

# Farm Credit Administration

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## INFORMATIONAL MEMORANDUM



December 17, 2004

To: The Chief Executive Officer  
All Farm Credit System Institutions

From: C. Edward Harshbarger, Acting Director  
Office of Policy and Analysis

Subject: Effective Interest Rate Disclosure

Section 4.13 of the Farm Credit Act of 1971, as amended (Act), requires that qualified lenders provide borrowers with meaningful and timely disclosure of the current rate of interest on loans and the effect of any purchases of stock or participation certificates (collectively referred to as "borrower stock") on the effective rate of interest. This requirement applies to all loans not subject to the Truth in Lending Act.

To clarify the requirement of the Act, the Farm Credit Administration (FCA) recently amended its regulations on disclosure of effective interest rates (EIR). The final EIR regulation contained in 12 CFR 617 became effective on May 10, 2004. Subsequent to the amendment, we received several inquiries from Farm Credit System institutions for guidance on compliance with the regulation, including a concern that the effect of borrower stock distorts the EIR on short-term loans.

While the Act requires that the cost of borrower stock be included in the EIR disclosure for all loans, FCA was mindful that additional or supplemental disclosures may also be appropriate. For this reason, the EIR regulation allows qualified lenders to provide supplemental disclosures explaining the effect of borrower stock on the EIR. An explanation of the nature of supplemental disclosures was provided in the preamble to § 617.7125 of the proposed rule:

Qualified lenders may not . . . assume retirement of stock in calculating the EIR disclosed to borrowers because the Act provides that borrower stock is "at risk" and a qualified lender cannot guarantee stock retirement. Qualified lenders may, however, provide supplemental disclosures to borrowers to demonstrate the effect of potential stock retirements so long as the additional disclosures are not misleading. See 68 FR 5590, February 4, 2003.

The preamble to § 617.7130 of the proposed rule further explains that:

The qualified lender may, at its discretion, include additional disclosures or examples—including illustrations of the impact on the effective interest rate of any

change in borrower stock ownership—so long as such disclosures are not misleading. See 68 FR 5591, February 4, 2003.

The final EIR regulation does not impose a formula or specific procedures for calculating the EIR. Instead, it requires all qualified lenders to establish policies and procedures for calculating the EIR using a standard methodology—the discounted cash flow method—for determining the EIR for disclosures to borrowers. FCA also eliminated the model forms contained in the Appendix to prior FCA regulation § 614.4367 to allow supplemental disclosures.

FCA believes the final EIR regulation fulfills the requirements of the Act. In cases where a qualified lender believes that the required EIR disclosure does not adequately inform a borrower of the cost of a loan, the qualified lender may provide supplemental disclosures to illustrate the effect of potential stock retirements in accordance with its policies and procedures adopted under FCA regulation § 617.7130. The qualified lender may also inform a borrower that an additional stock purchase is not required once the minimum requirement is met and that the value of stock is not lost after the loan is repaid. Moreover, qualified lenders may include other information, as appropriate, on the features of borrower stock, e.g., that the stock represents an investment in the lender, voting rights, patronage refunds, etc.

If you have any further questions, please contact me or Tong-Ching Chang, Senior Policy Analyst, Office of Policy and Analysis, at (703) 883-4461 (e-mail at [Changt@fca.gov](mailto:Changt@fca.gov)).