December 24, 2014

Mr. Barry Mardock

Deputy Director, Office of Regulatory Policy

Farm Credit Administration

1501 Farm Credit Drive

McLean, Virginia 22102-5090

Dear Mr. Mardock:

Thank you for the opportunity to comment on Farm Credit Administration's (FCA or Agency) proposed capital rule. I believe that adopting appropriate Basel III-based standards for the FCS will ultimately enhance investor understanding of the FCS's financial strength and increase marketability of third-party capital and debt securities, especially in periods of stress, thereby enabling the FCS to fulfill its mission. However, I also believe that strict conformance to rules and definitions designed for joint stock companies without recognizing our unique cooperative structure and the unique prudential capital needs of a GSE with a public policy mission is a mistake.

The existing capital rules were the result of extensive analysis, study and refinement during the past two decades and reflect the invaluable lessons learned during the 1980s' farm crisis. Such rules not only improved the quality and quantity of capital in the System, <u>they accommodated different philosophies within the System on how such capital is best accumulated</u>. The System's strong capital position before, during, and after the recent financial crisis is a testament to these

rules. I envisioned the proposed rules would result in a marriage of the successful elements of our current capital regulations with the current concepts embodied in the Basel III standards. The proposed rules, while making great strides towards this vision, falls short in several key areas discussed below.

Minimum Term: Length of Revolvement Program. The length of an association's revolvement program should be irrelevant to the issue of whether allocated surplus may be counted as CET1 or Tier 2 capital. I note that the Proposed Rule prohibits an institution from making capital distributions in any 12-month period in excess of its trailing 12-month earnings. This rule essentially requires capital to be replenished with new earnings before it is distributed. The Proposed Rule also places limits on distributions if capital levels fall below a capital conservation buffer that is substantially above the minimum standards. With these safeguards in place, there is no purpose served by imposing a minimum term on allocated surplus. Indeed, a minimum term could easily be confused with a "maturity" date in the minds of holders, itself creating an expectation of retirement in violation of a key definitional requirement of CET1. It makes little sense to impose what is, in effect, a 10-year "no-call" provision on an instrument that can be left outstanding indefinitely with no adverse legal or economic consequences whatsoever to the issuer.

Required Amendment to Capitalization Bylaws. The Proposed Rule establishes a default rule that all forms and types of allocated surplus (revolving, non-revolving, qualified, nonqualified) would no longer count in regulatory capital (i.e., Tier 1 or Tier 2 capital), even if the issuer prominently disclosed to members at the time of issuance that they would generally not receive this capital until liquidation. This default rule is subject to an exception. Under the exception, allocated surplus is elevated up to CET1 status (or Tier 2 status) if, and only if, the issuer obtains stockholder approval of a capitalization bylaw that tells the members that they will not and cannot receive a retirement of such allocated surplus within 10 years of the issuance date (or 5 years in case of Tier 2 capital).

As an issuer of nonqualified allocated surplus that is not subject to any type of retirement program and, indeed, has never been retired, Farm Credit West strenuously objects to a default rule that would remove this capital entirely from both Tier 1 and Tier 2 regulatory capital. Holders of our allocated surplus have no rights to distributions (short of an actual liquidation) because our Bylaws give the Board complete unfettered discretion to retain the capital indefinitely. I do not see how a bylaw amendment that limits our ability to make redemptions is necessary or appropriate when holders do not possess distribution rights in the first place. To our knowledge, no Farm Credit System institution or non-System cooperative has ever placed an explicit minimum term on its allocated equities.

Also, I believe our stockholders would be somewhat mystified receiving a ballot asking them to restrict the Board's discretion on the timing of allocated surplus retirements when I have already told our members not to expect any retirements of allocated surplus. I anticipate that many of our members would criticize the vote as a waste of money.

Moreover, the proposal could back-fire, creating pressure on the Board to begin retiring allocated surplus, at least at the 10-year mark. Then there is the possibility that stockholders reject the

proposal, resulting in a complete exclusion of our nonqualified notices from regulatory capital, notwithstanding that the notices themselves currently state that "Farm Credit West, ACA's Board of Directors considers this surplus to be permanently invested in the Association. As such, there is no current plan to revolve or redeem these amounts."

Treatment of Member Held Stock. I believe that all purchased stock in a System institution held by a member should count as Tier 2 capital, to the extent it does not count as Tier 1 capital, provided the stock lacks an explicit term or maturity. Under the Basel III criteria for Tier 1 and Tier 2 capital, I cannot envision a capital instrument that is characterized as equity under GAAP and that lacks an explicit maturity as falling completely outside of the definitions of Tier 1 and 2 capital. Member-held stock that is purchased as a condition of obtaining a loan or as part of an "H" stock program is fully at risk. Because such stock lacks an explicit maturity, it is redeemable solely at the Board's discretion and constitutes equity under GAAP. The Farm Credit Act recognizes member-held stock as regulatory capital through the statutory permanent capital requirement. It is our view that the Proposed Rule effectively supersedes the permanent capital ratio and, in so doing, excludes a large share of member-held stock as regulatory capital. I believe this aspect of the Proposed Rule thwarts congressional intent that allows all member-held, at-risk equity to count as regulatory capital. It also lacks the transparency sought in the Basel III framework by effectively ignoring legitimate at-risk capital investment in the association.

New Tier 1 leverage ratio. I believe the proposed 5% standard for the new Tier 1 leverage ratio is an arbitrary and capricious deviation from Basel III. There is simply no quantitative analysis or loss experience that justifies a 5% Tier 1 leverage ratio for the FCS while all other regulated financial institutions regardless of structure are subject to a 4% requirement. It is clear to me that FCA's proposal is excessive, unsupported, creates an unnecessary inconsistency with Basel III and would result in higher borrowing costs to the member-customers. This inconsistency with Basel III and with the approach taken by regulators around the globe will raise questions about the FCS's risk profile compared to other lending institutions. Such questions will irreparably harm the FCS and its mission achievement. In addition, the arbitrary higher leverage ratio will result in unnecessarily higher "dual capitalization" at wholesale FCS banks, given the two-tiered capitalization structure inherent in the FCS. For these reasons I ask FCA to establish a 4%Tier 1

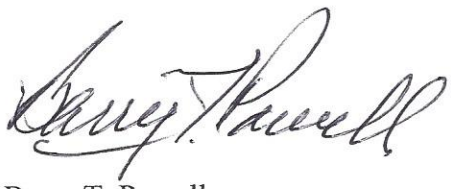
leverage ratio consistent with the Basel III guidance.

I am confident that, with the refinements to address the issues raised above, the proposed capital rule can be made workable and effective from a safety and soundness perspective and consistent with the implementation of Basel III by other regulators. Most importantly, these refinements are critical to ensure that the FCS can continue to function consistent with cooperative principles for the benefit of its member-customers as Congress clearly intended.

I feel that it is my responsibility as a director to protect the System's cooperative structure. This cooperative structure sets us apart from other financial institutions and it has given us the ability to fulfill our mission for nearly 100 years.

I appreciate the opportunity to comment on this proposed rule and FCA's willingness to consider my feedback.

Sincerely,



Barry T. Powell

Outside Director(Chairman-Audit Committee)

Farm Credit West