Fact Sheet

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Fact Sheet on Investment Management

The Farm Credit Administration (FCA) Board adopted a proposed rule on July 14, 2011, to revise its investment management regulations. FCA previously revised these regulations in 1999 and 2005. During the recent financial crisis, FCA recognized that these regulations should be updated and strengthened. In addition, in July 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 939A of the Dodd-Frank Act requires all Federal agencies to review their regulations that refer to or require the use of credit ratings, to remove those references and requirements, and to substitute other appropriate standards of creditworthiness. While this proposed rule does not propose new standards, it does discuss and seek comment about what is the best way to approach creditworthiness for eligible investments purchased by Farm Credit System (System) institutions. The proposed rule also seeks comment on several other issues.

Below is a summary of the proposed changes and a listing of the questions on which FCA seeks comment.

Summary of Proposed Changes

615.5131 Definitions: We propose to add definitions for “Government agency” and “Government-sponsored agency” to add clarity to our eligible investments table at § 615.5140.

615.5132 Investment Purposes: We propose to allow System institutions to exclude collateral posted as margin for derivative transactions from the 35-percent total investments as a percent of total outstanding loans calculation.

615.5133 Investment Management: We propose additional board policy requirements and enhanced internal controls of investments. We also propose to address eligibility through a section entitled “Due Diligence to Determine Eligibility, Suitability, and Value of Investments.” We propose to incorporate stress testing into the eligibility section. All investments, not just mortgage securities, would have to be stress tested, and investments that fail a stress test would no longer have to be divested. We also propose to strengthen our regulations over investment reporting so the board of directors would have sufficient information regarding investment portfolio practices and results.

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615.5135 Management of Interest Rate Risk: We propose to strengthen the interest rate risk management program of Farm Credit banks by adding new requirements for the interest rate risk management section of a bank's asset/liability management policy.

615.5136 Emergencies Impeding Normal Access of Farm Credit Banks to Capital Markets: This provision authorizes FCA, if it determines that an emergency exists, to adopt, in its sole discretion, a resolution providing relief from FCA's eligibility and liquidity reserve requirements. We propose changes that would broaden FCA's discretion in its granting of relief.

615.5140 Eligible Investments: We propose to reduce some of our portfolio limits and eliminate commercial mortgage-backed securities from the eligibility table.

615.5142 Association Investments: We would further clarify our expectations regarding associations that have investment portfolios.

615.5143 Management of Ineligible and Unsuitable Investments: Under the proposal, the eligibility of investments would be determined only at the time of purchase. An institution that purchased an ineligible investment would have to divest within 60 days unless FCA approved a divestiture plan for a longer period. An investment that is eligible when acquired, however, would not lose its eligibility even if its credit quality deteriorates such that it no longer meets FCA's regulatory eligibility criteria or the risk tolerance parameters contained in the board's investment policy. The proposed rule would also address requirements for board reporting and would reserve FCA's authority to require divestiture for safety and soundness reasons.

615.5174 Farmer Mac Securities: We propose that an institution must perform stress testing on mortgage securities issued or guaranteed by Farmer Mac only if the institutions did not originate the loans that back those securities. In addition, because other investments would no longer have to be divested if they fail a stress test, we propose to remove this requirement for Farmer Mac securities as well.

Listing of Questions on Which This Proposed Rule Seeks Comment

Questions related to section 615.5132

Question: Are Farm Credit banks able to purchase sufficient Treasury securities to enhance liquidity, while remaining within the constraint that total investments may not exceed 35 percent of total outstanding loans? Or should the percentage be raised and, if so, to what level and why?

Question: Should Treasuries be excluded from total investments when calculating the percentage of total investments to total loans outstanding? Would it be appropriate to exclude a portion of Treasury securities from the calculation? Would it be appropriate to apply a discount to Treasuries? What would be the basis for such a calculation change?

Questions related to section 615.5133

Question: Should FCA retain a standardized stress-testing option for institutions that do not wish to or do not have the capability of defining their own stress tests?

Question: Given that the Dodd-Frank Act requires us to eliminate credit ratings as a criterion for the eligibility of investments, would allowing System institutions to develop their own stress-testing standards result in a variety of investment portfolios that exhibit substantially different risk profiles? Could this result in an inappropriate amount of risk in some investment portfolios?

Question: Should our regulations require stress testing on all investments at the time of purchase? If not, on which investments should we require stress testing, and why? Should institutions be required to stress test their individual investments and their entire investment portfolio on a quarterly basis? Why or why not?

Questions related to section 615.5140

Dodd-Frank Act Compliance—Substitutes for Credit Ratings:

Question: Should FCA regulations specify financial measurements, benchmark indexes, or other measurable criteria against which institutions could evaluate the creditworthiness of their investments? Are there criteria other than those listed that should be included? Should the creditworthiness standard include specific standards for probability and loss given default? If so, why, and where could FCA source such data to derive such probabilities? Should this vary by asset class and/or type of investment? Would it be appropriate to combine this approach with one or more of the other approaches? If so, which ones, and why?

Question: Should FCA develop regulations that would require System institutions to develop their own internal assessment processes for evaluating creditworthiness of investments? Do System institutions have the capability of validating an internal assessment system for investments, and is it appropriate to allow institutions to develop their own internal model for assessing creditworthiness of investments? If so, what standards of creditworthiness should be included, and why? If we consider an internal model approach, what would be the criteria for eligibility, and why? Should an assessment of creditworthiness link directly to a bank's loan rating system? If so, how should differences in classifications pertaining to eligibility be handled? Would it be appropriate to combine this approach with one or more of the other approaches? If so, which ones, and why?

Question: Should FCA develop regulations that would require institutions to use third party assessments to assess creditworthiness? What reliable third party sources exist? Would it be appropriate to combine this approach with one or more of the other approaches? If so, which ones, and why?

Question: Should FCA develop a set of clearly defined criteria from which we would create a scale that ranks creditworthiness? If so, what definitional criteria should be used? Would it be appropriate to combine this approach with one or more of the other approaches? If so, which ones, and why?

Question: Do the above approaches allow for too much subjectivity and inconsistency? Is there an approach that would allow for objective criteria that would lead to consistency in assessing eligibility? How difficult and costly in practice would any of the potential approaches or combination of approaches be? Are there other approaches to assessing creditworthiness that would be more appropriate? What specific methods and standards should an institution be required to apply to appropriately assess the political and economic stability of a foreign country that hosts the obligor or issuer of an eligible investment?

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Portfolio Limits:

Question: Is it appropriate to establish an overall combined portfolio limit that would include all obligations except for money market instruments and those fully insured or fully guaranteed by Government agencies or Government-sponsored agencies? If so, what should the limit be? In addition, in light of the concentration that can occur in the housing sector, should we consider implementing a housing sector limit? Why or why not?

Questions related to section 615.5142

Question: Should we define surplus short-term funds? If so, how should we define it?

Question: Is our belief that surplus short-term funds should only be invested in overnight investments or in investments with maturities of 30 days or less appropriate?

Question: Is our proposed limitation on the permissible characteristics of investments purchased for the purpose of managing surplus short-term funds appropriate for associations, or does it unreasonably restrict an association's ability to properly hold and manage investments?

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