25 percent of more of the voting securities in another; or

(2) Controls in any manner the election of a majority of directors of another; or

(3) Exercises or has power to exercise a controlling influence over the management of another's operations; or

(4) Shares a common directorate or management with another. A common directorate is deemed to exist when one borrower can effectively control the board of directors of another borrower. Common management is deemed to exist if any employee of one borrower holds the position of chief executive officer, chief operating officer, or chief financial officer of another.

(e) *Loan* means any extension of credit or similar financial assistance authorized under the Act that is an asset of the institution whether it results from direct negotiations between a lender and a borrower or is purchased from or discounted for another lender, including participation interests. The term "loan" includes loans, contracts of sale, notes receivable, other similar obligations, guarantees, and lease financing. An institution "makes a loan" when it advances new funds, substitutes a different borrower for a borrower who is subsequently released, or adds another person's liability to an outstanding loan or commitment.

(f) *Primary liability* means an obligation to repay that is not conditioned upon an unsuccessful prior demand on another party.

(g) *Secondary liability* means an obligation to repay that only arises after an unsuccessful demand on another party.

**§ 614.4351 Banks.**

No Farm Credit Bank, agricultural credit bank, or Federal intermediate credit bank may, directly or indirectly, make or discount a loan, or enter into a commitment to make or discount a loan to a borrower, if after such loan or commitment the aggregate principal amount of all loans and commitments outstanding to a borrower, computed in accordance with § 614.4357, and loans and commitments attributed to such borrower under the rules of attribution set forth in § 614.4358 exceeds 20 percent of the bank's capital, calculated on a monthly basis.

**§ 614.4352 Direct lender associations.**

No direct lender association may make a loan or enter into a commitment to make a loan, if after such loan or commitment the aggregate principal amount of all loans and commitments outstanding to a borrower and loans and commitments attributed to such borrower under the rules of attribution set forth in § 614.4358, computed in accordance with § 614.4357, exceeds 20 percent of the association's capital, calculated on a monthly basis.

**§ 614.4353 Federal land bank associations.**

No Federal land bank association may assume endorsement liability on any loan or commitment outstanding to a borrower or attributed to a borrower under the rules of attribution set forth in § 614.4358, if after such endorsement the total of the association's endorsement liability on loans and commitments outstanding to or attributed to such borrower, computed in accordance with § 614.4357, would exceed 20 percent of the association's capital, calculated on a monthly basis.

10. Section 614.4354 is amended by removing paragraphs (a)(3), (a)(4), (b), (c), (d) and (e); redesignating paragraph (f) as new paragraph (b); and revising the introductory text of paragraph (a) to read as follows:

**§ 614.4354 Banks for cooperatives.**

(a) No bank for cooperatives may make a loan or enter into a commitment to make a loan to a borrower eligible to borrow under § 613.3110 if after the loan or commitment is made the aggregate principal amount of all loans and commitments outstanding to the borrower, computed in accordance with § 614.4357, and loans and commitments attributed to the borrower under the rules of attribution set forth in § 614.4358 exceeds the following percentages of the capital of the bank, calculated on a monthly basis.

\* \* \* \* \*

11. Sections 614.4357, 614.4358, and 614.4359 are added to read as follows:

**§ 614.4357 Computation of obligations.**

(a) *Inclusions.* For each borrower, loans subject to the lending limit shall include:

(1) The total unpaid principal of all legally enforceable loans and commitments outstanding, directly or indirectly, or attributed to a borrower, pursuant to § 614.4358, except as excluded by paragraph (b) of this section. Outstanding loans shall include loans that have been charged off on the books of the institution in whole or in part but have not been subsequently collected, except as excluded by paragraph (b)(3) of this section;

(2) Purchased interests in loans, including participation interests, to the extent of the amount of the purchased interest, including any undisbursed commitment; and

(3) Interests in loans, including participation interests, that are sold with recourse or sold pursuant to an agreement that provides for a divided interest in principal or collateral or for the sharing of risk and associated expenses on a basis other that pro rata, as described in § 614.4325(g)(3).

(b) *Exclusions.* The following loans and commitments to make such loans, when adequately documented in the loan file, may be excluded from loans to a borrower subject to the lending limit:

(1) Any loan or portion of a loan that carries a full faith and credit performance guaranty or surety of any department, agency, bureau, board, commission, or establishment of the United States Government, provided there is no evidence to suggest that the guaranty has become unenforceable and the institution can demonstrate that it is in compliance with the terms and conditions of the guarantee;

(2) Any loan that is fully secured by bonds, notes, certificates of indebtedness, or Treasury bills of the United States or by other such obligations fully guaranteed as to principal and interest by the United States, provided the loans are fully secured by the current market value of the obligations of the United States. If the market value of the collateral declines to below the balance of the loan, and the loan, when aggregated with other loans and commitments outstanding to or attributed to the borrower, causes the aggregate principal amount to exceed 20 percent of the institution's capital, the institution shall have 5 business days to bring the loan into conformance before it shall be deemed to be in violation of the lending limit;

(3) Loans that have been discharged in bankruptcy or that are legally unenforceable because of judicial decision or the expiration of the statute of limitations;

(4) Interests in loans sold, including participation interests, to the extent they have been sold without recourse, represent an undivided interest in principal and collateral, and share risk and associated expenses on a pro rata basis, as described in § 614.4325(g)(3); and

(5) Loans sold in their entirety to a pooler certified by the Federal Agricultural Mortgage Corporation, if an interest in a pool of subordinated participation interests is purchased to satisfy the requirements of title VIII of the Act.

**§ 614.4358 Attribution rules.**

(a) For the purpose of applying the lending limit to the indebtedness of a borrower (subject borrower), loans in the name of another borrower (the named borrower) shall be attributed to the subject borrower and aggregated with loans outstanding to the subject borrower when any of the following circumstances exist:

(1) The subject borrower is in any way primarily or secondarily liable for a loan made to the named borrower.

(2) The operations of a named borrower are so intertwined with the subject borrower's operations that the viability of the named borrower's operations will affect the viability of the subject borrower's operations.

(3) The subject borrower is deemed to be the source of repayment on the loan to the named borrower. Except for integrated operations (e.g., poultry processors), the subject borrower shall be deemed to be the source of repayment if the subject borrower supplies more than 30 percent of the named borrower's annual gross receipts. For the purpose of this paragraph, gross receipts includes, but is not limited to, gross revenues, intercompany loans, dividends and capital contributions.

(4) The proceeds of the loan to the named borrower are used by or for the direct benefit of the subject borrower. At a minimum, the proceeds of the loan to the named borrower shall be deemed to be used by or for the direct benefit of the subject borrower when:

(i) The proceeds of the loan are transferred to the subject borrower without a reasonably equivalent exchange of value or are loaned to the subject borrower;

(ii) The proceeds of the loan are used to purchase an asset that is transferred to the subject borrower without a reasonably equivalent exchange of value;

(5) The named borrower directly or indirectly controls or is controlled by the subject borrower.

(b) Each institution shall make provisions for appropriately designating loans to a named borrower that are attributed to a subject borrower and aggregated to ensure that loans to the subject borrower are within the lending limits.

**§ 614.4359 Nonconforming loans.**

(a) Loans or commitments, together with all loans and commitments outstanding or attributed to a borrower, must be within the lending limit on the date the loan or commitment is made. A subsequent decline in the lending limit below the aggregate amount of loans and commitments outstanding or attributed to a borrower does not result in a violation of the lending limit, but does cause the excess of the loans and commitments outstanding or attributed to a borrower over the lending limit to become nonconforming.

(b) Funds that are advanced pursuant to commitments that were within the lending limit at the time they were made do not result in a violation of the lending limit when they are funded, even if the leading limit subsequently declines, but such advances are deemed to be nonconforming.

(c) When the lending limit is exceeded because guaranteed loans no longer qualify for exclusion from the computation pursuant to § 614.4357(b)(1), the institution shall be deemed to be in violation of the lending limit if the guarantee is no longer enforceable due to the institution's failure to comply with the terms and conditions of the guarantee. If the guarantee becomes unenforceable because the guarantor is unable to pay, the loan shall be considered to be nonconforming.

(d) When a loan is excluded from the lending limit computation pursuant to § 614.4357(b)(2) and the value of the collateral qualifying it for exclusion subsequently declines and causes the lending limit to be exceeded, the loan shall be considered nonconforming for the period of 5 business days during which time the institution shall bring the loan into conformance before it shall be considered to be in violation of the lending limit.

(e) When the aggregate of loans and commitments outstanding and attributed to a borrower exceeds the lending limit, whether or not the institution is deemed to be in violation of the lending limit, no further loans and commitments with respect to the borrower may be made until they can be made without violating the new lending limit. A written plan prescribing the specific actions that will be taken by the institution and the borrower to bring the aggregate amount of loans and commitments outstanding or attributed to a borrower within the new lending limit must be documented in the loan file.

12. Section 614.4360 is revised to read as follows:

**§ 614.4360 Transition period.**

(a) *Loans.* Loans outstanding or attributed to a borrower on the effective date of these regulations that exceed the lending limit shall be brought into conformance by the earlier of the next maturity date, loan servicing action, or a period not to exceed 18 months. The aggregate of loans outstanding to a borrower and loans attributed to the borrower that cannot be brought into compliance by the end of the transition period, in spite of reasonable efforts to participate the excess, shall be deemed to be nonconforming and must be retired or liquidated in an orderly manner over a reasonable period, not to exceed 7 years. No further loans may be made to the borrower except pursuant to a commitment outstanding on the effective date of the regulation, unless they are necessary to protect the lender's interest and/or collateral.

(b) *Commitments*. Commitments made prior to the effective date of the regulation may be funded, but if they would result in nonconforming loans if fully funded, no additional funds may be advanced except to protect the lender's interest and/or collateral until the nonconformance is eliminated.

(c) Each institution shall develop a written plan outlining the specific actions that will be taken by the lending institution and the borrower in order to bring the nonconforming indebtedness into conformance.

**Subpart L -- Actions on Applications; Review of Credit Decisions**

13. Section 614.4440 is revised by redesignating paragraphs (f), (g), and (h) as new paragraphs (g), (h), and (i) respectively and adding a new paragraph (f) to read as follows:

**§ 614.4440 Definitions.**

\* \* \* \* \*

(f) *Independent appraiser* for the purposes of this subpart, means an appraiser who is a State-certified, State-licensed, designated, or an accredited appraiser, (as defined in § 614.4240) that qualifies under the standards established by the Farm Credit institution for the type of property to be appraised. Such an appraiser may not be a Farm Credit institution employee or have a relationship with the institution or any of its officers or directors that contravenes the provisions of part 612, subpart B.

\* \* \* \* \*

14. Section 614.4443 is amended by revising paragraph (c) to read as follows:

**§ 614.4443 Review process.**

\* \* \* \* \*

(c) *Independent appraisals.* (1) An applicant for a loan, or a borrower who has applied for a restructuring, may, as part of the request for a review, request an independent appraisal, by an independent appraiser, or any interests in property securing the loan (other than the stock or participation certificates of the lender held by the borrower). Within 30 days after a request for an appraisal, the credit review committee shall present the applicant or borrower with a list of three independent appraisers approved by the qualified lender, and the borrower shall select an appraiser from the list to conduct the appraisal, the cost of which shall be borne by the applicant or borrower. The lender shall provide a copy of the appraisal to the applicant or borrower, and consider the results of any such appraisal in any final determination with respect to the loan or restructuring.

(2) Such appraisals shall be completed in conformance with the appraisal requirements described in part 614, subpart F relative to appraisal standards, appraiser independence and appraiser qualifications.

\* \* \* \* \*

**PART 619 -- DEFINITIONS**

15. The authority citation for part 619 continues to read as follows:

**Authority:** Secs. 1.7, 2.4, 5.9, 5.12, 5.17, 5.18, 7.0, 7.6, 7.7, 7.8; 12 U.S.C. 2015, 2075, 2243, 2246, 2252, 2253, 2279a, 2279b, 2279b-1, 2279b-2.

16. Section 619.9195 is revised to read as follows:

**§ 619.9195 Loan participation.**

A fractional undivided interest in the principal amount of a loan is sold by a lead lender to a participating institution in accordance with the requirements of § 614.4330. The term "loan participation" does not include a subordinated participation interest.

**§ 619.9320 [Removed]**

17. Section 619.9320 is removed.

**Dated:** January 15, 1991.

**Curtis M. Anderson,**

*Secretary, Farm Credit Administration Board.*

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