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October 15, 2014

Mr. Barry F. Mardock
Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

RE: Proposed Rule on Investments - *Federal Register* 79 (July 25, 2014) 43301-43318

Dear Mr. Mardock:

United FCS, ACA (United FCS) appreciates the opportunity to comment on the Farm Credit Administration's (FCA or Agency) proposed rule regarding investments. We support FCA's objectives in this proposed rule-making and particularly those proposed provisions that recognize the need for more latitude and flexibility in association investment programs.

We strongly join in and support the comments submitted by the Farm Credit Council as they reflect the consensus view of the entire Farm Credit System on this important matter. Additionally we offer the following comments that focus on proposed Section 615.5142 pertaining to association investments.

Proposed 615.5142 (a) - Investment Eligibility Criteria Proposed 615.5142 (a) would authorize each System association, with the approval of its funding bank, to manage risk by purchasing and holding obligations that are issued by, or are fully guaranteed or insured as to the timely payment of principal and interest by, the Unites States or any of its agencies in an amount that does not exceed 10 percent of its total outstanding loans.

We applaud FCA's recognition that the risks Farm Credit Banks and their respective associations face are multifaceted, and agree that current requirements for association investments -- which specify only the two eligible purposes of reducing IRR and managing surplus short-term funds -- are too restrictive and do not provide associations the flexibility to manage their risks in today's environment. The proposed rules would grant to associations greater flexibility to hold investments for other risk management purposes, including concentration risk. We agree that such modernization is in the best interest of the system. We do however urge FCA to clarify that the proposed limitation on association investment portfolio size does not apply to certain investments authorized under other sections of FCA regulations.

In addition, we ask FCA to reconsider the limit on the size of association investment portfolios, by specifying the limit as a percent of either earning assets or total assets rather than as a percentage of loans. Our rationale for these requests is provided in our comments below.

Comment 1. FCA requested comments on whether the proposed rule should identify specific purposes for associations to purchase and hold investments. We believe that this proposed rule should not identify specific purposes for associations to purchase and hold investments.

In general terms, the purpose of association investments is, in FCA's words, "to manage risks"; or in greater detail, "…to appropriately manage and diversify risks while serving their primary mission of funding agriculture and rural America." We believe any attempt to further enumerate the specific purposes for which associations may purchase and hold investments – beyond the purpose of "...to manage risks" -- will prove to be inflexible and unnecessarily restrictive.

As FCA notes, U.S. government issued or guaranteed investments are generally liquid, and pose virtually no credit risk, although they do pose market risk. Investments may help associations diversify concentration risk as single-industry lenders. A limit on association investment portfolio size will ensure "… that loans to eligible borrowers always constitute the vast majority of System assets, which is consistent with the mission of each association."

Comment 2. We urge FCA to clarify that certain balance sheet components are to be excluded from the 10% of loans investment limit. FCA should ensure that the 10% of loans limit does not unintentionally detract from authorized business practices appropriate to our mission. Specifically, FCA should clarify that the language pertaining to the proposed 10-percent limit is aimed at investments used for the purpose of risk management, and explicitly excludes other specific investment items, such as investments in Farmer Mac (FMAC) MBS, Agriculture and Rural Community (ARC) bonds, investments in Rural Business Investment Companies (RBICs), and investments in unincorporated business entities (UBEs).

- The size limitation should exclude investments in FMAC MBS, as authorized under Section 615.5174, "…for the purposes of managing credit and interest rate risk, and furthering your mission to finance agriculture." This regulation further limits the total size of Farmer Mac securities investments as, "the total value of your Farmer Mac securities cannot exceed your total outstanding loans." Use of FMAC for credit or capital purposes should not create limits in other areas of risk management.
- The size limitation should exclude ARC bonds, which are authorized by FCA under Section 615.5140(e). Although some may include partial or conditional government guarantees, these mission-related securities are often treated as loans under GAAP accounting, and are a fulfillment of our mission to agriculture and rural America. We believe that all mission-related investment activity should be excluded from the limit on investments for risk management purposes.

- The size limitation should exclude USDA guaranteed bonds including RAB and ARC bonds. FCA's Informational Memorandum dated March 22, 2011 authorizes associations to purchase and hold USDA unconditionally guaranteed obligations with no limitation as to amounts.
- The size limitation should exclude investments in UBEs created to manage complex workout situations, and to efficiently structure programs that allow associations to collaborate on customer-oriented programs and services in the fulfillment of our mission and authorized under Section 611.1153. Programs such as AgDirect, crop insurance collaborations, and 4.25 Service Corps, are considered equity investments for many, and should not be considered when calculating risk management investments. These investments are already limited to 1% of loans (unless otherwise approved by FCA) under Section 611.1153(h).
- The size limitation should exclude investments in RBICs which authority is in accordance with title VI of the Farm Security and Rural Investment Act of 2002 and regulations issued by USDA (7 CFR 4290.10 through 4290.3099) . FCA has the authority to ensure that a system institution's investment in a RBIC is safe and sound and that they operate the RBIC in accordance with law and regulation.

Comment 3. The proposed calculation of an investment limit is the 30-day average balance of investments divided by the 30-day average balance of loans. Loans are defined in 615.5131, which provides that loans are calculated quarterly at quarter end using quarterly ADB (including accrued interest and excluding allowance for loan loss adjustments). Therefore, in this case, using the quarterly average daily balances for investments and loans is more appropriate because it limits distortions caused by seasonal fluctuations in loans and remains consistent with the definition in 615.5131.

Notwithstanding, we believe that total loans outstanding is an inappropriate benchmark for investments used in risk management. More appropriate options include (a) Earning Assets, (b) Loans plus Mission-related investments plus UBEs plus RBICs plus FMAC MBS, or (c) Total Assets.

- If an association were to transform "loans" into an "investment" (e.g., via securitization through Farmer Mac), any limit with loans as denominator would be inadvertently restrictive. System entities may utilize securitizations for liquidity, credit risk and capital management purposes, and therefore, we do not believe that converting loans into investment securities should cause a tighter constraint to be imposed on any other investment purpose. A denominator of (a), (b) or (c) would alleviate that predicament.

Accordingly, we request FCA to specify the limit as 10% of either earning assets or total assets rather than 10% of loans. This specification will avoid inappropriately restricting investments when loans are converted to investments.

<u>Proposed Part (b) – Risk Management Requirements</u>

Proposed 615.5142(b) would require an association to evaluate its investment management policies and determine and document how its investment activities are conducted in accordance with the risk management processes and procedures identified in proposed 615.5142 (b) (1), (b) (2), and (b)(3). In general, these proposed requirements are appropriate, as they require appropriate policies, controls and practices, and also require an association's investment management process to be appropriate for the size, risk, and complexity of the association and its investment portfolio.

<u>Comment 4.</u> FCA is interested in comments on how the FCA can structure the documentation requirements so they do not impose undue regulatory burden on funding banks or associations. We believe that much of the documentation for each specific investment program (e.g., SBA and USDA loans) should be at the program level rather than the individual security level, and that program documentation should address concentration limits, interest rate risk characteristics, investment process, and liquidity characteristics. Associations may also need documentation regarding asset class diversification, although the current proposal would limit associations to a single asset class that poses no credit risk.

- The requirement to address IRR are unchanged. An association with significant interest rate risk exposure must comply with 615.5182, which requires an association with IRR that could lead to significant declines in net income or MVE to comply with 615.5180, which establishes specific criteria for System banks to follow in managing IRR. IRR programs must be commensurate with the level of IRR at the association. To the extent the association has investments, its board must develop and implement an IRR management program which identifies, measures, monitors and controls IRR.
- The requirements relating to Other Relevant Factors include evaluating the association's management experience and capability, risk bearing capacity, unique circumstances, and objectives. Speculative trading is not permitted.

<u>Paragraph (c) – Funding Bank Supervision of Association Investments</u> This paragraph specifies that an association must request approval to buy and hold investments from its funding bank. We believe FCA should clarify that approval should be sought for each specific investment program (e.g., SBA and USDA loans), rather than on an individual investment basis.

- The funding bank must determine that association has adequate policies, procedures, internal controls and accounting and reporting systems for investments, capability to effectively manage risks, and has complied with 615.5142(b) – Risk Management Requirements.
- The funding bank must annually evaluate whether investments mitigate and manage association risks, and risk management practices continue to be adequate.

We have no comments on:

- Paragraph (d) which allows associations to request FCA approval to purchase and hold other investments (equivalent to existing 615.5140(e)), and provides that other investments would be subject to portfolio limit unless otherwise provided by FCA;
- Paragraph (e) which addresses transition and divestiture Issues for Association Investments;
- Section 615-5143 which addresses management of ineligible investments and reservation of authority to require divestiture.

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Again, we appreciate the opportunity to comment on these investments regulations. Use of investment authorities to manage liquidity and risk is of the utmost importance to the Farm Credit System.

Please contact me or President and Chief Executive Officer Marcus Knisely if you wish to discuss our comments or require any additional information.

Sincerely,

Sincerely,

Bradley Sunderland
Board Chair

Cc: Ken Auer, President and CEO – Farm Credit Council
Marcus L. Knisely, President and CEO – United FCS