



THE FARM CREDIT COUNCIL

January 17, 2012

Ms. Laurie A. Rea
Director
Office of Secondary Market Oversight
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Subject: Proposed Rule – Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Farmer Mac Investments and Liquidity Management – 12 CFR Part 652

Dear Ms. Rea:

We appreciate the opportunity to comment on the Farm Credit Administration's (FCA) proposed rule on Farmer Mac Investments and Liquidity management. We respect FCA's perspective and responsibilities as a safety and soundness regulator and understand that the proposed rule is intended to enhance safety and soundness at Farmer Mac. We believe this rule is critical as the Agency enhances its oversight of Farmer Mac.

As you know, the FCS Presidents Planning Committee has established a Treasurers' Workgroup (Workgroup) that includes financial officers from several associations throughout the System and all of the System Banks and the Federal Farm Credit Banks Funding Corporation. The comments provided herein were developed with input from that Workgroup. Nonetheless, we anticipate that some System institutions may submit their own comments. We offer the following general and section by section comments on the proposed rule.

Given the similarities between this proposed rule and the rule recently proposed on investment management at Farm Credit System (FCS) banks and associations, we would encourage FCA to refer to the many System comment letters filed on that rulemaking. Many of the same concepts are applicable to the rule proposed for Farmer Mac. Comments on the prescriptiveness of the Investment Management proposed rule are also applicable to this rule, as are the comments on investment management, limits, stress testing, eligible investments, and divestiture requirements. We are attaching our comment letter on the proposed rule for the FCS for your reference and as part of our comments on the proposed Farmer Mac rule.

While noting these similarities in the Agency's approach on the proposed rules for Farmer Mac and FCS institutions, we would point out a key difference for the Agency to consider as it prepares to finalize these rules. Farmer Mac is structured as a publicly traded stock corporation while FCS institutions are cooperatives. Farmer Mac also enjoys direct access to a line of credit with the U.S. Treasury. As a result, Farmer Mac enjoys the best of both worlds – private capital that can be traded at fair value and an explicit public backstop. We urge the Agency to consider this paradox carefully when establishing the scope of allowable investments for Farmer Mac.

Overall Comment

The Agency's proposal to set Farmer Mac liquidity and investment restrictions roughly equal to those set by the Agency for FCS institutions is, for the most part, a sound concept and ensures rough equality in areas where Farmer Mac and FCS institutions compete. We support this concept. However, our support for this broad concept is by far outweighed by our strong opposition to the Agency's decision – whether intentional or not – to allow Farmer Mac to use non-program investments as a business strategy to enhance returns for investors. The use by a Government Sponsored Enterprise, especially one with direct ties to the U.S. Treasury, of an investment portfolio to boost returns to private stockholders is inappropriate and would actively encourage management to push out on the risk curve to enhance yield. We urge the Agency to significantly rewrite the proposed revisions to 652.14 that would authorize investments that are “complementing program business activities.” We find the proposal inconsistent with the rule's stated objectives, overly expansive, and inconsistent with safety and soundness.

FCA specifically states that it is authorizing such investment purposes to allow Farmer Mac to enhance income performance even if such securities do not contribute to Farmer Mac's liquidity risk management. We see this regulatory philosophy as significant tolerance for risk taken by Farmer Mac in its investment portfolio. As major investors in Farmer Mac, we are opposed to regulatory provisions that authorize Farmer Mac to assume additional risk in non-program investments. The Agency's proposed rule should limit Farmer Mac's non-program investment activities to the three purposes that already exist – managing short-term surplus funds; complying with interest rate risk requirements, and complying with liquidity reserve requirements. This limit would be consistent with the limit set by the Agency for FCS institutions. There is no reason that the Farmer Mac standard should be more liberal than the standard set for FCS institutions.

We concur with FCA statements that liquidity investment portfolios can appropriately include investments that provide a positive return and still fulfill the authorized investment purposes under most market conditions. This concept and regulatory philosophy is equally applicable to FCS institutions and there is nothing unique to Farmer Mac's business model that supports a different treatment from the FCS. Therefore, we ask FCA to maintain regulatory comparability.

Section-by-Section Comments

§ 652.5 Definitions

FCA proposes to eliminate the definitions of “liquid investments” and “marketable” in recognition of the new term “highly marketable” addressed in § 652.40(c). We note, however, that the proposed description of “highly marketable” is identical to the recent proposed “marketable” description in the Liquidity and Funding Proposed Rule for the FCS. We do not understand the rationale for the inconsistency in regulatory terms and why FCA has not deemed it appropriate to eliminate the definitions for “liquid investments” and “marketable” investments applicable to System institutions as it has proposed to do so for Farmer Mac. The fundamental business model difference does not support this difference in treatment and we ask FCA to be consistent in regulatory safety and soundness requirements and supervision between the System and Farmer Mac.

Definitions for “contingency funding plan” and “liability maturity management plan” appear to be unnecessary as they simply refer to proposed regulatory sections and create excess regulatory text.

The definition of “non-program investments” is overly broad and allows for the holding of investments beyond the regulatory objectives of ensuring safety and soundness and continuity of funding as outlined in § 652.1. For this reason, the definition should be modified to clarify that non-program investments are those held to manage short-term surplus funds, comply with interest rate risk requirements, and comply with liquidity reserve requirements.

§ 652.10 Investment Management and Requirements

Our comments on proposed changes to § 615.5133 Investment Management for FCS institutions are largely applicable to the proposed changes to §652.10 (see attached letter). We ask that FCA refer to those comments and relevant sections, including responsibilities of the board of directors, investment policies, and internal controls. The requirements are practically the same until § 652.10(f). We ask that FCA follow a similar structure and approach for Farmer Mac as it proposed for the FCS in the investment management proposed rule.

In addition, we have some specific observations as follows:

- **Internal Controls:** The proposed rule adds to the list of personnel whose duties and supervision must be separated from those who execute transactions. It also requires an internal audit review at least annually. This is the same as the requirements under the proposed rule for the FCS institutions. We find these requirements to be overly prescriptive, for both the FCS and Farmer Mac. We believe it would be more appropriate for FCA to provide flexibility for internal audit to develop its own risk-based approach. We ask that the proposed regulatory language be modified to generalize the requirement.
- **Risk Assessments:** We see the detail and prescriptiveness for the risk assessment section as unnecessary, burdensome, and redundant to the proposed significant requirements for the investment policies. The approach proposed for the FCS institutions, while still excessive, was more streamlined and consistent with the overall objectives of the regulations.
- **Stress Testing:** The FCA is inconsistent in its approach to stress testing, giving Farmer Mac a more lenient standard than that applied to FCS institutions. The proposed rule would require that Farmer Mac stress test its entire investment portfolio each quarter. FCA proposes to require FCS institutions to stress test individual investments prior to purchase and quarterly thereafter. Moreover, the proposed regulatory text for stress testing [see § 652.10(f)(3)(ii)] differs in subtle and important ways from what was proposed for the FCS. While both proposals are excessively detailed and prescriptive, we find this type of inconsistency between regulatory requirements confusing and unnecessary given the subject of the regulations, and not supported by any business difference between Farmer Mac and the FCS.

We are uncertain as the reasons for these regulatory differences and we are hopeful that FCA can create conformity as do the OCC, FDIC, and Federal Reserve for the entities they regulate, many of which are also both primary and secondary providers of financial services. Therefore, we ask FCA for regulatory consistency for liquidity investments and investment management between Farmer Mac and the FCS.

§ 652.15 Non-program investment purposes and limitation

As discussed in our overall comments, we strongly object to the significant expansion of proposed authorized investment purposes of “complementing program business activities.” We

see no basis for such an expansion and we are concerned by the lack of definition of what constitutes such business activities.

This is a potentially dangerous expansion of authority for an entity that has previously incurred significant losses in its investment portfolio. It appears that the Agency's rationale for proposing this kind of broad authority expansion is to facilitate increased returns to investors in Farmer Mac's publicly traded stock. The Agency seems to accept Farmer Mac's arguments, made in their ANPRM comment letter, that Farmer Mac needs a broader range of eligible investments because its liquidity requirements are great and, consequently, its investment portfolio will be large as a percentage of its total assets. This rationale is precisely backwards. Given that Farmer Mac will have a relatively high percentage of investments relative to overall assets, those investments must be of even higher quality in order for them not to jeopardize Farmer Mac's ability to fulfill its statutory mission. A mistake in the investment portfolio, made more likely if Farmer Mac is reaching for additional return on investments to support its stock price, would be magnified given the relative size of the portfolio compared to other income producing assets.

This proposed revision adds significantly to potential investment risk at Farmer Mac. Therefore, we ask that FCA drop this proposed revision in its entirety.

§ 652.20 Eligible non-program investments

Our comments on proposed changes to § 615.5140 Investment Management for FCS institutions are largely applicable to the proposed changes to § 652.10 (see attached letter). The proposed table of investments appears consistent for both Farmer Mac and FCS, therefore our comments on the investment management proposed rule for FCS institutions are also applicable to the proposed Farmer Mac liquidity and investment rule in this area.

Additionally, we note two significant issues:

- **Non-agency mortgage securities limit:** Like the requirement proposed for the System, the proposed rule would reduce the investment portfolio limit for non-agency mortgage backed securities to 10 percent for Farmer Mac. We believe this requirement to be limiting in one's ability to manage an investment portfolio through time in an economically efficient and effective manner. Therefore, the lower limit should not be imposed. Similarly, FCA should not impose a lower limit in the FCS as proposed in its investment management proposed rule.
- **Senior-Most Position:** Similar to the requirement proposed for FCS institutions, the Agency proposes to require that mortgage securities, to be eligible for Farmer Mac investment, be considered as the "senior-most" position. We believe that the term "senior-most" in this usage refers to the loss allocation in liquidation of the securities and not to the order in which payment is made while the security is performing. Many mortgage securities are structured in a manner that certain investors receive cash flows during the initial years of the mortgage security and then others in later years. The sequencing of these payments is important to match maturities needed in liquidity investment portfolios. We strongly recommend that FCA clarify the intent of this "senior-most" requirement to be consistent with our understanding.

§ 652.25 Management of ineligible and unsuitable investments

Our comments on FCA's proposed changes to § 615.5143 for System institutions are largely applicable to the proposed changes to § 652.25 (see attached letter). The proposed revisions

are an improvement but they would be streamlined and improved by the elimination of § 652.25(a), which we find unnecessary and redundant to § 652.25(b).

§ 652.35 Liquidity management

FCA is proposing to require Farmer Mac to have a liquidity maturity management plan in addition to specifying requirements for interest rate risk management and a contingency funding plan. We find that this additional proposal is unnecessary and creates significant regulatory layering that is difficult to comply with in an effective and efficient manner. The concept of a liquidity maturity management plan is far too detailed for regulatory requirements and simply adds to regulatory burden without any clear corresponding benefit. As it does with the System, the FCA should address these types of issues through its supervisory processes not through additional burdensome and conflicting regulatory requirements.

§ 652.40 Liquidity reserve requirements and supplemental liquidity

We agree with FCA's proposal to increase the minimum liquidity requirement from 60 to 90 days. This is consistent with the requirement for other System institutions.

In addition, we have some specific suggestions as follows:

- The proposed rule is not clear on actual levels of liquidity required in the proposed four-level liquidity system. The Agency sets requirements for 15-days, 30-days, 90-days, and beyond 90-days but doesn't set actual levels of liquidity tied to these particular time frames. We suggest that the Agency clearly set actual liquidity requirements for each of these timeframes. Such an approach would be simpler to understand, implement, and monitor.
- We note that the proposed rule's description of "highly marketable" is essentially identical to the definition of "marketable" proposed by FCA in its liquidity and funding proposed rule for System institutions. We are concerned that the choice by FCA to use different terms for these identical concepts could be misunderstood to have significance. We ask that FCA use identical terms when describing identical requirements.
- The description of "highly marketable" appears unworkable given the vagueness of the proposed requirement that a security must be "easily and immediately convertible to cash with little or no loss in value." It is unclear what "immediately" means in different market environments, such as recently experienced during the financial crisis. At that time, low risk and high quality investments could not be sold given general illiquidity in the marketplace. In other words, nothing at that time was "immediately" marketable. As a result, all securities, including Treasury bonds, require time to sell depending on the market conditions and other factors. It is also unclear when the "highly marketable" standard should be applied, at purchase or throughout the life of a security holding, particularly as it pertains to the "with little or no loss in value." We are also uncertain if FCA means market value, face value, or some other value measurement. All in all, we believe that the entire proposed provision should be dropped given the specific and prescriptive requirements around the types of securities that can be counted in the liquidity reserve.

Conclusion

We support the basic concept that the liquidity standards for Farmer Mac and FCS institutions should essentially be the same. Much of the proposed rule appears to work toward this concept and we support the Agency's effort in this direction. We remain concerned, however, that differences remain between what is proposed for Farmer Mac and what is proposed for FCS institutions. We strongly encourage the Agency to adapt its proposed rule to more closely mirror the requirements for FCS institutions. The differences in the business models between Farmer Mac and FCS institutions do not justify the differences in liquidity and investment

management rules proposed by the Agency. Like the federal financial regulators, FCA should be able to create consistency between these requirements.

Most importantly, we are highly concerned with the double standard established by this proposed rule between Farmer Mac's investment flexibility and that granted to FCS institutions. Given the strong incentives for earnings growth created by Farmer Mac's public stock ownership model, we believe, if any differences are necessary, that the standard for Farmer Mac should be much more restrictive than the one set for cooperatively owned FCS institutions. The FCA should not finalize the proposed rule without significantly altering the allowable investments of Farmer Mac.

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Thank you very much for the opportunity to comment on this important proposed rule. We would be pleased to provide further information or answer any questions about this matter that the Agency might have.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles P. Dana". The signature is fluid and cursive, with a long horizontal stroke at the end.

Charles P. Dana
General Counsel

Enclosure