FARM CREDIT
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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. The Agency's efforts to modernize Farm Credit System (FCS) capital requirements will result in a framework that is consistent with Basel III standards applied to other financial institutions. I believe that adopting Basel III standards for the FCS will 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.

I appreciate the Agency's efforts to carefully consider and accommodate the FCS's cooperative structure in developing the proposed capital framework. While FCA has done an admirable job in drafting the proposed capital rule, I am concerned that it does not strike the appropriate balance between supporting and protecting the cooperative structure on which Congress based the FCS and aligning with the Basel III concepts written for joint stock companies. Unfortunately, parts of the Agency's proposal undermine the cooperative structure. As a result, I ask that FCA revise the proposed rule as outlined below to make it workable and supportive of the FCS's congressionally mandated cooperative structure:

1. Eliminate the requirement that FCS institutions obtain shareholder votes on the capitalization bylaw changes required by the proposed rule. This requirement results in a meaningless vote that puts the institution and its member-customers in an impossible situation. If member-customers do not approve the bylaw changes, the institution faces capitalization challenges. If member-customers approve the bylaw changes, they undermine the institution's ability to function consistent with cooperative principles. I appreciate FCA's desire to ensure that the capital plan features of each FCS institution are effectively communicated to their member-owners. However, rather than direct capitalization bylaw changes, the FCA could rely on board policies, directives, loan documentation or capital plans for such communication. Structurally, a board directive or similar document can accomplish the same outcome as a capitalization bylaw vote. Board direction, along with shareholder disclosures, is more than sufficient to implement FCA's proposed Basel III framework.

2. Reduce the proposed revolvement period for Common Equity Tier 1 (CET1) to 7 years and permit the normal revolving features of loan-based cooperative equity plans. There is no basis in Basel III for the proposed 10-year revolvement cycle of an individual share, and it is overly stringent and fundamentally inconsistent with cooperative principles.. It is also unnecessary given the other proposed capital controls. The proposed rule limits distributions to current year earnings unless specifically approved by FCA. FCA also proposes additional limits if capital levels fall below the proposed conservation buffer that is far above minimum standards. These controls and FCA prior approval eliminate any possible member-customer expectations for the distribution of income or retirement of stock

and effectively makes cooperative shares permanent. Given these controls, a 7-year revolvement cycle on a loan basis is easily justified. For cooperative capital, the length of time a share is outstanding is irrelevant to permanence. Rather, permanence is determined by member-customers' clear understanding that their shares are at-risk and committed to the long-term financial stability of their cooperative.

3. Eliminate the concept of 10-year revolvement cycles for association investments in their funding bank to qualify for CET1. Within the closed FCS cooperative structure, requiring a revolvement cycle for association-held bank equities is unnecessary, inefficient, ineffective, and without any discernable benefit. Each affiliated association's capital investment is understood and legally structured as a permanent capital contribution to the bank that is fully at risk and available to absorb losses. The law requires affiliated associations to capitalize and obtain funding from a Farm Credit Bank, which means they need to maintain a permanent investment in the bank. The ability to adjust this investment is critical for ensuring associations share proportionately and appropriately in bank capitalization and risk of loss. It is unnecessary and unworkable to require each association's individual bank shares to be outstanding for 10-years to qualify as CET1. This requirement means that the bank will be unable to function as a cooperative or equalize capital investments. It is critical FCA understand that the permanence of the bank capital is entirely unaffected by how capital is equalized among affiliated associations. I ask that FCA provide flexibility for banks to equalize capital investment among affiliated associations without compromising CET1 treatment.

4. Revise the proposed "safe harbor" provision that authorizes limited distributions, including stock retirements, without FCA prior approval to be consistent with similar provisions implemented by European bank regulators. The proposed limit of no reduction in CET1 provides no reasonable room for boards to manage capital without first seeking FCA prior approval. This burdensome requirement is far more restrictive than the approach taken by foreign bank regulators that implemented Basel III for the cooperatives under their jurisdiction. FCA should follow the same standards as these regulators and allow up to a 2% reduction in CET1 as long as capital ratios remain above the conservation buffer. In addition, the "haircut deduction" for early distributions is punitive and should be eliminated from the proposed regulations and handled through examination as there is no basis for this in Basel III.

5. Eliminate or refine the unallocated retained earnings (URE) sub-limit embedded within the proposed Tier 1 leverage requirement. The proposed sub-limit implies URE is of higher quality than CET1. There is no basis for this within Basel III either directly or in the context of a minimum URE standard embedded within CET1. Basel III did not see a safety and soundness need to establish URE as a "superior" class of CET1 and FCA has no basis for deviating from Basel III in this area. It is also significantly more stringent than FCA's current URE requirement given it is measured on total, unweighted assets. I ask that FCA authorize FCS institutions' boards to manage the components of CET1, including URE. If FCA sees a need for a URE standard, it should simply follow its current requirements and calculate the URE ratio on a risk-adjusted basis.

6. Reduce the proposed Tier 1 leverage requirement to 4% to be consistent with Basel III standards implemented by regulators across the globe. From my perspective, the proposed 5% standard 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. I ask FCA to establish a 4%Tier 1 leverage ratio consistent with the Basel III guidance.

7. Maintain the 50% and 20% risk-weight treatment of rural electric cooperative assets consistent with the current regulatory treatment. There has been no change in the unique characteristics and low risk profile of the electric cooperative industry. As FCA previously acknowledged, loans to this industry have lower risk because of: (1) the financial strength and stability of the underlying member systems; (2) the ability to establish user rates with limited third-party oversight; and (3) the exclusive service territories. These unique characteristics insulate the rural electric cooperative industry from many of the credit-related risks experienced by utility providers. I strongly encourage FCA to continue the 50% and 20% risk-weight treatment so the FCS can continue to fulfill its mission to finance the rural electric industry as it does today. If FCA does not make this change, the proposed rule will adversely affect the FCS's capital capacity to serve this industry and place it at a competitive disadvantage compared to other lenders who finance this industry.

I am confident that the refinements described above would make the proposed capital rule workable and effective from a safety and soundness perspective and consistent with the implementation of Basel III by other regulators. Most importantly, the refinements I ask FCA to make ensure that the FCS can 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,

Jack Hastings

Board Director
Farm Credit Illinois