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January 17, 2012

Via Electronic Mail to reg-comm@fca.gov
Laurie A. Rea
Director, Office of Secondary Market Oversight
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Notice of Proposed Rulemaking: "Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Farmer Mac Investments and Liquidity Management"
12 CFR Part 652, RIN 3052-AC56, November 18, 2011

Dear Ms. Rea:

The Federal Agricultural Mortgage Corporation ("Farmer Mac" or the "Corporation") appreciates the opportunity to respond to the request for public comment on the above-referenced proposed rule (the "Proposed Rule")[1] published by the Farm Credit Administration ("FCA") with respect to the non-program investments and liquidity regulations applicable to Farmer Mac (the "Liquidity and Investment Regulations"). Farmer Mac understands FCA's responsibility for ensuring the safety and soundness of Farmer Mac, and recognizes FCA's intent to enhance Farmer Mac's safety and soundness through the Proposed Rule. However, Farmer Mac has several concerns, questions, and suggestions that are outlined below in six broad categories.

1. Level 1 Investments

FCA has indicated that certain categories of non-program investments would qualify as "Level 1 Investments"[2] for purposes of satisfying Farmer Mac's first 30 days of liquidity in its days-of-liquidity measurement under the Liquidity and Investment Regulations. Farmer Mac believes that FCA should clarify in any final rule issued with respect to the Liquidity and Investment Regulations that investments maturing overnight, including overnight repurchase agreements, be included within the category of Level 1 Investments. As FCA has pointed out in the Proposed Rule, Level 1 Investments are intended to be "the most liquid investments" that

[1] 76 Fed. Reg. 71798 (Nov. 18, 2011).

[2] Under the Proposed Rule, Level 1 Investments include cash, Treasury securities, other Government agency obligations, Government-sponsored agency securities (excluding mortgage-backed securities) that mature within 60 days, and Diversified Investment Funds comprised exclusively of Level 1 instruments.

would "be used to fund [Farmer Mac's] obligations maturing in calendar days 1 through 30."[3] In Farmer Mac's experience, overnight investments are one of the most liquid investments available for Farmer Mac to fund its shorter-term obligations and possibly the most liquid investment to fund shorter-term obligations at a positive spread.[4] Overnight investments, such as overnight repurchase agreements, mature at market open each day and can be invested by Farmer Mac in cash at the Federal Reserve during the day and, if there is a market disruption, each night and day thereafter. Overnight investments provide an excellent source of liquidity for Farmer Mac and are a critical instrument in ensuring Farmer Mac's liquidity needs are met even today. FCA has indicated the importance for Farmer Mac's liquidity portfolio to be structured in such a manner so as to "not lose liquidity value in a market downturn" and enable Farmer Mac to meet its short-term obligations.[5] For the reasons described, overnight investments amply satisfy these conditions. Accordingly, Farmer Mac believes that overnight investments should be included within the category of Level 1 Investments.

In addition, Farmer Mac believes that FCA should expand the scope of Diversified Investment Funds ("DIFs") permitted as Level 1 Investments (including for the first 15 days of liquidity) to include DIFs that comply with the Securities and Exchange Commission's ("SEC") portfolio maturity requirements for money market funds.[6] As a practical matter, it would be difficult if not impossible to invest in DIFs that contain only Level 1 Investments as currently contemplated by the Proposed Rule due to the fact that the Proposed Rule would require Level 1 Investments (other than U.S. obligations) to mature within 60 days. However, in Farmer Mac's experience, any DIF containing Government-sponsored agency securities would have at least one security with a maturity exceeding 60 days. Furthermore, even within the category of DIFs comprised solely of Treasury securities, Farmer Mac is unaware of any DIF whose portfolio consists entirely of Treasury securities maturing within three years, which would be required to be eligible for Farmer Mac's first 15 days of liquidity under the Proposed Rule. As a result, these factors would effectively exclude DIFs from Level 1 Investment consideration under the Proposed Rule. Farmer Mac requests that FCA include DIFs in the category of Level 1 Investments (including for the first 15 days of liquidity), so long as the DIFs have no assets with a remaining maturity of greater than 397 days and a dollar-weighted average portfolio maturity of not more than 60 days (or 120 days without consideration of interest rate reset periods), which

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[3] Proposed Rule at 71813; *see also* Proposed Rule at 71820 (proposed 12 C.F.R. § 652.40(d)) (outlining composition of liquidity reserve and supplemental liquidity).

[4] FCA acknowledged in the Proposed Rule that its "regulations should recognize the tradeoff between the need for liquidity and the need for a reasonable return on assets." *See* Proposed Rule at 71800. Including overnight investments within the category of Level 1 Investments would allow for reasonable income generation without sacrificing liquidity risk management.

[5] *See* Proposed Rule at 71813.

[6] *See* Rule 2a-7(c)(2), 17 C.F.R. § 270.2a-7(c)(2).

are parameters consistent with SEC regulations for money market funds.[7] This would allow Farmer Mac to maintain its current investment practices with respect to DIFs while providing sufficient liquidity to address any safety and soundness concern on FCA's part.

2. Definitions and Terms

Farmer Mac also requests that FCA clarify various definitions and other terms that are vague in the Proposed Rule or, in Farmer Mac's opinion, require reconsideration. For example, FCA's proposed definition of "cash" includes only "cash balances held at the Federal Reserve Banks, proceeds from traded-but-not-yet-settled debt, and the insured amount of balances held in deposit accounts at Federal Deposit Insurance Corporation-insured banks."[8] FCA has also proposed to include "cash" as a category of Level 1 Investment under the Liquidity and Investment Regulations. However, the Proposed Rule is unclear as to the treatment of any cash that might be held at an insured depository institution in excess of the FDIC-insured limit.[9]

In addition, FCA's use of the terms "immediate," "prompt," and "senior-most"[10] in the Proposed Rule are unclear, resulting in each case in the potential for confusion or misapplication of the Liquidity and Investment Regulations. Requiring "immediate" action or "prompt" reporting leaves significant room for interpretation as to practical application. Farmer Mac believes that requiring action within a reasonable time frame as established in the Board's policies and procedures will accomplish the goal of sound liquidity risk management while eliminating the potential for misinterpretation of any "immediate" requirements. Furthermore, to the extent that FCA requires "prompt" reporting of any action, FCA should either establish a specific time frame in which to report or rely on its regular and ongoing safety and soundness examination to evaluate such action.

Farmer Mac also believes that FCA's two-prong test for determining whether an investment is "senior-most" is awkward and conflicts with market norms. The first prong – that an eligible investment must have senior liquidation preference within its series – is clear in its meaning and consistent with market perceptions of low-risk, liquid investments. However, the

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[7] *Id*.

[8] Proposed Rule at 71801; *see also* Proposed Rule at 71814 (proposed 12 C.F.R. § 652.5) (definition of "cash").

[9] For example, if Farmer Mac were to hold cash in an interest-bearing account in excess of $250,000, or if the FDIC rules providing for unlimited insurance for non-interest-bearing accounts were to expire as scheduled in 2013.

[10] *See* Proposed Rule at 71812 (noting that FCA's "interpretation of the term '*immediate*' in the description of 'highly marketable' will consider the overall quality of the investment); *Id.* at 71819 (proposed 12 C.F.R. § 652.35(c)(ii)) (requiring that management "report any deviation from the bank's [*sic*] liquidity policy, or failure to meet the board's liquidity targets *immediately* to the board) (emphasis added); *Id*. at 71818 (proposed 12 C.F.R. §652.25(a)) (noting the requirement for Farmer Mac to notify FCA "promptly" upon any eligible asset becoming ineligible or not suitable); and *Id.* at 71805 (noting that "senior-most" must meet liquidation preference requirements as well as have "a higher priority claim to any contractual cash flows" than other tranches of the respective series).

second prong – that an eligible investment must have the highest priority claim to any contractual cash flows – is highly limiting and could be difficult to implement. This second prong would preclude a variety of safe, highly liquid positions with senior liquidation preference but without first priority access to cash prior to default. For example, to better manage its interest rate risk, Farmer Mac has successfully invested in various credit instruments as to which Farmer Mac's position has senior liquidation priority, but as to which Farmer Mac receives payment after other investors in ongoing cash flows. The Proposed Rule's definition of "senior-most" would preclude these investments for Farmer Mac's investment portfolio as well as its interest rate risk management tools. Furthermore, for purposes of liquidity, the market generally prefers senior liquidation priority over contractual cash flows, particularly in a credit crisis in which liquidity is prone to tighten. Therefore, Farmer Mac believes that any final rule should define "senior-most" to only require senior liquidation preference.

3. Specificity of Liquidity Categories

Farmer Mac noted in its letter to FCA dated July 2, 2010[11] (the "ANPRM Comment Letter") Farmer Mac's concern about overly prescriptive regulations restricting the composition of its liquidity investment portfolio. In its letter, Farmer Mac emphasized that its "ability to respond quickly to market forces and adjust [its] use of a range of asset classes is crucial."[12] Under current market conditions, the approach embodied in the Proposed Rule may appear to strengthen Farmer Mac's existing days of liquidity requirement, but as has been demonstrated in the global market volatility of the past several months, no particular asset is ever immune from market swings, price fluctuations, and credit events. Farmer Mac understands FCA's view that holding higher balances of Treasury securities would theoretically improve balance sheet liquidity. However, recent experience has shown that a financial institution is able to claim robust liquidity only when it has the ability to maintain a portfolio of diversified assets coupled with solid risk management. As markets change, Farmer Mac needs to respond to market conditions and alter its composition of liquid assets. Accordingly, Farmer Mac believes that the safest course of action is for any final rule to exempt Treasury securities from the overall 35 percent of program volume limit, similar to margin pledged to satisfy derivative obligations.[13] The Proposed Rule would require Farmer Mac to hold significant amounts of Treasury securities to meet FCA's liquidity requirements, thereby utilizing a large portion of Farmer Mac's liquidity and investment portfolio capacity. Should market conditions change with Treasury securities, as experienced in August 2011, Farmer Mac would have neither sufficient capacity nor the ability

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[11] Letter to Mr. S. Robert Coleman, Director, Office of Secondary Market Oversight, Farm Credit Administration, dated July 2, 2010, regarding Advanced Notice of Proposed Rulemaking: "Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Farmer Mac Investments and Liquidity," 12 C.F.R. Part 652, RIN 3052-AC56, May 19, 2010.

[12] *Id.*

[13] *See* Proposed Rule at 71817 (proposed 12 C.F.R. § 652.15) (requiring that non-program investments, exclusive of qualifying USDA-guaranteed securities and investments pledged to meet derivative obligations, not exceed 35 percent of Farmer Mac's program assets).

to meet its liquidity needs through non-Treasury assets. However, excluding Treasury securities from the 35 percent of program volume limit would allow Farmer Mac to meet the liquidity goals prescribed by FCA in the Proposed Rule, while simultaneously allowing Farmer Mac to maintain adequate diversity for its liquidity and enterprise risk management.

4. Board Management of Liquidity Investments

Farmer Mac would like to reiterate the point made in its ANPRM Comment Letter that FCA's liquidity regulations should "establish broad guidelines that lead to prudent risk management rather than being prescriptive."[14] As FCA acknowledged in the Proposed Rule, FCA is "charged with establishing an appropriate regulatory and supervisory *framework*" to promote Farmer Mac's safety and soundness (emphasis added).[15] However, Farmer Mac believes that several of the proposed changes outlined in the Proposed Rule go well beyond establishing a framework for safety and soundness and instead impose FCA's judgment on proper business operations within the context of liquidity and enterprise risk management. Although FCA states that these requirements "are intended to provide clarity to [FCA's] expectations but are not intended to fundamentally change the [existing] requirements," the level of detail that the new requirements would impose is not consistent with the stated intent.[16] Among other new requirements, the Proposed Rule would require Board approval for Farmer Mac to manage relationships with securities firms, a risk assessment and independent valuation for each investment prior to purchase, and implementation of a specifically delineated Board reporting schedule.[17] These new requirements go beyond establishing a framework for safety and soundness. Rather, the specificity with which FCA would require Farmer Mac to engage in its investment risk management effectively supplants the business judgment of Farmer Mac's Board of Directors (including its authority to delegate functions to Farmer Mac's management) with that of FCA. A more appropriate framework would entail criteria that establish parameters, such as outlining risk management goals for Farmer Mac to accomplish through Board policy, rather than dictating procedure.

In addition, Farmer Mac believes that the Proposed Rule is overly prescriptive with respect to Farmer Mac's management of its internal controls process. For example, the Proposed Rule specifies which roles within Farmer Mac's management must be separated from others. Rather than allowing Farmer Mac's Board to determine the appropriate method for maintaining internal controls based on the strengths of the individuals comprising its staff, the Proposed Rule

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[14] *Id*.

[15] Proposed Rule at 71799.

[16] Proposed Rule at 71801.

[17] *See* Proposed Rule at 71816 (proposed 12 C.F.R. § 652.10(c)(1)(ii), (e), (f)(i)-(iii) and (g) (prescribing requirements for Board approval of securities firms, internal control processes, analysis and documentation for pre-purchase due diligence of investments, and Board reporting requirements)).

instead dictates the division of labor within Farmer Mac. Also, delineating specific procedural requirements for Farmer Mac's internal audit process, such as "ensuring *all* investments are eligible and suitable for purchase under [the Board's] investment policies,"[18] eliminates the flexibility necessary for Farmer Mac's internal auditors to establish their own risk-based approach to their audits based on their experience and professional guidelines. Once again, these new requirements would effectively substitute FCA's judgment regarding Farmer Mac's internal control process for that of its Board and auditors.

5. Investment Category Concentrations

Farmer Mac requests that FCA reconsider the asset class concentration limits outlined in the Proposed Rule, which Farmer Mac believes are unnecessary and burdensome. In particular, Farmer Mac believes that the five percent limit on collateral type for asset-backed securities ("ABS") and the ten percent limit on each Global Industry Classification Standard ("GICS") sector for corporate debt securities unnecessarily restrain Farmer Mac's ability to manage its investment portfolio, particularly when the overall categories of ABS and corporate debt securities are limited to 15 and 20 percent, respectively, of the entire portfolio, and within each of these categories, additional obligor limits apply.[19] Furthermore, these assets would not be used for primary liquidity under the Proposed Rule's Level 1 and Level 2 Liquidity categories, which would require Farmer Mac to hold a large amount of highly-liquid, government issued or supported securities. All of these factors alone would ensure a fully diversified and strong liquidity portfolio without the need for further concentration limits. Eliminating the concentration limits on ABS collateral types and GICS industry sectors would enable Farmer Mac's Board of Directors to establish its own policies that would enable Farmer Mac to effectively diversify its portfolio in a countercyclical fashion based on user demand and availability of securities. In contrast, retaining these limits, notwithstanding the existence of all other safeguards outlined in the Proposed Rule, could realistically have the effect of shutting out otherwise eligible investments that could be highly attractive to Farmer Mac from a risk management perspective. Farmer Mac believes that a framework that provides Farmer Mac with the flexibility to manage its investment portfolio in this regard to respond to market forces in real time is preferable to the one proposed and consistent with ensuring Farmer Mac's safety and soundness.

6. Alternatives to the Use of Credit Ratings for Farmer Mac's Non-Program Investments

Farmer Mac recognizes the considerable task faced by FCA in developing standards of creditworthiness in place of credit ratings for use in the Liquidity and Investment Regulations in accordance with Section 939A of the Dodd-Frank Act. Although the undue reliance on credit

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[18] Proposed Rule at 71816 (proposed 12 C.F.R. § 652.10(e)(4)) (emphasis added).

[19] Proposed Rule at 71818 (proposed 12 C.F.R. § 652.20(a)(7)-(8) and (d) (establishing concentration limits for ABS and corporate debt securities and obligor limits)).

ratings may have contributed to recent disruptions in the U.S. financial markets, Farmer Mac believes that the prospect of employing credit ratings as a component of assessing counterparty credit risk retains significant value, particularly for assessing counterparty risk. Farmer Mac also believes that no single indicator of credit risk is appropriate for determining the eligibility of assets in its investment portfolio. Farmer Mac currently uses a combination of metrics including market spreads, credit ratings and internal research to determine if an investment is appropriate for Farmer Mac. Standardizing this approach into an eligibility criterion can be difficult and highlights the complex and variable nature of defining maximum credit risk appropriate for the liquidity and investment portfolio. As a result, Farmer Mac recommends that any regulation allow Farmer Mac's Board of Directors to establish appropriate credit criteria and measurements for assets in Farmer Mac's investment portfolio, and enable FCA to monitor the Board's actions and policies through FCA's ongoing examination.

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We encourage FCA to consider the comments contained in this letter as FCA formulates its final regulations related to the Liquidity and Investment Regulations. Farmer Mac appreciates FCA's consideration of these comments and would be pleased to discuss these matters further at your request.

Very truly yours,

Michael A. Gerber
President and Chief Executive Officer