RURAL TELEPHONE BANK PRIVATIZATION STUDY REGULATORY REPORT

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Executive Summary

The regulatory review identified the attributes of the Cooperative and the Finance Company structures being considered for the private Bank.[1,2] A decision process that ranks the attributes as to their importance to the RTB Board and the stakeholders will assist in making the final decision on the optimal structure for the private Bank.

1. A cooperative association organization structure would typically have the following attributes:
   - Capital contributions can be required of members
   - Offers the ability to avoid or significantly reduce income taxes
   - Limited return on capital (could be put in the bylaws)
   - Vast majority of business is typically done within the required membership
   - Members are generally seeking the same benefits from the cooperative
   - One vote per member governance
   - Ability to issue multiple classes of stock
   - Subject to certain guiding principles established by the cooperative
   - Allowed to issue certificates of indebtedness
   - Patronage dividends distribution at the end of the year after certain amounts have been set aside for reserves
   - Each state has its own laws and regulations, some states restrict operations or ownership
   - Possible restrictions on earnings may limit capital market or outside investor attractiveness
   - Cooperative education or special contingency requirements may require some funds be set aside

   RTB currently operates as a hybrid. It is a corporation but it operates similar to a cooperative in many ways. For example, shareholders currently have only one vote

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1 The Privatization Committee of the RTB Board eliminated the Commercial Banking option during an early working session primarily due to the Board's desire to continue to serve rural communities as a source of financing for rural telecommunications. Additional considerations include loan portfolio constraints over concentration and diversification and regulation burdens focused at carrying deposits; which were not objectives for the privatized institution.

2 RTB management stated early in the study that the Administration would not support transition of the Bank to a Government-sponsored enterprise so this option was eliminated from consideration.

regardless of how many shares of the Bank's stock they may own,[3] borrowers are required to purchase stock and become shareholders of the Bank whenever they take out a loan, and patronage dividends are allocated to shareholders at the end of every year. Several of the attributes listed above could lower the Bank's cost of funds and help interest rate offerings but may also limit the opportunities open to the private Bank.

2. A finance company organization structure would typically have the following attributes:
    - Most often organized as Corporations, governed by general corporate law and primarily the Corporate Charter
    - Customary to allow one vote per share, although could be restricted by charter
    - No guiding principles/restrictions
    - Ability to issue multiple classes of stock
    - No restrictions on income or return on capital
    - Able to declare dividends at the discretion of the Board
    - No restrictions on ownership
    - No restrictions on customers and or lines of business
    - Able to make riskier investments
    - Each state has its own corporate laws and regulations, and some states have capital requirements for finance companies
    - Board make-up usually determined by largest shareholders
    - Subject to state consumer protection and usury laws
    - Subject to income taxes
    - Generally higher loan default rates than those seen by a cooperative
    - Higher expectations on the part of investors in terms of return on equity

    RTB is currently chartered as a corporation under the RE Act. A corporate structure similar to the current RTB could be established in the corporate bylaws and articles of incorporation. Several of the attributes cited above could challenge the Bank's ability to keep down its cost of funds and interest rate offerings, but a corporate structure would offer the private Bank the most freedom and flexibility.

[3] Per Section 406 (b) of the Rural Electrification Act of 1936.

Introduction

As the Rural Telephone Bank (RTB) addresses the issue of privatization, there are several corporate structure options open to the newly privatized bank. These options include the following: National Commercial Bank, Cooperative Association, and Finance Company. Following the discussion of preliminary reviews of the asset/liability management and the regulatory issues facing the RTB in terms of its eventual privatization, the Board elected to eliminate the option of a commercial bank from further consideration, choosing to focus further analysis on the options of a cooperative association or a finance company. The reasons for eliminating the commercial bank option were: 1) extensive regulation that accompany depository institutions, e.g., equity and capitalization requirements, articles of association, and location of office(s); 2) extensive regulation regarding the concentration of credit to single borrowers and diversity of risk; 3) a general lack of desire to set up a bank with depository accounts and branches that would require the bank to diversify its offerings; and 4) the Board's stated desire to focus on continuing to serve rural communities as a source of financing for rural telecommunications. Appendix 1 presents a brief summary of commercial banking requirements for a National Commercial Bank that would affect the RTB should it choose to take that approach. The purpose of this paper is to explore the regulatory issues for cooperative associations and finance companies, and to highlight the potential advantages and disadvantages for the RTB from a regulatory standpoint of each organizational structure.[1]

[1] This paper does not attempt to offer a legal opinion on regulatory or tax issues. The RTB is advised to consult with their legal and tax counsel for professional advice in these areas.

Cooperative Associations

A cooperative association is a democratic association of members that are organized for equality in ownership and governance. Cooperatives are typically deemed not-for-profit and net income is equally distributed among members in the form of patronage dividends. Each member is represented by one vote regardless of the number of shares of stock they may own. Typically, a cooperative does the majority of its business with its members and to do business with a cooperative you may be required to first become a member. Cooperatives are guided by several conceptual principles including open membership, democratic control, even distribution of excess earnings, limited return on member capital, and cooperative education The National Rural Utilities Cooperative Finance Corporation (CFC) as well as its subsidiary the Rural Telephone Finance Cooperative (RTFC) are organized as cooperatives. The CFC and RTFC operate in the same markets that the RTB serves. Details of the CFC organization are presented in Appendix 2, *Cooperative Bank Example - CFC*.

Because state law governs cooperatives, the operations of cooperatives may differ from state to state. Each state may have different membership requirements for cooperative members. For example, under the jurisdiction of the District of Columbia, all cooperative members must be organized as cooperatives themselves. (See Appendix 3, *Requirements of Cooperative Association Based in Washington, DC* for details.) Similarly, states may limit the type of businesses in which cooperatives may engage. For example in South Dakota, cooperatives are prohibited from engaging in banking or insurance.[2] Most cooperatives are able to operate in states outside their home state. In addition, most are able to issue multiple classes of stock and issue certificates of indebtedness. Each cooperative must also develop bylaws outlining the parameters of operation for their organization.

The general characteristics of cooperatives discussed here may differ according to a particular state's laws. Therefore, it is important that the RTB do thorough research on the particular laws that apply to whichever home state they choose. Appendixes 4, *General Requirements of a Cooperative Association Based in Virginia*, and 5, *General Requirements for a Cooperative Credit Association Based in Nebraska*, for more information on Virginia and Nebraska requirements for a cooperative association.

Management

Cooperatives usually are required to have a board of at least 3-5 people. That board is elected by the voting membership and has the responsibility of appointing and guiding the cooperative's senior executives. Each member of the cooperative has one vote, regardless of financial investment or the number of shares it holds. This equal voting status is meant to ensure that the cooperative boards more evenly represent all members of the cooperative membership. In other words, cooperative boards are not typically dominated by the largest shareholders.

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[2] S.D. 47-15-2.

Regulatory Oversight

Cooperatives are not universally regulated by one specific regulatory agency, as are banks. Since the RTB does not currently take deposits and is unlikely to start, it would be free from the oversight of the FDIC and would not be required to leave deposits at the Federal Reserve. Instead, the RTB would be governed by the laws of its home state and by its own bylaws. It would also be guided by the general principles of cooperative associations as noted above. One of these principles is the equitable distribution of excess earnings or net savings. Each state and cooperative interprets this principle differently; some distribute earnings according to a member's patronage while others use different standards. Many states require that cooperatives set aside a percentage of their net savings for special purposes such as member education or other contingencies before they are allowed to pay dividends.

Capital

Cooperatives have relatively few restrictions regarding the manner in which they may capitalize themselves. Subject to state laws and their own bylaws, cooperatives may issue more than one class of stock, borrow long-term funds, issue certificates of indebtedness, and even take non-returnable capital contributions. Many cooperatives require members to provide capital contributions as a condition of doing business with the cooperative. This requirement results in a below market source of capital. For RTB, maintaining the ability to access a below market source of capital will be essential if it is to continue offering low interest rate loans.

Another guiding principle of cooperatives is the limitation of return on capital. Because cooperatives are not-for-profit, return on investment capital is often limited by provisions in the bylaws, and in some cases by the states, or corporate policies.

Attributes Associated with Cooperative Associations

The following attributes of cooperatives are presented for the Board's consideration in deciding the RTB corporate structure:

1. The board of directors is elected by the membership and because voting members all have one vote, the board may more evenly reflect all of the member constituencies.[3] Since the RTB's membership structure currently resembles a cooperative association, organizing as a cooperative would maintain a similar structure. In addition, from an operational viewpoint, RTB's current operations are very similar to a cooperative. Therefore, organizing as a cooperative may require fewer changes in operating plans for the organization.
2. The greatest advantage a cooperative has over a finance company is its access to below market equity capital from its members. This can be accomplished through

[3] Per Section 406 (b) of the Rural Electrification Act of 1936.

a requirement for members to contribute a set amount of capital (e.g., 10 percent) to the cooperative before it is allowed to secure a loan from the cooperative. This is similar to RTB's requirement that borrowers purchase Class B stock as a part of any loan made by the Bank. This low cost source of capital could enable the RTB to continue to offer competitive lending rates.

3. As cooperative's goal in not centered on maximizing its profit but more so on serving its members.
4. Cooperatives can be exempt from Federal income tax burdens at the corporate level.
5. Default rates among cooperative users are typically lower than those seen by commercial banks or finance companies. This is another factor that will need to be kept at a very low level if the privatized Bank is going to be in position to continue to offer very competitive interest rates on its loans.
6. They primarily do business with their members. This limits their target market and potentially their ability to expand into different product lines.
7. Several states put very specific member eligibility requirements on cooperatives that can limit their membership base and customer base even further.
8. Cooperatives must limit their return on capital. This may affect their ability to access additional equity capital on the market.

Cooperative Association Summary

Because the RTB's current organization is similar to a cooperative association, there are many advantages and few disadvantages in organizing the privatized bank as a cooperative. In fact, the most compelling advantage in organizing as a cooperative association may be the low cost capital that cooperative members can provide. Unless the RTB plans to significantly change its lending rates, it may not be viable without continued access to a low cost source of capital.

Finance Companies

Finance companies are organizations that offer loans to individuals and businesses. They do not take deposits; instead, they fund their loans with their own debt and capital. Most often, they are organized as corporations but they are free to choose any organizational structure. Some well-known finance companies are General Motors Acceptance Corporation and General Electric Capital Commercial Finance. In the telecommunications field, some of the large equipment suppliers such as Cisco also operate finance companies as a means of offering their customers additional options for financing equipment purchases. Because they do not take deposits, finance companies are not regulated by the FDIC and are relatively free from regulation or government oversight. As a result, many finance companies are willing to take on riskier assets. A finance company can incorporate in any state and can operate nationwide, subject to applicable Federal and State laws.

Like cooperative associations, state incorporation laws vary widely for finance companies. Appendix 6 *General Requirements for a Finance Company Organized as a Corporation in Delaware*, provides a summary of the general requirements to incorporate in Delaware as an example. Governing statutes are primarily those concerning general corporate law. However, if a finance company lends to individuals, they must also comply with state usury, truth in lending, and consumer protection laws. To charter a finance company, the company must first obtain a license from the appropriate state agency and pay a nominal fee.

Management

If a finance company is organized as a corporation, it is governed by general corporate law, and therefore is subject to the same management requirements as other corporations. This means that they must have a Board of Directors, elected by the shareholders. Shareholders of a corporation typically have voting power according to the number of shares they own. As a result, corporate boards often reflect the interests of the largest shareholders.

Regulatory Oversight

Like cooperatives, finance companies do not take in deposits and therefore are not regulated by the FDIC. However, they are subject to state consumer protection, usury, and general corporate laws. If they lend to individuals, they are also subject to the Truth in Lending Act. Any state usury and general corporate laws would also be applicable in the state in which they are lending.

Capital

Finance companies have few restrictions on the type of capital they can raise. They can raise capital by borrowing from commercial banks, issuing bonds, or selling commercial paper or notes on the open market. Like most corporations, they have no restrictions on the number of shares they may issue or the number of classes of stock. Many states require a minimum capital requirement for finance companies but these are usually less burdensome than the requirements on state or national banks.

The following attributes of finance companies are presented for the Board's consideration in deciding the RTB corporate structure:

1. A finance company is legally structured as a corporation allowing it maximum flexibility in terms of operations.
2. There are no significant restrictions on management other than the general requirement to have a board of directors and to have senior officers of the corporation. The shareholders elect board members.
3. Finance companies are not limited to doing most of their business with member organizations. They can lend to any individual or entity. This would allow the RTB to broaden its target market. Similarly, finance companies are not limited in the types of lending they can do and, due to the lack of regulatory oversight; they are able to take on more risky assets. This would allow the RTB to diversify and broaden its lending base and, perhaps expand its lending products.
4. Both cooperatives and finance companies are relatively free from regulatory oversight; however, finance companies have an advantage in that they are free from the guiding principles that govern cooperatives. Finance companies do not have restrictions on the amount or frequency of the dividends they pay and they are not required to set aside funds for special purposes. Finance companies, therefore, may be able to seek out and serve a wider market.
5. Another key advantage finance companies have over cooperatives is that they are not limited in their return on capital. As a result, they are able to potentially attract a wider range of investors.
6. The shareholders who generally have one vote for every share of stock they own elect the board. As a result, the interests of the board may sometimes be skewed toward the interests of the largest shareholders and not equally represent the interests of all shareholders.
7. Currently, the RTB's organizational structure closely resembles a cooperative association. A change to a finance company organization may require a bigger change and adjustment for the RTB and its current members.
8. As a finance company, the RTB would not have routine access to below market equity capital from its members. It would need to raise all its capital from the market. Under the RTB's current required lending rate, loans are priced below market. They may not be able to continue to offer below market rates if the privatized Bank had to raise equity capital at market rates.
9. Because finance companies are often less conservative than banks or cooperatives they take on additional risks resulting in higher losses on loan defaults further impacting their ability to offer loans at or below market rates.

Finance Company Summary

RTB is currently chartered as a corporation under the RE Act. A corporate structure similar to the current RTB could be established in the corporate bylaws and articles of incorporation. Several of the attributes cited above could challenge the Bank's ability to keep down its cost of funds and interest rate offerings, but a corporate structure would offer the private Bank the most freedom and flexibility.

Conclusion

Either a cooperative or a finance company would be able to serve as the organizational structure for the privatized RTB. While the cooperative structure more closely resembles the current RTB structure, a finance company may offer additional flexibility that could be required as the privatized Bank faces increased competitive pressures. Appendix 7, *Comparison of Cooperatives and Finance Companies*, offers a side-by-side comparison of the two organizational structures.

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Appendix A
National Commercial Banking Requirements

National Banks

What are they?

National banks are familiar entities that have the powers to collect deposits, lend to individuals and businesses, and provide ancillary services such as stock brokerage and trust operations. To be chartered, a national bank must file with the Office of the Comptroller of the Currency (OCC). The OCC then determines if the bank can commence operations based on the bank's future earnings potential, quality and depth of management, adequacy of the capital structure, historical financial performance, and compliance with the National Banking Act and the FDIC requirements. National banks are able to operate in any state, in addition to their home state, subject to that state's local laws regarding out-of-state banks. They are able to issue more than one class of common and preferred stock.

Management Requirements

Generally, a national bank's board of directors consists of between 5 and 25 directors. Directors are elected to office for a period of not more than 3 years. At least a majority of the directors must reside in the bank's home state or within 100 miles of the bank's main office at least 1 year prior to being elected to the board and throughout the director's tenure on the board. Directors are elected by the shareholders and can appoint and direct the senior officers of the bank. (12USC71 & 12USC72)

Regulatory Oversight

National banks are regulated extensively by the OCC. They must file quarterly financial reports to the OCC and are subject to regular, usually annual, exams by the OCC auditors. Once a bank has been chartered, the FDIC automatically provides insurance on the bank's deposits up to $100,000. The FDIC uses a risk-based premium system to pay for this insurance assessing higher rates on the institutions posing greater risk to the Bank Insurance Fund (BIF). The FDIC places each institution in one of nine risk categories using a two step process based first on capital ratios and secondly on other relevant information. However, current law restricts FDIC from charging premiums to most banks that are well capitalized and highly rated by supervisors as long as the insurance fund is above a Designated Reserve Ratio (DRR) of 1.25% of insured deposits. The bank is also required to be a member of a Federal Reserve Bank in its district and must keep reserves at the Federal Reserve Bank. (12USC222)

Several specific regulations applying to national banks include the following:

A national bank must comply with the Community Reinvestment Act (CRA) requirements. CRA regulations state that all banks must meet the credit needs of the local communities in which they are chartered, including low and middle-income borrowers.

In general, a bank's legal lending limit prohibits them from lending more than 15% of its unimpaired capital and surplus to any one borrower, and an additional 10% if the loans are secured. (12USC84)

The maximum interest rate allowed on loans is the higher of; a rate of 7%, the discount rate on 90-day paper at their district Federal Reserve Bank plus 1%, or the highest interest rate allowed by the state's usury laws where the bank is operating. (12USC85)

In addition to the OCC examinations, national banks are subject to regular exams from the FDIC when a bank is considered in a weak position. These exams focus on five key areas: CRA requirements, compliance with consumer protection and fair lending regulations, safety and soundness with regard to financial condition, information systems, and trust.

Capital Requirements

Capital performs a variety of functions. In addition to supporting economic growth, it can also restrict excessive or unjustified growth through prudent policies of requiring a portion of asset growth be funded by additional capital. Capital also permits institutions to continue operating during periods of economic decline or other adverse events and promotes confidence in depositors, the public and investors. In order to be chartered by the OCC, a national bank must have initial paid-in capital of at least $1 million, net of organizational expenses. In addition, banks must comply with any state capital requirements in the states in which they operate. The OCC requires that a bank's primary capital-to-assets ratio be 4.0%. The total capital-to-assets ratio must be between 5.5% and 6.0%. Since 1992, the risk-based capital-to-assets ratio must be 8.0%. Until a bank's surplus is equal to capital, 10% of profits must be transferred to surplus.

<u>Minimum Capital Ratios</u>

(a) *Risk-based capital ratio.* All national banks must have and maintain the minimum risk-based capital ratios as set forth in OCC regulations. These regulations assign each of the bank's assets and off-balance sheet items to one of four risk categories. Each category has a specific risk weight. The combination of all risk-weighted assets becomes the denominator in determining the risk-based capital ratio.

(b) *Total assets leverage ratio.* All national banks must have and maintain Tier 1 capital in an amount equal to at least 3.0% of adjusted total assets. The minimum level would apply if the examination determines the institution is not anticipating or experiencing significant growth, has well diversified risk, good asset quality, sound liquidity and good earnings.

(c) *Additional leverage ratio requirement.* An institution operating at or near the level in paragraph (b) of this section should have well diversified risks, including no undue interest rate risk exposure, excellent control systems, good earnings, high asset quality, high liquidity, and well managed on- and off-balance sheet activities; and, in general, be considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System (CAMELS) rating system of banks. For all but the most highly rated banks meeting the conditions set forth in this paragraph (c), the minimum Tier 1 leverage ratio is 4%. In all cases, banking institutions should hold capital commensurate with the level and nature of all risks.

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Appendix B
Cooperative Bank Example - CFC

National Rural Utilities Cooperative Finance Corporation (CFC)

CFC is a cooperative serving member utility owners. They offer financial services and business management services to 1,045 electric cooperative owners located in 49 states and 4 US territories. They are based in Virginia but are organized under Washington, DC law. They have operations nationwide and have one controlled affiliate, the Rural Telephone Finance Cooperative which provides financing to the rural telecommunications industry.

1. CFC has 1,045 members, including 900 utility members, virtually all of which are consumer-owned cooperatives.
2. CFC is governed by a board of 20 directors.
3. They were granted tax-exempt status as a 501(c) (4) company.
4. CFC obtains its funding from the capital markets and from its members.
5. The CFC obtains debt financing through a combination of debt instruments including commercial paper, revolving credit lines and medium and long-term notes. Moody's has rated CFC's credit A1 for secured debt.
6. Each cooperative member is required to purchase membership subordinated certificates from CFC as a condition of membership.
7. CFC allocates its net margin annually to an education fund, a members' capital reserve and to members based on each member's participation in loan program during the year.

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Appendix C
Requirements of a Cooperative Association based in Washington, D.C.[1]

The DC Code outlines the following parameters for cooperative associations organized under Washington, DC law:

1. Any five or more natural persons or two or more associations may incorporate. (29-1102)
2. Any natural person, association, corporation, incorporated, or unincorporated group organized on a cooperative basis, any nonprofit group, or other entity shall be eligible for membership in an association if it has met the qualifications for eligibility, if any, stated in the articles or bylaws and shall be deemed a member upon payment in full for the par value of the minimum amount of share or membership capital stated in the articles as necessary to qualify for membership. (29-1123)
3. An association shall be managed by a board of not less than 5 directors, who shall be elected for a fixed term in the bylaws not to exceed 3 years. (29-1118)
4. The officers of an association shall include a president, 1 or more vice presidents, a secretary, and a treasurer, or a secretary-treasurer. The officers shall be elected annually by the directors unless the bylaws otherwise provide. (29-1119)
5. Each member has one vote and only one vote, except as may be altered in the bylaws. (29-1101)
6. The return on capital shall not exceed 6% per annum of the paid-up capital and shall be noncumulative. Total return on capital distributed for any single period shall not exceed 50% of the net savings for that period. (29-1122) (Net savings in this instance is the term used in lieu of "income." The term "margin" is also used in some states.)
7. At least once a year, the members and/or directors, as the bylaws may provide, shall apportion the net savings of the association in the following way (29-1131):
    ? Not less than 10% shall be placed in a reserve fund until such time as the fund shall equal at least 50% of paid-up capital.

    ? A portion of the remainder, as determined by the bylaws, shall be allocated to an education fund to be used in teaching cooperation, and a portion may also be allocated funds for the general welfare of the members of the association.

    ? The remainder shall be allocated at the same uniform rate to all patrons of the association in proportion to their individual patronage.

[1] Information taken from DC Code, Title 29, Chapter 11 – Cooperative Associations.

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Appendix D
General Requirements of a Cooperative Association based in Virginia[1]

The Virginia Code outlines the following general parameters for cooperative associations organized under Virginia state law:

1. Any persons, not less than five may associate themselves together as a cooperative association. (13.1-301)
2. The board of directors shall annually apportion the net earnings in the following way (13.1-306):
   ? Dividends shall be paid on the paid-up capital stock not exceeding 8% per annum.

   ? Not less than 10% of the remaining net earnings shall be set aside for a reserve fund until an amount has accumulated in the reserve fund equal to 30% of the paid-up capital stock.

   ? Five percent of the then remaining net earnings shall be set aside for an education fund to be used in teaching cooperation.

   ? The remainder of the net profits shall be apportioned by uniform dividends to its stockholder upon the amount of purchases of such association from its stockholders.

Note: The Virginia code of law has additional parameters laid out for agricultural cooperatives in Title 13.1, Chapter 3, Article 2.

[1] Information taken from Virginia Code, Title 13.1, Chapter 3 – Cooperative Associations.

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Appendix E
General Requirements for a Cooperative Credit Association based in Nebraska[1]

The Nebraska Code outlines the following parameters for cooperative associations organized under Nebraska law:

1. Any number of persons, not less than ten, or one or more cooperative companies, may form and organize a business by the adoption of articles of incorporation in the same manner and with like powers and duties. (21-1301)
2. Fifteen or more citizens resident in any one locality in this state may organize a cooperative credit association by subscribing to articles of association, set forth by the Department of Banking and Finance. (21-1310)
3. The principal place of business for said association must be in NE.
4. Said association must hold an annual meeting in January.
5. The number of directors for said association cannot be less than five Members of the credit committee and of the supervisory committee cannot be less than three. (21-1312)
6. Every association shall create a guaranty fund, to be held as a reserve to meet contingencies and losses during the life of the association. All fees and fines shall, after the payment of organization expenses, be added at once to the guaranty fund. At least 25% of the net earnings shall be set aside to this fund at the close of each fiscal year until the fund shall equal the amount of outstanding capital stock.
7. The Department of Banking and Finance shall require each cooperative credit association to obtain a surety bond naming the association and the State of Nebraska, jointly, as obliges, in an amount to be fixed by the director. Such a bond may contain a deductible amount of one thousand dollars. (21-1326.01)

[1] Information taken from Nebraska Code, Chapters 8 and 21 – Cooperative Credit Associations

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Appendix F
General Requirements for a Finance Company, Organized as a Corporation in Delaware

The Delaware Code outlines the following parameters for corporations organized under Delaware law:

1. Any person, partnership, association or corporation, without regard to such person's or entity's residence, domicile or state of incorporation, may incorporate or organize a corporation. (8-1-1-101-a)
2. The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors. The board of directors of a corporation shall consist of 1 or more members. Directors need not be stockholders unless so required by the certificate of incorporation or the bylaws. (8-4-141)
3. There is very little regulation of stock shares of cooperative associations in Delaware.

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Appendix G
Comparison of Cooperatives and Finance Companies

Cooperative Associations	Finance Companies
Shareholder Rights • Voting members all have one vote regardless of the amount of stock each may hold	**Shareholder Rights** • Typically stockholders are granted one vote per share of common stock owned but other classes of stock with different voting rights can be created
Management • States have different requirements for the make-up of management as far as the minimum number of board members, board member terms, purposes for which a cooperative can be formed, etc.	**Management** • Virtually no restrictions on management other than to have an elected Board of Directors and to have senior officers of the corporation
Lending Operations • Loans are limited to the purposes set forth in the co-ops bylaws • Co-op structure is similar to current RTB structure and would require fewer changes.	**Lending Operations** • No limitations on their target market • No limitations on the type of lending allowed • Able to take on greater risks
Regulatory Oversight • Co-ops typically do not take deposits and are not regulated by the FDIC. They are regulated by the states.	**Regulatory Oversight** • Do not take deposits and are not regulated by the FDIC. • If publicly traded or depending on the number of shareholders, would fall under SEC regulations.
Capital • Potential exists for access to below market equity capital from its members that could help RTB to continue to offer competitive lending rates.	**Capital** • Minimal capital requirements are very low or non-existent, depending on state laws. • Because they are structured as corporations, finance companies are very flexible in their ability to issue stock and various classes of stock. • They can tap private, outside investors • They are not limited in their ability to pay dividends or distribute profits.
Taxes • As a not-for-profit, co-ops can minimize their Federal tax burden at the corporate level.	**Taxes** • Would be subject to corporate income taxes
Possible Disadvantages	**Possible Disadvantages**
Lending Operations • Target market is limited to member companies • States often have member eligibility requirements further limiting target market • Some states may limit co-ops to certain types of businesses.	**Lending Operations** • Finance companies typically have to offer loans at above market rates due to higher cost of capital and riskier operations.
Capital • Co-ops may be required by the state to limit their return on capital, thereby limiting their access to some types of market equity capital. • Must distribute their profits equitably among members based on procedures set forth in their bylaws. • States often require investment in member education and/or other specialized functions.	**Capital** • Finance companies do not have routine access to low cost equity capital from members. They must raise all capital from the market and, as a result, investors expect a market-based return on investment. • From a shareholder perspective, distributions of income are not required but are left to the discretion of the Board of Directors.