

*Notice to FLCA and PCA Borrowers  
Concerning Your Investment in Your*



## **NOTICE TO FLCA AND PCA BORROWERS CONCERNING YOUR INVESTMENT IN YOUR FCS FINANCIAL**

To borrow from the FCS Financial, FLCA and/or the FCS Financial, PCA you must invest in the capital of the parent association, the FCS Financial, ACA ("Association"). This notice contains information about the stock and participation certificates issued by the FCS Financial, ACA to its members. Please read it carefully and make sure that you understand both the benefits and risks of an investment in your Association.

Under the provisions of the Agricultural Credit Act of 1987 ("1987 Act"), borrower equities, including Voting Stock ("Stock") and Participation Certificates ("Certificates"), issued prior to October 6, 1988, are generally protected against loss. The provisions of the 1987 Act generally require that when retiring such pre-October 6 equities, the Association shall retire the Stock and Certificates at their par or face value. However, these provisions are not applicable to Stock or Certificates issued after October 5, 1988. After that date, Stock and Certificates issued as a condition of obtaining a loan (which may include Stock issued in connection with loan assumptions, refinancings, reinstatements, etc.) are an investment in the Association that is at risk and not a compensating balance.

The 1987 Act required each Association's Board of Directors to develop a new capitalization plan and bylaws designed to permit the Association to meet the minimum capital adequacy standards established by the Farm Credit Administration ("FCA"), the Association's regulator. The recommended capitalization bylaws must be submitted to the Association's stockholders for approval. The Stock and Certificates described in this brochure are issued pursuant to the Association's capitalization bylaws, which were adopted by the Association Board and approved by stockholders in accordance with the requirements of the 1987 Act. The Association's capitalization bylaws are set out in the second part of this brochure.

### **Capital Adequacy**

FCA adopted capital adequacy and related regulations, which became effective in the first quarter of 1989. Under these regulations, the Association is required to maintain a minimum permanent capital ratio of 7 percent of risk-adjusted assets and off-balance sheet commitments. If the Association fails to satisfy the 7 percent standard, it may nevertheless be eligible for regulatory forbearance if it demonstrates the requisite progress towards meeting the standard. Regulatory forbearance would preclude FCA enforcement action solely as a result of the Association's failure to meet the minimum permanent capital adequacy standards, but would not remove the prohibition against retiring stock or making certain other distributions to shareholders discussed below.

The Association has the burden of meeting FCA's minimum capital standards based on its loan portfolio. Currently, the Association exceeds the 7 percent minimum capital adequacy standards established by the FCA regulations. The Association believes that it will continue to exceed such standards for the foreseeable future.

### **Voting Stock and Participation Certificates**

Under the capitalization bylaws, stock requirements are established by capitalization plans adopted from time to time by the Association's Board of Directors. A plan's stock requirement must fall within a range established by the bylaws. The minimum stock requirement a plan may establish is one share for each \$250 of the loan amount (2%) or fraction thereof with a maximum investment of 200 shares (\$1,000). The maximum stock requirement a plan may establish is one share per \$50 of the loan amount (10%) or fraction thereof.

The capitalization plan, which has been adopted by the Association's Board, provides for the minimum stock requirement. This means that the stock requirement shall be 2 percent of a customer's (defined as an individual or entity by tax identification number) outstanding principal balance on all loans or \$1,000, whichever is less.

The voting stock issued by the Association is called “Class C Stock” (Stock) and is generally issued only to farmers, ranchers, and producers or harvesters of aquatic products. Other persons who are eligible to borrow from the Association, such as suppliers of farm-related services and owners of rural homes, are issued Participation Certificates (Certificates) on essentially the same terms as Stock except as described below.

## **How Stock and Participation Certificates Are Purchased**

Shares of Class C Stock (and units of Participation Certificates) are sold for their par value (or face amount), which is \$5.00 each and can be paid for either with cash before the loan is made or with the proceeds of the loan, but the portion of the loan proceeds attributable to the purchase of Stock or Certificates is withheld by the Association and applied to the purchase price of the Stock or Certificates. When the purchase price is borrowed, the amount of the loan includes the cost of the Stock or Certificates and interest is charged on the entire loan. The total amount of the loan, including the portion used to pay for the Stock or Certificates, is a legally enforceable obligation that must be repaid in full. Associations do not issue physical certificates for Stock or Certificates. Instead, the ownership of Stock or Certificates is evidenced by entries recorded on the books of the Association as reflected in periodic account statements sent to each member.

## **Certain Important Characteristics of Stock and Participation Certificates**

The principal difference between Stock and Certificates is that the Class C Stock entitles its holder to one vote (regardless of how many shares are owned) with respect to the election of Association directors, who are responsible for the direction and control of the affairs of the Association, and other matters on which stockholders are entitled to vote. Holders of Certificates have no voting rights. With the exception of at least one position on the Board held by an “outside” director, only holders of Class C Stock are entitled to be elected as directors. In all other respects, Stock and Certificate holders have substantially the same rights and restrictions. Two years after the loan of a holder of Class C Stock is paid in full, any Class C Stock held by the borrower is automatically converted to non-voting stock.

The capitalization bylaws of the Association provide that dividends may be paid on Stock or Certificates with the approval of the Association’s Board of Directors. The bylaws also permit the Board to obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for a fiscal year or for that and subsequent fiscal years. Under the 1987 Act and the capitalization bylaws of the Association, dividends and patronage distributions may not be paid if, after or due to such action, the permanent capital of the Association would thereafter fail to meet the minimum capital adequacy standards established by the FCA.

The Association has a first lien on the Stock or Certificates held by a member as additional security for the member’s loan. If the member defaults, the value of the member’s investment (not to exceed par value or face amount) may be applied against the balance due on the loan or other indebtedness to the Association.

If the member’s Stock or Certificates are transferred, they are still subject to this lien. In any event, Stock and Certificates are transferable only to persons eligible to hold such equities.

Stock and Certificates do not appreciate in value. Any retirement or conversion will be at their original issue price or, if less, their book value. The possibility that this investment may result in a loss is discussed under the heading “Impairment.”

## **Retirement of Stock and Participation Certificates**

Under the 1987 Act, there is no longer an automatic right to have Stock or Certificates issued after October 5, 1988, retired upon repayment of the member’s loan. Under the Association’s bylaws, such Stock and Certificates are retireable only at the discretion of the Board of Directors. Stock is retired at the lower of book value or par value,

while Certificates are retired at the lower of book value or face amount. Book value will be determined in accordance with generally accepted accounting principles (GAAP).

The bylaws of the Association generally permit Stock and Certificates to be retired at the discretion of the Board of Directors in accordance with the Association's capitalization plan, which may provide for the orderly retirement of capital no longer needed to support a loan, provided the Association is in a sound financial condition. The retirement program may be suspended at any time at the discretion of the Board of Directors in order to protect the financial condition of the Association.

In addition, under the 1987 Act and its capitalization bylaws, the Association is prohibited from retiring Stock or Certificates if such retirement results in the Association's failure to satisfy the minimum capital adequacy standards established by the FCA.

## Impairment

Your ownership of Stock or Certificates in your Association is an investment and is subject to certain risks that could result in a partial or complete loss of the investment. You are responsible for repayment of the entire amount of your loan, including the amount borrowed to pay for your Stock or Certificates, regardless of the value of your Stock or Certificates.

These risks include:

- Loan losses experienced by the Association as a result of inadequate evaluation of credit risks or adverse trends in agriculture, such as loss of international markets, over production, weather conditions or disease.
- Increases in the amount of non accrual loans and properties acquired from borrowers that reduce the Association's revenues.
- Impairment of AgriBank, FCB's stock owned by the Association due to losses in other associations within the District, loan losses and net operating losses of the Bank, or the Bank's joint and several liability on System wide debt securities issued by other Banks in the national Farm Credit System.

As a result of these or any other risks, the capital of the Association could become impaired. Impairment means that the book value of the Stock or Certificates has declined below par value (or face amount), which is \$5.00 per share or unit. So long as the capital of an Association is impaired, its members would receive less than they had paid for their Stock or Certificates upon retirement. If the Association were to be liquidated at a time when its capital is impaired, holders of Stock or Certificates would receive less than the par value or face amount of their investment and may suffer a total loss of their investment in the Association. However, in any event, members would remain liable for the full amount of their loan from the Association, including the portion used to pay for the purchase of Stock or Certificates.

Of course, the Association will take all feasible action to prevent its capital from becoming impaired. The Association and the Bank maintain loss reserves and surplus accounts to protect against this possibility. The Association and Bank have also adopted comprehensive business plans designed to improve the institutions' financial condition and operating performance.

The 1987 Act also provides a mechanism for providing financial assistance to distressed associations and Banks. This mechanism is described in the Association's Annual Report. Copies of that report have been furnished to all shareholders. Additional copies are available from the Association upon request. However, the assistance mechanisms in the 1987 Act provide no assurance to members that Stock and Certificates issued after October 5, 1988, will be protected. Therefore, members are advised to review financial statements of their Association and of

AgriBank, FCB and other available information about the Farm Credit System. Copies of AgriBank, FCB's Annual and Interim Reports to Investors are available from the Association upon request.

## **Priority of Stockholders**

The Association's capitalization bylaws set out in this brochure establish priorities of classes of stock with respect to the distribution of earnings, distribution of losses, and distribution of remaining assets upon liquidation of the Association. FCA has not addressed the issue of such priority between holders of protected stock and at-risk stock. Should the FCA take a position inconsistent with the Association's capitalization bylaws, amendment of the bylaws might be necessary. Such amendment might affect a stockholder's priority with respect to such matters.

The next section of this brochure contains the Association's capitalization bylaws.

## ARTICLE VII — CAPITALIZATION

### 700 General Authority to Issue

The Board may determine the amount of the initial or additional stock or participation certificates in the Association to be subscribed for by borrowers served by the Association in order to meet the capital needs of the Association.

#### 700.1 Additional Subscriptions

Notwithstanding the general authority to issue stock, the Association may require its Members to subscribe to additional capital to meet its capital requirements under minimum capital adequacy Regulations.

#### 700.2 Stock Purchased as a Condition of Obtaining a Loan

If at any time the Association does not meet the minimum capital adequacy standard(s) established by the FCA, all stock required to be purchased as a condition of obtaining a loan shall be purchased from the Association and may not be purchased from persons other than the Association.

### 705 Ownership

Except as otherwise required by Regulations, evidence of ownership of stock and participation certificates may be by book entry, or in definitive form prescribed by the Association. All stock required to be purchased as a condition of obtaining the loan shall be paid for by the time the loan is closed.

### 710 Authorized Shares

The Association is authorized to issue those classes of stock and participation certificates and have outstanding such number of shares or units of each class as specified below, with each share or unit having a par or face value of \$5.00:

- 710.1 Class A Common Stock in the number of shares equal to the number of shares of Class A Common Stock outstanding in FLCA and PCA immediately prior to the formation of the Association. No further Class A Common Stock shall be issued.
- 710.2 Class B Common Stock in an unlimited number of shares.
- 710.3 Class C Common Stock in an unlimited number of shares.
- 710.4 Class D Common Stock in the amount of 50,000,000 shares.
- 710.5 Class E Common Stock in the amount of 500 million shares.
- 710.6 Class F Preferred Stock in the amount of 25,000,000 shares, provided that the issuance of such shares must be approved by a majority of those shares or units of each class of stock and participation certificates affected by the preference, voting as a class, whether or not such classes are otherwise authorized to vote.
- 710.7 Series 1 Participation Certificates in the number of units equal to the number of units of Series 1 Participation Certificates outstanding in FLCA and PCA immediately prior to the formation of the Association. No further Series 1 Participation Certificates shall be issued.

710.8 Participation Certificates in an unlimited number of units.

## **715 Capital Policy**

715.1 The Association's Board shall establish and adopt a capitalization plan with a minimum capital policy setting forth the minimum required capital level for Members of the Association. The minimum required capital level of each Member may not be less than the lesser of two percent (2%) of the collective total balance of each Member's loan(s) with the Association and the Subsidiaries, or \$1,000 per Member (floor), nor shall it exceed 10% (ceiling) of the face amount of the Member's note(s), and shall be evidenced by one or more classes of stock or participation certificates.

715.2 Unless the Board established otherwise in the capitalization plan and subject to the Act and Regulations, the required capital level of a Member shall be obtained by direct purchase of stock or participation certificates from the Association.

715.3 The Board has authority to reduce the minimum required capital level of a Member if the Member agrees to exchange that portion of capital held as stock not deemed to be Association permanent capital, for an equivalent amount of stock that qualifies as Association permanent capital. However, the Board may not reduce the minimum required capital level below the statutory floor.

715.4 The Board shall have authority, without Member approval, to change the percentages utilized to determine minimum required capital levels as long as the change is within the range authorized in Section 715.1 of these bylaws.

715.5 Changes to the minimum capital level outside the parameters set forth in Section 715.1 shall, subject to the minimum statutory requirements, require Voting Stockholder approval as provided in Section 770 of these bylaws.

## **720 Rights, Preferences, and Limitations of Classes of Stock**

### **720.1 Class A Common Stock**

Class A Common Stock shall be issued in exchange for stock issued prior to the close of business on October 5, 1988 as a condition for the extension of credit from the PCA (or its predecessors) or from the Bank or its predecessors. No further shares of this class of stock shall be issued. Holders of this stock will not have voting rights.

### **720.2 Class B Common Stock**

Class B Common Stock shall be issued to holders of Class C Common Stock, in a like number of shares, in exchange for such capital stock whenever the holder is no longer eligible to hold Class C Common Stock as required by law, these Bylaws, or the capitalization plan of the Association. Class B Common Stock may be converted back to Class C Common Stock, in a like number of shares, in order to meet the holder's required ownership of the latter class in order to qualify for an extension of credit. Holders of this stock will not have voting rights.

### **720.3 Class C Common Stock**

Class C Common Stock shall be issued only to those borrowers of the Association, PCA or FLCA who are eligible to be Voting Stockholders of the Association under the provisions of the Act and Regulations. As a condition for the extension of credit, new borrowers who are eligible to hold this class of stock shall, by the

time of the initial loan disbursement, purchase such amounts of Class C Common Stock as required by the capitalization plan of the Association. All owners of Class C Common Stock shall have the right to vote as provided in these Bylaws. Within two (2) years after the loan of a holder is paid in full, any Class C Common Stock held by the holders shall be converted automatically to Class B Common Stock.

#### 720.4 Class D Common Stock

Class D Common Stock shall be issued only to the holders of common or preferred stock or Participation Certificates as may be permitted under a plan adopted by the Board for the payment of allocated surplus distributions, dividend payments, and patronage distributions. Holders of this stock will not have voting rights.

#### 720.5 Class E Common Stock

Class E Common Stock shall be issued only to other System institutions. Holders of this stock will not have voting rights.

#### 720.6 Class F Preferred Stock

Class F Preferred Stock may be issued to investors who need not be eligible to borrow from any System institution. Holders of this stock will not have voting rights.

#### 720.7 Series 1 Participation Certificates

Participation Certificates issued in exchange for stock issued prior to the close of business on October 5, 1988 as a condition for the extension of credit from PCA (or its predecessors) or from the Bank or its predecessors are the Series 1 Participation Certificates. No further Series 1 Participation Certificates shall be issued. Holders of these certificates will not have voting rights.

#### 720.8 Participation Certificates

Participation Certificates shall be issued to borrowers from Association, PCA or FLCA who are not eligible to be Voting Stockholders of the Association. As a condition for the extension of credit, new borrowers not eligible to hold voting stock shall, by the time of the initial loan disbursement, purchase such amounts of Participation Certificates as required by the capitalization plan of the Association. The capitalization plan may also establish that, as a condition of obtaining a lease from the Association, the lessee shall be required to own at a minimum one (1) Participation Certificate or such other amount as may be determined by the Board from time to time, but in no event shall the required investment for a lease exceed that for a loan. Holders of the Participation Certificates will not have voting rights.

720.9 Other classes of capital stock shall have such rights, designations, preferences, qualifications, limitations and restrictions as shall be provided in the amendment or amendments of the bylaws establishing such classes of capital stock.

720.10 No fractional shares of stock or participation certificates, or cash in lieu of fractional shares, shall be issued or paid, except when necessary to implement issuance or retirement of any non-voting stock.

720.11 Loans designated for sale or sold into the secondary market.

- a) Notwithstanding the foregoing stock issuance provisions of these bylaws, no purchase or issuance of voting stock or participation certificates shall be required in the case of a loan made on or after February 10, 1996,

that is designated at the time the loan is made for sale into the secondary market. Except, however, if the loan so designated for sale is not sold into the secondary market during the 180 days beginning on the date of designation, the stock purchase requirements shall apply. If the loan is sold into the secondary market after the end of the 180-day period, the stock or participation certificates shall be retired provided that the Association would not, after or due to such retirement, fail to meet the applicable minimum capital adequacy standards established by FCA pursuant to the Act or Regulations promulgated thereunder.

- b) In the case of a loan made prior to February 10, 1996, but thereafter sold into the secondary market, all outstanding stock or participation certificates issued in connection with the loan shall be retired provided that the Association would not, after or due to such retirement, fail to meet the applicable minimum capital adequacy standards established by FCA pursuant to the Act or regulation promulgated thereunder.
- c) Parts a) and b) shall apply even though the Association retains a subordinated participation interest in a loan or pool of loans or contributes to a cash reserve.

## **725 Application of Earnings and Losses**

725.1 At the end of each fiscal year, the Association shall, after paying or providing for all operating expenses (including, without limitation, provisions for loan losses and losses on acquired property determined in accordance with GAAP), determine the amount of its consolidated net earnings or net losses for such year.

725.2 Any net earnings determined pursuant to Section 725.1 shall be applied in the following order of priority:

First, to the restoration of the amount of the impairment, if any, of all classes of preferred stock in the reverse order of such impairment on a pro-rata basis;

Second, to the restoration, pro rata, of the amount of the impairment, if any, of all classes of common stock and participation certificates on a pro-rata basis;

Third, to the restoration of the amount of the impairment, if any, of the allocated surplus account in the reverse order of impairment;

Fourth, to increase surplus to meet minimum capital adequacy standards established by Regulations;

Fifth, to increase surplus to meet Association capital adequacy standards, to such levels as is necessary to support competitive pricing at targeted earnings levels;

Sixth, to an appropriate contingency reserve as the Board, in its sole discretion, deems necessary;

Seventh, subject to the Act and the Regulations thereunder, in such manner as shall be determined by the Board including, without limitation, to the payment of dividends, patronage refunds, and retirement of any portion of any class of stock as provided for in Sections 730, 735 and 740 of these bylaws.

725.3 Any net losses determined pursuant to Section 725.1 to the extent they exceed any contingency reserve and unallocated surplus shall, except as otherwise provided in the Act, be treated as impairing: first, allocated surplus evidenced by nonqualified written notices of allocation, in the reverse order of issuance until all such allocated surplus has been impaired; second, allocated surplus evidenced by qualified written notices of allocation, in the reverse order of issuance until all such allocated surplus has been impaired; third to all classes of common stock and participation certificates until fully impaired; and fourth, to preferred stock (if any) until fully impaired. Impairments shall be considered as being applied pro rata to each share and/or unit outstanding in the class or, with respect to allocated surplus, pro rata based on year of issuance.

## 730 Dividends

### 730.1 Non-cumulative Dividends on Common Stock

Subject to the Act and the Regulations thereunder, and provided that at the time of declaration thereof no class of common stock and participation certificates shall be impaired, non-cumulative dividends may be declared on all classes of common stock and participation certificates as the Board from time to time may, in its sole discretion, determine. Dividends may be distributed in cash, stock which the recipient is eligible to hold, or both. Any dividends paid to the holders of common stock and participation certificates shall be on a per share basis without preference between classes of common stock and participation certificates or between holders of the same class of stock except that any class of common stock that results from the conversion of allocated surplus may be subordinated to other classes of common stock and participation certificates in the payment of dividends. Dividends may not be paid if the action would result in failure of the Association to meet minimum capital adequacy requirements established under Regulations. No dividends on common stock and participation certificates shall be paid with respect to any year for which the Association has passed an obligating resolution to distribute patronage under Section 735 hereof.

### 730.2 Cumulative Dividends on Preferred Stock

Subject to the Act and the Regulations thereunder, and provided that at the time of declaration thereof no class of common stock and participation certificates shall be impaired, cumulative dividends may be declared on all classes of preferred stock, as the Board from time to time may, in its sole discretion, determine, and not on a date certain or on the happening of any event, such as repayment of the loan. However, the obligation of the Association to pay dividends may be indefinitely deferred as long as no dividend is paid to holders of common stock and participation certificates and as long as no patronage refunds have been paid. The obligation of the Association to pay cumulative dividends is subordinated to the rights of holders of common stock and participation certificates to have their stock retired at book value not to exceed par upon liquidation. Cumulative dividends may be paid only in cash. Dividends may not be paid if the action would result in failure of the Association to meet minimum capital adequacy requirements established under Regulations.

### 730.3 Mandatory Reinvestment from Dividend Payment

If at the time of any cash dividend payment any Member's investment is below the minimum required capital level for such Member, established pursuant to Section 715 of these bylaws, the Association is authorized to use part of the dividend proceeds to increase the Member's investment to such minimum required level.

## 735 Patronage Refunds

735.1 General. Subject to the provisions of the Act and Regulations, prior to the beginning of any fiscal year or other period, the Association's Board may, by adoption of a resolution (the "Patronage Resolution"), obligate the Association to distribute its available Patronage-Sourced Net Earnings to Patrons on the basis of the quantity or value of patronage business done with the Association and its Subsidiaries. Patrons shall include Members and such other customers, borrowers and financial institutions with which the Association, PCA and/or FLCA conduct business during the fiscal year and as identified by the Board in the Patronage Resolution. Patronage-Sourced Net Earnings shall mean the net earnings of the Association, PCA and FLCA for the fiscal year, as computed under generally accepted accounting principles, attributable to patronage business done with or for Patrons. All transactions done with or for Patrons shall be deemed patronage business unless otherwise provided in the Patronage Resolution. Any outstanding Patronage

Resolution that is not rescinded prior to the beginning of a fiscal year shall become irrevocable and constitute a binding legal obligation of the Association with respect to such fiscal year. Each patronage transaction shall include as part of its terms, whether the same has been expressly referred to in said transaction or not, the provisions of this Article VII of the Bylaws.

Unless a plan using an alternative equitable and nondiscriminatory basis has been approved by the Board, all patronage distributions shall be in the proportion that the amount of interest paid by, or income earned from, each Patron bears to the total interest paid by, or income earned from, all Patrons. Any earnings pool that may be established for the payment of patronage distributions shall be established on a rational and equitable basis and shall insure that each Patron receives its fair share of the earnings of the Association and bears its fair share of the expenses of the Association. The Board shall retain discretion not to pay patronage distributions on one or more of such pools provided all Patrons are treated fairly and equitably.

#### 735.2 Mandatory Reinvestment from Cash Patronage Refunds

If at the time of any cash patronage refund payment, any Member's investment is below the minimum required capital level for such Member, established pursuant to Section 715 of these bylaws, the Association is authorized to use the cash patronage refund proceeds, except the portion required to be paid in cash, to increase the Member's investment to such minimum required level.

735.3 Restrictions on Distributions. The net earnings available for patronage distribution shall be determined after (i) making provision for the requirements of Section 725, including the setting aside of a portion of the net earnings in the unallocated surplus account, as deemed prudent for sound capital accumulation; and (ii) making provision for payment of the Association's federal income or related taxes for the fiscal year; provided, that, these amounts shall first come from net earnings, if any, attributable to sources other than patronage transactions with or for Patrons and any non-patronage-sourced net earnings not so applied shall be set aside in the unallocated surplus account. The Board in its resolution may establish a minimum level of available earnings and if the available earnings fall below this level no patronage distribution will be made.

735.4 Payment of Distributions. Patronage refunds may be in cash, Class D Common Stock, or allocations of earnings retained in an allocated surplus account, or any combination thereof; provided that the cash portion of any patronage distribution which includes a "qualified written notice of allocation" shall not be less than the amount required to qualify such distribution as a deduction for Federal income tax purposes. Distributions in the form of Class D Common Stock and allocated surplus may be in qualified or nonqualified form, as those terms are defined in 26 U.S.C. § 1388.

In the event that the total patronage distribution to a Patron is less than the minimum amount as determined annually by the Board, prior to the end of the taxable year, such distribution may be paid entirely in cash or applied to the Patron's indebtedness.

735.5 Application to Debt. Any part of the patronage allocated to a borrower, except any portion required to be allocated in cash, may, in the sole discretion of the Association, be applied to such borrower's indebtedness to the Association, PCA and/or FLCA. If the debt of a borrower is in default, any part of the patronage distribution to that borrower may, at the discretion of the Association, be applied against the borrower's indebtedness to the Association, PCA and/or FLCA.

735.6 Patron's Consent to Take Patronage Distribution into Income. Each person who hereafter applies for and is accepted to membership in this Association and each Member of this Association on the effective date of this bylaw who continues as a Member after such date, and each person who thereafter applies for and is issued stock or participation certificates of this Association shall, by such act alone, consent that the amount of any distributions with respect to the Member's patronage occurring after the date these bylaws were

adopted, which are made in or evidenced by “qualified written notices of allocation” as defined in 26 U.S.C. §1388 (including patronage allocations of surplus account and patronage refunds paid in stock of the Association), and which are received by the Member from the Association, will be taken into account (as income) by the Member at their stated dollar amounts in the manner provided in 26 U.S.C. §1385(a) in the taxable year in which such written notices of allocation are received by the Member. Such Members also consent by such act alone, to take into account (as income) in the same manner, the amount of any distributions with respect to patronage if the Member receives written notice that such amount has been applied on the Member’s indebtedness to the Association, PCA and/or FLCA.

The Association may obtain the written consent of each Patron that the amount of any distributions with respect to the Patron’s patronage, which are made in or evidenced by qualified written notices of allocation, as defined in 26 U.S.C. §1388 (including patronage allocations of surplus accounts and patronage refunds paid in Class D Common Stock), and which are received by him or her from the Association, will be taken into account as income by such person at the stated dollar amount in the manner provided in 26 U.S.C. §1385(a) in the taxable year in which such written notices of allocation are received. Such written consent may include a consent to take into account as income in the same manner the amount of any distributions with respect to patronage provided he or she receives written notice that such amount has been applied on his or her indebtedness to the Association, PCA and/or FLCA. The form of consent shall be prescribed by the Board, except that it shall be continuing in effect until revoked by the Patron. Such consent shall be continuing in effect until revoked by the Patron, and it may be included as part of the loan application or other appropriate form signed by borrowers. Any revocation shall become effective only with respect to patronage occurring on or after the first day of the first fiscal year of the Association beginning after the revocation is filed with the Association. Consent may also be obtained by use of a qualified check in the manner provided for in 26 U.S.C. §1388.

- 735.7 Capital Adequacy Standards. Notwithstanding other provisions of this section, the Association may not obligate itself to distribute earnings on a patronage basis if the permanent capital of the Association would be reduced to the extent that the Association would not meet its capital adequacy standards as determined from time to time in accordance with the Regulations.
- 735.8 Discretionary Retirement. If, at any time, the Board in its sole discretion shall determine that the financial condition of the Association shall not be impaired thereby, the patronage allocated to the accounts of Patrons may be retired in full or in part. No legal or equitable right to payment or redemption shall exist unless and until the Board shall have determined that funds are available and until the holder of allocated patronage shall have responded to a call for payment duly issued by the Board. Any such retirement of allocated patronage shall be made in such order of priority as shall be determined by the Board in its sole discretion.

Notwithstanding any other provision of these bylaws, the Board, in its sole discretion, shall have the power to retire the patronage allocated to any Patron in such events as death or bankruptcy, or to settle a dispute, on such terms and conditions as may be deemed appropriate by the Board, or in any instance in which the interests of the Association and its stockholders are deemed to be furthered thereby; and funds are determined by the Board to be available for such purpose.

- 735.9 PCA and FLCA. In the event of an Authorization Event under Section 110 hereof, where the Association arranges for the provision of credit and/or related services to its Members through PCA and/or FLCA, and such Members avail themselves of the arrangements made and maintained by the Association by borrowing or acquiring related services from PCA and/or FLCA, all net earnings or loss attributable to such provision of credit and/or related services shall be treated as net earnings or loss of the Association from business done with its Patrons and all business done with PCA and FLCA shall be treated as business done with the Association.

## 740 Retirement

### 740.1 General

Subject to Section 4.9A of the Act and Sections 740.3 of these bylaws the Board is authorized to retire all or any portion of any class of stock or participation certificates as it may determine, in its sole discretion, is unnecessary to meet the capital requirements of the Association and not on a date certain or on the happening of any event such as repayment of a loan or pursuant to an automatic retirement or revolvement plan, and any such stock so retired shall be retired at book value not to exceed par value; provided that, the Association shall not retire stock if the action would result in failure of the Association to meet minimum capital adequacy requirements established under Regulations; and provided further, that each Voting Stockholder continuing to do business with the Association shall retain at least one share of voting stock in accordance with Sections 720.3 of these bylaws.

### 740.2 Protected Stock

Any “protected” stock or participation certificates shall be retired as set forth in the capital adequacy plan at par value as of the date of such retirement, as defined in the “eligible borrower stock” provisions of Section 4.9A of the Act and Regulations, in the ordinary course of business.

### 740.3 Special Retirement

Except as is provided in law or Regulations, nothing in these bylaws shall restrict the authority of the Board to make special stock retirements on a case-by-case basis in consideration of the granting of forbearance, or the exchange of Association non-permanent capital for Association capital or any other appropriate business reason; provided that, the Association shall not retire stock if the action would result in failure of the Association to meet minimum permanent capital requirements, and provided further, that each Voting Stockholder continuing to do business with the Association shall retain at least one share of voting stock in accordance with Sections 720.3 of these bylaws.

740.31 When the debt of a holder of Class B Common stock, Class C Common Stock or Participation Certificates is in default on a loan or loans from the Association or the Subsidiaries, the Board may, but is not required to, retire such stock or participation certificates at book value not to exceed par, and apply all or part of the retirement proceeds in total or partial satisfaction of the holder’s indebtedness, as allowed by FCA Regulations.

740.32 When the debt of a holder of Class A Common stock or Series 1 Participation Certificates is in default on a loan or loans from the Association or the Subsidiaries, the Board may, but is not required to, retire such Class A Common Stock or Series 1 Participation Certificates at par value, and apply all or part of the retirement proceeds in total or partial satisfaction of the holder’s indebtedness, as allowed by FCA Regulations.

### 740.4 Mandatory Reinvestment from Retirement Proceeds

If at the time of any stock retirement any Member’s investment is below the required capital level established for such Member, pursuant to these bylaws, or, if retirement should cause the Member’s investment to fall below such minimum capital requirement, the Association is authorized to use part of the retirement proceeds to increase the Member’s investment to such minimum required level.

## 745 Allocated Surplus Account

745.1 As set forth in the Capitalization Plan and subject to the Regulations, the Association may create an allocated surplus account consisting of earnings held therein and allocated to borrowers on a patronage basis. Allocated surplus may be evidenced by either “qualified written notices of allocation” or “non-qualified written notices of allocation,” or both, as those terms are defined under Internal Revenue Code (“Code”) Section 1388:

- (a) All allocations in the form of qualified written notices of allocation shall be issued in annual series and shall be identified by the year of issuance. Each such series shall be retired fully or on a pro rata basis, only at the discretion of the Board, in order of issuance by years as funds are available.
- (b) All allocations in the form of non-qualified written notices of allocation shall be issued in annual series and identified by the year of issuance. Each annual series may be subdivided between two or more classes. Each such series, or class thereof, shall be retired at the discretion of the Board.

In the event of a net loss for any fiscal year, such allocated surplus shall be subject to impairment in the order specified herein, and on the basis of most recent allocations first as provided in Section 725.3. Only those persons to which allocated surplus may be issued may own such allocated surplus.

745.2 The Association and Subsidiaries, as applicable, shall have a lien on all surplus account allocations owned by any borrower, and all distributions thereof, as collateral for the borrower’s indebtedness to the Association and Subsidiaries.

745.3 When the debt of the borrower is in default or is in the process of final liquidation by payment or otherwise, the Association’s Board may, but is not required to, retire any and all surplus allocations owned by such borrower to be applied on the indebtedness. Any such retirement and application of surplus account allocations to indebtedness shall be before any similar retirement and application of any stock owned by the borrower.

745.4 The Association’s Board is authorized to retire, for cash or Class D Common Stock, all or any portion thereof of the allocated surplus as it may, in its sole discretion, determine unnecessary to meet the capital requirements of the Association, and not on a date certain or on the happening of any event. The Association shall not retire any allocated surplus if the action would result in the failure of the Association to meet minimum capital adequacy requirements established under Regulations. The retirement of allocated surplus is subordinated to the rights of the holders of common stock and participation certificates to have their stock retired at book value not to exceed par. Any allocated surplus account protected under the provisions of Section 4.9A of the Act shall be retired in accordance with the provisions of said section.

745.5 A record of the holders of allocated surplus shall be kept and maintained by the Association. Allocations of “qualified” amounts will be maintained separately from the allocations of “non-qualified” amounts. Such surplus accounts shall be transferable only to the Association or to an eligible Member of the Association in the manner established by the Board, and no transfer thereof shall be binding upon the Association unless so transferred on the books of the Association.

## 750 Transferability

750.1 Subject to Section 700.2 of these bylaws, all classes of stock and participation certificates shall be transferable to any holder to which such respective classes of stock and participation certificates may be issued in accordance with Section 720, et seq.

750.2 The Association shall be its own transfer agent in all matters relating to its capital stock and participation certificates.

750.3 Stock and participation certificates shall not be pledged or hypothecated to third parties, except as provided in the Regulations and these bylaws, and may be transferred on the Association's books only as authorized by these bylaws.

## **755 Lien**

All capital stock and participation certificates are subject to a lien in favor of the Association, PCA or FLCA, as their interest may appear, to secure any indebtedness of the holder of such capital investment.

## **760 Distribution on Liquidation**

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed in the following order of priority:

First, to the holders, pro rata, of all classes of preferred stock (if any) until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders;

Second, to the holders, pro rata, of all classes of common stock and participation certificates, until an amount equal to the aggregate par value of all such shares then issued and outstanding has been distributed to such holders;

Third, to the holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro-rata by year of issuance;

Fourth, to the holders of allocated surplus evidenced by non-qualified written notices of allocation, in the order of year of issuance and pro-rata by year of issuance;

Fifth, any remaining assets of the Association after such distributions shall be distributed to present and former Patrons on a patronage basis, to the extent practicable.

## **765 Loan Fees**

The Association's Board shall have the authority to establish loan origination fees or other such fees as they determine appropriate.

## **770 Amendment to Capitalization Bylaws and Issuance of Preferred Stock**

Any amendments to this Article VII or to the capitalization bylaws of PCA and FLCA, except those of a technical nature not affecting substantive rights, shall not become effective unless approved by a simple majority of the Voting Stockholders voting, in person or by proxy, at a meeting properly called as provided for in these bylaws. Issuances of preferred stock shall be approved by a majority of the shares of each class of equities affected by the preference, voting as a class, whether or not such classes are otherwise authorized to vote.

