has passed through the entire packing process in a single continuous run not to exceed a single work day (i.e., a run started one day and completed the next is considered two lots).

* * * * *

3. In § 301.75–7, paragraphs (a)(1), (a)(2), and (a)(6) would be revised to read as follows:

§ 301.75–7 Interstate movement of regulated fruit from a quarantined area.

(a) * * *

(1) Every lot of regulated fruit to be moved interstate must be inspected by an APHIS employee at the packinghouse for symptoms of citrus canker. Any lot found to contain fruit with visible symptoms of citrus canker will be ineligible for interstate movement from the quarantined area. The number of fruit to be inspected will be the quantity that is sufficient to detect, with a 95 percent level of confidence, lots of fruit containing 0.38 percent or more fruit with visible canker lesions or another quantity that gives a statistically significant confidence of detecting the disease at a level of infection to be determined by the Administrator.

(2) The owner or operator of any packinghouse that wishes to move citrus fruit interstate from the quarantined area must enter into a compliance agreement with APHIS in accordance with § 301.75–13.

* * * * *

(6) Each lot of regulated fruit found to be eligible for interstate movement must be accompanied by a limited permit issued in accordance with § 301.75–12. Regulated fruit to be moved interstate must be packaged in boxes or other containers that are approved by APHIS and that are used exclusively for regulated fruit that is eligible for interstate movement. The boxes or other containers in which the fruit is packaged must be clearly marked with the statement ''Limited Permit: USDA–APHIS–PPQ. Not for distribution in AZ, CA, HI, LA, TX, and American Samoa, Guam, Northern Mariana Islands, Puerto Rico, and Virgin Islands of the United States.'' Only fruit that meets all of the requirements of this section may be packed in boxes or other containers that are marked with this statement.

* * * * *

4. In § 301.75–11, paragraph (a), the introductory text would be amended by adding the words ''at least'' after the words ''treated in'' and a new paragraph (a)(4) would be added to read as follows:

§ 301.75–11 Treatments.

(a) * * *

(4) *Peroxyacetic acid.* The regulated fruit must be thoroughly wetted for at least 1 minute with a solution containing 85 parts per million peroxyacetic acid.

* * * * *

Done in Washington, DC, this 18th day of June 2007.

J. Burton Eller,

Acting Under Secretary for Marketing and Regulatory Programs.

[FR Doc. E7–12041 Filed 6–20–07; 8:45 am]

BILLING CODE 3410–34–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 revisions to our risk-based capital rules to more closely align minimum capital requirements with risks taken by Farm Credit System (FCS or System) institutions. We are seeking comments to facilitate the development of a proposed rule that would increase the risk sensitivity of the regulatory capital framework without unduly increasing regulatory burden. This ANPRM addresses possible modifications to our risk-based capital rules that are similar to the recent proposals of the other Federal financial regulatory agencies. We are also seeking comments on other aspects of our regulatory capital framework.

DATES: You may send comments on or before November 19, 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:* 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 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;
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 other federally regulated banking organizations;[1] and
4. Foster economic growth in agriculture and rural America through the effective allocation of System capital.

II. Background

The FCA's risk-based capital framework is based, in part, on the

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

''International Convergence of Capital Measurement and Capital Standards'' (Basel I) as published by the Basel Committee on Banking Supervision (Basel Committee)[2] and is broadly consistent with the capital requirements of the other Federal financial regulatory agencies.[3] We first adopted a risk-based capital framework for the System as part of our 1988 regulatory capital revisions[4] required by the Agricultural Credit Act of 1987[5] and made subsequent revisions in 1997,[6] 1998[7] and 2005.[8] 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. Our minimum regulatory capital requirements are contained in subparts H and K of part 615 of our regulations.[9]

The financial services industry has changed significantly since we adopted the Basel I-based capital framework for the System. Financial markets have become increasingly global and interconnected. Deregulation and consolidation have created larger, more complex financial institutions. Technological innovation has enabled such institutions to create increasingly sophisticated and complex financial products and services. Risk management and measurement techniques have also vastly improved. Financial regulators and industry participants agree that Basel I is no longer the best regulatory capital framework for many of the larger, more complex financial institutions and should be modernized to better reflect recent developments in banking and capital market practices.

For a number of years, the Basel Committee has worked to develop a new accord to incorporate the recent advancements 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.[10] In September 2006, the other Federal financial regulatory agencies issued an interagency notice of proposed rulemaking for implementing Basel II in the United States (U.S. Basel II).[11] U.S. Basel II would require core banks[12] and permit opt-in banks[13] (collectively referred to as Basel II banking organizations) to implement the new framework using the advanced internal ratings-based approach[14] to calculate the regulatory capital requirement for credit risk and the advanced measurement approach[15] to calculate the regulatory capital requirement for operational risk.[16]

Given the complexity and cost associated with adopting the advanced approaches, most U.S. banking organizations (collectively referred to as non-Basel II banking organizations) will not be required to implement, or choose to implement, U.S. Basel II. As a result, a bifurcated regulatory capital framework would be created in the United States, which could result in different regulatory capital charges for similar products offered by Basel II and non-Basel II banking organizations. Financial regulators, banking organizations, trade associations and other interested parties have raised concerns that the bifurcated structure could create a competitive disadvantage for non-Basel II banking organizations.

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 for non-Basel II banking organizations.[17] Basel IA is intended to help minimize the potential differences in the regulatory minimum capital requirements of Basel II and non-Basel II banking organizations. The proposal would allow non-Basel II banking organizations the option of adopting all the revisions of Basel IA or continuing to use the existing Basel I-based capital framework.[18] Proposed Basel IA would: (1) Increase the number of risk-weight categories to which credit exposures may be assigned; (2) expand the use of external credit ratings to risk weight certain exposures; (3) expand the range of recognized collateral and eligible guarantors; (4) employ loan-to-value ratios to determine the risk weight of most residential mortgages; (5) increase the credit conversion factor for some commitments with an original maturity of 1 year or less; (6) assess a risk-based capital charge for early amortizations in securitizations of revolving exposures; and (7) remove the 50-percent limit on the risk weight for certain derivative transactions.[19]

FCA's objective is to develop a proposed rule that better reflects recent advances in banking and capital market practices, minimizes potential competitive distortions that could result from a bifurcated regulatory capital framework in the United States, and more closely aligns our minimum capital requirements with the relative risk factors inherent in the System. We are considering whether we should modify our risk-based capital rules so that they are consistent with Basel IA where appropriate. However, we are also considering how the modifications should be tailored to fit the System's distinct borrower-owned lending cooperative structure and Government-sponsored enterprise (GSE) mission.[20]

[2] 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.*

[3] 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.''

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

[5] 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.

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

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

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

[9] 12 CFR part 615, subparts H and K.

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

[11] *See* 71 FR 55830 (September 25, 2006). This document is at *http://www.federalreserve.gov/generalinfo/base12/USImplementation.htm.*

[12] 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.

[13] 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.

[14] 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.

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

[16] The proposed rule seeks comments on whether Basel II banking organizations should be permitted to use other credit and operational risk approaches.

[17] 71 FR 77446 (December 26, 2006). This document is at *http://www.federalreserve.gov/generalinfo/basel2/USImplementation.htm.*

[18] A banking organization that chooses to adopt Basel IA can return to the Basel I-based capital framework, provided the change is approved by its primary Federal regulator and is not for the purpose of capital arbitrage. The other Federal financial regulatory agencies have stated that they do not expect banking organizations to alternate between the Basel I and Basel IA risk-based capital rules.

[19] Neither the U.S. Basel II nor the Basel IA proposed rules would affect the existing leverage ratio or prompt corrective action standards.

[20] 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,

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 and Basel IA 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. The System is a specialized lender to agriculture and rural America with a unique structure and risk profile. One of our objectives is to create 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 and recommendations with data, to the extent possible, in response to our questions.[21]

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.[22] Basel IA proposes to add three new risk-weight categories to allow for greater differentiation of credit risk and solicits comment on whether a 10-percent risk-weight category would be appropriate for very low risk assets. The proposed risk-weight categories are 35, 75, and 150 percent. The 35 and 75 percent risk-weight categories would provide the opportunity to increase the risk sensitivity for those exposures that are currently assigned a higher risk-based capital charge than may be warranted. The 150-percent risk-weight category would provide a more appropriate risk-based capital charge for higher risk exposures than is currently permitted under our existing capital rules.

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 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.[23] For example, in March 2003, we adopted an interim final rule that permitted System institutions to use NRSRO ratings to risk-weight highly rated investments in non-agency asset-backed securities (ABS) and mortgage-backed securities (MBS) to the 20-percent risk-weight category.[24] In April 2004, we expanded the use of NRSRO ratings to assign risk weights to loans to other financing institutions.[25] 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.[26] Furthermore, we recently permitted the use of NRSRO ratings to assign risk weights to certain electric cooperative credit exposures.[27]

Basel IA proposes to expand the use of NRSRO ratings to determine the risk-based capital charge for exposures to sovereign entities,[28] non-sovereign entities,[29] and securitizations, as displayed in Table 1 (long-term exposures) and Table 2 (short-term exposures) set forth below. External ratings for direct exposures to sovereign entities would be based on the external rating of the exposure or the sovereign entity's issuer rating if the exposure is unrated. Direct exposures to non-sovereign entities and securitizations would be based only on the external rating of the exposure.

TABLE 1.—BASEL IA PROPOSED RISK WEIGHTS BASED ON EXTERNAL RATINGS FOR LONG-TERM EXPOSURES[30]

Long-term rating category	Example	Sovereign risk weight (in percent)	Non-sovereign risk weight (in percent)	Securitization exposure* risk weight (in percent)
Highest investment grade rating	AAA	0	20	20
Second highest investment grade rating	AA	20	20	20
Third highest investment grade rating	A	20	35	35
Lowest investment grade rating-plus	BBB+	35	50	50
Lowest investment grade rating	BBB	50	75	75
Lowest investment grade rating-minus	BBB−	75	100	100
One category below investment grade	BB+, BB	75	150	200
One category below investment grade-minus	BB−	100	200	200
Two or more categories below investment grade	B, CCC	150	200	(*)

rural housing, certain farm-related businesses, agricultural and aquatic cooperatives, rural utilities, and foreign and domestic entities in connection with international agricultural trade.

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

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

[23] An 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.

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

[25] Other financing institutions are non-System financial institutions that borrow from System banks. *See* 69 FR 29852 (May 26, 2004).)

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

[27] *See* ''Revised Regulatory Capital Treatment for Certain Electric Cooperatives Assets,'' FCA Bookletter BL–053 (February 12, 2007).

[28] A sovereign entity is defined as a central government, including its agencies, departments, ministries, and the central bank. A sovereign entity does not include state, provincial, or local governments, or commercial enterprises owned by a central government.

[29] Non-sovereign entities include securities firms, insurance companies, bank holding companies, savings and loan holding companies, multilateral lending and regional development institutions, partnerships, limited liability companies, business trusts, special purpose entities, associations and other similar organizations.

[30] 71 FR 77452 (December 26, 2006).

TABLE 1.—BASEL IA PROPOSED RISK WEIGHTS BASED ON EXTERNAL RATINGS FOR LONG-TERM EXPOSURES[30]—Continued

Long-term rating category	Example	Sovereign risk weight (in percent)	Non-sovereign risk weight (in percent)	Securitization exposure* risk weight (in percent)
Unrated**	n/a	200	200	(*)

* A securitization exposure includes ABS and MBS, recourse obligations, DCS, and residuals (other than a credit-enhancing interest-only strip). For long-term securitization exposures that are externally rated more than one category below investment grade, short-term exposures that are rated below investment grade, or any unrated securitization exposures, the existing risk-based capital treatment as described in the agencies' recourse rule would be used.

** Unrated sovereign exposures and unrated debt securities issued by non-sovereigns would receive the risk weight indicated in Tables 1 and 2. Other unrated exposures, for example, unrated loans to non-sovereigns, would continue to be risk weighted under the existing risk-based capital rules.

TABLE 2.—BASEL IA PROPOSED RISK WEIGHTS BASED ON EXTERNAL RATINGS FOR SHORT-TERM EXPOSURES [31]

Short-term rating category	Example	Sovereign risk weight (in percent)	Non-sovereign risk weight (in percent)	Securitization exposure* risk weight (in percent)
Highest investment grade rating	A–1, P–1	0	20	20
Second-highest investment grade rating	A–2, P–2	20	35	35
Lowest investment grade	A–3, P–3	50	75	75
Unrated**	n/a	100	100	*

* A securitization exposure includes ABS and MBS, recourse obligations, DCS, and residuals (other than a credit-enhancing interest-only strip). For long-term securitization exposures that are externally rated more than one category below investment grade, short-term exposures that are rated below investment grade, or any unrated securitization exposures, the existing risk-based capital treatment as described in the agencies' recourse rule would be used.

** Unrated sovereign exposures and unrated debt securities issued by non-sovereigns would receive the risk weight indicated in Tables 1 and 2. Other unrated exposures, for example, unrated loans to non-sovereigns, would continue to be risk-weighted under the existing risk-based capital rules.

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?

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 banking industry has suggested that regulators recognize a wider variety of collateral types for the purpose of reducing risk-based capital requirements. In response, the other Federal financial regulatory agencies have proposed to expand the types of eligible collateral for risk-weighting purposes. Basel IA assigns lower risk weights to exposures collateralized by: (1) Securities issued or guaranteed by sovereigns that are externally rated at least investment grade by an NRSRO (*e.g.*, BBB- or Baa3) or the sovereign entity's issuer rating if the security is not rated; or (2) securities issued by non-sovereign entities that are externally rated at least investment grade by an NRSRO (*e.g.*, BBB or Baa2). The collateralized portion of the exposure would be assigned a risk weight (as listed in Table 1 and Table 2) according to the external rating of the collateral. The uncollateralized portion of the exposure would be assigned a risk weight according to the external rating of the exposure (or a sovereign entity's issuer rating where applicable).

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.

[31] 71 FR 77452 (December 26, 2006).

[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 *http://www.oecdwash.org.*

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.

Basel IA proposes to include guarantees from any entity that has long-term senior debt (without credit enhancements) rated at least investment grade by an NRSRO or, if the entity is a sovereign, an issuer rating that is at least investment grade (*e.g.*, BBB- or Baa3 for sovereigns and BBB or Baa2 for non-sovereigns).[36] The guaranteed portion of the exposure would be assigned a risk weight (as detailed in Table 1) according to the NRSRO rating of the eligible guarantor's long-term senior debt or, if the guarantor is a sovereign and its long-term debt is not rated, then the exposure would be assigned a risk weight according to the NRSRO rating of the sovereign. Non-guaranteed portions of the exposure would be assigned to the external rating of the exposure (or a sovereign entity's issuer rating where applicable).

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.[37] The 20-percent risk weight is intended to recognize the risks to the banks associated with lending to their affiliated associations. The other Federal financial regulatory agencies also assign a 20-percent risk weight to similar GSE and OECD depository institution exposures.[38] 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 might 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 other Federal financial regulatory agencies are exploring options to permit small business loans to qualify for a 75-percent risk weight.[39] They are also considering criteria for short-term loans that do not amortize, such as working capital loans and other revolving lines of credit.[40]

Question 6: We seek comment on what approaches we might use to improve the risk sensitivity of our risk-based capital rules for small agricultural and rural business loans. More specifically, what qualifying criteria might we use to assign small agricultural and rural business loans to risk-weight categories of less than 100 percent?

E. Loans Secured by Liens on Real Estate

1. First-Lien Loans

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. Basel IA proposes to risk weight first-lien residential mortgages, including mortgages held for sale and mortgages held in portfolio, based on LTV as outlined in Table 3 (farm real estate loans are not included in this table).[42] Basel IA proposes to include the risk-mitigating effects of loan-level private mortgage insurance in the calculation of LTV, provided the loan-level insurer is not affiliated with the banking organization and has long-term senior debt (without credit enhancement) externally rated at least the third highest investment grade by an NRSRO (*e.g.*, AA or Aa2).

TABLE 3.—BASEL IA PROPOSED LTV AND RISK WEIGHTS FOR 1–4 FAMILY FIRST LIENS[43]

Loan-to-value ratio (in percent)	Risk weight (in percent)
60 or less	20
Greater than 60 and less than or equal to 80	35

[36] *See* 71 FR 77453 (December 26, 2006). A recognized third party guarantee would have to: (1) Be written and unconditional, and if the third party is a sovereign, be backed by the full faith and credit of the sovereign; (2) cover all or a pro rata portion of contractual payments of the obligor on the reference exposure; (3) give the beneficiary a direct claim against the protection provider; (4) be non-cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary; (5) be legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced; and (6) require the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligor on the reference exposure without first requiring the beneficiary to demand payment from the obligor.

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

[38] Basel IA would retain the 20-percent risk weight for these types of exposures. *See* 71 FR 77451 and 77454 (December 26, 2006).

[39] *See* 71 FR 77462–77463 (December 26, 2006). The agencies suggest the following criteria for qualifying loans: (1) Total credit exposure to the business must not exceed $1 million; (2) loan(s) must be personally guaranteed by the owner(s) of the business and fully collateralized by the assets of the business; (3) loan(s) must be prudently underwritten, performing, and fully amortize within 7 years; (4) businesses must maintain a minimum debt service coverage ratio of 1.3; (5) loan(s) must not have been restructured; and (6) proceeds are not to be used to service any other outstanding loan obligation.

[40] For example, loans or draws from a revolving line of credit that mature in 18 months could forgo the amortization requirement provided the loan is to be repaid from anticipated proceeds of previously established financial transactions and the proceeds are pledged for the repayment of the loan.

[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] *See* 71 FR 77456 (December 26, 2006). Basel IA proposes to require institutions to calculate LTV at origination using the lower of the purchase price of the property or the value at origination in conformance with appraisal regulations and real estate lending guidelines. LTV would be updated quarterly to reflect any decrease in the principal balance, or if a negative amortization loan, an increase in the principal balance. Property values are updated only if a mortgage is refinanced and the banking organization extends additional funds.

[43] *See* 71 FR 77455 (December 26, 2006).

TABLE 3.—BASEL IA PROPOSED LTV AND RISK WEIGHTS FOR 1–4 FAMILY FIRST LIENS[43]—Continued

Loan-to-value ratio (in percent)	Risk weight (in percent)
Greater than 80 and less than or equal to 85	50
Greater than 85 and less than or equal to 90	75
Greater than 90 and less than or equal to 95	100
Greater than 95	150

The other Federal financial regulatory agencies are also evaluating approaches that would consider borrower creditworthiness in conjunction with LTV to determine the appropriate risk weight for first-lien mortgages.[44] Borrowers would be grouped by credit history using default odds obtained from credit reporting agencies' validation charts. A banking organization would determine a borrower's default odds by mapping the borrower's credit score to the credit reporting agencies' validation charts.

Question 7: We seek comment on all aspects of using LTV to determine the risk-based capital charge for farm real estate and qualified residential loans. Specifically, we ask that you address farm real estate and qualified residential loans separately when answering the following questions:

- *How might we determine the value* (*e.g.*, the denominator of the LTV) of the real estate at origination?
- *How should PMI or guarantees be treated in the calculation of LTV?*
- *How should LTV be adjusted over time?*
- *How should LTV be mapped to risk-weight categories?*
- *How might loan characteristics such as loan size, availability of credit scores, and payment frequency be used in conjunction with LTV?*
- *How might borrower creditworthiness be used in conjunction with LTV and how might they be mapped to risk-weight categories?*

2. Junior-Lien Loans

Our existing regulations permit System institutions to make short- and intermediate-term loans secured by a junior lien on a property as long as the System institution also holds the first lien on the property. Further, System institutions can make loans secured by stand-alone junior liens, provided the financing is used exclusively for repairs, remodeling, or other improvements to qualified rural homes.[45] Loans secured by junior liens are risk-weighted at 50 percent if the institution holds a first lien on a mortgage that is classified as a qualified residential loan. All other loans secured by junior liens are risk-weighted at 100 percent.

Basel IA proposes to risk-weight junior-lien mortgages based on a combined LTV.[46] For example, if a banking organization holds a first lien on a property, then the junior lien loan would be added to the first lien to determine the combined LTV and assigned the appropriate risk weight as outlined in Table 3.[47] For stand-alone junior liens, the banking organization would follow the same procedures, except the junior-lien loan would be combined with all senior-lien loans (all principal amounts outstanding would be aggregated) to determine the LTV and assigned the appropriate risk weight as outlined in Table 4.

TABLE 4.—BASEL IA PROPOSED LTV AND RISK WEIGHTS FOR 1–4 FAMILY JUNIOR LIENS[48]

Loan-to-value ratio (in percent)	Risk weight (in percent)
60 or less	75
Greater than 60 and less than or equal to 90	100
Greater than 90	150

Question 8: We seek comment on all aspects of using combined LTV to risk-weight junior-lien loans. Specifically, how should combined LTV be calculated at origination and adjusted over time? How should the combined LTVs be used to assign stand-alone junior-lien loans to risk-weight categories?

F. 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)[49] 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.[50] Basel IA proposes to retain the zero-percent CCF for commitments that are unconditionally cancelable[51] but assign a 10-percent CCF to all other short-term commitments. Further, Basel IA seeks comment on alternative approaches that would apply a single CCF of 20 percent to all short- and long-term commitments that are not unconditionally cancelable.

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

G. Adjusting Risk Weights on Exposures Over Time

The FCA welcomes comment on additional approaches or criteria (other than NRSRO credit ratings and LTVs addressed in previous sections) 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 allowing 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 might use to adjust the risk weight of credit exposures as the asset quality or default probability changes over time.

H. 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 intended to implicitly cover operational and other types of risks. As we move to a more risk-sensitive capital framework, it may be more appropriate to apply an explicit capital charge for operational risk, especially to cover risks associated with

[44] *See* 71 FR 77456 (December 26, 2006).

[45] *See* 12 CFR 614.4200(b)(4).

[46] *See* 71 FR 77458–77459 (December 26, 2006).

[47] The steps for determining the risk-adjusted value of the unfunded portion of a junior-lien loan (*e.g.*, a line of credit) would be as follows: (1) The unfunded commitment is multiplied by the appropriate credit conversion factor to determine the on-balance sheet credit equivalent; (2) the on-balance sheet credit equivalent is added to the first lien and the funded portion of the junior-lien loan to determine the combined LTV; and (3) the combined LTV is assigned the appropriate risk weight as outlined in Table 3. The unfunded commitment would be adjusted accordingly as the borrower utilizes the junior-lien loan.

[48] *See* 71 FR 77459 (December 26, 2006).

[49] 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.

[50] 50 Our existing regulations assign a zero-percent CCF to unused commitments with an original maturity of 14 months or less. Unused commitments with an original maturity of greater that 14 months can also receive a zero-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.

off-balance sheet activity. Basel IA is designed to implicitly cover risks other than credit risk, and therefore, does not propose an explicit capital charge for operational risk.

Question 11: We seek comment on whether we should consider a risk-based capital charge for operational risk.

I. 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) [52] of 103 percent [53] 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).[54] 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. Neither the U.S. Basel II nor the Basel IA proposed rules would affect the existing leverage ratio.

Question 12: 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.

J. Regulatory Capital Directives [55]

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 [56] 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. 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 13: 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.

K. 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.

The other Federal financial regulatory agencies are proposing more than one set of capital rules for the financial institutions they regulate. For example, implementation of U.S. Basel II would be limited, for the most part, to the largest, internationally active banks that meet certain infrastructure requirements. Basel IA would permit non-Basel II banking organizations the option of applying the revised Basel IA-based capital framework or remaining subject to the existing Basel I-based capital framework.[57] Consequently, a trifurcated regulatory capital framework would be created in the United States.

While our expectation is to implement a revised capital framework similar to Basel IA, we also recognize that some aspects of Basel II may be appropriate for the larger, more complex System institutions. However, we are still reviewing Basel II and its potential application to the System. Therefore, we are not seeking comments on Basel II 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 such as the Basel II and Basel IA proposed rules and recent best practices for economic capital modeling.

Question 14: 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?

Question 15: Additionally, we seek comment on any other methods that may be used to increase the risk sensitivity of our risk-based capital rules.

Dated: June 15, 2007.

Roland E. Smith,

Secretary, Farm Credit Administration Board.

[FR Doc. E7–11990 Filed 6–20–07; 8:45 am]

BILLING CODE 6705–01–P

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

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

[53] *See* 12 CFR 615.5335(a).

[54] *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.

[55] 12 CFR part 615, subpart M.

[56] A capital directive is defined in § 615.5355(a) 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)).

[57] A banking organization that chooses to apply Basel IA must do so in its entirety. However, a banking organization has the option of risk weighting existing mortgage loans using the existing Basel I-based capital rules. This option would apply only to those mortgage loans that the banking organization owned at the time it chose to apply Basel IA.