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September 29, 2014

Securities Act of 1933 – Section 3(a)(5)(A)

Office of Chief Counsel  
Division of Corporation Finance  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549

RE: Staple Cotton Discount Corporation

Dear Sir or Madam:

We write on behalf of Staple Cotton Discount Corporation, an agricultural credit cooperative association (“Staple Cotton Discount”). Staple Cotton Discount has historically offered and sold demand notes without registering such notes in reliance on Section 3(a)(5)(B)(ii) of the Securities Act of 1933, which exempts securities issued by corporations exempt from federal taxation under Section 501(c)(16) of the Internal Revenue Code. Staple Cotton Discount expects that in 2014 its tax status will change and it will no longer be exempt under Section 501(c)(16) of the Internal Revenue Code. For the reasons explained below, we hereby request that the Division of Corporation Finance confirm that it will not recommend any enforcement action to the Securities and Exchange Commission (the “Commission”) if, after Staple Cotton Discount ceases to be a corporation described in Section 501(c)(16) of the Internal Revenue Code, Staple Cotton Discount offers and sell its notes, as described below, in reliance on the exemption provided by Section 3(a)(5)(A) of the Securities Act of 1933 (the “Securities Act”).

Section 3(a)(5)(A) exempts securities issued by “a savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution, which is supervised and examined by State or Federal authority having supervision over any such institution.” It is our opinion that: (1) Staple Cotton Discount is a “cooperative bank” within the meaning of Section 3(a)(5)(A); (2) Staple Cotton Discount is a “similar institution”

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within the meaning of Section 3(a)(5)(A); (3) Staple Cotton Discount is supervised and examined by Federal authorities having supervision over Staple Cotton Discount; and (4) the demand notes proposed to be offered and sold by Staple Cotton Discount after Staple Cotton Discount ceases to be a corporation described in Section 501(c)(16) of the Internal Revenue Code will be exempt securities pursuant to Section 3(a)(5)(A). This opinion is conditioned on Staple Cotton Discount continuing to be organized and operated as a cooperative under and in accordance with the Mississippi Cooperative Marketing Act<sup>1</sup> and Staple Cotton Discount continuing to be an “OFI” (defined below) under the federal Farm Credit Act, and subject to supervision and examination by the Farm Credit Administration (“FCA”) and by CoBank, FCB (“CoBank”)<sup>2</sup>.

### **Background**

Staple Cotton Discount was incorporated in 1924 as a member-owned and operated cooperative under the Mississippi Cooperative Marketing Act. Staple Cotton Discount was organized by Staple Cotton Cooperative Association (“Staple Cotton Marketing”) and has been operated in conjunction with Staple Cotton Marketing since its formation. Staple Cotton Marketing sells cotton on a cooperative basis on behalf of farmers who are members of Staple Cotton Marketing. Staple Cotton Discount provides crop financing to farmers. Most of the farmers served by Staple Cotton Discount also market cotton through Staple Cotton Marketing.

Staple Cotton Discount’s business consists solely of making loans. All loans are made to members. Most loans made by Staple Cotton Discount are short-term loans made to finance annual crop production (“production loans”). In 2013-2014, the highest outstanding daily balance of production loans has been \$69,875,862. In the past five years, the highest outstanding daily balance of production loans was \$101,761,249.

Early in its history, Staple Cotton Discount qualified as an agricultural credit cooperative association under the Mississippi Rural Credit Law<sup>3</sup> for the purpose of becoming a retail lender in the federal Farm Credit System, with access to funds through the Federal Intermediate Credit Bank of New Orleans, Louisiana<sup>4</sup>. Staple Cotton Discount continues to be a retail lender in the federal Farm Credit System.

The Farm Credit System lends funds acquired in national money markets, through four

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<sup>1</sup> Now codified, as amended, as Miss. Code Ann. §§ 79-19-1 through 79-19-63.

<sup>2</sup> Or a successor bank to CoBank, FCB that is a federal instrumentality and exercises similar powers under the Farm Credit Act and FCA regulations.

<sup>3</sup> Now codified, as amended, as Miss. Code Ann. §§ 81-15-1 through 81-15-31.

<sup>4</sup> As a result of several mergers and reorganizations of the Farm Credit System, the wholesale lending authorities once exercised by the Federal Intermediate Credit Bank of New Orleans, Louisiana are now exercised by AgFirst Farm Credit Bank, and by CoBank, ACB, and its subsidiary, CoBank, FCB.

federally established wholesale banks that are federal instrumentalities to eligible institutions which, in turn, provide retail financing to American farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, and certain farm-related businesses.<sup>5</sup> The Farm Credit System is governed by the Farm Credit Administration (“FCA”), a federal agency. Staple Cotton Discount falls within the definition of “other financing institution” or “OFI” for purposes of the Farm Credit Act and FCA regulations<sup>6</sup>, and therefore, is eligible for Farm Credit System funding.<sup>7</sup> Staple Cotton Discount obtains Farm Credit System funding through CoBank, FCB (“CoBank”), a federally chartered instrumentality of the United States and a wholly owned subsidiary of CoBank, ACB, one of the four wholesale banks in the Farm Credit System.

Staple Cotton Discount operates on a non-profit cooperative basis for the benefit of its members with whom Staple Cotton Discount maintains a lending relationship. The members of Staple Cotton Discount are: (a) Staple Cotton Marketing, an affiliated cotton marketing farmers’ cooperative; (b) all persons who from time to time are members in good standing of Staple Cotton Marketing, and (c) any other person engaged in some activity authorized by Mississippi Code Annotated § 79-19-1, *et seq.*<sup>8</sup>, who (1) applies for admission for the purpose of participating in the activities of Staple Cotton Discount, and (2) is eligible for membership under the laws applicable to Staple Cotton Discount, and its bylaws in conformity thereto, and (3) agrees to abide by the bylaws, rules and regulations of Staple Cotton Discount. Members are not issued membership certificates and make no payment for membership status. Staple Cotton Discount maintains a list of the those persons or entities that are members of Staple Cotton Discount.

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<sup>5</sup> See the 2013 Annual Information Statement of the Farm Credit System, which provides information for investors in the debt securities jointly issued by the four Farm Credit System Banks — AgFirst Farm Credit Bank, AgriBank, FCB, CoBank, ACB and the Farm Credit Bank of Texas.

<sup>6</sup> The Farm Credit Act defines an OFI as “any national bank, State bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings institution, credit union, or any association of agricultural producers engaged in the making of loans to farmers and ranchers, and any corporation engaged in the making of loans to producers or harvesters of aquatic products.”

<sup>7</sup> Farm Credit System funding of OFIs is rooted in the historical authority of the Federal Intermediate Credit Banks (“FICBs”) to provide “intermediate credit” to both Production Credit Associations (“PCAs”) and OFIs to finance their short- and intermediate-term loans to eligible farmers, ranchers, and producers or harvesters of aquatic products. This authority was carried forward to Farm Credit Banks with the statutory mergers of the FICBs and Federal Land Banks in 1988. CoBank, as an Agricultural Credit Bank, now holds this authority through the Title I authorities it received in the consolidation of the Farm Credit Bank of Springfield and the National Bank for Cooperatives in 1995.

<sup>8</sup> Miss. Code Ann. § 79-19-7 provides that: “An association may be organized to engage in any activity in connection with the growing, breeding, handling, shipping, or utilization, or moving or marketing of the byproducts thereof of livestock and poultry of every description, and with the marketing or selling of agricultural products of its members, or with the harvesting, preserving, drying, processing, manufacturing, canning, packing, grading, storing, handling, shipping, or utilization thereof, or the manufacturing or marketing of the byproducts thereof; or in connection with the manufacturing, selling, or supplying to its members of machinery, equipment, or supplies; or in the financing of the above enumerated activities; or in any one or more of the activities specified herein.”

Annually all earnings not needed to pay dividends on the Class A Preferred Stock held by Staple Cotton Marketing<sup>9</sup> or for paying losses, adequately capitalizing Staple Cotton Discount, or any other necessary purposes are allocated as patronage dividends to the borrowing members of Staple Cotton Discount in proportion to the interest paid by such members.

Staple Cotton Discount issues notes (the "Notes"), which are unsecured debt obligations of Staple Cotton Discount, issuable in any amount of \$1,000 or more, payable upon demand to the holder thereof. The Notes pay a fluctuating rate of interest, which is fixed by Staple Cotton Discount usually at the beginning of each month. Staple Cotton Discount reserves the right to repay any Note at any time by mailing written notice of its intent to repay the Note to the holder thereof. The proceeds received by Staple Cotton Discount from issuance of the Notes are used primarily to fund agricultural loans to members of Staple Cotton Discount. There is no secondary market for the Notes.

Historically, the Notes have been issued by Staple Cotton Discount without registration with the Securities and Exchange Commission in reliance upon the exemption provided by Section 3(a)(5)(B)(ii) of the Securities Act for securities issued by corporations that are exempt from federal taxation under Section 501(c)(16) of the Internal Revenue Code. To qualify as a tax-exempt organization under Section 501(c)(16), a corporation must be organized by and operated in conjunction with an exempt farmers' cooperative under Section 521 of the Internal Revenue Code. Staple Cotton Discount was organized by, and is operated in conjunction with, Staple Cotton Marketing, which is an exempt farmers' cooperative under Section 521. However, it is contemplated that in 2014 Staple Cotton Marketing will voluntarily relinquish its status as an exempt farmers' cooperative under Section 521 of the Internal Revenue Code. When Staple Cotton Marketing ceases to be exempt under Section 521, Staple Cotton Discount will no longer be operated in conjunction with a corporation exempt under Section 521 and therefore, for that reason alone, it will no longer be exempt under Section 501(c)(16) of the Internal Revenue Code.

#### **Reasons for the Change in Tax Status**

When Staple Cotton Marketing and Staple Cotton Discount were created in the 1920s, most farmers' cooperatives were organized and operated to be exempt organizations under Section 521 of the Internal Revenue Code and thus not subject to federal tax. In 1951, however, the Internal Revenue Code provisions dealing with farmers' cooperatives were substantially revised. Under the revised provisions, exempt farmers' cooperatives are subject to tax but can reduce or eliminate their tax liability by paying patronage dividends to members of the cooperative, which patronage dividends are deducted from taxable income. Farmers' cooperatives that are not exempt organizations can also reduce or eliminate their tax liability on

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<sup>9</sup> Staple Cotton Discount has issued and has outstanding 10,000 shares of Class A Preferred Stock, \$100 par value, which are held by Staple Cotton Cooperative Association, an affiliated cooperative. At the discretion of the Board of Directors, the Class A Preferred Stock may be paid an annual interest dividend not to exceed 8% per annum. Otherwise, Staple Cotton Discount has no capital stock outstanding.

business done with members by paying patronage dividends to members of the cooperative. The main difference between exempt farmers' cooperatives and other farmers' cooperatives is that exempt farmers' cooperatives have more deductions available to reduce their taxable income. However, exempt farmers' cooperatives also have more restrictions on their income-producing activities and are subject to more burdensome record keeping requirements. Because the benefits of being exempt are no longer as significant as they were before 1951, today the vast majority of farmers' cooperatives are not exempt under Section 521.<sup>10</sup>

Staple Cotton Marketing (not Staple Cotton Discount, the entity for which we are requesting a no-action letter), has now chosen to forgo its exempt status. In the past, Staple Cotton Marketing's focus has been strictly marketing member cotton and paying patronage to members. To satisfy requirements under Section 521, the governing documents of Staple Cotton Marketing require transactions involving non-member cotton to be done on a patronage basis and prohibit Staple Cotton Marketing from handling non-producer cotton. By giving up its Section 521 status, Staple Cotton Marketing will no longer be subject to these restrictions. Staple Cotton Marketing will have more flexibility to respond to market conditions, for example, by trading cotton in secondary markets and by taking other actions to provide stability and income during periods when member production has declined. While revenues from non-member and non-producer transactions will be taxable, the after tax revenues from this business will be available to support the operations of Staple Cotton Marketing.<sup>11</sup>

With respect to Staple Cotton Discount, the change in Staple Cotton Discount's federal tax status results solely from the change in Staple Cotton Marketing's tax status. Otherwise, the operations of Staple Cotton Discount, the relation between Staple Cotton Discount and its members, and the Note program, will be unchanged. The change in Staple Cotton Discount's federal tax status is not expected to have any material effect on the financial condition of Staple Cotton Discount, because it will continue to be able to reduce or eliminate its tax liability through the payment of patronage dividends. The question of whether investors in Notes need the protections afforded by the federal securities laws is not affected at all by the change in Staple Cotton Discount's federal tax status.<sup>12</sup>

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<sup>10</sup> Carol R. Goforth, *Application of the Federal Securities Laws to Equity Interests in Traditional and Value-Added Agricultural Cooperatives*, DRAKE JOURNAL OF AGRICULTURAL LAW (Volume. 6, Spring 2001) 31, 36.

<sup>11</sup> An additional legal benefit of the Section 521 exemption is that the Securities Act exempts from registration requirements any securities issued by farmers' cooperatives that are exempt from tax under Section 521. Staple Cotton Marketing, however, is not engaged in the offer and sale of securities, and, therefore, has no need for this exemption. Specifically, we do not believe that Staple Cotton Marketing membership interests constitute "securities" for purposes of federal securities laws.

<sup>12</sup> It appears that when Congress in 1933 exempted farmers' cooperatives from the registration requirements of the Securities Act, it simply used the tax code provisions on farmers' cooperatives as a way to identify the types of organizations being exempted. Since at the time most farmer's cooperatives were exempt this worked. There is no reason to believe that the technical distinctions between the tax treatment of exempt farmers' cooperative and other

### **History of and Rationale for the Section 3(a)(5) Exemption**

Section 3(a)(5) as originally enacted exempted: "Any security issued by a building and loan association, homestead association, savings and loan association, or similar institution, substantially all the business of which is confined to the making of loans to members (but the foregoing exemption shall not apply with respect to any such security where the issuer takes from the total amount paid or deposited by the purchaser, by way of any fee, cash value or other device whatsoever, either upon termination of the investment at maturity or before maturity, an aggregate amount in excess of 3 per centum of the face value of such security), or any security issued by a farmers' cooperative association as defined in paragraphs (12), (13), and (14) of section 103 of the Revenue Act of 1932".

The legislative history relating to this exemption indicates a general desire to exempt this type of entity, but also indicates concerns that unscrupulous promoters were using the name "building and loan" to attract investors for fraudulent purposes.<sup>13</sup> In addition, there was a concern that at least in some states there was no active regulation of building and loan associations, making it easy for a fraudulent promoter to use sham "building and loan association" to defraud investors. Two approaches were considered to make sure the exemption was only available to legitimate organizations. One approach considered was to exempt institutions "operated under the laws and subject to the examination, supervision, and control of any State of the United States or any insular possession, and District of Columbia." The other approach was to exempt institutions "substantially all the business of which is confined to the making of loans to members," which is the approach adopted in the final legislation. *House Report No. 85, 73rd Cong., 1st Sess. (1933)*, at p. 15, explained the provision as follows: "Paragraph (5) exempts the securities of building and loan associations and similar institutions, but insists that such institutions as a condition to being exempt from the Act must do a true building and loan business by confining their business to the making of loans to their members." Institutions that confine their business to the making to members on a cooperative basis would be engaged in a legitimate business and would be controlled by the members doing business with the institution, thus reducing the potential for abuse.

In 1970, in conjunction with comprehensive amendments to the Investment Company Act of 1940, Section 3(a)(5) was amended to read as it currently reads. The legislative history provides the following explanation for the amendment:

Section 27(c) of the bill would amend section 3(a)(5) of the Securities Act to conform the exemption from registration under the Securities Act for securities issued by savings and loan associations and similar institutions with the

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farmers' cooperatives under current tax law has anything to do with the original intent of Congress in exempting farmers' cooperatives from the Securities Act.

<sup>13</sup> *Hearing on H.R. 4314 (March 31, 1933)*, pages 74-78.

exemptive language found in section 12(g)(2)(C) of the Securities Exchange Act of 1934. This amendment is technical and nonsubstantive in nature. Initial issues or secondary distributions of securities by savings and loan associations have always been exempt from registration under the Securities Act by virtue of section 3(a)(5). The exemption now refers to savings and loans "substantially all the business of which is confined to the making of loans to members." The quoted language amounts to an obsolete definition applicable to savings and loan associations under the "old" tax definition, which itself was changed by the Revenue Act of 1962. The amendment is designed to maintain this exemption but to update it for all savings and loan associations which are "supervised and examined by State or Federal authority having supervision over any such institution." - *House Committee Report No. 91-1382 (1970)*, page 44.

Although entities of the type listed in Section 3(a)(5) have as a common characteristic that substantially all of their business consists of making loans to members, after the 1970 amendment, the focus of the exemption shifted to supervision and examination by a State or Federal authority. Investors in institutions regulated by a State or Federal authority would not need the protections afforded by the registration requirements of the Securities Act where the institution is required periodically to provide audited financial statements and other material information to the regulator and where the regulator has the right to inspect the books and records of the institution. Regulations requiring maintenance of minimum levels of capital and imposing other financial and operational restrictions provide additional protections to investors that go beyond the protections afforded by the Securities Act.

**Staple Cotton Discount is a "Cooperative Bank" Within the Meaning of Section 3(a)(5)(A)**

Staple Cotton Discount should be considered a "cooperative bank" within the meaning of Section 3(a)(5)(A). A "cooperative" is an organization owned by those to whom it provides services. A "bank" is a business authorized to provide financial services, including lending money at interest. Therefore, a "cooperative bank" is an entity that provides financial services and is owned by the customers to whom these services are provided.

Neither the Securities Act nor the legislative history of Section 3(a)(5) explicitly defines the term "cooperative bank". In discussing this exemption in a Senate hearing prior to the adoption of the Securities Act, Senator Barkley referring to "building and loan associations, savings and loan associations, cooperative banks, and homestead associations" states "I guess they are all about the same thing, but the language is a little different."<sup>14</sup> What determines whether the exemption applies is not the name of an organization, but rather whether the organization actually provides financial services on a cooperative basis for the benefit of its

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<sup>14</sup> *Hearing on S. 875 Before the Committee on Banking and Currency, 73rd Cong., 1st Sess. (April 3, 1933) page 99.*

members and whether the organization is examined and supervised by state or Federal authorities.

Although Staple Cotton Discount does not have the words "cooperative bank" in its name, it provides financial services on a cooperative basis to its members as an "agricultural credit cooperative association" under the Mississippi Rural Credit Law and pursuant to the authorization granted by the Mississippi Cooperative Marketing Act. Therefore, Staple Cotton Discount is a "cooperative bank" for purposes of Section 3(a)(5)(A). As discussed in detail below, Staple Cotton Discount also meets the essential test for being an exempt cooperative bank, since it is examined and supervised by Federal authorities.

**Staple Cotton Discount is a "Similar Institution" Within the Meaning of Section 3(a)(5)(A)**

In *SEC v. American International Savings & Loan Association*, 199 F. Supp. 341 (D. Md. 1961), the Court found that a purported "savings and loan association" was not a savings and loan association or similar institution for purposes of Section 3(a)(5) of the Securities Act because substantially all of its business was not confined to the making of loans to members, which was an explicit requirement of Section 3(a)(5) at the time. The Court cited House Report No. 85, 73rd Cong., 1st Sess. (1933), at p. 15, where it is said: "Paragraph (5) exempts the securities of building and loan associations and similar institutions, but insists that such institutions as a condition to being exempt from the Act must do a true building and loan business by confining their business to the making of loans to their members." Although, as noted above, since 1970 Section 3(a)(5) has not contained the explicit requirement that substantially all of an institution's business be confined to the making of loans to members, the case has continuing relevance because it identifies the essential characteristics of a building and loan association, which is a necessary prerequisite to determining whether an institution is similar to building and loan associations. The Court noted that language almost identical with that contained in Section 3(a)(5) had been previously used by Congress in granting an income tax exemption to such associations, and quoted a Tax Court case which explained the essential nature of a building and loan association as follows:

"Mutuality among members is an essential attribute of a building and loan association, and the exemption statute under consideration recognizes this in limiting the exemption to building and loan associations, substantially all of the business of which is confined to making loans to members. Other factors of mutuality relate to the control and management of the business and its assets, and, in a more fundamental sense, to the opportunity and means it affords the members for saving and borrowing for home owning. Unlike a banking institution which operates primarily for the benefit of its investing stockholders, a building and loan association is, fundamentally, intended to be conducted for the benefit of its borrowing members as well as nonborrowers. This includes the principle that borrowing members are to receive substantially proportionate treatment with

respect to profits as nonborrowers.” *SEC v. American International Savings & Loan Association*, 199 F. Supp. at 347.

To summarize, the elements that make up the essential nature of a building and loan association are: (1) that its business is lending; (2) that substantially all of its loans are to members; and (3) that it operates on cooperative principles, including operation of the association for the benefit of borrowing members not investing stockholders, control of the association by borrowing members and sharing of profits by borrowing members. Although the 1970 amendment to Section 3(a)(5) deleted the explicit requirement that substantially all of the business of the association be confined to the making of loans to members, this characteristic is still an important element common to types of entities listed in Section 3(a)(5).

In *Idaho Central Credit Union*, SEC No-Action Letter, [1976-77 Transfer Binder] Fed. Sec. Law Rep. (CCH) ¶ 81,004 (Feb. 14, 1977), a credit union proposing to issue certificates of indebtedness in reliance on the exemption provided by Section 3(a)(5)(A) received a favorable no-action letter. The requestor argued that the credit union was a “similar institution” within the meaning of Section 3(a)(5)(A). The credit union’s business was confined to maintaining member savings accounts and making loans to its members. The Staff noted that the Idaho Department of Finance supervised the operation of the credit union and examined its books and records to insure compliance with applicable state requirements. Subsequent no-action letters issued to *Oregon Telco Credit Union*, made publicly available April 3, 1978, *Automatic Employees’ Federal Credit Union*, made publicly available February 12, 1979 and *U.S. Central Credit Union*, made publicly available December 21, 1992, have been based on the same analysis.

In *La Caisse Populaire Ste. Marie v. United States*, 563 F.2d 505 (1<sup>st</sup> Cir. 1977), the court found it necessary to determine the common understanding of the term “credit union” since the term was used but not defined in the section of the Internal Revenue Code being applied by the court. The court concluded that the common understanding of the term “credit union” was as follows:

“A credit union is a democratically controlled, cooperative, nonprofit society organized for the purpose of encouraging thrift and self-reliance among its members by creating a source of credit at a fair and reasonable rate of interest in order to improve the economic and social conditions of its members. A credit union is fundamentally distinguishable from other financial institutions in that the customers may exercise effective control.” 563 F.2d at 509.

The elements that according to the court in this case define a credit union are basically the same elements that make up the essential nature of a building and loan association according to the court in the *American International Savings & Loan Association* case: (1) being in the business of lending; (2) operating for the benefit of members, not stockholders; and (3) adhering to cooperative principles.

Staple Cotton Discount's business consists solely of making loans for agricultural purposes to its members.<sup>15</sup> The Mississippi Cooperative Marketing Act, under which Staple Cotton Discount is organized, limits the purposes for which an entity can be organized under the Mississippi Cooperative Act to providing services to members engaged in enumerated agricultural activities. In accordance with these provisions, Staple Cotton Discount's Articles of Association state that the purpose of Staple Cotton Discount is to finance the agricultural activities of its members. Staple Cotton Discount's General Financing Agreement with CoBank, which is discussed below, also restricts the business of Staple Cotton Discount to making loans for agricultural purposes.

The Mississippi Cooperative Marketing Act provides that "associations hereunder shall be deemed nonprofit, inasmuch as they are not organized to make profits for themselves, as such, or for their members, as such, but only for their members as producers." Miss. Code Ann. § 79-19-3. In accordance with this provision, Staple Cotton Discount is required to operate on a cooperative basis.

Under the Mississippi Cooperative Marketing Act and the bylaws of Staple Cotton Discount, the members of Staple Cotton Discount vote on the election of directors of Staple Cotton Discount and other matters that are required to be voted on by the members under the Mississippi Cooperative Marketing Act. Each member has one vote. The profits of Staple Cotton Discount are distributed to members as patronage dividends on the basis of business done with Staple Cotton Discount.

Just as the credit unions in *Idaho Central Credit Union* and subsequent no-action letters were deemed to be similar institutions to building and loan associations, Staple Cotton Discount should be considered a similar institution. The certificates of indebtedness in *Idaho Central Credit Union* were to be issued to nonmember individuals, partnerships or corporations. In the present case, the Notes will be sold to members, as well as nonmember individuals, partnerships or corporations. In *Idaho Central Credit Union* the purpose of the issuance of the certificates of indebtedness was to make available to the credit union an alternative source of funding. In the present case, the purpose of the issuance of the Notes is to make available to Staple Cotton Discount an alternative source of funding. In *Idaho Central Credit Union*, the credit union was a cooperative, nonprofit association. In the present case, Staple Cotton Discount is a cooperative, nonprofit association. In *Idaho Central Credit Union*, the purpose of the credit union was to create a source of credit at fair and reasonable rates of interest for its members. In the present case, the purpose of Staple Cotton Discount is to create a source of credit at fair and reasonable

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<sup>15</sup> In addition to making loans, building and loan associations and credit unions also generally accept deposits, upon which they maintain deposit insurance. Staple Cotton Discount does not accept deposits and does not maintain deposit insurance. Whether an entity accepts deposits has no relevance to the question of whether investors in its securities need the protections afforded by the federal securities laws. Likewise, deposit insurance is for the benefit of depositors and not for the benefit of investors, and therefore, has no relevance to the question of whether investors in its securities need the protections afforded by the federal securities laws.

rates of interest for its members. Therefore, each of the essential characteristics of a building and loan association and a credit union are equally applicable to Staple Cotton Discount.

**Staple Cotton Discount is Supervised and Examined by Federal Authorities**

Section 3(a)(5)(A) of the Securities Act requires that Staple Cotton Discount be “supervised and examined by State or Federal authority having supervision over any such institution.” Just as savings and loan associations are subject to regulation by the federal Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, Staple Cotton Discount is subject to supervision and examination by the Farm Credit Administration, a federal agency, and by CoBank, a federal instrumentality operating under the direction and supervision of the Farm Credit Administration. CoBank is chartered as a Farm Credit Bank under the Farm Credit Act, and its parent, CoBank, ACB, is chartered as an Agricultural Credit Bank under the Farm Credit Act. As an instrumentality of the federal government, CoBank is a federal authority for purposes of Section 3(a)(5). For purposes of Section 3(a)(5) supervision and regulation by CoBank, acting as an instrumentality of the federal government under the oversight of FCA, is equivalent to regulation and supervision directly by FCA.

Staple Cotton Discount is examined annually by CoBank and is subject to examination by FCA on as frequent a basis as FCA deems necessary.

FCA regulates Farm Credit System retail lenders, including OFIs such as Staple Cotton Discount, both directly through regulations, annual examination by wholesale bank staff, and, when deemed appropriate examinations by FCA staff. FCA also regulates OFIs, such as Staple Cotton Discount, by regulating and annually examining the lending relationship between Farm Credit Systems wholesale banks and OFIs, and the oversight of OFIs.

As a condition for extending funding to an OFI, each Farm Credit Bank or Agricultural Credit Bank must require the OFI to execute a general financing agreement pursuant to the regulations in subpart C of part 614 (12 CFR 614.4120<sup>16</sup> and 12 CFR 614.4130<sup>17</sup>). Staple Cotton

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<sup>16</sup> “§ 614.4120 Policies governing extensions of credit to direct lender associations and OFIs.

The board of directors of each Farm Credit Bank and agricultural credit bank shall adopt policies and procedures governing the making of direct loans to and the discounting of loans for direct lender associations and OFIs. The policies and procedures shall prescribe lending policies and loan underwriting standards that are consistent with sound financial and credit practices. The policies shall require a periodic review of the lending relationship with each direct lender association and OFI at intervals consistent with the term of the general financing agreement but in no case longer than 5 years. The policies shall require an evaluation of the creditworthiness of a direct lender association on the basis of credit factors and lending policies and loan underwriting standards set forth in part 614, subpart D, and may permit lending to such an institution on an unsecured basis only if the overall condition of the institution warrants. The stated term of a general financing agreement shall not exceed 5 years but may be automatically renewable for additional terms not to exceed 5 years if neither party objects at the time of renewal. The term of any general financing agreement that provides for unsecured lending to a direct lender association shall not exceed 1 year and may not be automatically renewed.”

Discount's current General Financing Agreement with CoBank, FCB dated as of October 15, 2013 contains the following pertinent provisions:

**Section 9.02. Knowledge of Act and Regulations.** The Borrower<sup>18</sup> has reviewed the Act and the Regulations, the FCA's orders or directives applicable to it, and the Lender's Policies and Procedures, and is aware of and understands that the Act, Regulations, FCA's orders and directives, and the Lender's Policies and Procedures establish requirements for eligibility for establishing and maintaining the borrower-lender relationship between the Borrower and the Lender. The Borrower is eligible to establish and maintain a relationship with the Lender in accordance with the terms and conditions of this Agreement and is an OFI pursuant to 12 CFR § 614.4540. The Borrower is aware that such relationship may be terminated or suspended for failure to comply substantially at all times with the Act, Regulations, FCA's orders and directives, and the Lender's Policies and Procedures, or as a result of a change in any of the foregoing.

**Section 10.02 Concentration Limits.** The Borrower agrees that at no time will the principal amount of Customer Loans which the Borrower has advanced or is committed to advance to any single Customer, or to Interlocking Borrowers considered in the aggregate, exceed (a) 35% of Risk Capital, (b) 15% of the sum of Risk Capital plus Investment Notes or (c) for any term loan, 25% of Risk Capital; provided that the limit described in the foregoing clause (c) shall not apply when there are no Advances outstanding under this Agreement.

**Section 10.03 Interest Income Ratio.** The Borrower shall maintain at all times a ratio of Customer Interest Income to Borrower Interest Expense of at least 1.35:1.00, exclusive of the Borrower's provision for loan losses.

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<sup>17</sup> “§ 614.4130 Funding and discount relationships between Farm Credit Banks or agricultural credit banks and OFIs.

(a) A Farm Credit Bank or agricultural credit bank shall not advance funds to, or discount loans for, an OFI, as defined in § 611.1205 of this chapter, except pursuant to a general financing agreement.

(b) The Farm Credit Bank or agricultural credit bank shall deliver a copy of the executed general financing agreement and all related documents, such as a promissory note or security agreement, and all amendments of any of these documents, within 10 business days after any such document or amendment is executed, to the Chief Examiner, Farm Credit Administration, or to the Farm Credit Administration office that the Chief Examiner designates.

(c) The total credit extended to the OFI, through direct loan or discounts, shall be consistent with the Farm Credit Bank's or agricultural credit bank's lending policies and loan underwriting standards and the creditworthiness of the OFI. The general financing agreement or promissory note shall establish a maximum credit limit determined by objective standards as established by the Farm Credit Bank or agricultural credit bank.”

<sup>18</sup> Staple Cotton Discount is referred to as the “Borrower” in the General Financing Agreement.”

**Section 10.04 Leverage.** The Borrower shall maintain at all times a Leverage Ratio of not greater than 7.0:1.0, measured as of the end of each calendar month.

**Section 10.05 Loans Outstanding to Risk Capital.** The Borrower shall maintain at all times a ratio of Customer Loans outstanding to Risk Capital of not more than 8.0:1.0.

**Section 10.06 Capitalization Ratio.** The aggregate amount of all of the Borrower's Investment Notes shall at all times exceed 60% of the sum of (a) the aggregate amount of all of the Borrower's Investment Notes plus (b) the Net Worth of the Borrower.

**Section 11.03 Compliance with Laws.** The Borrower will comply with the requirements of all applicable laws, rules, regulations and orders of any governmental authority, including without limitation the Act, Regulations, FCA orders or directives and the Lender's Policies and Procedures, and any changes thereto, including with respect to the Borrower's Investment Note Program, the noncompliance with which may, singly or in the aggregate, result in a Material Adverse Effect, unless the same is being contested by the Borrower in good faith and by appropriate proceedings and, to the extent required by GAAP, adequate reserves have been established therefor.

**Section 11.04 Keeping of Books and Records; Inspection.** The Borrower will maintain a system of accounting in accordance with GAAP. Upon reasonable notice from the Lender, the Borrower will permit the Lender or its representatives to have access to and examine and inspect the books and records and properties of the Borrower and confer with the officers of the Borrower and the Borrower's agents, employees and accountants at any reasonable time and from time to time.

**Section 11.06 Financial Statements and Other Information.** The Borrower will deliver to the Lender:

(a) Annual Financial Statements. As soon as available and in any event within 90 days after the end of each of its Fiscal Years, an audited statement of assets, liabilities and members' equity (balance sheet), changes in equity, statements of income, statements of retained earnings and statements of cash flows (the "Financial Statements") of the Borrower for such year, prepared in accordance with GAAP and setting forth in each Fiscal Year in comparative form the figures for the previous Fiscal Year, and all notes and schedules relating thereto, with an opinion thereon satisfactory to the Lender by a nationally or regionally recognized independent certified public accountant.

(b) Monthly Financial Statements. As soon as available but in no event more than 45 days after the end of each month, the following Financial Statements or other information concerning the operations of Borrower for such month and to date for the corresponding periods of the preceding Fiscal Year, all prepared in accordance with GAAP, (a) a consolidated balance sheet; (b) a consolidated summary of earnings; and (c) such other statements as the Lender may reasonably request.

(c) Management Letters. Promptly after receipt thereof, a copy of any management letters submitted to the Borrower by its independent certified public accountant.

(d) Management Certificate. Simultaneously with the delivery of each set of Financial Statements referred to in this Section 11.06, a certificate of the Borrower stating, to the best knowledge of the Borrower after reasonable inquiry, (i) whether there exists on the date of such certificate any Event of Default or Potential Default; and (ii) if any Event of Default or Potential Default exists, specifying the nature and period of existence thereof and the action the Borrower is taking or proposes to take with respect thereto.

(e) Borrowing Base and Compliance Report. As soon as available but in no event more than 45 days after the end of each calendar quarter (or at such other times or intervals as Lender may request), a completed Borrowing Base and Compliance Report for the previous calendar quarter. The report shall be accompanied by sufficient supporting detail from the Borrower's accounting records to substantiate the information contained in the report. The report must be signed by an authorized officer of the Borrower.

(f) Additional Information. From time to time such additional information regarding the financial condition or business of the Borrower as the Lender may reasonably request.

**Section 11.09 Inspections, Examinations.** The Borrower shall permit the Lender, the FCA or their respective agents, during normal business hours or at such other times as the parties may agree, to examine and make copies of or abstracts from the Borrower's properties, books, and records, and to discuss the Borrower's affairs, finances, operations and accounts with its respective officers, directors, employees and independent certified public accountants; provided that in the case of each meeting with the independent accountants the Borrower shall be given an opportunity to have a representative present at such meeting. The Borrower agrees to pay the reasonable expenses incurred by Lender's employees and agents of the Lender as may be required by the Lender in connection with examinations, audits or reviews.

**Section 11.10 Eligibility.** The Borrower shall preserve and maintain its status as an entity eligible to borrow from the Lender.

**Section 12.01 Change in Nature of Business.** The Borrower will not enter into any business other than the business of making Customer Loans to qualified Customers.

**Section 12.02 Investments.** The Borrower will not make any capital contribution to or investment in any Person or purchase any stock, bonds, notes, debentures, or other securities of any Person, except Permitted Investments.

**Section 12.03 Liens.** The Borrower will not create, incur, assume or permit to exist any Lien upon any of its Customer Loans, investments or other assets, except the Liens in favor of the Lender.

**Section 12.04 Other Indebtedness.** Without the prior written consent of the Lender, the Borrower will not create, assume, incur, suffer to exist or otherwise become or remain liable for any Indebtedness other than (a) the Indebtedness to the Lender, (b) liability incurred pursuant to the Investment Note Program, (c) Indebtedness owing to Staple Cotton Marketing and (d) liability incurred in connection with its employee savings account program.

**Section 12.05 Consolidations, Mergers, Etc.** The Borrower will not merge with or into or consolidate with any other Person nor make any material change in management.

**Section 12.06 Sales of Assets.** The Borrower will not sell, lease, transfer, liquidate or otherwise dispose of any Customer Loan without the prior written consent of the Lender.

**Section 12.07 Dividends, Etc.** The Borrower shall not declare or pay any dividends or retire capital equities or other written notices of allocation, or make any other distribution or allocation of its earnings, surplus or assets to any holder of stock, allocated equities or other written notices of allocation, except that the Borrower may distribute patronage-sourced earnings annually in the form of cash and qualified written notices of allocation debt; provided, however, the Borrower may declare or pay dividends on preferred stock not to exceed eight percent (8%) in any one fiscal year without the Lender's prior written consent, and may distribute patronage-sourced earnings annually in the form of cash and qualified written notices of allocation, so long as the cash portion of such distribution does not exceed fifty percent (50%) of such earnings, and such written notices constitute equity and not debt.

**Section 12.09 Change in Credit and Lending Policies.** The Borrower will not change or modify its Borrower Credit Policies without the prior written consent of the Lender.

**Section 12.10 Prior Consent to Customer Loans.** The Borrower will not take action on any loan made to a director or entity controlled by a director of (a) the Borrower; (b) any entity regulated by FCA; or (c) any state or federally regulated bank, without the prior written consent of the Lender.

**Section 12.12 Loans.** The Borrower shall not lend or advance money, credit or property to any person or entity, except for (a) trade credit extended in the ordinary course of business, (b) Eligible Loans and (c) if the Borrower owes no Indebtedness to the Lender, loans to Staple Cotton Marketing.

In addition to the supervision and examination provided for in the General Financing Agreement, Staple Cotton Discount as an OFI is subject to certain FCA regulations and provisions of the Farm Credit Act.

Under the Farm Credit Administration's regulations, no obligation shall be purchased from or discounted for and no loan shall be made or other similar financial assistance extended by a Farm Credit Bank or Agricultural Credit Bank to an OFI if the amount of such obligation added to the aggregate liabilities of such OFI, whether direct or contingent (other than bona fide deposit liabilities), exceeds ten times the paid-in and unimpaired capital and surplus of such OFI or the amount of such liabilities permitted under the laws of the jurisdiction creating such OFI, whichever is less.<sup>19</sup>

If an OFI that is indebted to a Farm Credit Bank or agricultural credit bank becomes insolvent, is in process of liquidation, or fails to service its loans properly, the Farm Credit Bank or agricultural credit bank may take over such loans and other assets that the OFI pledged as collateral. Once the Farm Credit Bank or agricultural credit bank exercises its remedies, it shall have the authority to make additional advances, to grant renewals and extensions, and to take such other actions as may be necessary to collect and service loans to the OFI's borrower. The funding Farm Credit Bank or agricultural credit bank may also liquidate the OFI's loans and other assets in order to achieve repayment of the debt.<sup>20</sup>

As an OFI, Staple Cotton Discount must comply with the following "borrower rights" provisions of the Farm Credit Act: (i) effective interest rate disclosure, (ii) notice of adverse credit decision, (iii) right to appeal adverse credit decisions to the lender's credit review committee, (iv) receiving copies of loan documents, and (v) the right to restructure distressed

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<sup>19</sup> 12 CFR § 614.4580(a).

<sup>20</sup> 12 CFR § 614.4600.

loans.<sup>21</sup>

Any OFI that is not a depository institution must consent in writing to examination by the FCA as a condition precedent for obtaining funding, discount and other similar financial assistance from a Farm Credit Bank or agricultural credit bank, and file such consent with its Farm Credit funding bank.<sup>22</sup> Staple Cotton Discount's written consent to examination by the Farm Credit Administration is currently set forth in Section 11.09 of the General Financing Agreement between Staple Cotton Discount and CoBank, which has been filed with CoBank, which is the Farm Credit funding bank for Staple Cotton Discount. FCA relies on CoBank staff to conduct annual examinations of Staple Cotton Discount, but FCA may use its own staff to examine Staple Cotton Discount in its discretion. In their annual examination of CoBank, FCA examiners are required to review and document CoBank's oversight of OFIs, including Staple Cotton Discount. FCA examiners review, among other things, CoBank's monitoring of the financial condition of OFIs and whether CoBank has appropriate financing agreements with the OFIs that address significant financial and operational requirements.<sup>23</sup> CoBank will continue in the future to make annual examinations of Staple Cotton Discount.

#### **Mississippi Secretary of State Order and Interpretive Opinion**

In 1987, Staple Cotton Discount asked the Securities Division of the Office of the Mississippi Secretary of State for a determination as to whether the Staple Cotton Discount's issuance of notes was exempt from registration requirements under the Mississippi Securities Act pursuant to Miss. Code Ann. § 75-71-201(4), which exempted securities "issued by and representing an interest in or a debt of...any federal savings and loan association, or any building and loan or similar association..." The Mississippi Secretary of State issued an order holding that the Staple Cotton Discount was a "similar association" to a savings and loan or building and loan association and that, therefore, the notes were exempt from registration. RE: Staple Cotton Discount Corporation, 1987 Miss. Sec. LEXIS 41 (November 9, 1987) (the "1987 Order"). The 1987 Order was conditioned on there being no material change in the relevant facts concerning the Staple Cotton Discount as set forth in the October 19, 1987 letter requesting the 1987 Order.

In 2010, the Mississippi Securities Act was comprehensively revised. Miss. Code Ann §75-71-301(1) under the revised Mississippi Securities Act provides an exemption from registration requirements for "federal covered securities," which includes exempt securities under Section 3(a)(5)(A) of the Securities Act of 1933. On May 2, 2014, the Securities Division of the Office of the Mississippi Secretary of State issued an interpretive opinion concurring in our firm's conclusion that the notes proposed to be offered and sold by the Staple Cotton Discount after the Staple Cotton Discount ceases to be a corporation described in Section 501(c)(16) of the

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<sup>21</sup> 12 CFR § 614.4560(d).

<sup>22</sup> 12 CFR § 614.4560(e).

<sup>23</sup> FCA Examination Manual, EM-350.

Internal Revenue Code will be exempt from registration under the Mississippi Securities Act: (1) pursuant to 1987 Order, and (2) as exempt securities under Section 3(a)(5)(A) of the Securities Act of 1933 that are, therefore, "federal covered securities" for purposes of Miss. Code Ann §75-71-301(1).

**Conclusion**

For the reasons set forth above, we hereby request that the Division of Corporation Finance confirm that it will not recommend any enforcement action to the Commission if, after Staple Cotton Discount ceases to be a corporation described in Section 501(c)(16) of the Internal Revenue Code, Staple Cotton Discount offers and sell its notes, as described above, in reliance on the exemption provided by Section 3(a)(5)(A) of the Securities Act.

We would appreciate your response to this request at the Staff's earliest convenience. If, for any reason, it does not appear the Staff will be able to concur with Staple Cotton Discount's position as stated in this letter, we would greatly appreciate the opportunity to discuss this matter with the Staff prior to the issuance of a formal response.

If you have questions or need additional information, please contact the undersigned at (601) 949-4701.

Very truly yours,

JONES WALKER LLP

/s/ Keith Parsons

Keith Parsons