Fact Sheet

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Fact Sheet on Capital Adequacy – Basel Accord Tier 1/Tier 2 ANPRM

FCA is publishing an advance notice of proposed rulemaking (ANPRM) to seek public comments to assist the agency in formulating new capital regulations that would minimize differences, to the extent appropriate, in regulatory capital requirements between Farm Credit System (System) institutions and commercial banks and savings associations; improve the transparency of System capital for System stockholders, investors, and the public; and foster economic growth in agriculture and rural America by more effectively allocating System capital.

The ANPRM poses questions on the possible promulgation of regulatory capital standards based on the Basel Accord (Basel I) Tier 1/Tier 2 capital framework, the recent proposal by the Basel Committee to revise the Basel I standards, and the federal banking agencies' guidelines, but tailored to account for the System's member-owned cooperative structure and its status as a government-sponsored enterprise.

The ANPRM provides for a 120-day comment period. The 13 questions are as follows:

1. We seek comments on the different ways System banks and associations retain and distribute capital, how their borrowers influence the System institution's retention and distribution of capital, and how such differences should be captured in a new regulatory capital framework. Should we adopt separate and tailored regulatory capital standards for banks and associations? Why or why not?

2. We seek comments on ways to address bank and association interdependent relationships in the new regulatory capital framework. Should we establish an upper Tier 1 minimum standard for banks and associations? Why or why not? If so, what capital items should be included in upper Tier 1, and should bank requirements differ from association requirements?

3. We seek comments on ways to ensure that the majority of Tier 1 and total capital is retained earnings and capital held or allocated to its borrowers. Should we establish specific regulatory restrictions on third-party capital? Why or why not? If so, should there be different restrictions for banks and associations?

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4. We seek comments on the role that permanent capital will play in a new regulatory capital framework. Should we replace any regulatory limits and/or restrictions based on permanent capital with a new limit based on Tier 1 or total capital? If so, what should the new limits and/or restrictions be? Also, we ask for comments on how, or whether, to reconcile the sum of Tier 1 and Tier 2 (e.g., total capital) with permanent capital.

5. We seek comments on other types of allocated surplus or stock in the System that could be considered unallocated retained earnings (URE) equivalents under a new regulatory capital framework. We ask commenters to explain how these other types of allocated surplus or stock are equivalent to URE.

6. We seek comments on ways to limit reliance on noncumulative perpetual preferred stock (NPPS) as a component included in Tier 1 capital while avoiding the downward spiral effect that can occur when other elements of Tier 1 capital decrease.

7. We seek comments to help us develop a capital regulatory mechanism that would allow System institutions to include allocated surplus and member stock in Tier 1 capital. What risk metrics would be appropriate to classify a System institution as Category 1, Category 2, or Category 3? What percentage ranges of specific financial ratios would be appropriate for each risk metric under each category? We also seek comments on the increased restrictions and/or reporting requirements listed in Category 2 and Category 3.

8. We seek comments on whether the FCA should count a portion of the allowance for loan losses (ALL) as regulatory capital. We also seek information on how losses for unfunded commitments equate to ALL and why they should be included as regulatory capital. We ask commenters to take into consideration the Basel Consultative Proposal and any recent changes to FFRA regulations in relation to the amount or percentage of ALL includible in Tier 2 capital.

9. We seek comments on the treatment of cumulative perpetual and term-preferred stock as Tier 2 capital subject to the same conditions imposed by the Federal Banking Agencies.

10. We seek comments on authorizing System institutions to include a portion of unrealized holding gains on available-for-sale (AFS) equity securities as regulatory capital. We ask commenters to provide specific examples of how this component of Tier 2 capital would be applicable to System institutions.

11. We seek comments on the treatment of intermediate-term preferred stock and subordinated debt as Tier 2 capital and conditions for their inclusion in Tier 2 capital.

12. We seek comments on how to develop a regulatory mechanism to make a type of perpetual preferred stock that can be continually redeemed (referred to as H stock by most associations that have issued it) more permanent and stable so that the stock may qualify as Tier 2 capital.

13. We seek comments on the regulatory adjustments in our current regulations that we expect to incorporate into the new regulatory capital framework. We also seek comments on the regulatory capital treatment for positions in securitizations that are downgraded and are no longer eligible for the ratings-based approach under the new regulatory capital framework.

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