Farm Credit Administration

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INFORMATIONAL MEMORANDUM

December 8, 2021

To: Chair, Board of Directors
Chief Executive Officer
Each Farm Credit System Institution

From: Roger Paulsen, Director and Chief Examiner
Office of Examination

Kevin Kramp, Director
Office of Regulatory Policy

Laurie Rea, Director
Office of Secondary Market Oversight

Subject: Managing the LIBOR transition

The Farm Credit Administration is issuing this informational memorandum to provide additional guidance to Farm Credit System (System) institutions, including the Federal Agricultural Mortgage Corporation (Farmer Mac), on the transition away from the London Interbank Offered Rate (LIBOR).

This guidance supplements the informational memorandum (PDF) we issued on December 18, 2020, in which we encouraged System institutions to stop entering into new contracts that reference LIBOR as soon as practicable and in any event no later than December 31, 2021. Entering into new LIBOR-referenced contracts after that date would present a safety and soundness risk.

This new informational memorandum clarifies the meaning of new LIBOR contracts and provides your institution with guidance on using alternative reference rates. The federal banking regulatory agencies issued similar guidance in a joint statement (PDF) on October 20, 2021.

If you have any questions, including transaction-specific questions, please send them to our LIBOR Phaseout Workgroup at LIBORphaseout@fca.gov.

What does FCA consider a "new" LIBOR-indexed contract?

In general, we consider a new LIBOR-indexed contract to include any new contract or change to an existing contract that creates additional LIBOR exposure (on- or off-balance-sheet) or extends the term of an existing LIBOR exposure. We would not consider a one-time, short-term extension (for example, 30 to 90 days) that is made to facilitate normal line-of-credit renewal processes to be a new contract for the purposes of this guidance.

For legally committed credit facilities and lines of credit originated before year-end 2021, we do not regard draws after 2021 as creating new LIBOR exposure. Whether we would consider draws on uncommitted lines of credit after 2021 to be new LIBOR exposures would depend on the circumstances in each instance.

For example, if the uncommitted line of credit would be used to finish a project or complete the current operating cycle, we would not expect your institution to stop the borrower draws or redraft and renegotiate the loan agreement. However, if the uncommitted line of credit covered subsequent operating cycles, we would expect you to reprice it to an alternative reference rate.

For both committed and uncommitted lines of credit, your institution should make a good-faith effort to reduce LIBOR exposures and ensure appropriate fallback provisions.

You should never structure a loan for the purpose of extending or prolonging LIBOR exposure.

Does FCA consider *purchases* of legacy LIBOR-indexed loans and investments to be new contracts?

We do not consider LIBOR-indexed loans and investments that were originated or issued before year-end 2021 (that is, legacy contracts) to be new LIBOR contracts. However, since purchasing such instruments would increase your institution's LIBOR exposure and related risks, we encourage you to avoid them. If you do decide to purchase such an instrument, your pre-purchase due diligence should at a minimum answer the following questions:

- Is the instrument appropriate for its purpose?
- Do sufficient fallback provisions exist, and do these provisions adequately support the instrument's performance and marketability after LIBOR ceases to be published? In general, we would consider the purchase of LIBOR-referencing instruments that lack appropriate fallback provisions to be an unsafe and unsound practice.
- How would a decline in market liquidity or a dislocation between LIBOR and other market rates before June 2023 affect the instrument's marketability and risks? For example, at System banks, investments held in the liquidity reserve must remain marketable (§ 615.5134(d)), and investments with a market value of less than 80% of their book value must be removed from a bank's supplemental liquidity buffer (§ 615.5134(e)).[1] A significant impairment in market depth and pricing for investments could result in their exclusion as a source of liquidity.
- If legacy LIBOR assets are traded between System institutions, do these trades benefit overall System risk management efforts, avoid concentrating LIBOR exposures in an individual institution, and maintain or reduce Systemwide LIBOR exposure?

What exceptions does FCA allow for entering into new LIBOR exposures?

We take the same position as that of the federal banking regulatory agencies; see the joint statement (PDF) issued on November 30, 2020. In summary, your institution may enter into new LIBOR contracts after year-end 2021 that reduce or hedge risks in legacy LIBOR

[1] The liquidity regulations for Farmer Mac differ from those described here. See 12 C.F.R. § 652.40(b).

exposures. This includes new LIBOR contracts established on behalf of members and borrowers to hedge their legacy LIBOR exposures, provided exposures created by these new contracts are largely offset.

We expect you to price new contractual commitments on syndicated and purchased loans to an alternative reference rate after year-end 2021.

Beyond the Secured Overnight Financing Rate (SOFR), how does FCA view other benchmark/reference rate alternatives to LIBOR, including credit-sensitive alternative rates?

Your institution should perform due diligence before using these alternative reference rates and update your due diligence when underlying market conditions change or your exposure and related strategies change. Key factors that you should consider include the following:

- How is the reference rate constructed?
- Is the reference rate based on an active market with high volumes of transactions (rather than a quoted rate)?
- How would the underlying market hold up under different market conditions, and are the reference rate and its underlying market expected to be resilient during times of market stress?
- Can you effectively hedge risks related to the reference rate?
- Is the reference rate appropriate for your institution's products, risk profile, risk management capabilities, customer needs, and operational capabilities?
- Do instruments indexed to the reference rate have strong fallback provisions?
- Will you need to create risk parameters to limit exposure to the reference rate?