Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FARM CREDIT ADMINISTRATION

12 CFR Parts 620, 621, 650, 651, 652, 653, 654, and 655

RIN 3052–AC18

Disclosure to Shareholders; Accounting and Reporting Requirements; Federal Agricultural Mortgage Corporation General Provisions; Federal Agricultural Mortgage Corporation Governance; Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Federal Agricultural Mortgage Corporation Disclosure and Reporting Requirements

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, our, or we) proposes regulations governing the Federal Agricultural Mortgage Corporation (Farmer Mac or the Corporation) in the areas of non-program investments and liquidity. We are proposing the regulations to ensure that Farmer Mac holds only high-quality, liquid investments to maintain a sufficient liquidity reserve, invest surplus funds, and manage interest-rate risk, while not holding excessive amounts of non-program investments considering Farmer Mac's status as a Government-sponsored enterprise.

DATES: Please send comments to the FCA by September 13, 2004.

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 Governmentwide *www.regulations.gov* portal. You may also send comments to Thomas G. McKenzie, Director, Office of Secondary Market Oversight, 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 in our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT: Thomas G. McKenzie, Director, Office of Secondary Market Oversight, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4280; TTY (703) 883–4434; or Jennifer A. Cohn, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4020, TTY (703) 883–2020.

SUPPLEMENTARY INFORMATION:

I. Objectives

The primary objectives of our proposal are to ensure the safety and soundness and continuity of Farmer Mac operations by:

- Establishing minimum liquidity standards that would require Farmer Mac to hold sufficient high-quality, marketable investments to provide adequate liquidity to fund maturing obligations and operational expenses for a minimum of 60 days;
- Specifying the type, quality, and maximum amount (or limit) of non-program investments [1] that may be held by Farmer Mac;
- Establishing diversification requirements, including portfolio limits on specific types of investments and counterparty exposure limits; and
- Requiring Farmer Mac's board of directors to approve liquidity and non-program investment management policies and implement appropriate internal controls to oversee the investment and liquidity management of the Corporation.

Another objective of this proposal is to better organize current regulatory sections pertaining to Farmer Mac, details of which are discussed in section XIV. below.

II. Background

Congress established Farmer Mac in 1988 as part of its effort to resolve the agricultural crisis of the 1980s. Congress expected that a secondary market for agricultural and rural housing mortgages would increase competitively priced mortgage credit to America's farmers, ranchers, and rural homeowners.

As originally structured, market demand for Farmer Mac services was low and the Corporation's ability to thrive and develop an active secondary market for long-term agricultural real estate loans was challenged. In 1996, statutory changes [2] by Congress made Farmer Mac's programs more attractive, but Farmer Mac still had difficulty in building and maintaining recognition in the secondary market. In early 1997, Farmer Mac adopted a new ''debt issuance strategy'' and consequently built its non-program investment portfolio to relatively high levels when compared to program assets. Farmer Mac's rationale for its debt issuance strategy was to increase its presence in the capital markets to attract more investors to its debt and mortgage-backed securities and reduce its borrowing and securitization costs.

Farmer Mac now has about $4.4 billion in assets, which includes about $1.7 billion in non-program investments. Also, Farmer Mac has over $4.0 billion in liabilities. (For comparison, 5 years ago liabilities totaled $1.6 billion, and 10 years ago liabilities totaled $452 million.) In addition to on-balance assets and liabilities, Farmer Mac now has in excess of $3.3 billion in off-balance sheet obligations associated with Long-Term Standby Purchase Commitments (LTSPC)[3] and Farmer Mac Guaranteed Securities (FMGS).[4]

[1] Pursuant to title VIII of the Farm Credit Act of 1971, as amended (Act), Farmer Mac issues debt in order to buy (invest in) ''program'' assets under the Corporation's core programs known as the Farmer Mac I Program and the Farmer Mac II Program. Under these programs, Farmer Mac purchases, or commits to purchase, ''qualified loans,'' as that term is defined in section 8.0(9) of the Act. Generally, ''qualified loans'' consist of loans on agricultural real estate or portions of loans guaranteed by the United States Department of Agriculture. Under section 8.0(1) of the Act, ''agricultural real estate'' includes both land used to produce agricultural commodities or products and single family, moderately-priced principal residential dwellings located in rural areas. In this preamble, we refer to loans made on this latter type of real estate as ''rural housing mortgages.'' We propose to define investments other than those in (1) ''qualified loans,'' or (2) securities collateralized by ''qualified loans'' as ''non-program'' investments.

[2] The Farm Credit System Reform Act of 1996 (Pub. L. 104–105) amendments authorized Farmer Mac to purchase agricultural real estate and rural housing mortgages directly, as a pooler, and to guarantee securities backed by those loans without a 10-percent ''subordinated interest'' or provision for private sector assumption of first losses.

[3] An LTSPC is a commitment by Farmer Mac to purchase specified eligible loans on one or more undetermined future dates. In consideration for Farmer Mac's assumption of the credit risk on the specified loans underlying an LTSPC, Farmer Mac receives an annual commitment fee on the outstanding balance of those loans in monthly installments based on the outstanding balance of those loans.

[4] Periodically, Farmer Mac transfers agricultural mortgage loans into trusts that are used as vehicles

Continued

We are proposing these regulations because, as Farmer Mac continues to grow, its exposure to various business risks, including liquidity risk, also can be anticipated to grow. In addition, excessive or inappropriate use of non-program investments is not consistent with the Corporation's status as a Government-sponsored enterprise (GSE). This proposal balances safety and soundness concerns with the program focus of the Corporation.

These proposed regulations do not address Farmer Mac's program investments. We will continue to monitor those investments for safety and soundness and other purposes through our examination, and off-site monitoring activities, of the Corporation.

III. Arrangement of This Proposal

The following preamble material is a section-by-section analysis of the subsequent proposed rule text. This arrangement allows FCA to provide additional details or rationale for our proposal. Also, in section XIV., we discuss how we propose to better organize our rules pertaining to Farmer Mac.

IV. Section 652.1—Purpose

This proposed section provides the user with a basic understanding of the contents and purpose of this subpart. We state that the purpose of this subpart is to ensure safety and soundness, continuity of funding, and appropriate use of non-program investments considering Farmer Mac's status as a GSE. It also highlights responsibilities of Farmer Mac's board of directors and management.

V. Section 652.5—Definitions

This proposed section alphabetically lists words or phrases that are applicable to this subpart and will help the user more fully understand the subpart and our requirements. Most of the definitions are self explanatory, but one definition will benefit from explanation. The proposed definition of ''Government-sponsored agency'' includes Government-sponsored enterprises such as Fannie Mae and Farmer Mac, as well as Federal agencies, such as the Tennessee Valley Authority, that issue obligations that are not explicitly guaranteed by the Government of the United States' full faith and credit.

VI. Section 652.10—Investment Management and Requirements

Farmer Mac, like any financial institution, must establish and follow certain fundamental practices to effectively manage risks in its investment portfolio. An effective risk management process for investments requires financial institutions to establish: (1) Policies; (2) risk limits; (3) a mechanism for identifying, measuring, and reporting risk exposures; and (4) a strong system of internal controls. Accordingly, proposed § 652.10 requires Farmer Mac's board of directors to adopt written policies that establish risk limits and guide the decisions of investment managers. More specifically, board policies must establish objective criteria so investment managers can prudently manage credit, market, liquidity, and operational risks. Additionally, proposed § 652.10 establishes other controls that are consistent with sound business practices, such as:

(1) Clear delegation of responsibilities and authorities to investment managers;

(2) Separation of duties;

(3) Timely and effective security valuation practices; and

(4) Routine reports on investment performance.

A. Responsibilities of the Board of Directors

Proposed § 652.10(a) outlines the basic responsibilities of the board of directors regarding Farmer Mac's non-program investment activities. The proposed rule requires the board to adopt written policies for managing those activities. The board must also ensure that management complies with the written policies and that appropriate internal controls are in place to prevent loss. The board, or a designated subcommittee of the board, must review the Corporation's investment policies at least annually. Any changes to the policies must be adopted by the board of directors and reported to FCA within 10 days of adoption.

B. Investment Policies

Proposed § 652.10(b) requires Farmer Mac's investment policies to address the purposes and objectives of investments, risk tolerance, delegations of authority, exception parameters, securities valuation, internal controls, and reporting requirements. Furthermore, the policies must address the means for reporting, and approvals needed for, exceptions to established policies. A general explanation of the board's investment objectives, expectations, and performance goals is necessary to guide investment managers. The proposed rule further requires that the investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of Farmer Mac's investments.

C. Risk Tolerance

Proposed § 652.10(c) requires Farmer Mac's board of directors to establish within its investment policies risk limits and diversification requirements for the various classes of eligible investments and for the entire investment portfolio. The policies must ensure that Farmer Mac maintains prudent diversification of its investment portfolio. Risk limits must be based on Farmer Mac's objectives, capital position, and risk tolerance capabilities. Risk tolerance can be expressed through several parameters such as duration, convexity, sector distribution, yield curve distribution, credit quality, risk-adjusted return, portfolio size, total return volatility, or value-at-risk.[5] Farmer Mac should use a combination of parameters to appropriately limit its exposure to credit and market risk. Farmer Mac's policies must identify the types and quantity of investments that the Corporation will hold to achieve its objectives and control credit, market, liquidity, and operational risks. Farmer Mac must establish risk limits for those four types of risk.

1. Credit Risk

Credit risk generally refers to the risk that an issuer, obligor, or other counterparty will default on its obligation to pay the investor under the terms of the security or instrument. Farmer Mac's investment policies must establish standards for addressing credit risk.

Credit risk is based on, among other factors, the ability of counterparties to honor their obligations and commitments. Farmer Mac should consider appropriate credit risk limits after fully considering its position with regard to a well-diversified investment portfolio. Accordingly, proposed § 652.10(c)(1)(i) requires Farmer Mac's

for the securitization of the transferred assets and the beneficial interests in the trusts are sold to third-party investors as FMGS. Farmer Mac guarantees the timely payment of principal and interest on the certificates issued by the trusts, regardless of whether the trusts actually receive scheduled payments on the related underlying loans. As consideration for Farmer Mac's assumption of the credit risk on these mortgage pass-through certificates, Farmer Mac receives an annual guarantee fee that is based upon the outstanding balance of the FMGS.

[5] Generically, duration is a measure of a bond's or portfolio's price sensitivity to a change in interest rates. Convexity measures the rate of change in duration with respect to a change in interest rates. A sector refers to a broad class of investments with similar characteristics or industry classification. Yield curve distribution refers to the distribution of the portfolio's investments in short-, intermediate-, or long-term investments. Value-at-risk is a methodology used to measure market risk in an investment portfolio.

investment policies to establish credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations based on a single or related counterparty(ies), a geographical area, industries, or obligations with similar characteristics.

The selection of dealers, brokers, and investment bankers (collectively, securities firms) is an important aspect of effective management of counterparty credit risk. Proposed § 652.10(c)(1)(ii) requires Farmer Mac's investment policies to establish criteria for selecting securities firms. A satisfactory approval process includes a review of each firm's financial statements and an evaluation of its ability to honor its commitments, including an inquiry into the general reputation of the securities firm. Farmer Mac should also review information from Federal or state securities regulators and industry self-regulatory organizations, such as the National Association of Securities Dealers, concerning any formal enforcement actions against the security firm, its affiliates, or associated personnel.

In addition, to further diversify Farmer Mac's exposure to credit risk, the proposed rule requires Farmer Mac to buy and sell eligible investments with more than one securities firm. Moreover, the proposed rule requires the board of directors or a designated subcommittee of the board, as part of its annual review of its investment policies, to review the criteria for selecting securities firms and determine whether to continue Farmer Mac's existing relationships with them. Any changes to the criteria or securities firms must be approved by the board of directors.

Proposed § 652.10(c)(1)(iii) requires Farmer Mac to establish appropriate collateral margin requirements on repurchase agreements.[6] The FCA is proposing this requirement because it is prudent, as a means of managing potential counterparty credit risk, for Farmer Mac to establish appropriate collateral margin requirements based on the quality of the collateral and the terms of the agreement. Farmer Mac must also manage its exposure to loss on repurchase agreements by regularly marking the collateral to market and ensuring appropriate controls are maintained over collateral held.

2. Market Risk

Market risk is the risk to a financial institution's financial condition resulting from adverse changes in the value of its holdings arising from movements in interest rates or prices. From a safety and soundness perspective, it is crucial for a financial institution's board and management to fully understand the market risks associated with investment securities prior to acquisition and on an ongoing basis. The most significant market risk of investment activities is interest rate risk. Proposed § 652.10(c)(2) would require Farmer Mac's board to set market risk limits for specific types of investments, and for the investment portfolio or for Farmer Mac generally.

To manage market risk exposure, this proposal would require Farmer Mac to evaluate how individual instruments and the investment portfolio as a whole affect the Corporation's overall interest rate risk profile. We also expect that Farmer Mac would timely monitor the price sensitivity of its investment portfolio and specify Corporation-wide interest rate risk limits.

In addition, we believe prudently managed financial institutions should establish interest rate risk limits on their investment portfolios and on certain types of securities. Accordingly, risk parameters should be commensurate with Farmer Mac's ability to measure, manage, and absorb risk. The board should consider Farmer Mac's level of capital and earnings and its tolerance for market risk exposure when setting risk parameters. Farmer Mac must document in its records or minutes any analyses used in formulating its policy or amendments to the policy. Market risk limits should be established in a manner that is consistent with all relevant regulations, policies, and guidance issued by the FCA.

3. Liquidity Risk

Liquidity risk may exist at both the investment and the institutional level. At the investment level, liquidity risk is the risk that Farmer Mac would not be able to sell or liquidate an investment quickly at a fair price. This inability may be due to inadequate market depth or market disruption.

At the institutional level, liquidity risk is the risk that Farmer Mac could encounter a liquidity crisis if it is unable to fund operations at reasonable rates because access to the capital markets is impeded. This impediment may result from a market disruption or real or perceived credit, operational, public policy, or business problems.

FCA expects Farmer Mac to manage liquidity risk at both the investment and the institutional levels. Accordingly, proposed § 652.10(c)(3) requires Farmer Mac's investment policies to describe the liquidity characteristics of eligible investments that it will hold to meet its liquidity needs and institutional objectives. Farmer Mac's investment policies must also require the Corporation to maintain sufficient quantities of liquid investments to comply with the liquidity reserve requirements of § 652.20.

Pursuant to § 652.25, the amount of Farmer Mac's non-program investments is subject to certain limitations so that its GSE status and preferred market access privileges are not abused through excessive amounts of non-program investments. FCA expects Farmer Mac's policies to strike an appropriate balance among the need for a liquidity reserve, the management of interest rate risk, and the investment of surplus funds as it strives to accomplish its institutional objectives and its public purpose as a GSE.

4. Operational Risk

Operational risk occurs when deficiencies in internal controls or information systems result in unexpected loss to a financial institution. Operational risk may arise from inadequate procedures, human error, information system failure, or fraud. Internal controls that effectively detect and prevent operating risks are an integral part of prudent investment management. The ability of management to accurately assess and control operating risks is frequently one of the greatest challenges that a financial institution faces with regard to investment activities. Therefore, proposed § 652.10(c)(4) would require Farmer Mac's investment policies to address operating risks, including delegations of authority and internal controls, in accordance with paragraphs (d) and (e) of § 652.10.

Farmer Mac also may be exposed to other sources of operating risks, such as legal risk that may result from contracts that are not legally enforceable. FCA expects Farmer Mac to adequately assess, control, and minimize operating risks relating to investment activities. Accordingly, we expect Farmer Mac to clearly define documentation requirements for securities transactions, retention and safekeeping of documents, and possession and control of purchased investment instruments.

[6] In general, whether a given agreement is termed a "repurchase agreement" or a "reverse repurchase agreement" depends largely on which party initiated the transaction. Market participants typically view the transaction from the dealer's perspective. In this preamble and the proposed regulation, the FCA uses the term "repurchase agreement" regardless of the perspective from which the transaction is viewed.

D. Delegation of Authority

Prudent management of investment activities requires an organizational structure that clearly delineates responsibility and accountability for all investment management functions, including risk measurement, and oversight. Accordingly, proposed § 652.10(d) specifically provides that all delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments. Farmer Mac should periodically review the Corporation's organizational structure to reveal conflicts of interest or inadequate checks and balances.

E. Internal Controls

Proposed § 652.10(e) sets forth internal control requirements for investment management of Farmer Mac. Proposed § 652.10(e)(1) would require Farmer Mac to establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

Proposed § 652.10(e)(2) would require a separation of duties and supervision between personnel executing investment transactions and those responsible for approving, revaluating, and overseeing the investments. Separation of duties promotes integrity, accuracy, and prudent business practices that reduce the risk of loss. Senior management must ensure that Farmer Mac's investment practices and risk exposure are regularly reviewed and evaluated by personnel who are independent from those responsible for executing investment transactions. Also, we consider separate and independent valuation of computer model assumptions and data used by investment managers a necessary part of these regular reviews.

Proposed § 652.10(e)(3) would require Farmer Mac to maintain records and management information systems that are appropriate for the level and complexity of its investment activities. This requirement is especially important as investment instruments become increasingly complex and internal controls depend on adequacy and accuracy of corporate records. Internal quantitative models, computer software, and management expertise must be adequate and fully integrated to adequately analyze individual investment instruments, the investment portfolio, and the effect investments have on Farmer Mac's cashflows, earnings, and capital.

F. Securities Valuations

Accurate and frequent securities valuation is essential to measuring risk and monitoring compliance with a financial institution's objectives and risk parameters. Prudent business practices dictate that a financial institution must understand the value and price sensitivity of its investments prior to purchase and on an ongoing basis. Appropriate securities valuation practices by the financial institution enable managers to fully understand the risks and cashflow characteristics of its investments. Farmer Mac should rely on valuation methodologies that take into account all the risk elements in a security to determine its price. Proposed § 652.10(f) establishes the basic requirements for securities valuations by Farmer Mac and generally requires Farmer Mac to perform an analysis of the credit and market risks on investments prior to purchase and on an ongoing basis. The primary objective of this provision is to ensure that management understands and the board appropriately oversees the risks and cashflow characteristics of any investment that Farmer Mac purchases.

Managers must have a reasonable and adequate basis for investment purchases, supported by appropriate analysis, for the Corporation's investment decisions, and must maintain adequate documentation regarding the decisions. We believe this is especially relevant to Farmer Mac given its status as a GSE. We expect the analysis to describe the basic risk characteristics of the investment and include a balanced discussion of risks involved in purchasing the investment. In preparing the analysis, investment managers should consider the current rate of return or yield, expected total return, and annual income. We also expect investment managers to consider the degree of uncertainty associated with the cashflows, and the investment's marketability, liquidity, credit risk, and market risk. For investments that have unusual, leveraged, or highly variable cashflows, investment managers must exercise extraordinary diligence and thoroughness in making investment decisions. The depth of analyses and documentation of such decisions must be commensurate with the investment risk.

A fundamental component of sound investment management is the independent verification of securities prices. Accordingly, proposed § 652.10(f)(1) requires Farmer Mac, before it purchases a security, to evaluate its credit quality and price sensitivity to changes in market interest rates. We also propose to require Farmer Mac to evaluate and document the size and liquidity of the secondary market for the security at the time of purchase. In addition, we expect Farmer Mac to monitor and update this information as market conditions change. While Farmer Mac must support its credit evaluations by using the most recent credit rating given to a security by a Nationally Recognized Statistical Rating Organization (NRSRO) in accordance with the requirements of § 652.35, the Corporation may not rely exclusively on NRSRO ratings prior to purchasing investments. An independent and timely evaluation performed by Farmer Mac is needed because there may be a lag before an adverse event is reflected in the credit rating. Therefore, Farmer Mac's analysis must indicate whether the security's risk has changed subsequent to the most recent NRSRO rating.

Proposed § 652.10(f)(1) also requires Farmer Mac to verify the value of a security that it plans to purchase, other than a new issue, with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction. Independent verification of price can be as simple as obtaining a price from an industry-recognized information provider. Farmer Mac may satisfy this requirement by independently verifying the price of a security with an online market reporting service, such as Bloomberg, Telerate, or Reuters. Although price quotes from information providers are not actual market prices, they confirm whether the broker's price is reasonable. In the event that Farmer Mac is unable to obtain a second price quote on a particular security, a price quote may be obtained on a security with substantially similar characteristics. However, such an alternative method increases analysis and documentation requirements and must be available for independent internal and external evaluators to assess. In addition, Farmer Mac may use internal valuation models to verify the reasonableness of prices it pays or receives for securities.

Finally proposed § 652.10(f)(1) requires the board's investment policies to fully address the extent of the prepurchase analysis that management needs to perform for various classes of instruments. For example, Farmer Mac should specifically describe the stress tests in § 652.40 that must be performed on various types of mortgage securities.

Proposed § 652.10(f)(2) would require Farmer Mac to determine, at least monthly, the fair market value of each security in its portfolio and the fair market value of its investment portfolio as a whole. We propose this provision to ensure that management and the board have the necessary information to assess the performance of Farmer Mac's investment portfolio. This requirement enables management to provide accurate and timely reports to the board of directors in accordance with proposed § 652.10(g) and manage market risks.

In satisfying the above requirements, proposed § 652.10(f)(2) would also require Farmer Mac to evaluate the credit quality and price sensitivity to the change in market interest rates of each security in Farmer Mac's portfolio and its whole investment portfolio. The substance and form of the evaluations are likely to vary depending on the type of instrument. Relatively simple or standardized instruments with readily identifiable risks require significantly less analysis than more volatile or complex instruments. (Proposed § 652.40 contains specific stress test guidance for evaluating the price sensitivity of mortgage securities.)

Other eligible investments that have uncertain cashflows as a result of embedded options (such as call options, caps, or floors) may require similar analytical techniques to appropriately evaluate the instruments. For example, prior to investing in asset-backed securities (ABS), the FCA expects Farmer Mac to conduct or obtain an evaluation of the collateral (including type, aging of the assets, and the credit quality of the underlying loans) and an analysis of the securities' structure and cashflows.

Proposed § 652.10(f)(3) requires Farmer Mac, before it sells a security, to verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction. We reiterate, independent verification of price can be as simple as obtaining a price from an industry-recognized information provider, which will verify whether the broker's price is reasonable. In the event that Farmer Mac is unable to obtain a second price quote on a particular security, a price quote may be obtained on a security with substantially similar characteristics as explained and qualified above so long as the analysis is adequately documented and appropriately supports the security's value.

G. Reports to the Board of Directors

Adequate reporting will help ensure the Farmer Mac board properly carries out its fiduciary responsibilities and provides an essential element of internal controls. Management reports must communicate effectively to the board the nature of the risks inherent in Farmer Mac's investment activities. Reporting should occur frequently so that the board has timely, accurate, and sufficient information in order to adequately oversee changes in the investment portfolio and Farmer Mac's risk profile.

Proposed § 652.10(g) requires management, at least quarterly, to report to the board, or a designated subcommittee of the board, on the performance and risk of each class of investments and the entire investment portfolio. The report must identify all gains and losses that Farmer Mac incurs during the quarter on individual securities it sells before maturity and why such securities were liquidated. Reports also must identify potential risk exposure to changes in market interest rates and any other factors (such as credit deterioration) that may affect the value of Farmer Mac's investment holdings. In addition, the regulation would require management's report to discuss how Farmer Mac's investments affect its overall financial condition and to evaluate whether the performance of the investment portfolio effectively achieves the objectives established by the board of directors. The report must specifically identify deviations from the board's policies and seek board approval for any deviations.

VII. Section 652.15—Interest Rate Risk Management and Requirements

Because interest rate risk management is such an important part of investment management, we propose in § 652.15 certain responsibilities of Farmer Mac's board of directors and management as well as policy requirements to address more generally the management of interest rate risk exposure. The proposed regulations outline our minimum expectations for the management of interest rate risk exposure.

The potentially adverse effect that interest rate risk may have on net interest income and the market value of Farmer Mac's equity is of particular importance. Unless properly measured and managed, interest rate changes can have significant adverse effects on Farmer Mac's ability to generate earnings, build net worth, and maintain liquidity.

Proposed § 652.15(a) requires Farmer Mac's board of directors to be responsible for providing effective oversight (direction, controls, and supervision) to the interest rate risk management program and to be knowledgeable of the nature and level of interest rate risk taken by Farmer Mac.

Proposed § 652.15(b) requires Farmer Mac's management to be responsible for ensuring that interest rate risk is properly managed on both a long-range and a day-to-day basis.

Proposed § 652.15(c) requires Farmer Mac's board of directors to adopt an interest rate risk management policy. At least annually, the board of directors, or a designated subcommittee of the board, must review the policy. Any changes to the policy must be approved by the board and reported to FCA within 10 days of adoption.

Proposed § 652.15(d) requires Farmer Mac's interest rate management policy, at a minimum, to:

(1) Address the purpose and objectives of interest rate risk management;

(2) Identify and analyze the causes of interest rate risks within its existing balance sheet structure;

(3) Require Farmer Mac to measure the potential impact of these risks on projected earnings and market values by conducting interest rate shock tests and simulations of multiple economic scenarios at least quarterly;

(4) Describe and implement actions needed to obtain its desired risk management objectives;

(5) Document the objectives that Farmer Mac is attempting to achieve by purchasing eligible investments that are authorized by § 652.35;

(6) Require Farmer Mac to evaluate and document, at least quarterly, whether these investments have actually met the objectives stated under paragraph (4) above;

(7) Identify exception parameters and post approvals needed for any exceptions to the policy's requirements;

(8) Describe delegations of authority; and

(9) Describe reporting requirements, including exceptions to policy limits.

Proposed § 652.15(e) requires Farmer Mac's management to report, at least quarterly, to the Corporation's board of directors, or a designated subcommittee of the board, describing the nature and level of interest rate risk exposure. It also would require that any deviations from the board's policy on interest rate risk must be specifically identified in the report and approved by the board, or designated subcommittee of the board.

VIII. Liquidity Reserve Management and Requirements

As discussed in section VI., Farmer Mac is subject to liquidity risk at both the investment and institutional levels. Farmer Mac must manage risk at both of these levels.

In making this proposal, we recognize Farmer Mac's long-term liquidity is dependent on its ability to obtain funding from the securities markets. To aid in assuring market access, temporary sources of highly liquid and low-risk investments are needed in the event of market disruptions or aberrations. Accordingly, we propose liquidity requirements in § 652.20 that address minimum reserves, policies, periodic and special reporting requirements, and high quality unencumbered investments as follows.

A. Minimum Daily Liquidity Reserve Requirement

The minimum daily liquidity reserve requirement in proposed § 652.20(a) will ensure that Farmer Mac has a pool of cash, eligible non-program investments, and/or securities backed by portions of Farmer Mac program assets (loans) that are guaranteed by the United States Department of Agriculture as described in section 8.0(9)(B) of the Act (subject to certain discounts) to fund its operations for a minimum of 60 days, if its access to the capital markets becomes impeded or otherwise threatened. The Farmer Mac program assets described above are held under a program known as the Farmer Mac II Program.

We believe the significance of maintaining an ample supply of liquid funds for safety and soundness reasons outweigh any burdens created by the minimum daily liquidity reserve requirement.

This proposed regulation will permit Farmer Mac sufficient time to make adjustments to the liquidity portfolio and any associated restructuring of Farmer Mac's maturing debt. We propose that within 24 months of this rule becoming effective, and thereafter, the minimum daily liquidity reserve requirement will be 60 days.

We seek comment on whether the 60-day minimum daily liquidity reserve requirement is too much or too little. We also seek comment on whether it is appropriate to include securities backed by portions of Farmer Mac program assets (loans) that are guaranteed by the United States Department of Agriculture (Farmer Mac II program assets) in the minimum daily liquidity reserve requirement.

B. Free of Lien

At § 652.20(b), we propose that all investments held for the purpose of meeting the minimum daily liquidity reserve requirement of this section must be free of liens or other encumbrances.

C. Discounts

We propose to subject some of the investments in the liquidity pool to certain discounts as they may exhibit somewhat less liquidity in adverse market conditions. Those investments include money market instruments, floating and fixed rate debt securities, diversified investment funds, and securities backed by portions of Farmer Mac program assets (loans) that are guaranteed by the United States Department of Agriculture as described in section 8.0(9)(B) of the Act. Additionally, we reserve the authority to modify or determine the appropriate discount for any investments used to meet the minimum daily liquidity reserve requirement. For example, if an adverse credit event or other adverse event caused an eligible investment to exhibit less liquidity, we might increase the discount associated with that investment.

D. Liquidity Reserve Policy

At § 652.20(d), we propose requirements that Farmer Mac's board must address when setting a liquidity reserve policy. We also propose that proper internal controls be put in place, and that the board of directors, or a designated subcommittee of the board, review and validate the policy's adequacy at least annually. Any changes to the policy must be approved by the board of directors, and Farmer Mac must provide a copy of the revised policy to FCA within 10 days of adoption.

At § 652.20(e), we propose the minimum contents of the policy. The policy must include a statement of the purpose and objectives of liquidity reserves; a listing of specific assets, debt, and arrangements that can be used to meet liquidity objectives; diversification requirements of Farmer Mac's liquidity reserve portfolio; exception parameters and post approvals needed; delegations of authority; and reporting requirements.

In addition, we propose the policy establish maturity limits and credit quality standards for non-program investments used to meet the minimum daily liquidity reserve requirement of § 652.20(a).

Furthermore, we propose that the policy establish minimum and target amounts of liquidity. For example, the policy could establish an internal liquidity minimum such as 75 days (in addition to the 60-day regulatory minimum), or it could set an optimum liquidity requirement such as 90 days of liquidity to be met 80 percent of the time (in addition to the 60-day regulatory minimum reserve requirement).

Finally, we propose the policy include the maximum amount of non-program investments that can be held for meeting Farmer Mac's liquidity needs, as expressed as a percentage of program assets and off-balance sheet obligations.

E. Liquidity Reserve Reporting

To ensure appropriate internal control and accountability, we propose at § 652.20(f) to require that Farmer Mac's management report specific information to its board of directors or a designated subcommittee at least quarterly. The reports would describe liquidity reserve compliance with policy and other requirements of this section. Any deviations from the board's liquidity reserve policy must be specifically identified in the report and approved by the board of directors.

At § 652.20(g), we propose special reporting requirements for Farmer Mac. Farmer Mac's management must immediately report to its board of directors if any violation of board policy requirements at § 652.20(e) occurs. We believe this will allow sufficient time for Farmer Mac's board of directors to understand the ramifications of any breach and take corrective measures to prevent violations of our minimum daily liquidity reserve requirement as proposed in § 652.20(a). The Farmer Mac board must report to FCA within 3 days of receiving a report of any noncompliance with board policy requirements that are specified in § 652.20(e).

Additionally, Farmer Mac must immediately report to the FCA when the regulatory minimum daily liquidity reserve requirement at § 652.20(a) are breached.

IX. Section 652.25—Non-Program Investment Purposes and Limitations

Proposed § 652.25 lists authorized purposes for Farmer Mac non-program investments and imposes limitations on those investments. Our proposal seeks to reasonably relate investments made by Farmer Mac to its program purpose of establishing a secondary market arrangement for agricultural and rural housing mortgages. In making this proposal, we recognize non-program investments provide for a blend of Farmer Mac needs; most fundamental of these needs is to provide highly liquid assets to meet immediate funding needs associated with Farmer Mac's business in agricultural and rural housing mortgages. Farmer Mac also uses non-program investments in managing interest rate risk and providing flexibility in responding to fluctuating liquidity and economic conditions. Any non-program investments not appropriately related to the above needs warrant specific attention and justification. We recognize that investment fund management and prediction of changes in the market are very complex and fully support Farmer Mac's ability to respond appropriately in times of adversity. Therefore, holding adequate levels of highly liquid assets to meet funding needs during market disruptions is a fundamental safety and soundness matter. At the same time, Farmer Mac's powers to make non-program investments cannot result in inappropriate use of its GSE charter.

At § 652.25(a), we provide that non-program investments are authorized to comply with interest rate risk and liquidity reserve requirements and to manage surplus short-term funds.

At § 652.25(b), we propose that non-program investments cannot exceed the greater of $1.5 billion or the aggregate of the following: (1) Thirty (30) percent of total assets; and (2) a reasonable estimate of off-balance sheet loans covered by guarantees or commitments that Farmer Mac likely will be required to purchase during the upcoming 12-month period, not to exceed 15 percent of total off-balance sheet obligations.

In proposing the limitations, we recognized that Farmer Mac's liquidity needs are unique and considered such issues as off-balance sheet contingency funding needs and how those needs could fluctuate in times of sector or geographic adversity. We recognized that Farmer Mac's need for market presence and penetration is also unique. Additionally, we considered that in certain circumstances, Farmer Mac may borrow up to $1.5 billion from the U.S. Treasury to fulfill the guarantee obligations of the Corporation.

We seek comment on whether the $1.5 billion component or the aggregation component is too much or too little in relation to our proposed minimum daily liquidity reserve requirement set forth in § 652.20(a). In addition, should off-balance sheet obligations be permitted or not be permitted in determining the maximum levels of non-program investments? Finally, should we consider other issues pertinent to Farmer Mac's non-program investment needs or practices such as its ''debt issuance strategy''?

X. Section 652.30—Temporary Regulatory Waivers or Modifications for Extraordinary Situations

Proposed § 652.30 provides that the FCA may waive or modify restrictions on the size of Farmer Mac's investment portfolio and/or the liquidity reserve during times of economic stress, financial stress, or other extraordinary situations. As waivers or modifications are approved, we may impose certain expirations, plans to return to compliance, or other limitations. The flexibility of this provision enables the agency to tailor specific remedies for particular problems or particular circumstances that might arise.

Examples of extraordinary situations include, but are not necessarily limited to: (1) Disrupted access to capital markets due to financial, economic, agricultural, or national defense crises; and (2) situations specific to Farmer Mac that necessitate modified liquidity reserves, other investments, or other measures for continued market access.

XI. Section 652.35—Eligible Non-Program Investments

The proposed rule provides Farmer Mac with a broad array of eligible high-quality, liquid investments while providing a regulatory framework that can readily accommodate innovations in financial products and analytical tools. Similar classes of investments, such as full faith and credit obligations of Federal and state governments and short-term money market instruments, are grouped together in a table. Our proposed rule provides definitions for many of those investments in § 652.5.

Farmer Mac may purchase and hold the eligible non-program investments listed in § 652.35 to maintain liquidity reserves, manage interest rate risk, and invest surplus short-term funds. Only investments that can be promptly converted into cash without significant loss are suitable for achieving these objectives. For this reason, the eligible investments listed in § 652.35 generally have short terms to maturity and high credit ratings from NRSROs. Furthermore, all eligible investments are either traded in active and universally recognized secondary markets or are valuable as collateral. To enhance safety and soundness, for many of the investments, we propose that they comprise certain maximum percentages of the total non-program investment portfolio. We propose these portfolio caps to limit credit risk exposures, to promote diversification, and to curtail investments in securities that may exhibit considerable price volatility, price risk, or liquidity risks. We also propose obligor limits to help reduce exposure to counterparty risk.

A. Obligations of the United States

We propose to authorize Farmer Mac to invest in Treasuries and other obligations (except mortgage securities) fully insured or guaranteed by the United States Government or a Government agency. Farmer Mac may, for example, hold deposits that are insured by the Federal Deposit Insurance Corporation or portions of loans that are guaranteed by the Small Business Administration.

B. Obligations of Government-Sponsored Agencies

We propose to authorize Farmer Mac to invest in Government-sponsored agency securities (except mortgage securities) and other obligations (except mortgage securities) fully insured or guaranteed by Government-sponsored agencies. However, because Farmer Mac is also a Government-sponsored agency, we believe counterparty exposures should be limited. Accordingly, we propose that Farmer Mac may not invest more than 100 percent of its total capital in any single Government-sponsored agency. This limitation does not apply to Farmer Mac's own securities (*e.g.*, agricultural mortgage-backed securities issued by Farmer Mac and retained in its portfolio).

C. Municipal Securities

We propose to authorize investment in the general obligations of state and municipal governments. We also propose to authorize investment in revenue bonds of state and municipal governments; however, we propose to limit revenue bonds to 15 percent or less of the total investment portfolio.

D. International and Multilateral Development Bank Obligations

We propose to authorize obligations of international and multilateral development banks, provided the United States is a voting shareholder. Examples of eligible banks include the International Bank for Reconstruction and Development (World Bank), Inter-American Development Bank, and the North American Development Bank. Other highly rated banks working in concert with the World Bank to promote development in various countries are also eligible, subject to the shareholder-voting requirement above.

E. Money Market Instruments

We propose to authorize investments in Federal funds, negotiable certificates of deposit, bankers acceptances, and prime commercial paper. These money market instruments have high credit quality and short maturities and can be sold on active secondary markets prior to maturity. Therefore, we place no portfolio limits on these investments.

We propose to authorize investments in noncallable term Federal funds and Eurodollar time deposits. However, we propose to limit these investments to 20 percent or less of the total investment portfolio and require maturities of 100 days or less to control concentration risk in these non-negotiable instruments.

We propose to authorize investments in Master Notes that have maturities of 270 days or less, but Master Notes cannot comprise more than 20 percent of the total investment portfolio.

We propose to authorize investments in repurchase agreements collateralized by eligible investments or marketable securities rated in the highest credit rating category by an NRSRO. We propose to require that repurchase agreements have maturities of 100 days or less. In addition, if the counterparty defaults, Farmer Mac must divest itself of noneligible securities as required under proposed § 652.45.

F. Mortgage Securities

We propose to authorize investments in mortgage securities that are issued or guaranteed by the United States or a Government agency. Farmer Mac must perform the stress testing described in proposed § 652.40 on these securities.

We propose to authorize investments in mortgage securities issued by a Government-sponsored agency. Farmer Mac must perform the stress testing described in proposed § 652.40 on these securities. In addition, the combined amount of the securities cannot comprise more than 50 percent of Farmer Mac's total investment portfolio. We propose to authorize investments in non-Government agency or Government-sponsored agency securities that comply with 15 U.S.C. 77(d)5 or 15 U.S.C. 78c(a)(41). Farmer Mac must perform the stress testing described in proposed § 652.40 on these securities. In addition, the securities must maintain the highest credit rating by an NRSRO. These types of mortgage securities are typically issued by private sector entities and are mostly comprised of securities that are collateralized by ''jumbo'' mortgages with principal amounts that exceed the maximum limits of Fannie Mae or Freddie Mac programs.[7] The securities must meet: (1) The requirements of 15 U.S.C. 77d(5) that pertain to mortgage securities that are offered and sold pursuant to section 4(5) of the Securities Act of 1933; or (2) the requirements of 15 U.S.C. 78c(a)(41) that pertain to residential mortgage-related securities within the meaning of section 3(a)(41) of the Securities Exchange Act of 1934. Generally speaking, this means the securities are secured by a first lien on a single parcel of real estate (residential or mixed residential and commercial properties) and originated by a qualifying financial institution. Additionally, we propose to require that these securities comprise 15 percent or less of Farmer Mac's total investment portfolio because they are not explicitly or implicitly guaranteed by the United States, typically require credit enhancements to receive a high NRSRO credit rating, and are dependent upon a myriad of factors (collateral, terms, and originators) to achieve satisfactory credit quality and liquidity.

We propose to authorize investment in commercial mortgage-backed securities (CMBS),[8] which are collateralized by mortgages on commercial properties, such as apartment buildings, shopping centers, office buildings, and hotels. CMBS typically have yield-maintenance provisions or other features that provide greater prepayment protection to investors than residential mortgage securities. However, the structures of CMBS can vary widely and the more unique structures may contain additional risks that need to be thoroughly evaluated. Investment managers must fully understand the cashflow characteristics and price sensitivity of CMBS investments. Nonetheless, with appropriate safety and soundness controls, CMBS may provide Farmer Mac with greater investment portfolio diversification. Therefore, we propose to authorize investments in the securities provided that: (1) The security has the highest NRSRO credit rating; (2) the security is backed by a minimum of 100 loans; (3) loans from a single mortgagor cannot exceed 5 percent of the mortgage security pool; and (4) the mortgage security pool is geographically diversified and complies with Farmer Mac board policy. In addition, Farmer Mac must perform the stress testing described in proposed § 652.40 on these securities.

G. Asset-Backed Securities (ABS)

We propose to allow investment in ABS secured by credit card receivables, automobile loans, home equity loans, wholesale automobile dealer loans, student loans, equipment loans, and manufactured housing loans. Under this proposal, securities collateralized by home equity loans qualify as ABS, not mortgage securities.

Investments in ABS must have the highest NRSRO credit rating and cannot comprise more than 20 percent of Farmer Mac's total investment portfolio. Furthermore, if a fixed or floating rate ABS is at its contractual interest rate cap, it must have a 5-year weighted average life (WAL),[9] or less.

H. Corporate Debt Securities

We propose to allow investment in corporate debt securities with maturities up to 5 years and one of the two highest NRSRO credit ratings. Additionally, the securities cannot be convertible to equity securities and cannot comprise more than 20 percent of Farmer Mac's total investment portfolio.

I. Diversified Investment Funds

We propose to authorize investment in shares of any investment company that is registered under section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a–8, as long as the investment company's portfolio consists solely of investments that are authorized by § 652.40. Prior to investing in a particular investment company, Farmer Mac would be required to evaluate the investment company's risk and return objectives. As part of this evaluation, Farmer Mac should determine whether the investment company's use of derivatives is consistent with FCA guidance and Farmer Mac's investment policies. For instance, we would generally view it an unsafe and unsound practice for Farmer Mac to invest in an investment company that uses financial derivatives for speculative purposes rather than as a risk management tool. Farmer Mac must maintain appropriate documentation on each investment, including a prospectus and analysis, so its investment and selection process can be independently and objectively audited and examined. If Farmer Mac's shares in each investment company comprise 10 percent or less of Farmer Mac's total investment portfolio, no maximum portfolio limits are triggered. However, if Farmer Mac's shares in a particular investment company comprise more than 10 percent of Farmer Mac's total investment portfolio, then the pro rata interest in an asset class of security in an investment company must be added to the same asset class of Farmer Mac's other investments to determine investment portfolio limits. For example, if Farmer Mac has 12 percent of its total

[7] Other asset classes in the non-Government agency security class exist, including (1) Housing and Urban Development paper; (2) high loan-to-value loans; (3) Community Reinvestment Act loans; and (4) loans to borrowers with conforming loan balances with other features that prevent agency securitization, such as low documentation, self-employment, and unique property features.

[8] ''CMBS'' refers only to securities backed by mortgages on commercial real estate. This term does not cover Fannie Mae mortgage securities on mixed residential and commercial properties or mortgage securities on commercial real estate that the Small Business Administration issues or guarantees.

[9] Generally, the WAL is the average amount of time required for each dollar of invested principal to be repaid, based on the cashflow structure of an ABS and an assumed level of prepayments. Nearly all ABS are priced and traded on the basis of their WAL, not their final maturity dates.

investment portfolio (*i.e.*, more than 10 percent) in Diversified Investment Company Alpha (Alpha), then Farmer Mac would have to determine the composition of investments in Alpha's portfolio. The pro rata dollar amount of corporate debt securities (one example of the many asset classes) in Alpha would have to be added to Farmer Mac's corporate debt securities, and that combined amount would have to be 20 percent or less of Farmer Mac's total investment portfolio. Again, corporate debt securities are used only as an example. Any asset class in Farmer Mac's portfolio with an investment portfolio limit would have to be computed the same way.

J. Rating of Foreign Countries

We want to ensure that investments from outside the United States are of minimal risk to Farmer Mac, a GSE. For that reason, at § 652.35(b) we propose that whenever the obligor or issuer of an eligible investment is located outside the United States, the host country must maintain the highest sovereign rating for political and economic stability by an NRSRO.

K. Marketable Investments

Marketability without significant loss is one of the key components of liquidity. Proposed § 652.40(c) requires that all eligible investments, except money market instruments, must be readily marketable. We note that an eligible investment is marketable if Farmer Mac can sell it promptly at a price that closely reflects its fair value in an active and universally recognized secondary market. We also propose to require Farmer Mac to evaluate and document the size and liquidity of the secondary market for the investment at time of purchase.

L. Obligor Limits

Previously, we discussed the risks of investment concentrations and the benefits of a well diversified and high quality investment portfolio. In proposed § 652.35(d)(1), we prohibit Farmer Mac from investing more than 20 percent of its total capital in eligible investments issued by any single entity, issuer, or obligor. However, the obligor limit would not apply to Government agencies or Government-sponsored agencies. Instead, we propose that Farmer Mac may not invest more than 100 percent of its total capital in any one Government-sponsored agency. There are no obligor limits for Government agencies.

Also, at proposed § 652.35(d)(2), we require Farmer Mac to count securities that it holds through an investment company towards the obligor limits of this section unless the investment company's holdings of the security of any one issuer do not exceed 5 percent of the investment company's total portfolio.

M. Investments in Preferred Stock of Farm Credit System Institutions and Other Investments Approved by FCA

With our prior written approval, Farmer Mac may purchase non-program investments in preferred stock issued by Farm Credit System (System) institutions and in other non-program investments that are not expressly authorized by FCA regulations.

Proposed § 652.35(e) requires that Farmer Mac request our approval to invest in preferred stock issued by System institutions. We propose this requirement to enhance our oversight of the flow of capital and investments between System institutions and Farmer Mac.

Farmer Mac presently owns preferred stock in two System institutions. An increasing number of System institutions are issuing preferred stock for a variety of valid reasons, including meeting long-term capital objectives and supporting growth. However, as the safety and soundness regulator for System banks and associations and Farmer Mac, we have concerns that continued and expanded preferred stock investments could potentially reduce the quality of System institution and Farmer Mac capital. Concentration and systemic risks concerns arise from Farmer Mac's ability to invest in unlimited amounts of preferred stock issued by System institutions, and potentially in the future, vice-versa.[10]

As we noted previously, for any investment that does not fit wholly within one of the investment categories that we describe or provide for, we reserve the authority to determine an appropriate discount as the investment is considered in meeting the minimum daily liquidity reserve requirement of proposed § 652.20(a).

Similar to our rules for Farm Credit banks and associations, proposed § 652.35(f) requires that Farmer Mac receive FCA approval for any investments that are not specifically included in this section as eligible non-program investments.

Farmer Mac's request for FCA approval to invest in the preferred stock of System institutions or other non-program investments must explain the risk characteristics of the investment and the purpose and objective for making the investment.

[10] On April 22, 2004, the FCA Board adopted a provision, in another proposed rule, that would require System institutions to obtain FCA approval when investing in Farmer Mac preferred stock.

XII. Stress Tests for Mortgage Securities

A. Overview/Reason for Proposal

For several reasons, stress testing is an essential risk management practice for Farmer Mac to perform on mortgage securities in its investment portfolio. Stress testing is essential when the cashflows from investments or assets of financial institutions change in response to fluctuations in market interest rates. For example, although credit risk on highly rated mortgage securities is minimal, mortgage securities may expose investors to significant interest rate risk. Since borrowers may prepay their mortgages, investors may not receive the expected cashflows and returns on these securities. Prepayments on these securities are affected by the spread between market rates and the actual interest rates of mortgages in the pool, the path of interest rates, and the unpaid balances and remaining terms to maturity on the mortgage collateral. The price behavior of a mortgage security also depends on whether the security was purchased at a premium or at a discount.

To better control and manage these factors, we propose that Farmer Mac employ appropriate analytical techniques and methodologies to measure and evaluate interest rate risk inherent in mortgage securities. More specifically, prudent risk management practices require Farmer Mac to examine the performance of each mortgage security under a wide array of possible interest rate scenarios.

We propose in § 652.40 to allow Farmer Mac to accomplish this performance analysis by developing stress tests that measure the price sensitivity of mortgage instruments over different interest rate/yield curve scenarios.

The methodology that Farmer Mac uses to analyze mortgage securities must be appropriate for the complexity of the instrument's structure and cashflows. Prior to purchase and each quarter thereafter, Farmer Mac must use stress tests to determine that the risk in the mortgage securities is within the risk limits of Farmer Mac's board investment policies. The stress tests must be able to determine at the time of purchase and each subsequent quarter that the mortgage security does not expose Farmer Mac's capital or earnings to excessive risks.

B. Other Considerations and Requirements of Stress Testing

Farmer Mac may consider the effect of a derivative hedge transaction on the price sensitivity of instruments as part of its evaluation of whether a particular mortgage security is a suitable investment.

Under proposed § 652.40(b), we require that Farmer Mac's management:

(1) Rely on verifiable information to support all its assumptions, including prepayment and interest rate volatility assumptions.

(2) Document the basis for all assumptions that are used to evaluate the security and its underlying mortgages.

(3) Document all subsequent changes in Farmer Mac's assumptions.

(4) Report to the Corporation's board of directors in accordance with § 652.10(g) if at any time after purchase the mortgage security no longer complies with the requirements of proposed § 652.40.

We believe the proposals under § 652.40 allow Farmer Mac the latitude to consider a number of relevant factors when evaluating a mortgage security's suitability while promoting overall safety and soundness by not exposing Farmer Mac's capital and earnings to excessive risk.

XIII. Divestiture of Ineligible Non-Program Investments

In § 652.45 we propose that an ineligible non-program investment or security must be divested within 6 months, unless FCA approves, in writing, a plan that authorizes the investment or its divesture over a longer period of time. An acceptable plan generally requires Farmer Mac to divest of the ineligible investment or security as quickly as possible without substantial financial loss. We propose that until the ineligible investment or security is actually divested of, Farmer Mac's investment manager must report at least quarterly to Farmer Mac's board of directors and to FCA's Office of Secondary Market Oversight about the status and performance of the ineligible instrument, the reason why it remains ineligible, and the investment manager's progress in divesting of the investment or security.

XIV. Better Organizing Rules That Apply to Farmer Mac

We propose moving some existing regulation sections that pertain specifically to Farmer Mac to a centralized location in our regulations so they can be more easily located and used. The following table provides details of our proposal and shows where this proposed rule would be located:

PROPOSED ORGANIZATION OF FARMER MAC RULES

Proposed new part	Proposed new part name	Proposed new subpart	Proposed new subpart name	Proposed new sections	From
650	Federal Agricultural Mortgage Corporation—General Provisions.		Receiver and Conservator	§§ 650.1–650.80	Existing Part 650, Subpart C, §§ 650.50 to 650.68
651	Federal Agricultural Mortgage Corporation—Governance.		Conflicts of Interest	§§ 651.1–651.4	Existing Part 650, Subpart A, §§ 650.1 to 650.4
652	Federal Agricultural Mortgage Corporation—Funding and Fiscal Affairs.	A	Investment Management	§§ 652.1–652.45	Newly proposed in this rule.
652	Federal Agricultural Mortgage Corporation—Funding and Fiscal Affairs.	B	Risk-Based Capital	§§ 652.50–652.105	Existing Part 650, Subpart B, §§ 650.20 to 650.31
653	Reserved				
654	Reserved				
655	Federal Agricultural Mortgage Corporation—Disclosure and Reporting Requirements.	A	Annual Report of Condition of the Federal Agricultural Mortgage Corporation.	§ 655.1	Existing Part 620, Subpart G, § 620.40
655	Federal Agricultural Mortgage Corporation—Disclosure and Reporting Requirements.	B	Accounting and Reporting Requirements.	§ 655.50	Existing Part 621, Subpart E, § 621.20

XV. Regulatory Flexibility Act

Farmer Mac has assets and annual income in excess of the amounts that would qualify it as a small entity. Therefore, Farmer Mac is not a "small entity" as defined in the 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.

List of Subjects

12 CFR Part 620

Accounting, Agriculture, Banks, banking, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 621

Accounting, Agriculture, Banks, banking, Penalties, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 650

Agriculture, Banks, banking, Conflicts of interest, Rural areas.

12 CFR Part 651

Agriculture, Banks, banking, Conflicts of interest, Rural areas.

12 CFR Part 652

Agriculture, Banks, banking, Rural areas, investments, capital.

12 CFR Part 655

Accounting, Agriculture, Banks, banking, Accounting and reporting requirements, Disclosure and reporting requirements, Rural areas.

For the reasons stated in the preamble, we propose amending parts 620, 621, and 650 of chapter VI, adding parts 651, 652, and 655 to chapter VI, and reserving parts 653 and 654 of chapter VI, title 12 of the Code of Federal Regulations to read as follows:

PART 655—FEDERAL AGRICULTURAL MORTGAGE CORPORATION DISCLOSURE AND REPORTING REQUIREMENTS

1. Add the heading for a new part 655 to read as set forth above.

2. Add the authority citation for new part 655 to read as follows:

Authority: Sec. 8.11 of the Farm Credit Act (12 U.S.C. 2279aa–11).

PART 620—DISCLOSURE TO SHAREHOLDERS

3. The authority citation for part 620 continues to read as follows:

Authority: Secs. 5.17, 5.19, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2254, 2279aa–11); sec. 424 of Pub. L. 100–233, 101 Stat. 1568, 1656.

Subpart G—Annual Report of Condition of the Federal Agricultural Mortgage Corporation

§ 620.40 [Redesignated as § 655.1]

4. Redesignate subpart G of part 620, consisting of § 620.40 as subpart A of new part 655, consisting of § 655.1.

PART 621—ACCOUNTING AND REPORTING REQUIREMENTS

5. The authority citation for part 621 continues to read as follows:

Authority: Secs. 5.17, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2279aa–11).

Subpart E—Reports Relating to Securities Activities of the Federal Agricultural Mortgage Corporation

§ 621.20 [Redesignated as § 655.50]

6. Redesignate subpart E of part 620, consisting of § 621.20 as subpart B of new part 655, consisting of § 655.50.

PART 651—FEDERAL AGRICULTURAL MORTGAGE CORPORATION GOVERNANCE

7. Add the heading for a new part 651 to read as set forth above.

8. The authority citation for new part 651 is added 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.

9. Add a new part 652 to read as follows:

PART 652—FEDERAL AGRICULTURAL MORTGAGE CORPORATION FUNDING AND FISCAL AFFAIRS

Subpart A—Investment Management

Subpart B—Risk-Based Capital Requirements [Reserved]

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 A—Investment Management

§ 652.1 Purpose.

This subpart contains the Farm Credit Administration's (FCA) rules for governing liquidity and non-program investments held by the Federal Agricultural Mortgage Corporation (Farmer Mac). The purpose of this subpart is to ensure safety and soundness, continuity of funding, and appropriate use of non-program investments considering Farmer Mac's special status as a Government-sponsored enterprise (GSE). The subpart contains requirements for Farmer Mac's board of directors to adopt policies covering such areas as investment management, interest rate risk, and liquidity reserves. The subpart also requires Farmer Mac to comply with various reporting requirements.

§ 652.5 Definitions.

For purposes of this subpart, the following definitions will apply:

Affiliate means any entity established under authority granted to the Corporation under section 8.3(b)(13) of the Farm Credit Act of 1971, as amended.

Asset-backed securities (ABS) means investment securities that provide for ownership of a fractional undivided interest or collateral interests in specific assets of a trust that are sold and traded in the capital markets. For the purposes of this subpart, ABS exclude mortgage securities that are defined below.

Eurodollar time deposit means a non-negotiable deposit denominated in United States dollars and issued by an overseas branch of a United States bank or by a foreign bank outside the United States.

Farmer Mac, Corporation, you, and your means the Federal Agricultural Mortgage Corporation and its affiliates.

FCA, our, or we means the Farm Credit Administration.

Final maturity means the last date on which the remaining principal amount of a security is due and payable (matures) to the registered owner. It does not mean the call date, the expected average life, the duration, or the weighted average maturity.

General obligations of a state or political subdivision means:

(1) The full faith and credit obligations of a state, the District of Columbia, the Commonwealth of Puerto Rico, a territory or possession of the United States, or a political subdivision thereof that possesses general powers of taxation, including property taxation; or

(2) An obligation that is unconditionally guaranteed by an obligor possessing general powers of taxation, including property taxation.

Government agency means an agency or instrumentality of the United States Government whose obligations *are* fully and explicitly guaranteed as to the timely repayment of principal and interest by the full faith and credit of the United States Government.

Government-sponsored agency means an agency or instrumentality chartered or established to serve public purposes specified by the United States Congress but whose obligations *are not* explicitly guaranteed by the full faith and credit of the United States Government.

Liquid investments are assets that can be promptly converted into cash without significant loss to the investor. A security is liquid if the spread between its bid price and ask price is narrow and a reasonable amount can be sold at those prices promptly.

Long-Term Standby Purchase Commitment (LTSPC) is a commitment by Farmer Mac to purchase specified eligible loans on one or more undetermined future dates. In consideration for Farmer Mac's assumption of the credit risk on the specified loans underlying an LTSPC, Farmer Mac receives an annual commitment fee on the outstanding balance of those loans in monthly installments based on the outstanding balance of those loans.

Market risk means the risk to your financial condition because the value of your holdings may decline if interest rates or market prices change. Exposure to market risk is measured by assessing the effect of changing rates and prices on either the earnings or economic value of an individual instrument, a portfolio, or the entire Corporation.

Maturing obligations means maturing debt and other obligations that may be expected, such as buyouts of long-term standby purchase commitments or repurchases of agricultural mortgage securities.

Mortgage securities means securities that are either:

(1) Pass-through securities or participation certificates that represent ownership of a fractional undivided interest in a specified pool of residential (excluding home equity loans), multifamily or commercial mortgages, or

(2) A multiclass security (including collateralized mortgage obligations and real estate mortgage investment conduits) that is backed by a pool of residential, multifamily or commercial real estate mortgages, pass-through mortgage securities, or other multiclass mortgage securities.

(3) This definition does not include agricultural mortgage-backed securities guaranteed by Farmer Mac itself.

Nationally recognized statistical rating organization (NRSRO) means a rating organization that the Securities and Exchange Commission recognizes as an NRSRO.

Non-program investments means investments other than those in:

(1) ''Qualified loans'' as defined in section 8.0(9) of the Farm Credit Act of 1971, as amended; or

(2) Securities collateralized by ''qualified loans.''

Revenue bond means an obligation of a municipal government that finances a specific project or enterprise, but it is not a full faith and credit obligation. The obligor pays a portion of the revenue generated by the project or enterprise to the bondholders.

Total capital means total capital in accordance with generally accepted accounting principles.

Weighted average life (WAL) means the average time until the investor receives the principal on a security, weighted by the size of each principal payment and calculated under specified prepayment assumptions.

§ 652.10 Investment management and requirements.

(a) *Investment policies—board responsibilities.* Your board of directors must adopt written policies for managing your non-program investment activities. Your board must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. At least annually, your board, or a designated subcommittee of the board, must review these investment policies. Any changes to the policies must be adopted by the board. You must report any changes to these policies to FCA within 10 days of adoption.

(b) *Investment policies—general requirements.* Your investment policies must address the purposes and objectives of investments, risk tolerance, delegations of authority, exception parameters, securities valuation, internal controls, and reporting requirements.

Furthermore, the policies must address the means for reporting, and approvals needed for, exceptions to established policies. Investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of your investments.

(c) *Investment policies—risk tolerance.* Your investment policies must establish risk limits and diversification requirements for the various classes of eligible investments and for the entire investment portfolio. These policies must ensure that you maintain prudent diversification of your investment portfolio. Risk limits must be based on the Corporation's objectives, capital position, and risk tolerance capabilities. Your policies must identify the types and quantity of investments that you will hold to achieve your objectives and control credit, market, liquidity, and operational risks. Your policies must establish risk limits for the following four types of risk:

(1) *Credit risk.* Your investment policies must establish:

(i) Credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations based on a single or related counterparty(ies), a geographical area, industries or obligations with similar characteristics.

(ii) Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms). You must buy and sell eligible investments with more than one securities firm. As part of your annual review of your investment policies, your board of directors, or a designated subcommittee of the board, must review the criteria for selecting securities firms. Any changes to the criteria must be approved by the board. Also, as part of your annual review, the board, or a designated subcommittee of the board, must review existing relationships with securities firms. Any changes to securities firms must be approved by the board.

(iii) Collateral margin requirements on repurchase agreements. You must regularly mark the collateral to market and ensure appropriate controls are maintained over collateral held.

(2) *Market risk.* Your investment policies must set market risk limits for specific types of investments, and for the investment portfolio or for Farmer Mac generally. Your board of directors must establish market risk limits in accordance with these regulations (including, but not limited to, §§ 652.15 and 652.40) and our other policies and guidance. You must evaluate how individual instruments and the investment portfolio as a whole affect the Corporation's overall interest rate risk profile. You must document in the Corporation's records or minutes any analyses used in formulating your policies or amendments to the policies.

(3) *Liquidity risk.* Your investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and the Corporation's objectives.

(4) *Operational risk.* Investment policies must address operational risks, including delegations of authority and internal controls in accordance with paragraphs (d) and (e) of this section.

(d) *Delegation of authority.* All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) *Internal controls.* You must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties and supervision between personnel who execute investment transactions and personnel who approve, revaluate, and oversee investments.

(3) Maintain records and management information systems that are appropriate for the level and complexity of your investment activities.

(f) *Securities valuations.*

(1) Before you purchase a security, you must evaluate its credit quality and price sensitivity to changes in market interest rates. You must also document the size and liquidity of the secondary market for the security at the time of purchase. In addition, you must also verify the value of a security that you plan to purchase, other than a new issue, with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

Your investment policies must fully address the extent of the prepurchase analysis that management needs to perform for various classes of instruments. For example, you should specifically describe the stress tests in § 652.40 that must be performed on various types of mortgage securities.

(2) At least monthly, you must determine the fair market value of each security in your portfolio and the fair market value of your whole investment portfolio. In doing so you must also evaluate the credit quality and price sensitivity to the change in market interest rates of each security in your portfolio and your whole investment portfolio.

(3) Before you sell a security, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(g) *Reports to the board of directors.* At least quarterly, Farmer Mac's management must report to the Corporation's board of directors, or a designated subcommittee of the board:

(1) On the performance and risk of each class of investments and the entire investment portfolio;

(2) All gains and losses that you incur during the quarter on individual securities that you sold before maturity and why they were liquidated;

(3) Potential risk exposure to changes in market interest rates and any other factors that may affect the value of your investment holdings;

(4) How investments affect your overall financial condition;

(5) Whether the performance of the investment portfolio effectively achieves the board's objectives; and

(6) Any deviations from the board's policies. These deviations must be formally approved by the board of directors.

§ 652.15 Interest rate risk management and requirements.

(a) The board of directors of Farmer Mac must provide effective oversight (direction, controls, and supervision) to the interest rate risk management program and must be knowledgeable of the nature and level of interest rate risk taken by Farmer Mac.

(b) The management of Farmer Mac must ensure that interest rate risk is properly managed on both a long-range and a day-to-day basis.

(c) The board of directors of Farmer Mac must adopt an interest rate risk management policy that establishes appropriate interest rate risk exposure limits based on the Corporation's risk-bearing capacity and reporting requirements in accordance with paragraphs (b) and (c) of this section. At least annually, the board of directors, or a designated subcommittee of the board, must review the policy. Any changes to the policy must be approved by the board of directors. You must report any changes to the policy to FCA within 10 days of adoption.

(d) The interest rate risk management policy must, at a minimum:

(1) Address the purpose and objectives of interest rate risk management;

(2) Identify and analyze the causes of interest rate risks within Farmer Mac's existing balance sheet structure;

(3) Require Farmer Mac to measure the potential impact of these risks on projected earnings and market values by conducting interest rate shock tests and simulations of multiple economic scenarios at least quarterly;

(4) Describe and implement actions needed to obtain Farmer Mac's desired risk management objectives;

(5) Document the objectives that Farmer Mac is attempting to achieve by purchasing eligible investments that are authorized by § 652.35 of this subpart;

(6) Require Farmer Mac to evaluate and document, at least quarterly, whether these investments have actually met the objectives stated under paragraph (d)(4) of this section;

(7) Identify exception parameters and post approvals needed for any exceptions to the policy's requirements;

(8) Describe delegations of authority; and

(9) Describe reporting requirements, including exceptions to policy limits.

(e) At least quarterly, Farmer Mac's management must report to the Corporation's board of directors, or a designated subcommittee of the board, describing the nature and level of interest rate risk exposure. Any deviations from the board's policy on interest rate risk must be specifically identified in the report and approved by the board, or a designated subcommittee of the board.

§ 652.20 Liquidity reserve management and requirements.

(a) *Minimum daily liquidity reserve requirement.* Within 24 months of this rule becoming effective, and thereafter, Farmer Mac must hold cash, eligible non-program investments under § 652.35 of this subpart, and/or securities backed by portions of Farmer Mac program assets (loans) that are guaranteed by the United States Department of Agriculture as described in section 8.0(9)(B) of the Act (in accordance with the requirements of paragraphs (b) and (c) of this section), to maintain sufficient daily liquidity to fund a minimum of 60 days of maturing obligations, interest due, and operating expenses. You must maintain sufficient documentation to demonstrate that you meet this minimum liquidity reserve requirement on a daily basis.

(b) *Free of lien.* All investments held for the purpose of meeting the liquidity reserve requirement of this section must be free of liens or other encumbrances.

(c) *Discounts.* The amount that may be counted to meet the minimum daily liquidity reserve requirement is as follows:

(1) For cash and overnight investments, multiply the cash and investments by 100 percent;

(2) For money market instruments and floating rate debt securities, multiply the instruments and securities by 95 percent of market value;

(3) For diversified investment funds, multiply the individual securities in the funds by the discounts that would apply to the securities if held separately;

(4) For fixed rate debt securities, multiply the securities by 90 percent of market value;

(5) For securities backed by portions of Farmer Mac program assets (loans) guaranteed by the United States Department of Agriculture as described in section 8.0(9)(B) of the Act, multiply the securities by 50 percent; and

(6) We reserve the authority to modify or determine the appropriate discount for any investments used to meet the minimum daily liquidity reserve requirement.

(d) *Liquidity reserve policy—board responsibilities.* Farmer Mac's board of directors must adopt a liquidity reserve policy. The board must also ensure that management uses adequate internal controls to ensure compliance with the liquidity reserve policy standards, limitations, and reporting requirements established pursuant to this paragraph and to paragraphs (e), (f), and (g) of this section. At least annually, the board of directors or a designated subcommittee of the board must review and validate the liquidity policy's adequacy. The board of directors must approve any changes to the policy. You must provide a copy of the revised policy to FCA within 10 days of adoption.

(e) *Liquidity reserve policy—content.* Your liquidity reserve policy must contain at a minimum the following:

(1) The purpose and objectives of liquidity reserves;

(2) A listing of specific assets, debt, and arrangements that can be used to meet liquidity objectives;

(3) Diversification requirements of your liquidity reserve portfolio;

(4) Maturity limits and credit quality standards for non-program investments

used to meet the minimum daily liquidity reserve requirement of paragraph (a) of this section;

(5) The minimum and target (or optimum) amounts of liquidity that the board believes are appropriate for Farmer Mac;

(6) The maximum amount of non-program investments that can be held for meeting Farmer Mac's liquidity needs, as expressed as a percentage of program assets and off-balance sheet obligations;

(7) Exception parameters and post approvals needed;

(8) Delegations of authority; and

(9) Reporting requirements.

(f) *Liquidity reserve reporting—periodic reporting requirements.* At least quarterly, Farmer Mac's management must report to the Corporation's board of directors or a designated subcommittee of the board describing, at a minimum, liquidity reserve compliance with the Corporation's policy and this section. Any deviations from the board's liquidity reserve policy (other than requirements specified in § 652.20(e)(5)) must be specifically identified in the report and approved by the board of directors.

(g) *Liquidity reserve reporting—special reporting requirements.* Farmer Mac's management must immediately report to its board of directors any noncompliance with board policy requirements that are specified in § 652.20(e)(5). The Farmer Mac board must report to FCA within 3 days of receiving a report of any noncompliance with board policy requirements that are specified in § 652.20(e)(5). Farmer Mac must immediately report to the FCA when the minimum daily liquidity reserve requirement at § 652.20(a) is breached.

§ 652.25 Non-program investment purposes and limitations.

(a) Farmer Mac is authorized to hold eligible non-program investments listed under § 652.35 for the purposes of complying with the interest rate risk requirements of § 652.15, complying with the liquidity reserve requirements of § 652.20, and managing surplus short-term funds.

(b) Non-program investments cannot exceed the greater of $1.5 billion or the aggregate of the following:

(1) Thirty (30) percent of total assets; and

(2) A reasonable estimate of off-balance sheet loans covered by guarantees or commitments that Farmer Mac likely will be required to purchase during the upcoming 12-month period, not to exceed 15 percent of total off-balance sheet obligations.

§ 652.30 Temporary regulatory waivers or modifications for extraordinary situations.

Whenever the FCA determines that an extraordinary situation exists that necessitates a temporary regulatory waiver or modification, the FCA may, in its sole discretion:

(a) Modify or waive the minimum daily liquidity reserve requirement in § 652.20 of this subpart; and/or

(b) Increase the amount of eligible investments that you are authorized to hold pursuant to § 652.25 of this subpart.

§ 652.35 Eligible non-program investments.

(a) You may hold only the types, quantities, and qualities of non-program investments listed in the following Non-Program Investment Eligibility Criteria Table. These investments must be denominated in United States dollars.

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Non-Program Investment Eligibility Criteria Table

ASSET CLASS	FINAL MATURITY LIMIT	NRSRO ISSUE OR ISSUER CREDIT RATING REQUIREMENT	OTHER REQUIREMENTS	MAXIMUM PERCENTAGE OF TOTAL NON-PROGRAM INVESTMENT PORTFOLIO
(1) Obligations of the United States • Treasuries • Other obligations (except mortgage securities) fully insured or guaranteed by the United States Government or a Government agency.	None	NA	None	None
(2) Obligations of Government-sponsored agencies • Government-sponsored agency securities (except mortgage securities). • Other obligations (except mortgage securities) fully insured or guaranteed by Government-sponsored agencies.	None	NA	None	None
(3) Municipal Securities				
• General obligations	10 years	One of the two highest.	None	None
• Revenue bonds	5 years for fixed rate bonds and 10 years for index/ floating rate bonds	Highest	None	15%
(4) International and Multilateral Development Bank Obligations	None	None	The United States must be a voting shareholder.	None
(5) Money Market Instruments				
• Federal funds	1 day or continuously callable up to 100 days	One of the two highest short-term.	None	None
• Negotiable certificates of deposit	1 year	One of the two highest short-term.	None	None
• Bankers acceptances	None	One of the two highest short-term.	Issued by a depository institution.	None
• Prime commercial paper	270 days	Highest short-term.	None	None
• Non-callable term Federal funds and Eurodollar time deposits.	100 days	Highest short-term.	None	20%
• Master notes	270 days	Highest short-term.	None	20%
• Repurchase agreements collateralized by eligible investments or marketable securities rated in the highest credit rating category by an NRSRO.	100 days	NA	If counterparty defaults, you must divest non-eligible securities as required under § 652.45.	None

Note: You must also comply with requirements of paragraphs (b), (c), and (d) of this section, and § 651.40 when applicable. "NA" means not applicable.

ASSET CLASS	FINAL MATURITY LIMIT	NRSRO ISSUE OR ISSUER CREDIT RATING REQUIREMENT	OTHER REQUIREMENTS	MAXIMUM PERCENTAGE OF TOTAL NON-PROGRAM INVESTMENT PORTFOLIO
(6) Mortgage Securities				
• Issued or guaranteed by the United States or a Government agency.	None	NA	Stress testing under § 652.40.	None
• Government-sponsored agency mortgage securities.	None	One of the two highest.	Stress testing under § 652.40.	50%
• Non-Government agency or Government-sponsored agency securities that comply with 15 U.S.C. 77d(5) or 15 U.S.C. 78c(a)(41).	None	Highest	Stress testing under § 652.40.	15% combined
• Commercial mortgage-backed securities.	None	Highest	• Security must be backed by a minimum of 100 loans. • Loans from a single mortgagor cannot exceed 5% of the pool. • Pool must be geographically diversified pursuant to the board's policy. • Stress testing under § 652.40.	
(7) Asset-Backed Securities secured by: • Credit card receivables • Automobile loans • Home equity loans • Wholesale automobile dealer loans • Student loans • Equipment loans • Manufactured housing loans	None	Highest	Maximum of 5-year WAL for fixed rate or floating rate ABS at their contractual interest rate caps.	20% combined
(8) Corporate Debt Securities	5 years	One of the highest two.	Cannot be convertible to equity securities.	20%
(9) Diversified Investment Funds Shares of an investment company registered under section 8 of the Investment Company Act of 1940.	NA	NA	The portfolio of the investment company must consist solely of eligible investments authorized by this section. The investment company's risk and return objectives and use of derivatives must be consistent with FCA guidance and your investment policies.	None, if your shares in each investment company comprise less than 10% of your portfolio. Otherwise counts toward limit for each type of investment.

Note: You must also comply with requirements of paragraphs (b), (c), and (d) of this section, and § 651.40 when applicable. "NA" means not applicable.

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(b) *Rating of foreign countries.* Whenever the obligor or issuer of an eligible investment is located outside the United States, the host country must maintain the highest sovereign rating for political and economic stability by an NRSRO.

(c) *Marketable investments.* All eligible investments, except money market instruments, must be readily marketable. An eligible investment is marketable if you can sell it promptly at a price that closely reflects its fair value in an active and universally recognized secondary market. You must evaluate and document the size and liquidity of the secondary market for the investment at time of purchase.

(d) *Obligor limits.* (1) You may not invest more than 20 percent of your total capital in eligible investments issued by any single entity, issuer or obligor. This obligor limit does not apply to Government-sponsored agencies or Government agencies. You may not invest more than 100 percent of your total capital in any one Government-sponsored agency. There are no obligor limits for Government agencies.

(2) *Obligor limits for your holdings in an investment company.* You must count securities that you hold through an investment company towards the obligor limits of this section unless the investment company's holdings of the security of any one issuer do not exceed 5 percent of the investment company's total portfolio.

(e) *Preferred stock and other investments approved by the FCA.* (1) You may purchase non-program investments in preferred stock issued by other Farm Credit System institutions only with our written prior approval. You may also purchase non-program investments other than those listed in the Non-Program Investment Eligibility Criteria Table at paragraph (a) of this section only with our written prior approval.

(2) Your request for our approval must explain the risk characteristics of the investment and your purpose and objectives for making the investment.

(3) We reserve the authority to determine an appropriate discount for any investment that does not fit wholly within one of the investment categories that we describe or provide for as the investment is considered in meeting the minimum daily liquidity reserve requirement of § 652.20(a).

§ 652.40 Stress tests for mortgage securities.

(a) You must perform stress tests to determine how interest rate changes will affect the cashflow and price of each mortgage security that you purchase and hold, except for adjustable rate mortgage securities that reprice at intervals of 12 months or less and are tied to an index. You must also use stress tests to gauge how interest rate fluctuations on mortgage securities affect your capital and earnings. The stress tests must be able to measure the price sensitivity of mortgage instruments over different interest rate/yield curve scenarios and be consistent with any asset liability management and interest rate risk policies. The methodology that you use to analyze mortgage securities must be appropriate for the complexity of the instrument's structure and cashflows. Prior to purchase and each quarter thereafter, you must use the stress tests to determine that the risk in the mortgage securities is within the risk limits of your board's investment policies. The stress tests must enable you to determine at the time of purchase and each subsequent quarter that the mortgage security does not expose your capital or earnings to excessive risks.

(b) You must rely on verifiable information to support all your assumptions, including prepayment and interest rate volatility assumptions. You must document the basis for all assumptions that you use to evaluate the security and its underlying mortgages. You must also document all subsequent changes in your assumptions. If at any time after purchase, a mortgage security no longer complies with requirements in this section, Farmer Mac's management must report to the Corporation's board of directors in accordance with § 652.10(g).

§ 652.45 Divestiture of ineligible non-program investments.

(a) *Divestiture requirements.* You must divest of an ineligible non-program investment or security within 6 months unless we approve, in writing, a plan that authorizes you to divest the instrument over a longer period of time. An acceptable plan generally would require you to divest of the ineligible investment or security as quickly as possible without substantial financial loss.

(b) *Reporting requirements.* Until you divest of the ineligible non-program investment or security, the manager of your investment portfolio must report at least quarterly to your board of directors and to FCA's Office of Secondary Market Oversight about the status and performance of the ineligible instrument, the reasons why it remains ineligible, and the manager's progress in divesting of the investment.

Subpart B—Risk-Based Capital Requirements [Reserved]

PART 650—FEDERAL AGRICULTURAL MORTGAGE CORPORATION GENERAL PROVISIONS

10. The authority citation for part 650 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.

11. Amend part 650 by revising the part heading to read as set forth above.

§§ 650.1 through 650.68 [Redesignated]

12. Redesignate §§ 650.1 through 650.68 as follows:

Old section	New section
650.1, subpart	A 651.1.
650.2, subpart A	651.2.
650.3, subpart A	651.3.
650.4, subpart A	651.4.
650.20, subpart B	652.50, subpart B.
650.21, subpart B	652.55, subpart B.
650.22, subpart B	652.60, subpart B.
650.23, subpart B	652.65, subpart B.
650.24, subpart B	652.70, subpart B.
650.25, subpart B	652.75, subpart B.
650.26, subpart B	652.80, subpart B.
650.27, subpart B	652.85, subpart B.

Old section	New section
650.28, subpart B	652.90, subpart B.
650.29, subpart B	652.95, subpart B.
650.30, subpart B	652.100, subpart B.
650.31, subpart B	652.105, subpart B.
Appendix A to Subpart B of Part 650	Appendix A to Subpart B of Part 652.
650.50, subpart C	650.1.
650.51, subpart C	650.5.
650.52, subpart C	650.10.
650.55, subpart C	650.15.
650.55, subpart C	650.15.
650.56, subpart C	650.20.
650.57, subpart C	650.25.
650.58, subpart C	650.30.
650.59, subpart C	650.35.
650.60, subpart C	650.40.
650.61, subpart C	650.45.
650.62, subpart C	650.50.
650.63, subpart C	650.55.
650.64, subpart C	650.60.
650.65, subpart C	650.65.
650.66, subpart C	650.70.
650.67, subpart C	650.75.
650.68, subpart C	650.80.

Subpart A—General Provisions

§ 650.75 [Amended]

13. Amend newly designated § 650.75 by removing the reference ''§ 620.40'' and adding in its place, the reference ''§ 655.1'' in paragraph (c).

PART 653—[ADDED AND RESERVED]

PART 654—[ADDED AND RESERVED]

14. Add and reserve parts 653 and 654.

Dated: May 27, 2004.

Jeanette C. Brinkley,

Secretary, Farm Credit Administration Board.

[FR Doc. 04–12998 Filed 6–10–04; 8:45 am]

BILLING CODE 6705–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 2003–NM–178–AD]

RIN 2120–AA64

Airworthiness Directives; Short Brothers Model SD3 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This document proposes the adoption of a new airworthiness directive (AD) that is applicable to all Short Brothers Model SD3 series airplanes. This proposal would require testing for stiffness of the aft pintle pin bushing of the main landing gear (MLG), and inspecting and measuring the aft pintle pin bushings of the MLG for damage, and for out-of-limit dimensions of the bushing bore. This proposal would also require corrective action if necessary. This action is necessary to detect and correct corrosion and deterioration of the aft pintle pin bushings of the MLG. Corrosion and deterioration of the bushings, if not detected and corrected, could result in the MLG not extending fully during landing, with consequent damage to the airplane structure. This action is intended to address the identified unsafe condition.

DATES: Comments must be received by July 14, 2004.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Transport Airplane Directorate, ANM–114, Attention: Rules Docket No. 2003–NM–178–AD, 1601 Lind Avenue, SW., Renton, Washington 98055–4056. Comments may be inspected at this location between 9 a.m. and 3 p.m., Monday through Friday, except Federal holidays. Comments may be submitted via fax to (425) 227–1232. Comments may also be sent via the Internet using the following address: *9-anm-nprmcomment@faa.gov.* Comments sent via fax or the Internet must contain ''Docket No. 2003–NM–178–AD'' in the subject line and need not be submitted in triplicate. Comments sent via the Internet as attached electronic files must be formatted in Microsoft Word 97 or 2000 or ASCII text.

The service information referenced in the proposed rule may be obtained from Short Brothers, Airworthiness & Engineering Quality, P.O. Box 241, Airport Road, Belfast BT3 9DZ, Northern Ireland. This information may be examined at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington.

FOR FURTHER INFORMATION CONTACT: Todd Thompson, Aerospace Engineer, International Branch, ANM–116, FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington 98055–4056; telephone (425) 227–1175; fax (425) 227–1149.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested persons are invited to participate in the making of the proposed rule by submitting such written data, views, or arguments as they may desire. Communications shall identify the Rules Docket number and be submitted in triplicate to the address specified above. All communications received on or before the closing date for comments, specified above, will be considered before taking action on the proposed rule. The proposals contained in this action may be changed in light of the comments received.

Submit comments using the following format:

• Organize comments issue-by-issue. For example, discuss a request to change the compliance time and a