68 FR 23425, 05/02/2003

Handbook Mailing HM-03-10

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC20

Eligibility and Scope of Financing

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Farm Credit Administration (FCA) is considering whether to revise its regulations governing eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters who borrow from Farm Credit System (FCS or System) institutions that operate under titles I or II of the Farm Credit Act of 1971, as amended (Act). We are also considering whether we should modify our regulatory definition of "moderately priced" rural housing. We invite your comments.

DATES: You may send us comments by July 31, 2003.

ADDRESSES: You may send comments by electronic mail to "reg-comm@fca.gov," through the Pending Regulations section of FCA's Web site, "www.fca.gov," or through the government-wide "www.regulations.gov" portal. You may also send comments to Robert E. Donnelly, Acting Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or by facsimile to (703) 734-5784. You may review copies of all comments we receive at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

Mark L. Johansen, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434,

or

Richard Katz, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Introduction

We received two petitions under 5 U.S.C. 553(e) to repeal § 613.3005, which limits the amount

of credit that FCS institutions that operate under titles I or II of the Act can extend to eligible farmers, ranchers, and aquatic producers or harvesters (collectively referred to as "farmers"). The petitioners state that the Act does not restrict the System's authority to finance all the credit needs of any group of eligible farmers and, therefore, § 613.3005 should be eliminated as having no basis in law. The petitioners also state that § 613.3005 unnecessarily restricts the System's ability to serve creditworthy and eligible farmers, particularly those who have significant off-farm income, and young, beginning, and small farmers. One petitioner also asked us to change the definition of "moderately priced" rural housing in § 613.3030(a)(4). The petitioner stated that this definition has not kept pace with the evolving rural housing market and, therefore, is preventing FCS institutions that operate under titles I and II from fully serving the housing needs of eligible non-farm rural residents.

We have decided to start a rulemaking in response to these two petitions. We reserve judgment on the appropriate legal interpretation of the relevant provisions of the Act. Nevertheless, we believe it is appropriate to review our regulations governing eligibility and scope of financing for farmers and our definition of "moderately priced" rural housing. The goal of this rulemaking is to explore how our regulations can become more responsive to the needs of all eligible and creditworthy farmers and rural residents within the boundaries of the Act.

II. Background

A. Farmers

Section 1.9 of the Act authorizes FCS mortgage lenders to extend credit to "bona fide farmers, ranchers, or producers or harvesters of aquatic products." Section 1.11(a)(1) of the Act states that "Loans made by a Farm Credit [mortgage lender] to farmers, ranchers, and producers or harvesters of aquatic products may be for any agricultural or aquatic purpose and other credit needs of the applicant. . . ." Similarly, section 2.4(a)(1) authorizes certain FCS associations to "make, guarantee, or participate with other lenders in short- and intermediate-term loans and other similar financial assistance to . . . bona fide farmers and ranchers and the producers or harvesters of aquatic products, for agricultural or aquatic purposes and other requirements of such borrowers. . . ."

Under § 613.3000(a)(1), a "bona fide farmer or rancher" is "a person owning agricultural land or engaged in the production of agricultural products . . . ." The scope of financing regulation, § 613.3005, which the petitioners asked us to repeal, states:

> It is the objective of each bank and association, except for banks for cooperatives, to provide full credit, to the extent of creditworthiness, to the full-time bona fide farmer (one whose primary business and vocation is farming, ranching, or producing or harvesting aquatic products); and conservative credit to less than full-time farmers for agricultural enterprises, and more restricted credit for other credit requirements as needed to ensure a sound credit package or to accommodate a borrower's needs as long as the total credit results in being primarily an agricultural loan. However, the part-time farmer who needs to seek off-farm employment to supplement farm income or who desires to supplement off-farm income by living in a rural area and is carrying on a valid agricultural operation, shall have availability

> of credit for mortgages, other agricultural purposes, and family needs in the preferred position along with full-time farmers. Loans to farmers shall be on an increasingly conservative basis as the emphasis moves away from the full-time bona fide farmer to the point where agricultural needs only will be financed for the applicant whose business is essentially other than farming. Credit shall not be extended where investment in agricultural assets for speculative appreciation is a primary factor.

B. Non-Farm Rural Housing

Existing § 613.3030(a)(4) establishes two methods that FCS lenders may use to determine whether rural housing is "moderately priced." The first method derives from section 8.0(1)(B) of the Act, which defines "moderate priced" for the purpose of secondary market financing as dwellings (excluding the land) that do not exceed $100,000, as adjusted for inflation. The second method authorizes FCS banks and associations to determine whether housing in a particular rural area is "moderately priced" by documenting data from a credible, independent, and recognized national or regional source. Housing values at or below the 75th percentile are deemed to be moderately priced.

III. Questions

This rulemaking gives you the opportunity to tell us whether and how we should change our eligibility and scope of financing regulations for eligible farmers. We want to know if you think we should change the eligibility criteria for farmers as defined in § 613.3000. In addition, we seek your input on whether we should repeal, retain, or amend the scope of financing requirements in § 613.3005. We are particularly interested in your views on how we should regulate FCS lending for farmers' other credit needs. Please respond to the following questions.

1. Current § 613.3000(a)(1) defines a bona fide farmer, rancher, or aquatic producer as a person who either owns agricultural land or is engaging in the production of agricultural products. Do you think the FCA should retain or change this definition? If you favor changing this definition, please offer specific recommendations.

2. What limits, if any, should FCA regulations place on lending for farmers' other credit needs?

3. How should we regulate access to the other credit needs of eligible farmers who derive most of their income from off-farm sources? Do you favor retaining the current regulatory distinction between full-time and part-time farmers? If not, what would be a better approach?

4. Should we change our definition of "moderately priced" rural housing in § 613.3030(a)(4)? If you favor changing the definition, please offer specific recommendations.

The FCA welcomes other ideas or suggestions you may have about our eligibility and scope of financing regulations for eligible farmers and our regulations defining "moderately priced" rural housing.

The FCA also plans to conduct a public meeting on eligibility and scope of financing for

eligible farmers and our definition of "moderately priced" rural housing. We will publish a separate notice in the Federal Register that will provide interested parties more information about the public meeting.

Dated: April 29, 2003

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

68 FR 23426, 05/02/2003

Handbook Mailing HM-03-11

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC20

Eligibility and Scope of Financing

AGENCY: Farm Credit Administration.

ACTION: Notice of public meeting.

SUMMARY: The Farm Credit Administration (FCA or agency) announces a public meeting to hear your views about whether and how we should revise our regulations governing eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters who borrow from Farm Credit System institutions that operate under titles I or II of the Farm Credit Act of 1971, as amended (Act) and our definition of "moderately priced" rural housing.

DATES: The public meeting will be held on June 26, 2003, in McLean, Virginia, 22102-5090 (703) 883-4056.

ADDRESSES: The FCA will hold the public meeting at our headquarters location at 1501 Farm Credit Drive, McLean, Virginia at 9:00 a.m. Eastern Daylight Savings Time. You may submit requests to appear and present testimony for the public meeting by electronic mail to "reg-comm@fca.gov," through the Pending Regulations section of FCA's Web site, "www.fca.gov," or through the government-wide "www.regulations.gov" portal. You may also submit requests to Robert E. Donnelly, Acting Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or by facsimile to (703) 734-5784.

FOR FURTHER INFORMATION CONTACT:

Mark L. Johansen, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434,

or

Richard Katz, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Background

We started this rulemaking in response to two petitions that asked us to repeal the scope of financing regulations in § 613.3005. One petitioner also asked us to modify our definition of "moderately priced" rural housing in § 613.3030(a)(4). The goal of this rulemaking is to explore how our regulations can become more responsive to the needs of all eligible ranchers, and aquatic producers or harvesters (collectively referred to as "farmers") and non-farm rural residents within the boundaries of the Act. We are publishing an Advance Notice of Proposed Rulemaking (ANPRM) in this issue of the Federal Register. In this document, we are announcing that we will hold a public meeting so you have another forum to present your views to us.

II. Topics

At the hearing, we will ask that you answer the same questions we asked in the ANPRM:

1. Current § 613.3000(a)(1) defines a bona fide farmer, rancher, or aquatic producer as a person who either owns agricultural land, or is engaging in the production of agricultural products. Do you think the FCA should retain or change this definition? If you favor changing this definition, please offer specific recommendations.

2. What limits, if any, should FCA regulations place on lending for farmers' other credit needs?

3. How should we regulate access to the other credit needs of eligible farmers who derive most of their income from off-farm sources? Do you favor retaining the current regulatory distinction between full-time and part-time farmers? If not, what would be a better approach?

4. Should we change our definition of "moderately priced" rural housing in § 613.3030(a)(4)? If you favor changing the definition, please offer specific recommendations.

III. Request To Present Testimony

Anyone wishing to present testimony in person may notify us by June 21, 2003, or register to speak on the day of the meeting. A request to speak should provide the name, address, and telephone number of the person wishing to testify and the general nature of the testimony. Requests to provide testimony in person will be honored in order of receipt.

Parties who register to speak on the day of the meeting may be invited to provide their testimony if time permits. If more people wish to testify than time permits, we will accept written statements for the record for 30 calendar days following the date of the public meeting.
Please limit oral testimony at the meeting to 10 minutes per person and allow 5 minutes for follow-up questions. At the public meeting, we will also accept, for the record, written comments on questions and issues raised in the ANPRM or any other comments that attendees may have on the subject of eligibility and scope of financing for farmers, ranchers, and aquatic producers and harvesters and the definition of "moderately priced" rural housing.
You may also wish to submit written statements or detailed summaries of the text of your testimony. Written comments that you wish to submit to supplement your testimony should be presented to us by the close of the public meeting.

Written copies of the testimony, along with a recorded transcript of the proceedings, will be

included in our official public record. A transcript of the public meeting and any written statements submitted to the agency will be available for public inspection at our office in McLean, Virginia.

IV. Special Accommodations

The meeting is accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be received by FCA's Office of Communications and Public Affairs at (703) 883-4056, (TTY (703) 883-4056) by June 21, 2003.

Dated: April 29, 2003

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

68 FR 44490, 07/29/2003

Handbook Mailing HM-03-15

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC20

Eligibility and Scope of Financing

AGENCY: Farm Credit Administration.

ACTION: Proposed rule; extension of comment period.

SUMMARY: The Farm Credit Administration (FCA) is extending the comment period on our Advance Notice of Proposed Rulemaking concerning eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters, and "moderately priced" rural housing. We are extending the comment period so all interested parties have more time to respond to our questions.

DATES: Please send your comments to the FCA by October 29, 2003.

ADDRESSES: We encourage you to send comments by electronic mail to "reg-comm@fca.gov," through the Pending Regulations section of FCA's Web site, "www.fca.gov," or through the government-wide "www.regulations.gov" portal. You may also send comments to S. Robert Coleman, Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or by facsimile to (703) 734-5784. You may review copies of all comments we receive at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

Mark L. Johansen, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434.

Or

Richard A. Katz, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION: On May 2, 2003, FCA published a notice in the *Federal Register* seeking public comment on whether it should revise its regulations governing eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters who

borrow from Farm Credit System institutions that operate under titles I or II of the Farm Credit Act of 1971, as amended. In addition, we requested public comment on whether we should modify our regulatory definition of "moderately priced" rural housing. The comment period expires on July 31, 2003. *See* 68 FR 23425, May 2, 2003.

We also held a public meeting on June 26, 2003, to hear views from the public about whether and how we should revise our regulations governing eligibility, scope of financing, and "moderately priced" rural housing. After the public meeting two members of the public requested that we extend the comment period for an additional 90 days. In response to this request, we are extending the comment period until October 29, 2003, so all interested parties have more time to respond to our questions. The FCA supports public involvement and participation in its regulatory and policy process and invites all interested parties to review and provide comments on our notice.

Dated: July 23, 2003

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

71 FR 60678, 10/16/2006

Handbook Mailing HM-06-13

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC33

Eligibility and Scope of Financing; Processing and Marketing

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA or Agency) proposes to amend its regulation governing financing of processing and marketing operations by Farm Credit System (Farm Credit, FCS, or System) institutions under titles I and II of the Farm Credit Act of 1971, as amended (Act). Specifically, this proposal would revise the criteria used to determine eligibility of legal entities for financing as processing and marketing operations. FCA further proposes a non-substantive technical correction to its regulation defining the term "person".

DATES: Comments should be received on or before December 15, 2006.

ADDRESSES: We offer a variety of methods to receive your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. As faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, please consider another means to submit your comment if possible. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- Agency Web site: http://www.fca.gov. Select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we received at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit

items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Barry Mardock, Associate Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA, (703) 883-4456, TTY (703) 883-4434;

or

Michael A. Anderson, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, Denver, CO, (303) 696-9737, TTY (303) 696-9259;

or

Howard I. Rubin, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4029, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Background

Sections 1.11(a)(1) and 2.4(a)(1) of the Act authorize Farm Credit Banks and associations to finance the processing and marketing operations of bona fide farmers, ranchers, and aquatic producers or harvesters that are “directly related” to the operations of the borrower, provided that the operations of the borrower supply some portion of the raw materials used in the processing or marketing operation (throughput).[1] Current § 613.3010(a)(1) provides that a borrower is eligible for financing for a processing or marketing operation only if the borrower is eligible to borrow from the System or is a legal entity in which eligible borrowers own more than 50 percent of the voting stock or equity.

We believe that our current rule, focusing solely on the percentage of eligible borrower ownership in a legal entity, is unnecessarily narrow. Therefore, FCA proposes to add additional specific criteria for determining what legal entities are eligible for financing for processing and marketing operations in accordance with the provisions in sections 1.11(a) and 2.4(a) of the Act. While potentially expanding the pool of eligible legal entities, we believe that the additional criteria properly ensure that there is a sufficiently strong economic link – or identity of interests – between eligible borrowers and the processing or marketing entity so that the financing can be considered made and “directly related” to eligible borrowers and their operations.

II. Need for Proposed Rule

FCA believes its amendment to § 613.3010 will permit System associations to more effectively meet the credit needs of eligible borrowers in the face of changing agricultural and economic conditions while remaining consistent with the Act. We recognize the increasing importance of value-added agriculture and aquaculture and the changing ownership structures in processing and marketing operations. As part of these changing agricultural and economic conditions, FCA seeks to ensure that affordable and dependable credit for businesses that add value to farm and aquatic products and commodities remains available for the benefit of agricultural and aquacultural producers (and the rural communities in which they operate).

As farmers, ranchers, and producers or harvesters of aquatic products look for opportunities to increase farm and aquaculture income and diversify income sources, the importance of value-added agriculture and aquaculture has emerged, benefiting both producers and rural communities. Producers are pursuing value-added activities to gain more direct access to markets and a greater share of the consumers' food dollar. As such, farmers are increasingly relying on vertical integration and coordination of production, processing, and marketing to deliver products that meet consumer needs. These opportunities have stemmed from increased consumer demands regarding health, nutrition, and convenience; efforts by food processors to improve their productivity; and technological advances that enable producers to produce what consumers and processors desire. With the continuous shifting to a global economy, the international market for value-added products is growing.

Ownership structures within processing and marketing operations are changing as substantial capital investments cannot be fully raised through traditional methods. The farmer-owned sole proprietorships or closely held entities prevalent in the past are often no longer economically viable. Therefore, new forms of cooperatives, limited liability corporations, limited liability partnerships, and other ownership structures – requiring outside investment - are being used to address equity and debt capital needs. For example, many of the new ethanol plants are only partially owned by farmers; however, these plants are usually directly related to the farmer-owners' operations and provide significant benefits to the rural communities in which they are located.

Moreover, even where sole proprietorships or closely held entities are economically viable, they are often not advisable from a legal liability, tax, or estate planning perspective. In fact, structuring a processing or marketing operation with prudent legal liability considerations protects borrowers' financial interests and is an acceptable safety and soundness practice. We believe that our rules shouldn't create a circumstance that forces eligible borrowers to reject prudent legal, business and tax advice if they wish to continue borrowing from their FCS lender.

Processing and marketing agricultural businesses are projected to continue to evolve and grow within rural America. The entrepreneurial spirit of farmers, ranchers, and producers of aquatic products will require a reliable and flexible source of credit and financial services. As value-added agriculture continues to grow, agricultural producers are challenged by the need to attract substantial capital in order to improve income for their benefit and the benefit of rural America.

FCA recognizes the importance of these value-added enterprises to producers and rural America and believes this proposed regulation will help ensure dependable credit for businesses that add value to farm and aquatic products and commodities, as well as the communities in which they operate. We believe that revisions to this regulation will provide the FCS with the additional flexibility to meet the existing and future credit needs of processing and marketing entities upon which farmers, ranchers, and producers or harvesters of aquatic products are increasingly dependent for economic survival.

III. Section-by-Section Analysis

The two criteria contained in existing § 613.3010(a)(1) and (a)(2) are retained in paragraphs (a)(1) and (a)(2), with paragraph (a)(2) making clear that it only applies to a legal entity that does not qualify for financing under paragraph (a)(1) as a bona fide farmer, rancher, or producer or harvester of aquatic products. However, as discussed above, we believe that a limitation based solely on the percentage of voting stock held by eligible borrowers - representing pure numerical voting "control" of the entity - is an unnecessarily narrow way of looking through a legal entity to determine whether a loan can be viewed as made to an eligible borrower or "directly related to" an eligible borrower's operation. Therefore, the proposal would add new paragraph (a)(3) to provide alternative ways of determining actual

eligible borrower "control" over a legal entity where the eligible borrower owns 50 percent or less of the voting stock or equity, new paragraph (a)(4) to provide eligibility for legal entities where eligible borrowers have a significant equity stake and provide a substantial amount of the throughput, and new paragraph (a)(5) to provide financing for legal entities that are a direct extension or outgrowth of an eligible borrower's production operation, regardless of the amount of eligible borrower ownership of the legal entity. A legal entity will need to meet one of these criteria in order to borrow from an FCS association.

A. Section 613.3010(a)(3)-–Majority Voting, Management, or Actual Control

Under proposed § 613.3010(a)(3), if eligible borrowers own 50 percent or less of the voting stock or equity and one or more of those eligible borrowers/owners regularly produce some portion of the throughput used in the processing or marketing operation, then one of the following criteria must be met:

1. Majority Voting Control

Proposed § 613.3010(a)(3)(i) provides that a legal entity is eligible for financing under this paragraph if eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and "exercise majority voting control over the entity." An example of this is a corporation with separate classes of voting stock, where the eligible farmer-owned class of stock exercises actual majority voting control regardless of their overall percentage ownership of stock. Another example would be where holders of a majority of voting stock agree, by contract or otherwise, to allow eligible farmer-owners to exercise voting control. This provision would also encompass a legal entity in which eligible borrowers have the voting power to elect at least 40 percent of the entity's board of directors (or general partners of a limited partnership, or managing members of a limited liability company) and non-eligible investors can elect no more than 40 percent, with the remainder to be elected through mutual agreement.

2. Management Control

Proposed § 613.3010(a)(3)(ii) would authorize financing for a legal entity in which eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and "exercise control over management of the legal entity." Eligible borrowers could exercise control over management by "constituting a majority of the directors of a corporation, general partners of a limited partnership, or managing members of a limited liability company." In these circumstances, eligible borrowers are exercising actual management direction and control over the entity, even though they may not own a majority of the voting stock or equity.

3. Actual Control

Proposed § 613.3010(a)(3)(iii) would authorize financing for a legal entity in which eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and "exercise the documented power and authority to directly determine and implement the policies, business practices, management, and decision-making process of the legal entity." This is intended to cover unusual circumstances where the borrower does not meet the specific criteria of paragraphs (a)(3)(i) or (a)(3)(ii) but where, through contractual agreement or otherwise, eligible borrowers have "documented power and authority" over the legal entity.

B. Section 613.3010(a)(4)--Substantial Ownership Interest and Supply of Throughput

Proposed § 613.3010(a)(4) would authorize financing for a legal entity "in which eligible borrowers under § 613.3000(b) own at least 25 percent of the voting stock or equity and supply 20 percent or more of the throughput used in the processing or marketing operation." Under this provision, eligible borrower-owners do not need to exercise voting control over the entity because the substantial ownership requirement coupled with the 20-percent throughput requirement ensures that eligible borrowers have both a significant investment in the entity and the operation is "directly related to" eligible borrowers' operations.

C. Section 613.3010(a)(5)--Extension or Outgrowth of Production Operations

Proposed § 613.3010(a)(5) would authorize financing for a legal entity that regularly processes or markets some portion of an eligible borrower's throughput and whose operations are a direct extension or outgrowth of that eligible borrower's operation. This is intended to cover entities – regardless of ownership – in which an eligible borrower has significant involvement, that fulfill the eligible borrower's business needs, and that are functionally integrated with the eligible borrower's production operation. Under paragraph (a)(5), the legal entity's financial condition is necessarily dependent upon the continued involvement of the eligible borrower. This mutual interdependency in financial performance is further indicia that the processing and marketing operation is part, or an "extension or outgrowth," of the eligible borrower's production operation.

As discussed above, many farming operations are evolving to include value-added processing and marketing operations. In many instances, value-added processing and marketing operations are formed by, and for the direct benefit of, eligible borrowers, their families, or other individuals with direct ties to an eligible borrower's production activities. In these instances, the processing or marketing operation is truly part of – or a "direct extension or outgrowth" of - the production operation. However, the ownership structures of these value-added operations are typically crafted to meet tax and liability concerns – rather than FCS requirements – and consequently may not satisfy the requirements of our current rule. Moreover, family members owning and operating value-added businesses may not themselves qualify for financing as "bona fide farmers." However, the economic reality is that these value-added operations are integrated with and inextricably linked to an eligible borrower's production activities.

Under the Act and our rules, the processing or marketing financing must be a credit need of the eligible borrower. Therefore, paragraph (a)(5) provides that the eligible borrower must establish the necessary link between the processing and marketing entity and the eligible borrower's operation.

The first specific element that an eligible borrower must demonstrate under paragraph (a)(5) is that "the legal entity was created and operates with the active support and involvement of the eligible borrower." An example of this is the eligible borrower who assists a family member or friend in a start-up processing or marketing company in which the eligible borrower does not have any legal ownership; however, the start-up company provides an opportunity for the eligible borrower to manage production risk through product control for the benefit of that eligible borrower. The eligible borrower's "active" involvement (meaning more than a token investment of money, time, resources, or throughput) in the creation of the legal entity and continued active involvement in the operation of the legal entity is evidence that the operation is truly an "extension or outgrowth" of the eligible borrower's production operation. Where the financing is for a start-up venture, the eligible borrower should be able to demonstrate, through a business plan or otherwise, the eligible borrower's intent to remain actively involved in the processing and marketing operation.

The second specific element that an eligible borrower must demonstrate under paragraph (a)(5) is that “the legal entity fulfills a business need and supports the operation of the eligible borrower through product branding or other value-added business activity directly related to the operations of the eligible borrower.” Regardless of direct ownership by an eligible borrower, a processing or marketing operation may be so integral to the eligible borrower’s operation and economic well-being that without it, the eligible borrower would not receive the same economic benefit. This processing or marketing operation may support the eligible borrower’s business needs through product branding, product customization to meet specific contract requirements, or any other value-added activity that meets the needs of the user or consumer and benefits the economic well-being of the eligible borrower.

The third criterion an eligible borrower must demonstrate is that “the legal entity and the eligible borrower coordinate to operate in a functionally integrated manner.” This coordination may be evidenced by shared resources (such as management expertise, employees, or assets) or other indicia of integration. We believe that Congress intended for the System to provide financing to assist eligible borrowers in the upward vertical integration of their operations.

The fourth requirement implements the statutory mandate that the eligible borrower must provide some throughput to the processing or marketing operation.

IV. Technical Correction

We are also proposing to correct an omission that inadvertently occurred during the January 30, 1997, regulatory amendments[2] by adding the words “a legal entity or” to the § 613.3000(a)(3) definition of “[p]erson”. This does not provide any additional authority and is in accord with our stated intent published in the 1997 Federal Register final rule preamble.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not “small entities” as defined in the Regulatory Flexibility Act.

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[1] 12 U.S.C. 2019(a)(1), 2075(a)(1). Each Farm Credit Bank has transferred its title I authority to make long-term real estate mortgage loans to Federal land bank associations pursuant to section 7.6 of the Act (12 U.S.C. 2279b).

[2] See 62 FR 4441 (Jan. 30, 1997).

List of Subjects in 12 CFR Part 613

Agriculture, Banks, banking, Credit, Rural areas.

For the reasons stated in the preamble, part 613 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended to read as follows:

PART 613--ELIGIBILITY AND SCOPE OF FINANCING

1. The authority citation for part 613 continues to read as follows:

Authority: Secs. 1.5, 1.7, 1.9, 1.10, 1.11, 2.2, 2.4, 2.12, 3.1, 3.7, 3.8, 3.22, 4.18A, 4.25, 4.26, 4.27, 5.9, 5.17 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2017, 2018, 2019, 2073, 2075, 2093, 2122, 2128, 2129, 2143, 2206a, 2211, 2212, 2213, 2243, 2252).

Subpart A--Financing Under Titles I and II of the Farm Credit Act

§ 613.3000 [Amended]

2. Amend § 613.3000(a)(3) by adding the words "a legal entity or" before the words "an individual".

3. Revise § 613.3010(a) to read as follows:

§ 613.3010 Financing for processing or marketing operations.

(a) *Eligible borrowers*. A borrower is eligible for financing for a processing or marketing operation under titles I and II of the Act only if the borrower:

(1) Is a bona fide farmer, rancher, or producer or harvester of aquatic products who regularly produces some portion of the throughput used in the processing or marketing operation; or

(2) Is a legal entity not eligible under paragraph (a)(1) of this section in which eligible borrowers under § 613.3000(b) own more than 50 percent of the voting stock or equity and regularly produce some portion of the throughput used in the processing or marketing operation; or

(3) Is a legal entity not eligible under paragraph (a)(1) of this section in which eligible borrowers under § 613.3000(b) own 50 percent or less of the voting stock or equity, regularly produce some portion of the throughput used in the processing or marketing operation and:

(i) Exercise majority voting control over the legal entity; or

(ii) Exercise control over management of the legal entity, such as constituting a majority of the directors of a corporation, general partners of a limited partnership, or managing members of a limited liability company; or

(iii) Exercise the documented power and authority to directly determine and implement the policies, business practices, management, and decision-making process of the legal entity; or

(4) Is a legal entity not eligible under paragraph (a)(1) of this section in which eligible borrowers under § 613.3000(b) own at least 25 percent of the voting stock or equity and supply 20 percent or more of the throughput used in the processing or marketing operation; or

(5) Is a legal entity not eligible under paragraph (a)(1) of this section that is a direct extension or outgrowth of an eligible borrower's operation. To obtain financing for a legal entity under this paragraph, the eligible borrower must establish that:

(i) The legal entity was created and operates with the eligible borrower's active support and involvement,

(ii) The legal entity fulfills a business need and supports the operation of the eligible borrower through product branding or other value-added business activity directly related to the operations of the eligible borrower,

(iii) The legal entity and the eligible borrower coordinate to operate in a functionally integrated manner, and

(iv) The legal entity regularly processes or markets some portion of the eligible borrower's throughput.

* * * * *

Date: October 11, 2006

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

72 FR 1300, 01/11/2007

Handbook Mailing HM-07-1

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC33

Eligibility and Scope of Financing; Processing and Marketing

AGENCY: Farm Credit Administration.

ACTION: Proposed rule; reopening of comment period.

SUMMARY: The Farm Credit Administration (FCA, Agency, or we) Board reopens the comment period for 45 days following the date of publication in the *Federal Register* on the proposed rule to amend its regulation governing financing of processing and marketing operations by Farm Credit System (Farm Credit, FCS, or System) institutions under titles I and II of the Farm Credit Act of 1971, as amended (Act), so that interested parties will have additional time to provide comments.

DATES: Please send your comments to us on or before February 26, 2007.

ADDRESSES: We offer a variety of methods to receive your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. As faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, please consider another means to submit your comment if possible. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- Agency Web site: http://www.fca.gov. Select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we received at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses

to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Barry Mardock, Associate Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA, (703) 883-4456, TTY (703) 883-4434;

or

Michael A. Anderson, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, Denver, CO, (303) 696-9737;

or

Howard I. Rubin, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4029, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION: On October 16, 2006, FCA published a proposed rule in the *Federal Register* to amend its regulations in part 613 governing financing of processing and marketing operations by System institutions under titles I and II of the Farm Credit Act of 1971, as amended (Act). *See* 71 FR 60678. Specifically, this proposal would add additional specific criteria to determine eligibility of legal entities for financing as processing and marketing operations. The Agency further proposed a non-substantive technical correction to its regulation defining the term "person". The comment period closed on December 15, 2006. In letters dated December 15, 2006, the Independent Community Bankers of America, Independent Bankers of Colorado, Nebraska Independent Community Bankers, Independent Bankers Association of Texas, and Financial Services Roundtable requested the FCA to extend the comment period for at least 90 days because of the breadth and complexity of the proposed rule. On December 19, 2006, the Farm Credit Council filed an opposition to the request for extension of comment period, stating that the proposed rule is of "vital importance to America's farmers and ranchers," that "ample time" has already been provided to interested parties to review and comment and that any additional comment period should not extend past January 15, 2007. The commenters requesting an extension asserted that the proposed rule will significantly expand the lending authority of FCS institutions to include virtually all commercial enterprises, up to and including WalMart. Such a wide scale expansion of lending authority is not the intent of the proposed rule. Instead, as discussed at length in the preamble to the proposed rule, the intent of the amended rule is to better ensure that FCS institutions are meeting their statutory mandate to provide necessary credit to bona fide farmers and ranchers for their processing and marketing needs in light of changing ownership structures in the modern agricultural economy. In their written comments on the proposed rule, many FCS institutions submitted examples of family farm operations (that already borrow from FCS lenders) that cannot obtain FCS credit for their processing and marketing operations under current FCA rules because of the way ownership of the processing or marketing operation is structured.

Because the FCA supports public involvement and participation in its regulatory process, we are reopening the comment period for 45 days and invite and encourage all interested parties to submit constructive and specific suggestions on ways our proposed rule can be improved to better meet our goal of ensuring that all bona fide farmers and ranchers have access to FCS credit for their processing and marketing needs in accordance with the Act.

Dated: January 5, 2007

James M. Morris,
Acting Secretary,
Farm Credit Administration Board.

69 FR 12694, 03/17/2004

Handbook Mailing HM-04-5

[6705-01-P]

FARM CREDIT ADMINISTRATION

Systematic Collection of Standardized Loan Data

AGENCY: Farm Credit Administration.

ACTION: Notice with request for comment.

SUMMARY: The Farm Credit Administration (FCA or agency) is seeking public input on the changes it should consider making to its systematic collection of standardized loan data. The agency currently collects basic descriptive information from Farm Credit System (FCS or System) banks and associations, in a standardized format, using the Loan Account Reporting System–Modified (LARS-M). The agency is planning to reengineer its collection of standardized loan data to meet its current and future information needs. In support of this reengineering project, FCA is seeking public comment on changes the agency should consider making to the loan data it collects; what processes and technological approaches to employ when collecting loan data; how to minimize the reporting burden on System institutions while meeting agency needs; and what types of standardized reports to make available to the general public and System institutions.

DATES: Please send your comments to the FCA by May 3, 2004.

ADDRESSES: We encourage you to send comments by electronic mail to "reg-comm@fca.gov" or through the Pending Regulations section of FCA's Web site, "www.fca.gov." You may also send comments to Andrew Jacob, Assistant Director, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090 or by facsimile to (703) 734-5784. You may review copies of all comments we receive at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

Gaylon J. Dykstra, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4073, TTY (703) 883-4434.

or

Howard Rubin, Senior Attorney, Office of the General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4029, TTY (703) 883-2020.

SUPPLEMENTARY INFORMATION:

I. Background

A. What is LARS-MLoan Data Does FCA Collect?

FCA currently collects certain standardized loan information from FCS banks and associations using the LARS-M. Examples of standardized variables collected include:

1. The date the loan was originated and the date on which it matures;

2. The primary agricultural commodity produced by the borrower;

3. Whether a loan is covered by a government guarantee;

4. If a loan is past due, the number of days the loan payment is delinquent;

5. The risk of the loan based on the uniform classification system as defined in the FCA Examination Manual (EM-320); and

6. Whether the borrower is in bankruptcy or the loan is in foreclosure status.

The agency also obtains direct institution-specific loan data as needed for examination purposes.

B. How Does FCA Use Loan Data?

FCA uses loan information to support its supervision and regulation of System institutions. For supervisory purposes, loan information is important for evaluating portfolio risk associated with agricultural lending and analyzing credit risks in individual agricultural loans. Loan data are also required for monitoring Systemwide trends and emerging vulnerabilities. For regulatory purposes, loan information is used for developing regulations and other public policy actions. FCA also uses loan data in fulfilling reporting requirements and informational requests.

C. Identifying Loan Portfolio Risk

Identification of risks in a loan portfolio is essential to FCA's evaluation of an institution's safety and soundness. Loan portfolio risk reflects individual loan exposures and the combined effects on a portfolio. Risk in individual loans is a function of characteristics associated with a borrower's agricultural operation and financial condition and performance. Examples of loan characteristics include the commodities produced, geographic location, payment history, financial strength, and off-farm income. These types of loan data are important determinants of the credit risk of a loan. Therefore, FCA access to loan data is critical for evaluating portfolio risks of System institutions and the credit risk of individual loans.

D. Monitoring Systemwide Trends

Analyzing Systemwide trends and emerging vulnerabilities is a critical agency activity for monitoring the overall mission accomplishment and ongoing safety and soundness of the FCS. Monitoring Systemwide trends helps FCA identify when risks are impacting the System's agricultural loans. For example, the System may show an overall increase in delinquent loans. Access to loan data allows the agency to analyze this trend and associated characteristics, such as geographic location, commodity linkage, or other commonalities among affected institutions. Similarly, the agency uses loan data to analyze the impact of emerging vulnerabilities, such as food safety concerns, trade disputes, changes in government support programs, shifts in consumer preferences, and climactic events. Using

loan data, the agency can better identify vulnerable System loans. Access to loan data increases FCA's understanding of the systemic risks facing the FCS and helps the agency determine if any policy actions are needed.

E. Developing Regulations and Policy

FCA uses loan data to support its regulation of System institutions. For example, loan data provide information needed to evaluate the impact of capital adequacy standards, lending limits, and liquidity requirements. Moreover, access to loan data allows the agency to analyze the effectiveness and results achieved from regulations and policy actions.

F. Fulfilling Reporting Requirements and Responding to Information Requests

The agency is required to periodically provide reports to Congress. The agency also frequently responds to information requests from Congress and others. Ready access to loan data aids FCA in timely and accurately responding to reporting requirements and information requests.

G. Why is FCA Considering ChangingLARS-M its Standardized Collection of Loan Data?

LARS-M was first implemented in 1987 and last revised in 1993. While LARS-M provides FCA with a standardized and centralized collection of loan data, it has not kept pace with changes in financial reporting systems, is incomplete as to loan types, lacks detail, and only allows access to current quarter data. FCA, therefore, believes improvements are needed to fully meet the agency's current and future information needs.

FCA examiners also obtain loan information directly from System institutions on an ad hocas-needed basis for use in conducting examinations, but this information is not standardized or centralized. As a result, directly downloaded data are not useful or available for Systemwide analysis or reporting. More importantly, the downloaded data vary considerably by FCA field office since loan information systems vary across System institutions. Therefore, standardized and centralized collection of loan data would help overcome the variety in electronic loan information systems used by FCS institutions.

II. Objectives of This Project

The objectives of FCA's project to reengineer its standardized collection of loan data from System institutions are to:

1. Determine the appropriate set of loan data to collect on a systematic, centralized, and standardized basis that meets the agency's needs;

2. Streamline the collection process of loan data to enhance reliability, timeliness, and data accuracy;

3. Minimize the reporting burden on System institutions; and

4. Provide appropriate standardized reports to internal and, potentially, external parties.

The reengineering project will address the limitations of the current approach to a standardized collection of loan data. The agency is already considering the data elements it needs to collect on

individual loans, including what specific financial information, loan performance data, and other essential information about loan characteristics that are necessary for adequately evaluating portfolio and loan risks. Moreover, the project will also address the agency's need to collect information for all loans made by System institutions. Along with these considerations, the agency is evaluating the data elements needed to model loan performance characteristics through time, such as probability of default, loss severity, and exposures at default. In the future, modeling loan performance may become a key aspect in the evaluation of a System institution's capital adequacy. FCA is also evaluating new technologies to streamline and improve the collection process. This evaluation includes reducing the reporting burden by relying on an efficient process that utilizes information readily available in the different FCS institutions' electronic loan information systems.

FCA is also evaluating the standardized reports the agency currently uses in conducting its supervisory and regulatory programs, including considering the type of reports to make available to the general public and System institutions in light of legal restrictions and other constraints regarding the release of private and sensitive business information used solely for examination purposes.

III. Questions

To augment the agency's experience and expertise with agricultural lending practices and credit analysis, FCA is seeking public input on the changes it should consider making as it reengineers the systematic collection of standardized loan data from System institutions. Specifically, the agency requests comments on:

1. What suggestions do you have regarding loan data elements?

2. What processes and technological approaches to employ to streamline the collection of loan data?

3. How to minimize the reporting burden on System institutions while meeting the agency's informational needs?

4. What standardized reports to make available to the general public and System institutions, considering the need to protect private and proprietary confidential information?

Along with these questions, we welcome any other comments or suggestions the agency should consider as it moves forward with this initiative.

Date: March 12, 2004

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

72 FR 52301, 09/13/2007

Handbook Mailing HM-07-5

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 652

RIN 3052-AC36

Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Risk-Based Capital Requirements

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, Agency, us, or we) adopts a proposed rule that would amend regulations governing the Federal Agricultural Mortgage Corporation (Farmer Mac or the Corporation). We propose to update the model in response to recent additions to Farmer Mac's program operations that are not addressed in the current version of the model. We propose to amend the current model's assumption regarding the carrying cost of nonperforming loans to better reflect Farmer Mac's actual business practices. We further propose to add a new component to the model to recognize counterparty risk on nonprogram investments through application of discounts or "haircuts" to the yields of those investments and to make technical amendments to the layout of the model's Credit Loss Module. The effect of the rule is to update the model so that it continues to appropriately reflect risk in a manner consistent with statutory requirements for calculating Farmer Mac's regulatory minimum capital level.

DATES: You may send us comments by October 29, 2007.

ADDRESSES: We offer several methods for the public to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- Agency Web site: http://www.fca.gov. Select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: S. Robert Coleman, Director, Office of Secondary Market Oversight, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

- FAX: (703) 883-4477. Posting and processing of faxes may be delayed, as faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or on our Web site at http://www.fca.gov. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Joseph T. Connor, Associate Director for Policy and Analysis, Office of Secondary Market Oversight, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4280, TTY (703) 883-4434;

or

Rebecca Orlich, Senior Counsel, Office of the General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4420, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Purpose

It is the Agency's objective that the risk-based capital stress test (RBCST) continue to determine regulatory capital requirements consistent with statutory requirements and constraints. The purpose of this proposed rule is to revise the risk-based capital (RBC) regulations that apply to Farmer Mac to more accurately reflect changes in Farmer Mac's operations or business practices. The substantive issues addressed in this proposed rule are treatment of program loan volume with certain credit enhancement features (e.g., Off-Balance Sheet AgVantage volume, subordinated interests, and program loan collateral pledged in excess of Farmer Mac's guarantee obligation (hereafter, "overcollateral")), counterparty risk on nonprogram investments, and the resolution timing for nonperforming loans and associated carrying costs. We also propose minor formatting changes to the structure of the Credit Loss Module that are in the nature of technical changes.

II. Background and Summary of Revisions

In 2006, Farmer Mac initiated a program to guarantee timely repayment of principal and interest on notes that are collateralized by Farmer Mac-eligible agricultural real estate mortgage assets and are also secured by an obligation of the mortgage lender. We will refer to this product as Off-Balance Sheet AgVantage. The first such transaction was a guarantee of $500 million in guaranteed notes announced by Farmer Mac on January 23, 2006. Subsequently, Farmer Mac announced similarly structured transactions for $1 billion each on July 13, 2006, and April 11, 2007. The current version of the RBCST lacks a component to recognize the credit enhancement provided by the lender's obligation and, consequently, this volume is excluded from the modeled loan portfolio. We propose to begin including this product in the RBCST model. Further, in the event that Farmer Mac introduces products that include a subordinated interest retained by the primary lender, we propose a modeling treatment of such structures.

We proposed revisions to the treatment of nonprogram investments and the carrying cost of nonperforming loans in our rule published in November 2005.[1] We did not adopt those proposed revisions in the final rule that amended other parts of the model.[2] We now propose revisions to these two components that differ somewhat from those proposed in November 2005. We propose to account for counterparty risk on nonprogram investments by applying a discount (or "haircut") to the yields of nonprogram investments scaled according to credit ratings, with a 10-year phase-in. We propose a method of calculating the carrying cost of nonperforming loans over a period we refer to as the Loan Loss Resolution Time period, or "LLRT", that will include a quarterly update of the LLRT estimate.

Finally, we propose other technical changes to improve formatting and clarity of labeling in certain cells of the Credit Loss Module worksheets.

III. Issues, Options Considered, and Proposed Revisions

A. Treatment of Off-Balance Sheet AgVantage Program Volume

In 2006, Farmer Mac initiated a program to guarantee the timely repayment of principal and interest on notes that, in addition to being collateralized by Farmer Mac-eligible agricultural real estate mortgages, are also secured by an obligation of the primary lender of those mortgages. The current version of the model lacks a component to recognize the credit enhancement provided by the issuer's general obligation and any contractually required loan collateral in excess of the face value of the guaranteed notes.

We propose to revise the model to include this program volume by modeling all loans in guaranteed note portfolios in the same manner as all other program volume, with two differences. The first difference would recognize the risk mitigation provided by the general obligation by reducing the age-adjusted dollar losses estimated on the subject loans by an adjustment factor derived from historical default rates by the whole letter credit ratings of corporate bond issuers as reported by a nationally recognized statistical rating organization (NRSRO). The second difference would address the risk-reducing effects of contractually required overcollaterization of the subject portfolio, if any.

The derivation and application of the general obligation adjustment factor would be as follows. We would define five levels of credit ratings from "AAA" to "below BBB and unrated." We would assign each of the NRSRO-rating categories to one of the five general whole-letter rating categories we define. The adjustment factors applied would be equal to the average cumulative issuer-weighted, 10-year corporate default rates from 1920 through the most recent year as published by Moody's Investor Services.[3] For issuers that are rated below BBB or are unrated, the model would apply a factor equal to the 10-year corporate default rates on Speculative-Grade bonds published in the same report. This rate would then be further adjusted to obtain an estimated loss rate related only to a general obligation of the corporate issuer/Off-Balance Sheet AgVantage counterparty with a given credit rating by considering the loss-severity rate as implied by recovery rates published in the same annual Moody's report (i.e., 1 minus recovery rate). In this case, because recovery rates are not published by whole-letter credit rating categories in the Moody's report, we would apply a loss severity implied by Moody's average Defaulted Bond Recovery Rates by Lien Position for as long a period as the Moody's report provides. Moody's 2006 report includes a table of data on recovery rates from 1982 to 2006. We propose to adopt a severity rate adjustment to historical corporate default rates based on the published long-term recovery rate for senior unsecured bonds. We considered using the recovery rates of the "All Bonds" category to calculate implied loss-severity rate factors but rejected that approach because we believe that the senior unsecured category is likely to reflect a more accurate analog of a general obligation than a "catch-all" category like "All Bonds" that would include senior secured bond and subordinated bond categories in addition to the

senior unsecured category. We believe that neither of these bond lien position categories reflects the nature of a general obligation as accurately as the senior unsecured category.

We considered whether the senior secured category might be more applicable, given the mortgage loans that collateralize this obligation. However, we believe our proposed application is justified because, in the RBCST's Credit Loss Module, we target an estimate of the ultimate loss rate associated with the occurrence of what are assumed to be independent events (a corporate default and agricultural mortgage loan pool defaults). For example, suppose that a counterparty utilizing Farmer Mac's Off-Balance Sheet AgVantage product goes bankrupt. We assume that the default event is uncorrelated with the occurrence of worst-case stress in the agricultural lending sector. Therefore, we treat the estimated loss rate calculation on the general obligation separately from the estimated loss rate calculation on the program loan collateral. Thus, we believe the estimation of a counterparty default/severity rate should be done separately from and without regard to the loan collateral and, therefore, that the senior unsecured severity rate is most appropriate.

The following table sets forth the proposed credit loss adjustment factors and their components (Adjustment Factor = Default Rate x Severity Rate).[4]

Whole Letter Rating	Default Rate	Severity Rate	General Obligation Adjustment Factor
AAA	0.89%	55%	0.49%
AA	2.31%	55%	1.26%
A	2.90%	55%	1.58%
BBB	7.29%	55%	3.98%
Below BBB and Unrated	27.39%	55%	15.16%

The adjustment factors would be updated quarterly as the updated Moody's report on Default and Recovery Rates of Corporate Bond Issuers becomes available. In the event that there is an interruption of Moody's publication of this annual report, or FCA informs Farmer Mac it has determined that the report has changed so much that it prevents or calls into question the identification of suitable updated factors, the prior year's factors would remain in effect until FCA revises the process through rulemaking.

In addition, the loan portfolio collateral underlying Off-Balance Sheet AgVantage volume may contain loan collateralization in excess of the face value of the note. This overcollateral may be contractually required or it may be provided by the issuer of the guaranteed note to reduce administrative expense associated with monitoring the eligibility of the collateral, or both. We view overcollateral in excess of contractually required amounts as solely an administrative convenience for the lender in question. When there is excess overcollateral, any loan in the overcollateral can automatically be deemed to replace a loan that might become ineligible under the AgVantage contract without the need for additional action on the part of either party. However, when it is discretionary and not contractually required, the amount of excess overcollateral provided by Farmer Mac's counterparty is subject to change at any time. Therefore, we believe that overcollateral that is required by contract and is not simply an administrative convenience should be recognized in the model for the risk mitigation it provides, but that the additional collateral provided solely for administrative convenience should not.

Whenever overcollateral exists, we model a portfolio that is larger than the dollar amount of Farmer Mac's guarantee obligation because there is no direct means to segregate a specific set of loans in

the total collateral portfolio that could be considered to comprise 100 percent of the face value of the guaranteed notes. We then need an adjustment to reduce the amount of submitted loan collateral for purposes of estimating credit losses in the Credit Loss Module (CLM) in order to avoid the model's recognition of the credit risk on loan volume that is in excess of the contractually required volume.

Given the above considerations, we propose the following treatment. The Off-Balance Sheet AgVantage volume will be modeled using separate worksheets of the CLM with added features to:

(1) Scale the estimated losses to be commensurate with losses associated with the contractually required minimum collateral. To achieve this, we multiply the estimated dollar losses of each loan after age adjustment by the ratio of the guaranteed amount to total submitted loan collateral; and

(2) Recognize the risk mitigation provided by the contractually required overcollateralization. To do so, expected losses after the adjustment in "(1)" above are compared to the dollar amount of contractually required overcollateral, and any estimated credit loss dollars in excess of the contractually required overcollateral are input in the model as loss rates applied to that pool's underlying portfolio volume.

(3) Recognize the risk mitigation provided by the counterparty's general obligation. This is accomplished by multiplying any remaining losses after the adjustments in "(1)" and "(2)" above by the appropriate general obligation adjustment factor according to the counterparty's whole-letter issuer credit rating (set forth in the table above) to reflect the likelihood of exhausting the capacity of the issuer to maintain adequate collateral.

We acknowledge that the order of these adjustments may seem incongruous with the legal structure of a given transaction, but we believe the proposed order makes sense from a modeling perspective. For example, the counterparty's general obligation might legally be first in terms of the security provided in support of Farmer Mac's risk position – followed by access to the loan collateral after an event of default by the counterparty. However, we adjust for the risk-mitigation of the contractually required overcollateralization first, followed by the adjustment for the general obligation. As a practical matter, we believe that Farmer Mac, to make itself whole on any losses after the counterparty defaults, would first work through the overcollateral, which would be held by a bankruptcy-remote vehicle. Only after that overcollateral proved insufficient to make Farmer Mac whole, would it need to pursue further recovery from the counterparty.

B. <u>Add a Treatment for Products that Could Include a Subordinated Interest Retained by the Primary Lender or Seller</u>

In the event Farmer Mac introduces new products that include the specific retention of a portion of the credit risk at either a loan level or a pool level by the primary lender or seller, this loan volume would also be modeled in separate worksheets of the CLM. The model would recognize the subordinated interest by multiplying the age-adjusted dollar losses in the subject portfolio by one minus the percentage of the subordinated interest in order to isolate the portion of estimated loss that Farmer Mac would incur. To the extent that such structures include further stratification of losses, such as a cap on the exposure to losses assumed by Farmer Mac, such stratification would be treated in a similar manner.

C. <u>Add Haircuts on Nonprogram Investments</u>

Currently, the RBCST does not include a component to reflect counterparty risk on Farmer Mac's

portfolio of nonprogram investments or its derivatives. We propose adopting a system of haircuts to the yields on investment securities scaled according to credit ratings, with larger haircuts applied to cash flows from investments from issuers with lower credit ratings. We previously proposed haircuts in our November 2005 proposed rule but did not include them in our final rule published on December 26, 2006.

The previously proposed rule based investment haircuts on the risk-based capital regulations of the Office of Federal Housing Enterprise Oversight (OFHEO) (12 CFR part 1750). OFHEO's haircut levels were based on worst-case corporate bond default rates using Depression-era default rates and recovery rates, expanded to a 10-year period. For all counterparties, the default rates used were 5 percent for AAA, 12.5 percent for AA, 20 percent for A, 40 percent for BBB and 100 percent for below BBB or unrated. Severity rates used were 70 percent for nonderivative securities, yielding net haircuts of 3.5 percent, 8.75 percent, 14.0 percent, and 28.0 percent for ratings AAA through BBB, respectively. One hundred percent (100%) haircuts were applied to the "BBB or unrated" category. Our November 2005 proposal contained the same haircut levels as in OFHEO's regulations.

We decided not to adopt the November 2005 haircut proposal out of concern that the worst-case perspective on historical default rates is not as appropriate for Farmer Mac as it is for the housing Government-sponsored enterprises (GSEs). While it is plausible that worst-case stress in the housing markets could be highly correlated with worst-case conditions throughout the economy as exhibited by corporate bond defaults, we believe that worst-case agricultural credit conditions would likely be far less correlated with events of major stress in financial markets generally. Therefore, we have based the haircuts in this proposed rule on average bond default rates rather than worst-case historical corporate defaults. In addition, we have chosen not to follow a similar method for expansion of the worst case interval to the 10-year time interval. Instead, we propose a more direct reliance on empirical evidence and base the haircuts on Moody's Average 10-year cumulative issuer-weighted corporate default rates by whole letter rating, adjusted by the average implied long-term severity rate for Senior Unsecured bonds. The weighted-average yields of non-program investment categories would be reduced by the haircut percentage phased in linearly over the 10-year modeling horizon. The haircut levels are the same as the loss rate adjustment factors proposed above for application on loans underlying guaranteed notes, and like those factors these will be updated as new information becomes available. The proposed investment haircuts to recognize counterparty risk are as follows:

Whole Letter Credit Rating	Haircut
AAA	0.49%
AA	1.26%
A	1.58%
BBB	3.98%
Below BBB and Unrated	15.16%

We propose to phase in the haircuts over the 10-year modeling horizon, based on our assumption that defaults on investments in response to a general downturn in the economy would not be instantaneous but rather spread through time. Furthermore, consistent with the OFHEO rule, we would not assign the rating of a parent company to its unrated subsidiary because NRSROs will not impute a corporate parent's rating to a derivative or credit enhancement counterparty in the context of a securities transaction, and because extending that rating to the unrated subsidiary would be tantamount to the regulator rating the subsidiary.[5] However, when an investment is structured as a collateralized obligation backed by the issuer's general obligation and, in turn, a pool of collateral, we accept the issuer rating of

that issuer as the credit rating applicable to the security. Unrated securities that are fully guaranteed by GSEs receive the same treatment as AAA securities. Unrated securities backed by the full faith and credit of the U.S. Government do not receive a haircut.

In the event that FCA approves the purchase of an unrated investment, and portions of that investment with specific risk characteristics are later sold by Farmer Mac, the Director will take reasonable measures to adjust the haircut level applied to the investment to recognize the change in the risk characteristics of the retained portion. In taking these measures, the Director will consider the approaches taken to address capital requirements related to similar investments that have been adopted by other federal financial institution regulators.

We propose to apply the haircuts to yields on a weighted-average basis by investment categories established in the "Data Inputs" worksheet of the RBCST, e.g., commercial paper, corporate debt and asset-backed securities, agency mortgaged-backed securities and collateralized mortgage obligations. This treatment would require Farmer Mac to calculate the weighted-average haircut by investment category to be applied to the weighted-average yields for each investment category and to input the haircuts into the "Data Inputs" worksheet. The proposed haircuts are set forth in the table in paragraph e. of section 4.1 in the appendix A, subpart B of part 652.

We considered proposing a similar haircut on derivative securities, on the ground that credit stress that impacts Farmer Mac's nonprogram investment portfolio would reasonably be expected to affect its derivatives counterparties and its terms of access to the swap market.[6] We believe a more appropriate approach to haircutting derivatives may be to reflect lost payments on defaulted derivative securities in a net-receive position, as well as the "replacement cost"—i.e., the additional expense associated with the replacement of derivative positions when the counterparty defaults and the market value of the derivative has increased since the date the defaulted derivative contract was executed. Such an increased market value would be to Farmer Mac's benefit when the counterparty does not default, but to its detriment when it does default. The Agency plans to address this issue in future revisions of the RBCST and specifically requests comment on the most appropriate approach to incorporate into the RBCST such "replacement cost" risk relating to derivative securities.

D. Improve the Estimate of Carrying Costs of Nonperforming Loans by Revising LLRT Assumptions

The RBCST was originally developed with a loss-severity estimate that assumes it would take Farmer Mac 1 year to work through problem loans from the point of default through final disposition. An estimate was used because, at the time of development of the RBCST, historical nonperforming loan resolution timing data from Farmer Mac were not sufficient. Farmer Mac data collected since that time indicate that an adjustment to the 1-year assumption to recognize Farmer Mac's actual historical experience is appropriate. If the actual historical time interval is longer than the current model's assumption, the capital needs for carrying nonperforming assets are likely understated in the model. Therefore, we propose amendments to the model to reflect costs associated with any additional time period over which Farmer Mac has carried nonperforming loans on average throughout its history. The LLRT is the weighted average time in fractions of 1 year that Farmer Mac has carried nonperforming loans from the date of the last interest payment, the Interest Paid-Through Date (ITPD) and the date the loan is finally resolved. This proposed LLRT differs from that proposed in November 2005 in the method used to estimate the LLRT period, as described in detail below.

In the final rule preamble to RBCST Version 2.0 published December 26, 2006, we discussed our intent to review further the scaling factor used to estimate the unpaid premium balance associated with

estimated loan loss dollar volume. After further review, we believe that basing the scaling factor on the total current portfolio average relationship between origination loan amount and current outstanding loan amounts, as originally proposed, is more appropriate than basing the scaling factor on that same relationship among the small universe of loans that have been through the default and resolution process historically. Our view is based on the small size of the latter data set. This proposed rule also clarifies the calculation of the LLRT period and incorporates additional information provided by Farmer Mac regarding its actual historical LLRT experience.

With the exception of the 1-year period assumed in the loss-severity rate, the current RBCST under a steady-state scenario requires backfilling of loan loss volume with like assets, without recognizing any of the costs associated with carrying loans as non-earning, but funded, assets. Under the proposed rule, the RBCST would reflect additional costs associated with carrying the unpaid principal balance of nonperforming loans during the portion of the LLRT period that exceeds the 1-year assumption.

The change would be incorporated into the RBCST as follows. Off-balance sheet loans with estimated losses are assumed to be purchased from the off-balance sheet portfolio and fully funded at the short-term cost of funds rate used in the model, and any associated guarantee fee income is reversed. The short-term cost of funds (adjusted to incorporate interest rate shock effects) is used to estimate this additional funding cost in recognition of Farmer Mac's actual business practices. On-balance sheet loans generating losses are also removed from the interest earnings calculations and continue to generate interest expense at the blended cost of long- and short-term funds for the portion of the LLRT period that exceeds 1 year. In response to a comment on the original proposed rule, the rates are not adjusted to incorporate interest rate shock effects in this proposed rule, in contrast to the original proposal of this revision, in recognition that these rates would be in place at the time of the onset of the stress. The model would continue to backfill new loans at the point of loan resolution to retain its steady-state specification.

The proposed revisions involve two principal changes from the current RBCST. First, the date of backfill would be moved to a point in time that more accurately reflects Farmer Mac's actual experience. The model would then capture the additional costs of carrying loans in a non-interest earning category on the balance sheet. Second, the guarantee fee income would be reduced by the weighted average guarantee fee in the portfolio multiplied by the relevant off-balance sheet loan volume over the portion of the LLRT period that exceeds one year. The LLRT would become a data input to be updated with each quarterly submission of the model.

When we first proposed to revise this component in November 2005, we received several comments that noted the need for greater clarity in the LLRT's calculation formula. We have attempted to provide greater clarity in the proposed LLRT calculation as follows:

(1) Assemble in a spreadsheet individual loan level data for all historical nonperforming loans that migrated from the program loan portfolio into nonaccrual status. Identify the "resolution type," i.e., whether the loan resolved by the borrower bringing the loan current or paying off the loan in full, or whether the loan was foreclosed and liquidated prior to being placed in real estate owned (REO), or placed in REO. For each of these resolution types, include the associated dates (e.g., the date the loan was brought current, paid off, liquidated prior to REO, or placed in REO);

(2) Include the following data elements:

Loan Number
Origination Date
Original Balance
Payment Frequency
Interest Paid Through Date (ITPD)
Non-Accrual Date
Unpaid Principal Balance (UPB) at Non-Accrual Date
Accrued Interest Through Non-Accrual Date
Resolution-type Code (assign numerical code to each type listed in the paragraph above)
Resolution Date
Net Gain/Loss Amount

(3) Remove loan records with missing data elements in "(2)" above from the database for purposes of the LLRT calculation;

(4) Calculate the number of days between the ITPD and the Resolution Date for each loan;

(5) Divide that number of days by 365. The quotient is the LLRT for each loan. Calculate the weighted-average LLRT using weights based on the total obligation at the Non-Accrual Date (Unpaid Principal Balance at Non-Accrual) and input the resulting weighted-average LLRT into the model's Data Inputs worksheet.

(6) For nonperforming loans that have not resolved, include these loans in the calculation using the quarter end "as of" date of each model submission in place of the resolution date, but include them only if the calculated time interval to the "as of" date is longer than the calculated average LLRT when these records are excluded. In other words, if the carrying time interval is not longer than the calculated LLRT using the data set excluding these records, the records should be excluded from the final LLRT calculation. This will prevent loan records that have not gone completely through the resolution process from exerting a downward influence on the LLRT but allow them to have an upward influence if the unresolved loans' LLRTs are greater than the calculated average before inclusion of such loans.

Farmer Mac commented on our November 2005 proposal that the application of funding rates to the calculation of the carrying cost of nonperforming loans is inconsistent with its actual practice and that the proposed change should be withdrawn. Farmer Mac's comment focused on three aspects of the proposed LLRT change. We will summarize those three and then provide a discussion of each with our response. In this discussion, we refer to liabilities due in 1 year or less as short-term liabilities and to liabilities due after 1 year as "long-term" debt. The comment's three points were: (a) Farmer Mac does not fund nonperforming loans using a certain tenor of debt with perfect consistency, (b) Farmer Mac can effectively change the cost of funds of any nonperforming on-balance sheet loan by employing a "cross-funding" strategy, and (c) the model should not fund on-balance sheet, nonperforming loans at the shocked interest rates under the interest rate risk stress component in the model because these loans would, by having been on the balance sheet at the point in time when rates are shocked, have already been funded at pre-shock rates.

Farmer Mac acknowledged that purchases of nonperforming, off-balance sheet loans would be

done at short-term rates in the preponderance of cases, which is consistent with this proposed rule. However, Farmer Mac stated that, in actual practice, it uses a mix of short- and long-term debt because it decides on the appropriate funding term for such purchases based on the existing yield curve conditions and REO disposition expectations. While we accept the premise that in certain cases Farmer Mac might fund such purchases using longer term debt, we believe these cases are likely to be rare exceptions (e.g., steeply inverted yield curves) and do not create a sufficiently compelling reason to add more complexity to the model such as, for example, a new data input for average off-balance sheet nonperforming loan funding rates. Therefore, we made no change to this specific aspect of the model in this proposed rule.

Farmer Mac commented that it could employ a cross-funding strategy to effectively fund on-balance sheet non-performing loans at the short–term debt rates such as it uses in most cases of purchases of off-balance sheet nonperforming loans. While we agree that such opportunities could occur, we believe that assuming that Farmer Mac would always have the opportunity to purchase new program assets with the same size and expected life characteristics as on-balance sheet nonperforming loans is too broad an assumption to incorporate into the model. While it is possible that Farmer Mac could execute a similar rebalancing and reassignment of debt tenors among its program assets by adjustments to its ongoing daily funding selections, we would also view such a potentially complex incorporation of this contingent scenario into the model as unjustified for the added level of accuracy it might provide in certain cases. Therefore, we have made no change to the funding rates applied to calculate carrying cost of on-balance sheet nonperforming loans in this proposed rule.

Finally, Farmer Mac commented that the model should not fund on-balance sheet, nonperforming loans at shocked interest rate levels established by statute because these loans would, by having been already on the balance sheet at the point in time when rates are shocked, have been funded at pre-shocked rates. We agree with the comment and have revised the cost of funds applied to on-balance sheet nonperforming loans during the LLRT to pre-shock blended long- and short-term cost of funds rates in this proposed rule.

The proposed LLRT revisions are forward-looking only. In other words, actual loans that defaulted in year zero and are in their second year of nonperforming status in year one of the model's 10-year time horizon are not included in the proposed LLRT revision, and therefore no adjustment to restate current balance sheet amounts is needed. We considered an approach involving such a restatement but rejected it as unnecessarily complex. We note that our proposed revision to more accurately reflect the carrying cost of nonperforming loans results in less additional stress in a down-rate interest rate risk environment. This result is appropriate, as it would be less costly to fund nonperforming loans when interest rates are relatively low.

We propose one further adjustment to complete the LLRT revision. The RBCST is sometimes referred to as an "origination loan model" because it performs its loss estimation based on origination loan amounts and dates. The model does not incorporate loan interest rates or amortization of the loan portfolio. However, implementation of the LLRT revision would require us to make an estimate of loan amortization because it would be inaccurate to estimate the additional carrying cost associated with the LLRT period by applying the appropriate cost of funds to a loan's origination amount. We propose to use the portfolio average principal amortization to make this adjustment (i.e., total portfolio current scheduled principal balance divided by total origination balance). We would also incorporate into the blended rate used to calculate the carrying cost of nonperforming on-balance sheet loans an increment of interest expense associated swap expense according to Farmer Mac's practice of combining debt and swap contracts to fund loans.

E. Technical Changes to Improve Formatting and Clarity of Cell Labeling and Submission

Deadlines

In the RBCST spreadsheet, we have relocated the quarter-end date selection pull-down menu from the Assumptions and Relationships page to the Capital worksheet for convenience. We have also made line item labeling changes to enhance clarity in both the CLM and the RBC modules. We have also revised § 652.85 to update submission deadlines to be the same as the filing deadlines of Farmer Mac's public disclosures on Forms 10-Q and 10-K required by the Securities and Exchange Commission.

IV. Impact of Proposed Changes on Required Capital

We have evaluated the impact of the proposed changes to the currently active version of the model, Version 2.0. Our tests indicate that changes related to the LLRT would have the most significant impact on risk-based capital calculated by the model. The table below provides an indication of the impact of the revisions in the quarter ended March 31, 2007. The lines labeled "General Obligation Adjustment", "Investment Haircuts", and "Carrying Costs of Nonperforming Loans" present the impacts if only that revision were made to the current version, and the column labeled "Difference" calculates the impact of that individual change for the quarter ended March 31, 2007, compared to the requirement calculated using the currently active Version 2.0. The bottom line presents the impact of all proposed revisions in Version 3.0. As the table shows, the individual estimated impacts do not have an additive relationship to the total impact on the model output. This is due to the interrelationship of the changes with one another when they are combined in Version 3.0.

Calculated Regulatory Capital ($ in thousands)	3/31/2007	Difference
RBCST Version 2.0	80,831	
Treatment of Loans Backed by an Obligation of the Counterparty and Contractually Required Overcollateral.	73,244	-7,587
Investment Haircuts	83,922	3,091
Carrying Cost of Nonperforming Loans	105,170	24,340
RBCST Version 3.0 Change Impacts	100,079	19,249

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies the rule will not have a significant economic impact on a substantial number of small entities. Farmer Mac has assets and annual income over the amounts that would qualify it as a small entity. Therefore, Farmer Mac is not considered a "small entity" as defined in the Regulatory Flexibility Act.

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[1] 70 FR 69692 (November 17, 2005).
[2] 71 FR 77247 (December 26, 2006).
[3] Hamilton, D., Ou S., Kim R., Cantor R., "Corporate Default and Recovery Rates, 1920 – 2006," published by Moody's Investors Service, February 2007 – the most recent edition as of April 2007.
[4] Ibid; Default Rates, page 22, Recovery Rates (Severity Rate = 1 minus Senior Unsecured Average Recovery Rate) page 18.

[5] 66 FR 47730, 47777 (September 13, 2001).
[6] The term "derivative" refers to over-the-counter financial derivative instruments used by Farmer Mac to hedge interest rate risk and synthetically extend the term structure of its debt to reduce funding costs.

List of Subjects in 12 CFR Part 652

Agriculture, Banks, banking, Capital, Investments, Rural areas.

For the reasons stated in the preamble, part 652 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended to read as follows:

PART 652--FEDERAL AGRICULTURAL MORTGAGE CORPORATION FUNDING AND FISCAL AFFAIRS

1. The authority citation for part 652 continues to read as follows:

Authority: Secs. 4.12, 5.9, 5.17, 8.11, 8.31, 8.32, 8.33, 8.34, 8.35, 8.36, 8.37, 8.41 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2252, 2279aa-11, 2279bb, 2279bb-1, 2279bb-2, 2279bb-3, 2279bb-4, 2279bb-5, 2279bb-6, 2279cc); sec. 514 of Pub. L. 102-552, 106 Stat. 4102; sec. 118 of Pub. L. 104-105, 110 Stat. 168.

Subpart B--Risk-Based Capital Requirements

2. Amend § 652.65 by redesignating paragraph (b)(5) as new paragraph (b)(6) and adding a new paragraph (b)(5) to read as follows:

§ 652.65 Risk-based capital stress test.

* * * * *

(b) * * *

(5) You will further adjust losses for loans that collateralize the general obligation of Off-Balance Sheet AgVantage volume, and for loans where the program loan counterparty retains a subordinated interest in accordance with Appendix A to this subpart.

* * * * *

3. Amend § 652.85 by revising paragraph (d) to read as follows:

§ 652.85 When to report the risk-based capital level.

* * * * *

(d) You must submit your quarterly risk-based capital report for the last day of the preceding quarter by the earlier of the reporting deadlines for Securities and Exchange Commission Forms 10-K and 10-Q, or the 40th day after each of the quarter's ending March 31st, June 30th, and September 30th, and the 75th day after the quarter ending on December 31st.

4. Appendix A of subpart B, part 652 is amended by:

a. Revising the table of contents;
b. Revising the first and second sentences of section 2.0;
c. Redesignating existing section 2.4 as new section 2.5;
d. Adding a new section 2.4;
e. Revising section 4.1 e.;
f. Revising the last sentence of section 4.2 b.(3) introductory text;
g. Redesignating existing section 4.2 b.(3)(C) and (D) as new paragraph (3)(F) and (G);
h. Adding new section 4.2 b. (3)(C), (D), and (E);
i. Revising section 4.4;

j. Revising section 4.5 a.;

k. Removing the word "unretained" and adding in its place, the word "retained" in the ninth sentence of section 4.6 b.

Appendix A -- Subpart B of Part 652--Risk-Based Capital Stress Test

1.0 Introduction.
2.0 Credit Risk.
2.1 Loss-Frequency and Loss-Severity Models.
2.2 Loan-Seasoning Adjustment.
2.3 Example Calculation of Dollar Loss on One Loan.
2.4 Treatment of Loans Backed by an Obligation of the Counterparty and Loans for which Pledged Loan Collateral Volume Exceeds Farmer Mac-Guaranteed Volume.
2.5 Calculation of Loss Rates for Use in the Stress Test.
3.0 Interest Rate Risk.
3.1 Process for Calculating the Interest Rate Movement.
4.0 Elements Used in Generating Cashflows.
4.1 Data Inputs.
4.2 Assumptions and Relationships.
4.3 Risk Measures.
4.4 Loan and Cashflow Accounts.
4.5 Income Statements.
4.6 Balance Sheets.
4.7 Capital.
5.0 Capital Calculations.
5.1 Method of Calculation.

* * * * *

2.0 Credit Risk.

Loan loss rates are determined by applying the loss- frequency equation and the loss-severity factor to Farmer Mac loan-level data. Using this equation and severity factor, you must calculate loan losses under stressful economic conditions assuming Farmer Mac's portfolio remains at a "steady state." * * *

* * * * *

2.4 Treatment of Loans Backed by an Obligation of the Counterparty, and Loans for which Pledged Loan Collateral Volume Exceeds Farmer Mac-Guaranteed Volume.

You must calculate the age-adjusted loss rates for these loans that includes adjustments to scale losses according to the proportion of total submitted collateral to the guaranteed amount as provided for in the "Dollar Losses" column of the transformed worksheets in the Credit Loss Module based on new data inputs required in the "Coefficients" worksheet of the Credit Loss Module. Then, you must adjust the calculated loss rates as follows.

a. For loans in which the seller retains a subordinated interest, subtract from the total estimated age-adjusted dollar losses on the pool the amount equal to current unpaid principal times the subordinated interest percentage.

b. Some pools of loans underlying specific transactions could include loan collateral volume pledged to Farmer Mac in excess of Farmer Mac's guarantee amount ("overcollateral"). Overcollateral can be either: (i) Contractually required according to the terms of the transaction, or (ii) not contractually

required, but pledged in addition to the contractually required amount at the discretion of the counterparty, often for purposes of administrative convenience regarding the collateral substitution process, or (iii) both (i) and (ii).

1. If a pool of loans includes collateral pledged in excess of the guaranteed amount, you must adjust the age-adjusted, loan-level dollar losses by a factor equal to the ratio of the guarantee amount to total submitted collateral. For example, consider a pool of two loans serving as security for a Farmer Mac guarantee on a note with a total issuance face value of $2 million and on which the counterparty has submitted 10-percent overcollateral. The two loans in the example have the following characteristics and adjustments.

Loan	Origination Balance	Age-Adjusted Loss Rate	Estimated Age-Adjusted Losses	Guarantee Amount Scaling Adjustment (2/2.2)	Losses Adjusted for Overcollateral
1	$1,080,000	7.0%	$75,600	90.91%	$68,727
2	$1,120,000	5.0%	$56,000	90.91%	$50,909

2. If a pool of loans includes collateral pledged in excess of the guaranteed amount that is required under the terms of the transaction, you must further adjust the dollar losses as follows. Calculate the total losses on the subject portfolio of loans after age adjustments and any adjustments related to total submitted overcollateral as described in "1." above. Calculate the total dollar amount of contractually required overcollateral in the subject pool. Subtract the total dollars of contractually required overcollateral from the adjusted total losses on the subject pool. If the result is less than or equal to zero, input a loss rate of zero for this transaction pool in the Data Inputs worksheet of the RBCST. A new category must be created for each such transaction in the RBCST. If the loss rate after subtracting contractually required overcollateral is greater than zero, proceed to additional adjustment for the risk-reducing effects of the counterparty's general obligation described in "3." below.

3. Loans with a positive loss estimate remaining after adjustments in "1." and "2." above, are further adjusted for the security provided by the general obligation of the counterparty. To make this adjustment, multiply the estimated dollar losses remaining after adjustments in "1." and "2." above by the appropriate general obligation adjustment factor based on the counterparty's whole-letter issuer credit rating by a nationally recognized statistical rating organization (NRSRO).

The following table sets forth the general obligation adjustment factors and their components by whole-letter credit rating (Adjustment Factor = Default Rate x Severity Rate).[15]

Whole-Letter Rating	Default Rate	Severity Rate	General Obligation Adjustment Factor
AAA	0.89%	55%	0.49%
AA	2.31%	55%	1.26%
A	2.90%	55%	1.58%
BBB	7.29%	55%	3.98%
Below BBB and Unrated	27.39%	55%	15.16%

The adjustment factors will be updated annually as Moody's annual report on Default and

Recovery Rates of Corporate Bond Issuers becomes available, normally in January or February of each year. In the event that there is an interruption of Moody's publication of this annual report, or FCA determines that the format of the report has changed enough to prevent or call into question the identification of updated factors, the prior year's factors will remain in effect until FCA revises the process through rulemaking.

4. Continuing the previous example, the pool contains two loans on which Farmer Mac is guaranteeing a total of $2 million and with total submitted collateral of 110 percent of the guaranteed amount. Of the 10-percent total overcollateral, 5 percent is contractually required under the terms of the transaction. The pool consists of two loans of slightly over $1 million. Total overcollateral is $200,000, of which $100,000 is contractually required. The counterparty has a single "A" credit rating, and after adjusting for contractually required overcollateral, estimated losses are greater than zero. The net loss rate is calculated as described in the steps in the table below.

		Loan A	Loan B
1	Guaranteed Volume	$2,000,000	
2	Origination Balance of 2-Loan Portfolio	$ 1,080,000	$ 1,120,000
3	Age-adjusted Loss Rate	7%	5%
4	Estimated Age-adjusted Losses	$75,600	$56,000
5	Guarantee Volume Scaling Factor	90.91%	90.91%
6	Losses Adjusted for Total Overcollateral	$68,727	$50,909
7	Contractually required Overcollateral on Pool (5%)	$100,000	
8	Net Losses on Pool Adjusted for Contractually Required Overcollateral	$19,636	
9	General Obligation Adjustment Factor for "A" Issuer	1.58%	
10	Losses Adjusted for "A" General Obligation	$ 310	
11	Loss Rate Input in the RBCST for this Pool	0.02%	

The net, fully adjusted losses are distributed over time on a straight-line basis. When a transaction reaches maturity within the 10-year modeling horizon, the losses are distributed on a straightline over a timepath that ends in the year of the transaction's maturity.

* * * * *

4.1 Data Inputs.

* * * * *

e. Weighted Haircuts for Non-Program Investments. For non-program investments, the stress test adjusts the weighted average yield data referenced in section 4.1 b. to reflect counterparty risk.

Non-program investments are defined in § 652.5. The Corporation must calculate the haircut to be applied to each investment based on the lowest whole-letter credit rating the investment received from a NRSRO using the haircut levels in the following two tables. The first table provides the mappings of NRSRO ratings to whole-letter ratings for purposes of applying haircuts. Any "+" or "-" signs appended to NRSRO ratings that are not shown in the table should be ignored for purposes of mapping NRSRO ratings to FCA whole-letter ratings. The second table provides the haircut levels by whole-letter rating category.

FCA Whole-Letter Credit Ratings Mapped to Rating Agency Credit Ratings.

FCA Ratings Category	AAA	AA	A	BBB	Below BBB and Unrated
Standard & Poor's Long-Term	AAA	AA	A	BBB	Below BBB and Unrated
Fitch Long-Term	AAA	AA	A	BBB	Below BBB and Unrated
Moody's Long-Term	Aaa	Aa	A	Baa	Below Baa and Unrated
Standard & Poor's Short-Term	A-1+	A-1	A-2	A-3	SP-3, B, or Below and Unrated
	SP-1+	SP-1	SP-2		
Fitch Short-Term	F-1+	F-1	F-2	F-3	Below F-3 and Unrated
Moody's		Prime-1 MIG1 VMIG1	Prime-2 MIG2 VMIG2	Prime-3 MIG3 VMIG3	Not Prime, SG and Unrated
Fitch Bank Ratings	A	B	C	D	E
		A/B	B/C	C/D	D/E
Moody's Bank Financial Strength Rating	A	B	C	D	E

FARMER MAC RBCST Maximum Haircut by Ratings Classification

Ratings Classification	Non-Program Investment Counterparties (excluding Derivatives)
Cash	0.00%
AAA	0.49%
AA	1.26%
A	1.58%
BBB	3.98%
Below BBB and Unrated	15.16%

Certain special cases will receive the following treatment. For an investment structured as a collateralized obligation backed by the issuer's general obligation and, in turn, a pool of collateral, reference the Issuer

Rating or Financial Strength Rating of that issuer as the credit rating applicable to the security. Unrated securities that are fully guaranteed by Government-sponsored enterprises (GSE) such as the Federal National Mortgage Corporation (Fannie Mae) will receive the same treatment as AAA securities. Unrated securities backed by the full faith and credit of the U.S. Government will not receive a haircut.

If FCA approves the purchase of an unrated investment, and portions of that investment are later sold by Farmer Mac according to their specific risk characteristics, the Director will take reasonable measures to adjust the haircut level applied to the investment to recognize the change in the risk characteristics of the retained portion. The Director will consider similar methods for dealing with capital requirements adopted by other Federal financial institution regulators in similar situations.

Individual investment haircuts must then be aggregated into weighted-average haircuts by investment category and submitted in the "Data Inputs" worksheet. The spreadsheet uses these inputs to reduce the weighted-average yield on the investment category to account for counterparty insolvency according to a 10-year linear phase-in of the haircuts. Each asset account category identified in this data requirement is discussed in section 4.2, "Assumptions and Relationships."

* * * * *

4.2 Assumptions and Relationships.

* * * * *

b. * * *

(3) Elements related to income and expense assumptions. * * * These parameters are the gain on agricultural mortgage-backed securities (AMBS) sales, miscellaneous income, operating expenses, reserve requirement, guarantee fees and loan loss resolution timing.

* * * * *

(C) The stress test assumes that short-term cost of funds is incurred in relation to the amount of defaulting loans purchased from off-balance sheet pools. The remaining unpaid principal balance on this loan volume is the origination amount reduced by the proportion of the total portfolio that has amortized as of the end of the most recent quarter. This volume is assumed to be funded at the short-term cost of funds and this expense continues for a period equal to the loan loss resolution timing period (LLRT) period minus 1. We will calculate the LLRT period from Farmer Mac data. In addition, during the LLRT period, all guarantee income associated with the loan volume ceases.

(D) The stress test generates no interest income on the estimated volume of defaulted on-balance sheet loan volume required to be carried during the LLRT period, but continues to accrue funding costs during the remainder of the LLRT period.

(E) You must update the LLRT period in response to changes in the Corporation's actual experience with each quarterly submission.

* * * * *

4.4 Loan and Cashflow Accounts.

The worksheet labeled "Loan and Cashflow Data" contains the categorized loan data and cashflow accounting relationships that are used in the stress test to generate projections of Farmer Mac's performance and condition. As can be seen in the worksheet, the steady-state formulation results in account balances that remain constant except for the effects of discontinued programs, maturing Off-Balance Sheet AgVantage positions, and the LLRT adjustment. For assets with maturities under 1 year, the results are reported for convenience as though they matured only one time per year with the additional convention that the earnings/cost rates are annualized. For the pre-1996 Act assets, maturing balances are added back to post-1996 Act account balances. The liability accounts are used to satisfy the accounting identity, which requires assets to equal liabilities plus owner equity. In addition to the

replacement of maturities under a steady state, liabilities are increased to reflect net losses or decreased to reflect resulting net gains. Adjustments must be made to the long- and short-term debt accounts to maintain the same relative proportions as existed at the beginning period from which the stress test is run with the exception of changes associated with the funding of defaulted loans during the LLRT period. The primary receivable and payable accounts are also maintained on this worksheet, as is a summary balance of the volume of loans subject to credit losses.

4.5 Income Statements.

a. Information related to income performance through time is contained on the worksheet named "Income Statements." Information from the first period balance sheet is used in conjunction with the earnings and cost-spread relationships from Farmer Mac supplied data to generate the first period's income statement. The same set of accounts is maintained in this worksheet as "Loan and Cashflow Accounts" for consistency in reporting each annual period of the 10-year stress period of the test with the exception of the line item labeled "Interest reversals to carry loan losses" which incorporates the LLRT adjustment to earnings from the "Risk Measures" worksheet. Loans that defaulted do not earn interest or guarantee and commitment fees during LLRT period. The income from each interest-bearing account is calculated, as are costs of interest-bearing liabilities. In each case, these entries are the associated interest rate for that period multiplied by the account balances.

Dated: September 7, 2007.

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

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[15] Hamilton, D., Ou S., Kim R., Cantor R., "Corporate Default and Recovery Rates, 1920 – 2006," published by Moody's Investors Service, February 2007 – the most recent edition as of April 2007; Default Rates, page 22, Recovery Rates (Severity Rate = 1 minus Senior Unsecured Average Recovery Rate) page 18.

72 FR 61568, 10/31/2007

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[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 615

RIN 3052-AC25

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Capital Adequacy--Basel Accord

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking (ANPRM).

SUMMARY: The Farm Credit Administration (FCA or we) is considering possible modifications to our risk-based capital rules for Farm Credit System institutions (FCS or System) that are similar to the standardized approach delineated in the New Basel Capital Accord. We are seeking comments to facilitate the development of a proposed rule that would enhance our regulatory capital framework and more closely align minimum capital requirements with risks taken by System institutions. We are also withdrawing our previously published ANPRM.

DATES: You may send comments on or before March 31, 2008.

ADDRESSES: We offer several methods for the public to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- Agency Web site: http://www.fca.gov. Select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed, as faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or on our Web site at http://www.fca.gov. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Laurie Rea, Associate Director, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4232, TTY (703) 883-4434,

or

Wade Wynn, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4262, TTY (703) 883-4434,

or

Rebecca S. Orlich, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objective of this ANPRM is to gather information to facilitate the development of a comprehensive proposal that would:

1. Promote safe and sound banking practices and a prudent level of regulatory capital for System institutions;[1]

2. Improve the risk sensitivity of our regulatory capital requirements while avoiding undue regulatory burden;

3. To the extent appropriate, minimize differences in regulatory capital requirements between System institutions and federally regulated banking organizations;[2] and

4. Foster economic growth in agriculture and rural America through the effective allocation of System capital.

In addition, we are withdrawing our previous ANPRM on capital, published in the Federal Register on June 21, 2007 (72 FR 34191), as described more fully below.

II. Background

The FCA's risk-based capital requirements for System institutions are contained in subparts H and K of part 615 of our regulations.[3] Our risk-based capital framework is based, in part, on the "International Convergence of Capital Measurement and Capital Standards" (Basel I) as published by the

Basel Committee on Banking Supervision (Basel Committee)[4] and is broadly consistent with the capital requirements of the other Federal financial regulatory agencies.[5] We first adopted a risk-based capital framework for the System as part of our 1988 regulatory capital revisions[6] required by the Agricultural Credit Act of 1987[7] and made subsequent revisions in 1997,[8] 1998[9] and 2005.[10] Under the current capital framework, each on- and off-balance sheet credit exposure is assigned to one of five broad risk-weighting categories to determine the risk-adjusted asset base, which is the denominator for computing the permanent capital, total surplus, and core surplus ratios.

For a number of years, the Basel Committee has worked to develop a more risk sensitive regulatory capital framework that incorporates recent innovations in the financial services industry. In June 2004, it published the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II) to promote improved risk measurement and management processes and more closely align capital requirements with risk.[11] Basel II has three pillars: 1) Minimum capital requirements for credit risk, operational risk, and market risk, 2) supervision of capital adequacy, and 3) market discipline through enhanced public disclosure. Banking organizations have various options for calculating the minimum capital requirements for credit and operational risk. For credit risk, the options are the standardized approach, the foundation internal ratings-based approach, and the advanced internal ratings-based approach (A-IRB). For operational risk, the options are the basic indicator approach, the standardized approach, and the advanced measurement approach (AMA).

In September 2006, the other Federal financial regulatory agencies issued an interagency notice of proposed rulemaking for implementing the advanced approaches of Basel II in the United States (the advanced capital framework).[12] This advanced capital framework would require core banks[13] and permit opt-in banks[14] to use the A-IRB[15] to calculate the regulatory capital requirement for credit risk and the AMA[16] to calculate the regulatory capital requirement for operational risk.[17]

Given the small number of core banks and the complexity and cost associated with voluntarily adopting the advanced approaches, only a small number of U.S. banking organizations are expected to implement the advanced capital framework. As a result, a bifurcated regulatory capital framework will be created in the United States, which could result in different regulatory capital charges for similar products offered by those that apply the advanced capital framework and those that do not. Financial regulators, banking organizations, trade associations and other interested parties have raised concerns that the bifurcated structure could create a significant competitive disadvantage for those that do not apply the advanced capital framework.

In December 2006, the other Federal financial regulatory agencies addressed these concerns by issuing an interagency notice of proposed rulemaking (Basel IA) to improve the risk sensitivity of the existing Basel I-based capital framework.[18] Subsequently, the FCA issued an ANPRM,[19] published in June 2007, addressing issues similar to those addressed in Basel IA. Basel IA was intended to help minimize the potential differences in the regulatory minimum capital requirements of those banks applying the advanced capital framework and those banks that would not. The other Federal financial regulatory agencies received a significant number of comments opposing their Basel IA proposal. Many commenters argued that the benefits of complying with Basel IA did not outweigh the burdens, and many questioned why the U.S. banking agencies were creating a separate rule that had only minor differences from the standardized approach under Basel II. On July 20, 2007, the other Federal financial regulatory agencies announced that they intended to replace the Basel IA proposal with a proposed rule that would provide all non-core banks the option to adopt the standardized approach under Basel II.[20] Their stated intent is to finalize a standardized approach for banks that do not adopt the advanced approaches before the core (and opt-in) banks begin their first transition period year under the advanced approaches of Basel

II.

The other Federal financial regulatory agencies plan to replace Basel IA with a proposed rule patterned after the standardized approach under Basel II. Consequently, we are withdrawing our previous ANPRM and replacing it with one that is also consistent with the standardized approach. We intend to develop a proposed rule that is similar to the capital requirements of the other Federal financial regulatory agencies where appropriate but also tailored to fit the System's distinct borrower-owned lending cooperative structure and Government-sponsored enterprise (GSE) mission.

The questions posed in this ANPRM are, for the most part, similar to the questions we asked in our previous ANPRM.[21] We have revised the technical material in most places to conform to the standardized approach of Basel II. For example, we replaced the risk-weight categories that were in the Basel IA proposed rule with the risk-weight categories that are contained in the standardized approach under Basel II. We ask commenters to consider the revised material when answering the following questions. We seek comments from all interested parties to help us develop a comprehensive proposal that would enhance our regulatory capital framework and increase the risk sensitivity of our risk-based capital rules without unduly increasing regulatory burden.

III. Questions

When addressing the following questions, we ask commenters to consider the overarching objectives of Basel II to more closely align capital with the specific risks taken by the financial institution rather than relying on a "one-size-fits-all" approach for determining regulatory minimum risk-based capital requirements. Our objective is to develop a more dynamic risk-based capital framework that is more sensitive to the relative risks inherent in System lending and other mission-related activities. We seek comments on specific criteria that might be used to determine appropriate risk weights that meet this objective without creating undue burden. Specifically, we ask that you support your comments with data, to the extent possible, in response to our questions.[22]

A. Increase the Number of Risk-Weight Categories

Our existing risk-based capital rules assign exposures to one of five risk-weight categories: 0, 20, 50, 100, and 200 percent.[23] The standardized approach of Basel II adds risk-weight categories of 35, 75, and 150 percent and replaces the 200-percent risk-weight category with a 350-percent risk-weight category.[24] The 35-percent risk-weight category would apply to certain residential mortgages. The 75-percent risk-weight category would apply to certain retail claims (e.g., small business loans). The 150-percent and 350-percent risk-weight categories would apply to certain higher risk externally rated exposures (e.g., those below investment grade).

Question 1: We seek comment on what additional risk-weight categories, if any, we should consider for assigning risk weights to System institutions' on- and off-balance sheet exposures. If additional risk-weight categories are added, what assets should be included in each new risk-weight category?

B. Use of External Credit Ratings to Assign Risk-Weight Exposures

1. Direct Exposures

In recent years, the FCA has permitted System institutions to use external ratings to assign risk weights to certain credit exposures linked to nationally recognized statistical rating organizations (NRSROs) ratings.[25] For example, in March 2003, we adopted an interim final rule that permitted System

institutions to use NRSRO ratings to place highly rated investments in non-agency asset-backed securities (ABS) and mortgage-backed securities (MBS) in the 20-percent risk-weight category.[26] In April 2004, we expanded the use of NRSRO ratings to assign risk weights to loans to other financing institutions.[27] In June 2005, we adopted a ratings-based approach to assign risk weights to recourse obligations, direct credit substitutes (DCS), residual interests (other than credit-enhancing interest-only strips), and other ABS and MBS investments.[28] Furthermore, we recently permitted the use of NRSRO ratings to assign risk weights to certain electric cooperative credit exposures.[29]

The standardized approach of Basel II expands the use of NRSRO ratings to determine the risk-based capital charge for long-term exposures to sovereign entities, non-central government public sector entities (PSEs), banks[30], corporate entities, and securitizations as displayed in Table 1 set forth below.[31]

Table 1 – The Standardized Approach Risk Weights Based on External Ratings for Long-Term Exposures

Credit Assessment	Sovereign Risk Weight (in percent)	PSE and Bank* Risk Weights (in percent)		Corporate Risk Weight (in percent)	Securitization**Risk Weight (in percent)
		Option 1	Option 2		
AAA to AA-	0	20	20	20	20
A+ to A-	20	50	50	50	50
BBB+ to BBB-	50	100	50	100	100
BB+ to BB-	100	100	100	100	350
B+ to B-	100	100	100	150	Deduction ***
Below B-	150	150	150	150	Deduction ***
Unrated	100	100	50	100	Deduction ***

* The Standardized Approach provides two options for PSEs and bank exposures: (1) Option 1 assigns a risk weight one category below that of sovereigns; (2) Option 2 assigns a risk weight based on the individual bank rating. Option 2 also provides risk weights for short-term claims as follows: (1) AAA to BBB- and unrated = 20 percent; (2) BB+ to B- = 50 percent; and (3) Below B- = 150 percent.

** Short-term rating categories are as follows: (1) A-1/P-1 = 20 percent; (2) A-2/P-2 = 50 percent; (3) A-3/P-3 = 100 percent; and (4) All other ratings or unrated = Deduction.

*** Banks must deduct the entire amount from capital. However, if banks originate a securitization and the most senior exposure is unrated, the bank may use the "look through" treatment, which is the average risk weight of the underlying exposures subject to supervisory review.

System institutions provide financing to agriculture and rural America through a variety of lending[32] and investment[33] products. They also hold highly rated liquid investments to manage liquidity, short-term surplus funds, and interest rate risk. Our existing risk-based capital rules assign most agricultural and rural business[34] loans and mission-related investment assets to the 100-percent risk-weight category unless the risk exposure is mitigated by an acceptable guarantee or collateral. The FCA is considering the expanded use of NRSRO ratings to assign risk weights to other externally rated credit exposures in the System, such as corporate debt securities and loans.

Question 2: We seek comments on all aspects of the appropriateness of using NRSRO ratings to assign risk weights to credit exposures. If we expand the use of external ratings, how should we align the risk-weight categories with NRSRO ratings to determine the appropriate capital charge for externally rated credit exposures? Should any externally rated positions be excluded from this new ratings-based approach? We ask commenters to consider the substantial reliance on NRSRO ratings as a means of evaluating the quality of debt investments in view of recent events in the subprime mortgage market.

2. Recognized Financial Collateral

Our current risk-based capital rules assign lower risk weights to exposures collateralized by: (1) Cash held by a System institution or its funding bank; (2) securities issued or guaranteed by the U.S. Government, its agencies or Government-sponsored agencies; (3) securities issued or guaranteed by central governments in other OECD[35] countries; (4) securities issued by certain multilateral lending or regional development institutions; or (5) securities issued by qualifying securities firms.

The standardized approach of Basel II has two methods for recognizing a wider variety of collateral types for risk-weighting purposes.[36] Under the simple approach, the collateralized portion of the exposure would be assigned a risk weight (as listed in Table 1) according to the external rating of the collateral. The remainder of the exposure would be assigned a risk weight appropriate to the counterparty. Collateral would be subject to a 20-percent floor unless the collateral is cash, certain government securities or repurchase agreements, and it would be marked-to-market and revalued every 6 months. Securities issued by sovereigns or PSEs must be rated at least BB- or its equivalent by a NRSRO. Securities issued by other entities must be rated at least BBB- or its equivalent by an NRSRO. Short-term debt instruments used as collateral must be rated at least A-3/P-3 or its equivalent by an NRSRO.

Under the comprehensive approach, the banking organization adjusts the value of the exposure by the discounted value of the collateral. Discount values, known as supervisory haircuts, are displayed in Table 2 set forth below. For example, sovereign debt rated A+ with a 5-year maturity used as collateral is discounted by 3 percent, and corporate debt rated A+ with a 5-year maturity is discounted at 6 percent.

Table 2 – Standard Supervisory Haircuts in the Comprehensive Approach for Credit Mitigation

Issue rating for debt securities	Residual maturity	Sovereigns and PSEs* (in percent)	Other issuers** (in percent)
AAA to AA- or A-	≤ 1 year	0.5	1
	> 1 year, ≤ 5 years	2	4
	> 5 years	4	8
A+ to BBB- or A-2/A-3/P-3	≤ 1 year	1	2
	> 1 year, ≤ 5 years	3	6
	> 5 years	6	12
BB+ to BB-	All	15	

* Includes PSEs treated as sovereigns
** Includes PSEs not treated as sovereigns

Question 3: We seek comment on whether recognizing additional types of eligible collateral would improve the risk sensitivity of our risk-based capital rules without being overly burdensome. We also seek comment on what additional types of collateral, if any, we should consider and what effect the collateral should have on the risk weighting of System exposures.

3. Eligible Guarantors

Our existing capital rules permit the use of third party guarantees to lower the risk weight of certain exposures. Guarantors include: (1) The U.S. Government, its agencies or Government-sponsored agencies; (2) U.S. state and local governments; (3) central governments and banks in OECD countries; (4) central governments in non-OECD countries (local currency exposures only); (5) banks in non-OECD countries (short-term claims only); (6) certain multilateral lending and regional development institutions; and (7) qualifying securities firms.

The standardized approach of Basel II expands the range of eligible guarantors to include sovereign entities, PSEs, banks and securities firms that have a lower risk weight than the counterparty.[37] All other guarantors must be rated A- (or its equivalent) or better by a NRSRO. The guarantee must: (1) Represent a direct claim on the protection provider, (2) be explicitly referenced to specific exposures or pools of exposures, (3) be irrevocable, and (4) unconditional. The guarantor's risk weight would be substituted for the risk weight assigned to the exposure. Non-guaranteed portions of the exposure would be assigned to the external rating of the exposure.

Question 4: We seek comment on what additional types of third party guarantees, if any, we should recognize and what effect such guarantees should have on the risk weighting of System exposures.

C. Direct Loans to System Associations

The FCA is considering ways to better align our risk-based capital requirements for direct loans with System associations. System banks make direct loans to their affiliated associations who, in turn, make retail loans to eligible borrowers. Our current risk-based capital rules assign a 20-percent risk weight to direct loans at the bank level and another risk weight (depending upon the type of loan) to retail loans at the association level.[38] The 20-percent risk weight is intended to recognize the risks to the banks associated with lending to their affiliated associations. We are exploring methods to improve the risk sensitivity of our risk-based capital rules by assigning different risk weights to direct loan exposures based on the System association's distinct risk profile.

Question 5: We seek comment on what evaluative criteria or methods we should use to assign risk weights to direct loans to System associations. How should the criteria be used to adjust the risk weight as the quality of the direct loan changes over time?

D. Small Agricultural and Rural Business Loans

Our existing risk-based capital rules assign small agricultural and rural business loans to the 100-percent risk-weight category unless the credit risk is mitigated by an acceptable guarantee or acceptable collateral. The standardized approach of Basel II applies a 75-percent risk weight to certain retail claims[39] provided: (1) The exposure is to an individual person or persons or to a small business, (2) the exposure is in the form of a revolving credit, line of credit, personal term loan or lease, or small business facility or commitment, (3) the regulatory supervisor is satisfied that the retail portfolio is sufficiently diversified to warrant such a risk weight, and (4) the total credit exposure to the borrower

does not exceed approximately $1.4 million.[40]

Question 6: We seek comment on what approaches we should use to improve the risk sensitivity of our risk-based capital rules for small agricultural and rural business loans. More specifically, what criteria should we use to classify an agricultural or rural business as a small business? What criteria should we use to assign risk-weights of less than 100 percent to these types of loans?

E. Loans Secured by Liens on Real Estate

The FCA is considering ways to use loan-to-value ratios (LTV) and other criteria to determine the risk-based capital charges for farm real estate and qualified residential loans. Our existing capital rules assign farm real estate loans to the 100-percent risk-weight category and qualified residential loans[41] to the 50-percent risk-weight category. The standardized approach of Basel II assigns a 35-percent risk weight to all prudently underwritten residential mortgages. Basel IA had proposed to risk-weight loans secured by first and second liens on residential real estate based on LTV. We continue to believe that LTV is a viable option for determining appropriate risk-weights for farm real estate and qualified residential loans. We are also considering approaches that would combine borrower creditworthiness and other loan characteristics in conjunction with LTV.

Question 7: We seek comment on all aspects of using LTV to determine the appropriate risk-weight for farm real estate, qualified residential loans, or any other asset class. We also welcome comments on other methods that could be used to improve the risk sensitivity of our risk-based capital rules for these types of loans.

F. Loans 90 Days or More Past Due or in Nonaccrual[42]

Our existing risk-based capital rules assign most loans to the 100-percent risk-weight category unless the credit risk is mitigated by an acceptable guarantee or collateral. When exposures reach 90 days or more past due or are in nonaccrual status, there is a higher probability that the financial institution might incur a loss. The standardized approach of Basel II addresses this potentially higher risk of loss by assigning the unsecured portion of a loan that is 90 days or more past due (net of specific provisions) as follows:

- 150-percent risk weight when specific provisions are less than 20 percent of the outstanding amount of the loan;
- 100-percent risk weight when specific provisions are 20 percent or more of the outstanding amount of the loan;
- When specific provisions are 50 percent or more of the outstanding amount of the loan, the supervisor has the discretion to reduce the risk weight to 50 percent.

Question 8: We seek comment on all aspects related to risk-weighting exposures that reach 90 days or more past due or are in nonaccrual status.

G. Short- and Long-Term Commitments

Under § 615.5212, off-balance sheet commitments are generally risk-weighted in two steps: (1) The off-balance sheet commitment is multiplied by a credit conversion factor (CCF)[43] to determine its on-balance sheet credit equivalent; and (2) the on-balance sheet credit equivalent is assigned to the

appropriate risk-weight category in § 615.5211 according to the obligor, after considering any applicable collateral and guarantees.[44] The standardized approach of Basel II assigns a 0-percent CCF to unconditionally cancelable commitments,[45] a 20-percent CCF to short-term commitments, and a 50-percent CCF to long-term commitments.[46]

Question 9: We seek comment on what approaches we should use to risk weight short- and long-term commitments that are not unconditionally cancelable.

H. Adjusting Risk Weights on Exposures over Time

The FCA welcomes comment on additional approaches or criteria that might be used to adjust the risk weight of exposures throughout the life of the asset. Our existing risk-based capital rules assign a static risk weight to assets within a given asset class without providing for risk-weight adjustments as asset quality improves or deteriorates. For example, most loans to System borrowers are risk-weighted at 100 percent throughout the life of the loan without making risk-weight adjustments based on credit classifications or other credit performance factors.

Question 10: We seek comment on what methods we should use to adjust the risk weight of credit exposures as the asset quality or default probability changes over time.

I. Capital Charge for Operational Risk

The FCA welcomes comments on possible approaches for determining a capital charge for operational risk. The broad risk-weighting categories under our existing capital rules are primarily designed to protect against credit or counterparty risk. As we move toward a more risk-sensitive capital framework, it may be appropriate to apply an explicit capital charge for operational risk, especially to cover risks associated with off-balance sheet activity.

Basel II defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people, systems, or from external events. This definition includes legal risk but excludes strategic and reputational risk. As previously mentioned, Basel II has three methods for applying a capital charge for operational risk. Under the basic indicator approach, the operational capital charge is equal to 15 percent of the 3-year average of positive annual gross income. Under the standardized approach, the operational capital charge is equal to the sum of a fixed percentage of the 3-year average of the gross income of eight business lines.[47] Under the AMA, the operational capital charge is derived from a bank's internal operational risk management systems and processes.

Question 11: We seek comment on what approach we should consider, if any, in determining a risk-based capital charge for operational risk.

J. Disclosure[48]

The FCA recognizes that market discipline contributes to a safe and sound banking environment and enhances risk management practices. Pillar III of Basel II is designed to complement the minimum capital requirements and supervisory review process by encouraging market discipline through meaningful public disclosure. The disclosure requirements are intended to allow market participants to assess key information about an institution's risk profile and associated level of capital to better evaluate risk management performance, earnings potential and financial strength.

Pillar III of Basel II presents the following general disclosure requirements: 1) Banks should have a formal disclosure policy approved by the board of directors that addresses the institution's approach for

determining the disclosures it should make;[49] 2) banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency of them; 3) banks should decide which disclosures are relevant based on the materiality concept;[50] and 4) the disclosures should be made on a semi-annual basis, subject to certain exceptions.[51]
The other Federal financial regulatory agencies have proposed the following additional requirements in the advanced capital framework: 1) The disclosures would follow U.S. generally accepted accounting principles, SEC mandates, and existing regulatory reporting requirements; 2) the banks would be required to disclose quantitative information on a quarterly basis following SEC deadlines; 3) the disclosures would be made publicly available (for example, on a Web site) for each of the last 3 years (that is, 12 quarters);[52] 4) disclosure of key financial ratios must be provided in the footnotes to the year-end audited financial statements;[53] 5) the chief financial officer must certify that the disclosures are appropriate; and 6) the board of directors and senior management are responsible for establishing the internal control structure over financial reporting.

Question 12: We seek comment on all aspects of the Basel II public disclosure requirements. Specifically, how would the System apply the public disclosure requirements of Pillar III given its unique cooperative structure?

K. Capital Leverage Ratio

We are considering whether we should supplement our existing risk-based capital rules with a minimum capital leverage ratio requirement for all FCS institutions to further promote the safety and soundness of the System. Our existing capital regulations require System banks to maintain a minimum net collateral ratio (NCR)[54] of 103 percent[55] but do not impose a capital leverage ratio on System associations. The NCR provides a level of protection for operating and other forms of risk at System banks, but it does not differentiate higher quality from lower quality capital. The other Federal financial regulatory agencies currently supplement their risk-based capital rules with a leverage ratio of Tier 1 capital to total assets (Tier 1 leverage ratio).[56] The Tier 1 leverage ratio consists of only the most reliable and permanent forms of capital such as common stock, non-cumulative perpetual preferred stock, and retained earnings.

Question 13: We seek comment on whether our capital rules should include a minimum capital leverage ratio requirement for all System institutions. We also seek comment on changes, if any, that should be made to the existing regulatory minimum NCR requirement applicable to System banks that would make it more comparable to the Tier 1 ratio used by the other Federal financial regulatory agencies.

L. Regulatory Capital Directives[57]

We are considering whether we should modify our capital rules to specify potential early intervention criteria for the issuance of capital directives. Currently, FCA has the discretion to issue a capital directive[58] when an institution's capital is insufficient. The FCA, however, has not defined capital or other financial early intervention thresholds to require an institution to take corrective action as described in § 615.5355. Early intervention approaches have been used in other contexts, including the System's Market Access Agreement and the statutory requirements applicable to other regulated financial institutions.[59] An early intervention capital directive framework could provide a clearer indication of when we would impose additional and increasing supervisory oversight on an institution to address continuing deterioration in its financial condition and capital position from credit, interest rate, or other financial risks.

Question 14: We seek comment on revising our current capital directive regulations to include an early intervention framework. We also seek comment on potential financial thresholds, such as capital ratios or risk measures, that would trigger an FCA capital directive action.

M. Multi-Dimensional Regulatory Structure

As stated above, one of FCA's objectives is to implement a revised capital framework that improves the risk sensitivity of our capital rules while avoiding undue regulatory burden. There are currently five banks and 95 associations in the System with varying degrees of asset size, complexity of operations, and sophistication in their risk management practices. Some System institutions have the risk management capabilities to apply more complex, risk-sensitive regulatory capital requirements than other System institutions. It may be appropriate for the FCA to adopt more than one set of capital rules to account for these differences. However, this approach could result in different capital requirements for the same type of transaction and increase examination and oversight costs.

As described above, the other Federal financial regulatory agencies are in the process of proposing two sets of capital rules for the financial institutions they regulate. The implementation of the advanced capital framework would be limited, for the most part, to the largest, internationally active banks that meet certain infrastructure requirements. Other banks would implement a simpler capital framework patterned after the standardized approach of Basel II.
While our expectation is to implement a revised capital framework similar to the standardized approach of Basel II, we also recognize that some aspects of the advanced approaches may be appropriate for the larger, more complex System institutions. However, we are still reviewing the advanced approaches of Basel II and its potential application to the System. Therefore, we are not seeking comments on specific aspects of the advanced approaches at this time. Rather, we are considering the overall regulatory capital framework for the System in light of the changes occurring in the financial services industry and recent best practices for economic capital modeling.

Question 15: We seek comment on the most appropriate risk-based capital framework for the System and the reasons we should implement one framework over another. Should we consider creating a uniform regulatory capital structure for the System or a multi-dimensional regulatory structure and allow each System institution the option of choosing which capital framework it will apply? How might this new risk-based capital framework increase the costs or regulatory burden to the System? Would the increased costs be justified by improved risk sensitivity, risk management, and more efficient capital allocation?

N. Reporting Requirements and Transition Period[60]

The other Federal financial regulatory agencies have announced that they will be replacing Basel IA with a proposed rule that would provide all non-core banks the option of adopting the standardized approach under Basel II. Their stated intent is to finalize a standardized approach for non-core banks before the core banks begin their first transition period year under the advanced capital framework. Our objective is to minimize, to the extent possible, the time interval between the issuance of their final rule and ours. We also need a transition period to make appropriate modifications to the Call Reporting System to track the new risk-based capital requirements.

Question 16: We seek comment on an appropriate timetable for implementing our new risk-based capital rules. Specifically, what is an appropriate time interval between the issuance of the other Federal financial regulatory agencies' final rule on the standardized approach of Basel II and ours? How long should the transition period be to allow System institutions to adjust to the new risk-based

capital rules?

Question 17: Additionally, we seek comment on any other methods that may be used to increase the risk sensitivity of our risk-based capital rules.

Dated: October 25, 2007

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

[1]The System was created by Congress in 1916 and is the oldest GSE in the United States. System institutions provide credit and financially related services to farmers, ranchers, producers or harvesters of aquatic products, and farmer-owned cooperatives. They also make credit available for agricultural processing and marketing activities, rural housing, certain farm-related businesses, agricultural and aquatic cooperatives, rural utilities, and foreign and domestic entities in connection with international agricultural trade.

[2]Banking organizations include commercial banks, savings associations, and their respective bank holding companies.

[3]Our regulations can be accessed at http://www.fca.gov/index.html.

[4]The Basel Committee on Banking Supervision was established in 1974 by central banks with bank supervisory authorities in major industrialized countries. The Basel Committee formulates standards and guidelines related to banking and recommends them for adoption by member countries and others. All Basel Committee documents are available at http://www.bis.org.

[5]We refer collectively to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision as the “other Federal financial regulatory agencies.”

[6]See 53 FR 39229 (October 6, 1988).

[7]Pub. L. 100-233 (January 6, 1988), section 301. The 1987 Act amended many provisions of the Farm Credit Act of 1971, as amended, which is codified at 12 U.S.C. 2001 et seq.

[8]See 62 FR 4429 (January 30, 1997).

[9]See 63 FR 39219 (July 22, 1998).

[10]See 70 FR 35336 (June 17, 2005).

[11]See www.bis.org/publ/bcbsca.htm for the 2004 Basel II Accord as well as updates in 2005 and 2006.

[12]See 71 FR 55830 (September 25, 2006). This document is at http://www.federalreserve.gov/generalinfo/basel2/USImplementation.htm.

[13]Core banks are banking organizations that have consolidated total assets of $250 billion or more or have consolidated on-balance sheet foreign exposures of $10 billion or more.

[14]Opt-in banks are banking organizations that do not meet the definition of a core bank but have the risk management and measurement capabilities to voluntarily implement the advanced approaches of Basel II with supervisory approval.

[15]A banking organization computes internal estimates of certain key risk parameters for each credit exposure or pool of exposures and feeds the results into regulatory formulas to determine the risk-based capital requirement for credit risk.

[16]Internal operational risk management systems and processes are used to compute risk-based capital requirements for operational risk.

[17]The other Federal financial regulatory agencies also seek comments on whether core and opt-in banks should be permitted to use other credit and operational risk approaches.

[18]71 FR 77446 (December 26, 2006). This document is at http://www.federalreserve.gov/generalinfo/basel2/USImplementation.htm.

[19]72 FR 34191 (June 21, 2007).

[20]Joint Press Release, “Banking Agencies Reach Agreement On Basel II Implementation,” (July 20, 2007). This document is at http://www.occ.gov/ftp/release/2007-77.htm.

[21]Questions 1, 3, 4, 5, 9 and 10 in this ANPRM are identical to those numbered questions posed in our previous ANPRM. Questions 2, 6 and 11 are slightly different. Question 7 in this ANPRM replaces Questions 7 and 8 in our previous ANPRM. Questions 8, 12, and 16 are new to this ANPRM. Questions 13 through 15 are identical to Questions 12 through 14 in our previous ANPRM. Question 17 is identical to Question 15 in our previous ANPRM.

[22]Please note that any data you submit will be made available to the public in our rulemaking file.

[23]FCA’s risk-weight categories are set forth in 12 CFR 615.5211.

[24]Basel IA proposed adding risk-weight categories of 35, 75, and 150 percent.

[25]A NRSRO is a credit rating organization that is recognized by and registered with the Securities and Exchange Commission (SEC) as a nationally recognized statistical rating organization. See 12 CFR 615.5201. See also Pub. L. 109–291.

[26]See 68 FR 15045 (March 28, 2003).

[27]Other financing institutions are non-System financial institutions that borrow from System banks. See 69

FR 29852 (May 26, 2004).

[28]These changes are consistent with those of the other Federal financial regulatory agencies. See 70 FR 35336 (June 17, 2005).

[29]See "Revised Regulatory Capital Treatment for Certain Electric Cooperatives Assets," FCA Bookletter BL-053 (February 12, 2007).

[30]Banks include multilateral development banks and securities firms.

[31]Basel IA proposed the categories sovereign entities, non-sovereign entities, and securitizations with different risk-weight categories.

[32]The Farm Credit Banks provide wholesale funding to their affiliated associations who, in turn, make retail loans to eligible borrowers. CoBank, ACB, provides both wholesale funding to its affiliated associations and retail loans to cooperatives and other eligible borrowers.

[33]System banks and associations are permitted to make mission-related investments to agriculture and rural America. See "Investments in Rural America—Pilot Investment Programs," FCA Informational Memorandum (January 11, 2005).

[34]Agricultural businesses include farmer-owned cooperatives, food and fiber processors and marketers, manufacturers and distributors of agricultural inputs and services, and other agricultural-related businesses. Rural businesses include electric utilities and other energy-related businesses, communication companies, water and waste disposal businesses, ethanol plants, and other rural-related businesses.

[35]OECD stands for the Organization for Economic Cooperation and Development. The OECD is an international organization of countries that are committed to democratic government and the market economy. An up-to-date listing of member countries is available at http://www.oecd.org or www.oecdwash.org.

[36]Basel IA proposed assigning lower risk weights to exposures collateralized by securities issued by sovereigns or non-sovereigns that were externally rated at least investment grade.

[37]Basel IA proposed to include guarantees from any entity that had long-term senior debt rated at least investment grade (or issuer rating if a sovereign).

[38]Our risk-based capital rules also assign a 20-percent risk weight to similar GSE and OECD depository institution exposures.

[39]The other Federal financial regulatory agencies stated in Basel IA that they were exploring options to permit certain small business loans to qualify for a 75-percent risk weight.

[40]We present a comparable threshold in terms of U.S. dollars. The standardized approach of Basel II has a threshold of €1 million.

[41]Qualified residential loans are rural home loans (as defined by 12 CFR 613.3030) and single-family residential loans to bona fide farmers, ranchers, or producers or harvesters of aquatic products that meet

the requirements listed in 12 CFR 615.5201.

[42]This section was not in the previous ANPRM.

[43]A CCF is a number by which an off-balance sheet item is multiplied to obtain a credit equivalent before placing the item in a risk-weight category.

[44]Our existing regulations assign a 0-percent CCF to unused commitments with an original maturity of 14 months or less. Unused commitments with an original maturity of greater than 14 months can also receive a 0-percent CCF provided the commitment is unconditionally cancelable and the System institution has the contractual right to make a separate credit decision before each drawing under the lending arrangement. All other unused commitments with an original maturity of greater than 14 months are assigned a 50-percent CCF.

[45]An unconditionally cancelable commitment is one that can be canceled for any reason at any time without prior notice.

[46]Basel IA proposed to retain the 0-percent CCF for all unconditionally cancelable commitments, apply a 10-percent CCF to all other short-term commitments, and retain the 50-percent CCF for all long-term commitments.

[47]Each business line is multiplied by a fixed percentage and then summed together to determine the annual gross income. The eight lines of business are corporate finance (18 percent), trading and sales (18 percent), retail banking (12 percent), commercial banking (15 percent), payment and settlement (18 percent), agency services (15 percent), asset management (12 percent), and retail brokerage (12 percent).

[48]This section was not in the previous ANPRM.

[49]Disclosure is a qualifying criterion under Pillar I to obtain lower risk weightings and/or to apply specific methodologies.

[50]Pillar III of Basel II provides minimum disclosure requirements on capital structure and adequacy, and risk exposure and assessment on credit risk, market risk, operational risk, equities, and interest rate risk in the banking book.

[51]Disclosure of key capital ratios should be made on a quarterly basis. Qualitative disclosures providing a general summary of a bank's risk management objective and policies, reporting system and definitions may be published on an annual basis.

[52]U.S. Basel II banks are encouraged to provide this information in one place on the entity's public Web site.

[53]These disclosures would be tested by external auditors as part of the financial statement audit.

[54]The net collateral ratio is a bank's net collateral as defined in 12 CFR 615.5301(c) divided by the bank's adjusted total liabilities.

[55]See 12 CFR 615.5335(a).

[56]See 12 CFR 3.6(b) and (c); 12 CFR part 208, appendix B and 12 CFR part 225, appendix D; 12 CFR 325.3; and 12 CFR 567.8.

[57]12 CFR part 615, subpart M.

[58]A capital directive is defined in § 615.5355(a) as an order issued to an institution that does not have or maintain capital at or greater than the minimum ratios set forth in 12 CFR 615.5205, 615.5330, and 615.5335, or established under subpart L of part 615, or by a written agreement under an enforcement or supervisory action, or as a condition of approval of an application. The FCA's authority is set forth in sections 4.3(b)(2) and 4.3A(e) of the Farm Credit Act (12 U.S.C. 2154(b)(2) and 2154a(e)).

[59]See 12 U.S.C. 1831o for the prompt corrective action provisions that apply to commercial banks and savings associations.

[60]This section was not in the previous ANPRM.

73 FR 15955, 03/26/2008

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[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 615

RIN 3052-AC25

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Capital Adequacy--Basel Accord

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking (ANPRM); extension of comment period.

SUMMARY: The Farm Credit Administration (FCA, Agency or we) is extending the comment period on our ANPRM that seeks comments to facilitate the development of enhancements to our regulatory capital framework to more closely align minimum capital requirements with risks taken by Farm Credit System (FCS or System) institutions. We are extending the comment period so all interested parties will have additional time to provide comments.

DATES: You may send comments on or before December 31, 2008.

ADDRESSES: We offer several methods for the public to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. Regardless of the method you use, please do not submit your comments multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- Agency Web site: http://www.fca.gov. Select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed, as faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or on our Web site at http://www.fca.gov. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

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or

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or

Rebecca S. Orlich, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION: On October 31, 2007, FCA published a notice in the Federal Register seeking public comment to facilitate the development of a proposed rule that would enhance our regulatory capital framework and more closely align minimum capital requirements with risks taken by System institutions. See 72 FR 61568. The comment period is scheduled to expire on March 31, 2008. In a letter dated March 4, 2008, the Federal Farm Credit Banks Funding Corporation, on behalf of the System banks and associations, requested that the Agency extend the comment period until December 31, 2008. In view of the number and the complexity of the questions asked in the ANPRM, we have granted this request. The FCA supports public involvement and participation in its regulatory process and invites all interested parties to review and provide comments on our ANPRM.

Dated: March 21, 2008

Roland E. Smith,
Secretary,
Farm Credit Administration Board.