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February 12, 2015

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

Subject: Regulatory Capital, Implementation of Tier1/Tier 2 Framework

Dear Mr. Mardock:

Farm Credit West (FCW) appreciates the opportunity to comment on the Farm Credit Administration's (FCA or Agency) proposed rule on regulatory capital and the implementation of a tiered approach that is comparable to the Basel III framework.[1] The bulk of this letter represents the collective analysis and comments coordinated by the Farm Credit Council (FCC), which we fully support and hereby submit as our own comments. FCW has added additional commentary to the FCC coordinated response on pages 12 and 29, which we would bring to your attention to assist in your analysis of this response.

We are grateful for the work that FCA has put into modernizing the System's capital regulations to better align with those of other federally regulated financial institutions.[2] This modernization will be helpful to external investors and others who are acquainted with the Basel III framework and understand the overall financial strength and capital capacity of individual Farm Credit System (FCS or System) institutions as cooperative financial institutions.

While we strongly support the FCA's modernization of the FCS's regulatory capital framework, we have serious concerns that FCA has yet to strike the appropriate balance recognizing FCS's cooperative structure and fundamental reliance by FCS institutions on cooperative equities to meet regulatory capital requirements. Based on our review of the proposed rule, FCA has proposed a far harsher approach to implementing a Basel III framework compared with the implementation by U.S. bank regulators.[3] Two striking examples of FCA's harsher approach are the treatment of FCS retained earnings and the imposition of a significantly higher Tier 1 leverage requirement.

As currently written, the proposed rule discourages the formation, retention, and distribution of member-held equity, undermining cooperative business principles that have been in place for decades. Section 4.3A of the Farm Credit Act of 1971, as amended, (Act) does not provide FCA

[1] Basel III was published in December 2010 and revised in June 2011. The text is available at http://www.bis.org/publ/bcbs189.htm.
[2] 78 FR 62018 (October 11, 2013) (final rule of the OCC and the FRB); 79 FR 20754 (April 14, 2014) (final rule of the FDIC).
[3] References to Basel III throughout the comment letter refer to U.S. banking regulators' final capital rules cited in footnote 2, unless otherwise noted.

authority to develop capital rules that are antithetical to cooperative values.[4] We also believe that FCA has significant discretion within the Basel III framework to recognize the FCS's cooperative constitution and legal structure to recognize cooperative equity as available to absorb losses during stressful periods.

We ask that FCA use its discretion and authority to modify the proposed regulatory text to address our comments prior to issuing a final rule. Our comment letter highlights needed modifications that would allow FCA to achieve its objectives, result in appropriate comparability with Basel III and ensure FCS institutions can continue to operate as cooperatives for the long-term.

Threshold Issues

We have identified numerous threshold issues with the proposed regulatory capital rule that we believe undermine cooperative principles and member participation in the management, ownership and control of FCS institutions as required by the Act. The threshold issues demonstrate FCA has proposed capital requirements that effectively position FCS bank and association cooperative retained earnings and equities as inferior to equities of joint stock companies. FCA has provided no data or other evidence to support this inferior treatment.

In all regards, the proposed regulatory capital rule disfavors the cooperative business model, penalizing institutions when they follow the distinctive cooperative notions of "user benefit", "user ownership" and "user control." As expected by Basel III, FCA should take into account all principles specific to the constitution and legal structure of cooperatives.[5] With this in mind, we offer the following threshold comments that if implemented by FCA would bring balance to the final rule and result in regulatory capital requirements that are comparable to Basel III and sensitive to the FCS's cooperative structure.

Threshold Issue Number 1- Treatment of System Allocated Retained Earnings

Basel III as implemented by U.S. banking regulators includes all retained earnings in Common Equity Tier 1 (CET1) for all banking organizations they regulate, <u>including mutual banks</u>.[6] The FCS supports FCA following the lead of the U.S. banking regulators and asks that FCA include all FCS retained earnings in CET1.

Basel III recognizes two broad categories of CET1: (1) retained earnings and (2) paid-in capital instruments that meet a 13-factor test.

As to retained earnings, the rule is clear—CET1 includes all retained earnings. Basel III does not establish tiers of retained earnings; it does not subtract from retained earnings the amount that a bank has announced that it plans to distribute to shareholders in the normal course of business; it does not apply a discount factor to retained earnings to reflect public market pressures to make quarterly dividend distributions (even when a bank's failure to make a dividend could ultimately increase its cost of funds or threaten its liquidity). Indeed, retained earnings are categorically included in a commercial bank's CET1 notwithstanding that the bank is generally free to distribute in a given year the sum of its total net income for that year plus its retained net income for the preceding two years.[7]

FCA has proposed that allocated retained earnings must have a 10-year minimum term in order to be treated as CET1. While we understand the importance of "permanence" with respect to CET1,

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[4] 12 U.S.C. 2001 Sec 1.1(b) of the Farm Credit Act of 1971.

[5] See footnote 12,"Basel III: A global regulatory framework for more resilient banks and banking systems", published in December 2010 and revised in June 2011.

[6] 78 FR 62044 (October 11, 2013)

[7] See 12 U.S.C. 60(b) and 12 C.F.R. 5.63 and 5.64.

there is no basis in Basel III for a 10-year holding period. Moreover, an allocated equity with an express minimum term of 10 years is no more permanent than an allocated equity that is perpetual on its face, particularly when a separate rule requires FCA consent for distributions that exceed 12-month trailing earnings. The proposed minimum term/revolvement period should be eliminated. As discussed above, allocated equities are simply retained earnings and should be included in CET1 without qualification.

In stark terms, the proposed rule treats an institution's "allocation" of retained earnings as a capital distribution rather than a retention of earnings. As a result, under the existing bylaws of System institutions, each dollar of retained earnings with a patron's name on it is automatically excluded from regulatory capital. This default exclusion applies to all forms of allocations, including FCB attributed surplus, ACB patronage surplus, and association written notices of allocation dating from the System's inception, in each case irrespective of retirement practices. As a result, approximately $11.2 billion of these forms of capital (12% of the System's aggregate capital before eliminations for combined financial reporting) will no longer count as regulatory capital unless effectively reissued under new bylaw amendments (described below).[8]

FCS's allocated retained earnings should be accorded capital treatment at least as favorable as commercial banks' retained earnings. Allocated retained earnings do not possess the features identified in Basel III as having the effect of reducing loss absorbency (e.g., cumulative dividends) during periods of economic or market stress. Therefore, allocated retained earnings strengthen an institution's capacity to withstand losses during periods of economic or market stress.

Several FCS institutions that experienced credit and business issues suspended patronage distributions or significantly reduced allocated surplus redemptions with no material adverse effects to capital, liquidity or mission fulfillment. The table below shows the capital position for three such institutions.

	December 31,						
($ in millions)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Institution 1							
Total Capital to Assets	12%	12%	12%	13%	14%	13%	15%
Permanent Capital Ratio	11%	11%	12%	16%	15%	14%	15%
Core Surplus Ratio	10%	9%	10%	11%	11%	11%	12%
Patronage/Redemptions	$8.0	$11.5	$1.6	$1.3	$14.5	$42.7	$25.0
Institution 2							
Total Capital to Assets	16%	16%	15%	16%	19%	21%	22%
Permanent Capital Ratio	15%	15%	14%	14%	16%	19%	21%
Core Surplus Ratio	15%	14%	14%	14%	15%	19%	20%
Patronage/Redemptions	$1.3	$1.0	$0.0	$0.0	$0.0	$0.3	$1.0
Institution 3							
Total Capital to Assets	13%	13%	15%	16%	19%	22%	24%
Permanent Capital Ratio	13%	13%	14%	15%	17%	21%	22%
Core Surplus Ratio	13%	13%	13%	15%	17%	20%	21%
Patronage/Redemptions	$5.0	$5.4	$0.0	$0.1	$2.0	$7.0	$7.4

[8] This number is as of June 30, 2014 and includes so-called "URE equivalents" that would need bylaw amendments to qualify as CET1.

Source: Six Year Trend Report, FCA's Consolidated Reporting System

In these real life examples, the institutions' capital positions stabilized and then grew following the suspension of patronage distributions or significantly reduced allocated surplus redemptions. Loan volume declined in some instances, but this was the result of more conservative lending practices rather than "borrower flight." Most importantly, the institutions resolved their credit and business issues and resumed patronage distributions or increased allocated surplus redemptions. This demonstrates that FCS institution retained earnings should qualify as CET1 without application of any limiting criteria.

FCA has historically expressed a concern with member-owner pressure for the payment of patronage dividends or redemption of allocated retained earnings. Factually, FCS institutions do not face any greater pressure to distribute retained earnings than the pressure on commercial banks to make dividend payments from retained earnings. The U.S. banking regulators have addressed concerns about pressure to make distributions from retained earnings during periods of market or financial stress through specific regulatory approval requirements. FCA should adopt a similar approach.

Unless FCA can cite specific evidence that FCS institutions face greater pressure to distribute allocated retained earnings relative to commercial banks' retained earnings, FCA should not deviate from Basel III. Therefore, FCA should treat FCS institution allocated retained earnings the same as U.S. bank regulators treat commercial bank retained earnings. If FCA is determined to differentiate its treatment of FCS institution retained earnings from that of commercial banks, it should only do so through specific criteria applicable solely to retained earnings.

Although specific criteria applicable only to retained earnings is not a Basel III concept, it would be necessary if FCA remains resolute in differentiating the treatment of FCS institution retained earnings. While it is clear that the revolvement period does not impact the availability of cooperative equities to absorb losses, FCA has used revolvement as a basis for distinguishing among allocated equities in the current regulatory framework.[9] Therefore, FCA could consider continuing this practice by categorizing the treatment of retained earnings as CET1, Additional Tier 1 (AT1) or Tier 2 (T2) based on the institution's revolvement pattern and practices.

To qualify as CET1, FCS institutions would have to demonstrate a pattern and practice of revolving allocated equities on a 5-year or greater cycle pursuant to a loan-based capital plan (see response to question 1 in Appendix A). If a FCS institution does not follow a loan-based capital plan, it would demonstrate its revolvement plan, pattern and practice by the year of allocation.

To qualify as AT1, FCS institutions would have to demonstrate a plan, pattern, and practice of revolving allocated equities on a 3 to 5 year cycle. Allocated equities not qualifying for CET1 or AT1 treatment under the criteria outlined previously would qualify as T2 capital. Overall, the approach outlined ensures that all stockholder equities under generally accepted accounting principles (GAAP) are included in regulatory capital measures. Under the proposed rule, FCA would not count all stockholder equities under GAAP as regulatory capital, which is inconsistent with Basel III.

The revolvement approach outlined above is conceptually consistent with FCA's current regulatory treatment of earnings retained as allocated equities. Over 20 plus years of experience has demonstrated the current approach results in the availability of high-quality capital to absorb

[9] We want to emphasize that a revolvement period is simply not relevant in the loss absorbing capacity of allocated equities and does not create an expectation or legal right relative to member-owners, particularly given the significant regulatory controls over revolvement. The proposed rule strengthens regulatory controls that would require adequate disclosures regarding the at-risk nature of the institution's equities and the prohibition of capital distributions or revolvement that would compromise the financial well-being of the institution.

losses. The long-standing success of the current regulatory capital treatment of allocated equities demonstrates that the proposed 10-year revolvement cycle is excessively harsh and not supportable from a Basel III permanence perspective. If FCA ultimately decides not to drop the proposed revolvement requirement or not to follow current regulatory revolvement cycles, a 7-year revolvement requirement for CET1 treatment of allocated equities would be more reasonable and workable from a cooperative structure perspective.

Threshold Issue Number 2 – Association Investment in its Funding Bank

FCA's application of a proposed minimum revolvement cycle to associations' investment in their funding bank is unworkable, anti-cooperative, and inconsistent with statutory re-affiliation provisions. The proposed CET1 requirement for a 10-year revolvement cycle for associations' investments in their funding bank creates challenging, bureaucratic, costly and burdensome restrictions on the capitalization of the bank without any discernable benefit in capital quality or quantity. In fact, it effectively implements a "first in first out" redemption principle for an association's investment in the bank.[10] As a result, when a bank wants to retire capital either to equalize investments among its associations or to provide financial support to a struggling association, it must select stock that has been outstanding for more than 10 years. This will result in adverse tax consequence if the oldest stock has a zero tax basis while more recently purchased stock has a full tax basis. In fact, such retirements would necessarily dissipate combined bank-association capital. FCA's proposed approach is inconsistent with Congressional intent and unnecessary to align its capital regulations with Basel III. Moreover, it functionally makes it impossible for associations to re-affiliate as provided for in the Act.

Fundamentally, in the closed, cooperative structure of the FCS, an affiliated association's capital investment is legally and functionally a permanent capital contribution to the bank and is understood as such by associations. This structure results in a permanent relationship that continues until liquidation, re-affiliation, or termination of System status, all of which require FCA prior approval. The level of bank capital an association is obligated to contribute to its funding bank is a percentage of its outstanding direct loan balance and is perpetual in nature as long as the association has a direct loan outstanding. The ability to adjust an association's capital investment in its funding bank ensures that affiliated associations proportionately share in the bank capitalization and risk of loss.

The permanence of the association's legal obligation to contribute to bank capital is entirely unaffected by how capital contributions are equalized among affiliated associations or if capital follows the association in the event of re-affiliation. Nor does the bank stock contain any feature that would allow an association to call its investment. The proposed 10-year revolvement of allocated equities means that the bank will not be able to function as a cooperative, including the ability to equalize capital contributions among affiliated associations or allow for re-affiliation in an appropriate way. It is unnecessary and unworkable to require association's allocated equities that make up their capital investments in their funding bank to be outstanding for 10 years in order to be counted as CET1. FCA should recognize these allocated equities as retained earnings of the bank. Furthermore, the proposed capital rule would not allow a reduction in the bank's CET1 without FCA approval. Therefore, FCA should treat the associations' stock investment in their funding bank as CET1 and exclude that capital from any minimum revolvement requirements.

The definition of capital applicable to an association's investment in a Farm Credit Bank (FCB) should differ from that of a member's investment in their association given the organizational structure of the FCS. Different capital definitions are justified for two reasons.

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[10] This FIFO rule recalls the pre-1971 Act, when Congress mandated that FICBs retire stock on a FIFO basis. See 12 U.S.C. 1071 (1969). The difference is that the pre-1971 law beneficially assisted the FICBs in making tax advantageous retirements of the old purchased stock (with full tax basis) before the more recent allocated stock, thus preventing retirements from dissipating System capital. The effect of the proposed rule is precisely the opposite.

First, as discussed previously, the Act establishes a structure whereby an association obtains its funding from a FCB and the association has minimal opportunity to obtain funding from any other source.[11] Regulation § 615.5000 clearly states the financial interdependence between FCBs and affiliated associations as follows: "The **System banks**, acting through the Federal Farm Credit Banks Funding Corporation (Funding Corporation), have the **primary responsibility for obtaining funds for the lending operations of the System institutions**" (emphasis added).

Second, FCS banks have rights to call, preserve and build capital from their affiliated association borrowers that association's lack. A FCS bank's capitalization bylaws give it the ability to increase the investment requirement for existing direct loan volume, as well as the ability to retain excess investments with or without paying a return (patronage or interest credit) to the over-invested association. A bank's general financing agreement (GFA) allows it to increase spreads on existing advances immediately without Association approval.

An association's investment in a FCB results from the statutorily directed financial relationship, which is simply different from the financial relationship between an association and its members. While a member is required to capitalize an association, the member is also free to borrow from a financial institution other than the FCS. An association does not have this same flexibility and, as a result, its investment in a FCB is by statute and operation of law a permanent aspect of its capitalization, regardless if a FCB periodically equalizes such investment. While we had thought that treatment of cooperative equities could be identical throughout the FCS, it is clear that is not logical or desirable relative to FCB cooperative shares arising from affiliated associations' investments, which are effectively eliminated when the FCS is evaluated on a combined district or System basis.

Threshold Issue Number 3 - Required Capitalization Bylaw Amendments

In order for a FCS institution to count cooperative equities in CET1 or T2 capital, the proposed rule would require the institution to obtain stockholder approval of certain capitalization bylaw amendments impacting the rights of the cooperative equities—a measure that is legally tantamount to a re-issuance of the cooperative equities. FCA has also imposed a bylaw requirement for AT1 capital instruments relating to FCA prior approval for any redemption of such instruments. The proposed capitalization bylaw provisions are fundamentally unworkable, unnecessarily costly, and legally problematic. The bylaw requirements result in a meaningless vote that puts the FCS institution and its member-owners in a Catch-22 situation. If the member-owners do not approve the required bylaw changes, the institution would have to exclude from regulatory capital shareholder equities under GAAP, resulting in capitalization challenges. However, approving the required bylaw changes would undermine the institution's ability to function consistent with cooperative principles as expected by the Act.[12] Moreover, institutions with modest amounts of cooperative equities may prefer to exclude their cooperative equities from regulatory capital than bear the cost, operational burdens, member confusion, and uncertainty of a stockholder vote. Such a decision may make economic sense in isolation but could lead to redemption of excluded cooperative equities. When extrapolated across the System, such economically rational decisions at an institution level could be harmful to the overall regulatory capital position of the System.

The proposed bylaw amendment requirement may expose FCS institutions to legal challenge under general corporate law with respect to holders of notices of allocation (i.e., qualified and non-qualified) who are not voting stockholders. Not all such holders will have a right under the existing FCA regulations to vote on bylaw changes that they may see as affecting their holder rights (e.g.,

[11] 12 U.S.C. 2073 – Section 2.2(12) states that associations "may borrow money from the Farm Credit Bank, and with the approval of such bank, borrow from and issue notes or other obligations to any commercial bank or other financial institution", which further emphasizes that the FCB is the primary lender to FCS associations.

[12] The U.S. banking regulators were careful not to require banks to reissue equities or change governing documents to satisfy the new CET1 standard. See Fed. Reg. vol. 78, No. 198, pages 62045-62046 (Oct. 11, 2013). FCA should provide the same level of consideration and sensitivity with respect to FCS cooperative equities.

retirement as solely within board of directors' discretion). We are further unsure of the reason for this bylaw amendment provision in the proposed capital rule, since there is no basis for it in Basel III and creates unnecessary complications. FCA may be of the view that a bylaw change is needed to create a clear legal distinction among various holders of allocated surplus and other equity to identify what is CET1, AT1 or T2 capital. We recognize the need to ensure that allocated equities must be permanent to be available to absorb losses. We submit, however, that the permanence of allocated equity has already been addressed in the Act with respect to controls on capital retirements and other distributions retained by each institution's board of directors and the FCA.

We also recognize the need to have clear distinctions between holders of allocated equities to ensure they can satisfy the criteria associated with CET1, AT1, and T2. A bylaw change is not the best or even an appropriate way to accomplish this distinction. Based on our research, we believe there are better means for creating a clear distinction among allocated equities than requiring a capitalization bylaw change.

Section 4.3A of the Act requires that the bylaws adopted by shareholder vote shall enable System institutions to meet capital adequacy standards established under regulations issued by the FCA.[13] As a result of this requirement, FCS institution bylaws provide the board of directors significant discretion for the management of capital resources to achieve ongoing compliance with regulatory capital requirements. Boards manage this compliance by adopting a capital plan, as required by §615.5200.

We submit that FCA can more appropriately and cost-effectively address the expectation for a "legal distinction" within allocated retained earnings by modifying the proposed regulatory capital-planning requirement. As part of the capital plan, FCA could require the board to adopt a binding resolution on the treatment of retained and allocated equities to achieve ongoing compliance with the new capital requirements. The board resolution would be binding unless and only if modified by a change in the capitalization bylaws approved by all shareholders pursuant to §615.5220. We believe that FCA could require the resolution by regulation for the sole purpose of implementing the proposed regulatory capital requirements, which would effectively allow all FCS institutions to comply with these requirements without the burden and uncertainty of a shareholder vote, particularly if the vote may result in technical non-compliance with minimum capital standards.

Threshold Issue Number 4 - Higher Minimum Tier 1 Leverage Ratio

The 5% Tier 1 leverage ratio requirement is excessive and unsupported. Under Basel III, the Tier 1 leverage ratio requirement is 4%. Requiring a 5% minimum standard for the FCS results in an unnecessary inconsistency with Basel III and the requirements applicable to commercial banks and, as previously discussed, would create an un-level playing field in the capitalization of loans to farmers and other eligible borrowers. Moreover, this difference in minimum standards may raise questions and suspicion that the FCS is fundamentally riskier compared to other lending institutions and thus requires a higher standard. According to FCA, the proposed 5% minimum Tier 1 leverage ratio:

> "…takes into consideration the fact that System institutions are financially and operationally interconnected, member-owned cooperatives, and monoline lenders that currently provide credit to approximately 41 percent of the U.S. agricultural sector. They have a business model and risk profile that are substantially different from traditional banking organizations. The higher 5.0 percent leverage ratio also helps to ensure that System institutions continue to have sufficient systemic loss-absorbing capital to withstand a severely adverse economic event while continuing to provide a steady flow of credit to U.S. agriculture in view of the System's unique GSE mission. While System banks do have off-balance sheet items that would have to be risk

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[13] See 12 U.S.C. 2154a

weighted--especially unfunded commitments in this proposal--the banks also have a large portion of instruments in the 20 percent risk weighting category, primarily the direct loans to their affiliated associations, and the 0 percent risk weighting category. We believe it is important for System banks to hold enough capital to protect against risks other than credit risk (e.g. interest rate risk, liquidity risk, premium risk, operational risk, etc.)."[14]

We respectfully disagree that a higher 5% minimum leverage ratio is justifiable based on these considerations. We believe that such an inference does irreparable harm to the FCS and its mission achievement, particularly given the lack of any quantitative support for the difference. FCA's justification is insufficient and unsupported by loss experience, making this proposed requirement arbitrary and capricious.

Basel III was a response to systemic risks revealed during the financial crisis, largely originating from prevalent funding practices (such as reliance on short-term deposits, wholesale funding, overnight repurchase agreement and other forms of inter-bank transactions) that had the effect of correlating risk sensitivities. The inter-connections and inter-dependences between financial institutions were revealed when losses at one institution drained liquidity available to other institutions—even those with relatively high Tier 1 capital ratios. As liquidity dried up, banks came under pressure to retire lower quality Tier 1 capital instruments (hybrid instruments) when they were most needed to absorb losses. To address this phenomenon, Basel III prescribed a reduction in overall leverage, as well as an increase in both the quantity of capital (higher minimums) and the quality of capital (retained earnings rather than hybrid instruments) as essential to protect the banking system and its depositor base from systemic risks and the liquidity crises they engender.

The proposed rule says nothing about how the systemic risks that informed Basel III has any bearing on System banks and their associations. We note that the System benefits from a clear division and insulation between the source of its capital (members) and the source of its debt funds (joint and several debt issuances). No association that experienced financial distress over the past 6 years ever had its liquidity threatened, in stark contrast to the experience of many non-System financial institutions.

Basel III increased the leverage requirement applicable to banking institutions in light of specific liquidity risks unique to banking practices. The System has its own unique risks, primarily a concentration in agriculture. However, stress testing and economic capital modeling by System institutions provide evidence that System institutions "…continue to have sufficient systemic loss-absorbing capital to withstand a severely adverse economic event while continuing to provide a steady flow of credit to U.S. agriculture in view of the System's unique GSE mission."[15] In short, there is no empirical basis for the assertion the System's risks are any more significant than the systemic risks that gave rise to the financial crisis and that were cited in Basel III as a justification for an increased leverage ratio. Certainly, there is no basis for a 25% higher standard.

It is true that "System institutions are financially and operationally interconnected, member-owned cooperatives, and monoline lenders that currently provide credit to approximately 41 percent of the U.S. agricultural sector."[16] However, it is not clear how this implies that a higher leverage ratio is needed for FCS institutions than for commercial banks. Interconnectedness of FCS banks and associations is in part a result of the two-tiered structure of the System, and each tier must be capitalized independently. In addition, System Banks are interconnected by virtue of joint and several liability for Systemwide debt obligations, and have implemented mechanisms (including CIPA and MAA) to ensure each bank and district remains financially healthy. The assertion that System institutions are monoline lenders would seem to imply greater risk for the System, however, the theoretically more diverse portfolios of commercial banks did not prevent them from

[14] 79 FR 52821 (September 4, 2014)
[15] Ibid.
[16] Ibid.

experiencing severe stress during the 2008-09 financial crisis, while the System remained essentially unstressed. The financial crisis demonstrated that Basel III was required to achieve adequate capitalization of the commercial banks, whereas System institutions were adequately capitalized during the financial crisis and functioned effectively. For FCA to require FCS institutions to hold more capital than Basel III requires of commercial banks is unsupported by the facts, loss data, or any reasonable analysis of risk. While we respect that FCA has regulatory safety and soundness discretion, we also recognize that it should be supported by appropriate analysis of relevant data. We submit that FCA has not provided reasonable facts or data analysis to support imposing the higher 5% minimum leverage ratio requirement.

Moreover, the proposed 5% minimum leverage ratio is inappropriate for wholesale FCS banks. While it is true that System banks have a large portion of instruments in the 20% risk weight category – primarily the direct loans to their affiliated associations -- FCA appears to have not considered the two-tiered capitalization that exists within the System. System associations and banks must capitalize retail loans at the same risk-based minimum levels as commercial banks, and in addition, System banks must capitalize wholesale loans to associations at a 20% risk weight. Due to this two-tiered capitalization of association retail loans, the System must effectively hold minimum capital for association retail loans totaling 120% of the amount required for commercial banks' retail loans. In addition, both the associations and banks will be subject to the capital conservation buffer, so total capital levels at both the banks and associations will be significantly higher than regulatory minimums. This amount of capitalization is more than adequate to protect not only against credit risk, but against interest rate risk, liquidity risk, operational risk, and other risks.

Imposing a 5% minimum Tier 1 leverage ratio requirement instead of 4% as required for commercial banks under Basel III results in an inconsistent application of Basel III and inappropriately creates a situation where the FCA provides commercial banks an advantage compared to FCS associations when offering a loan to a specific agricultural borrower. Further, the proposed higher leverage ratio requirement effectively reduces the FCS's ability to achieve its mission, particularly during stressful periods, by decreasing lending capacity by over 20 percent assuming capital positions are near or at regulatory minimum levels. Under such an assumption, the impact of lower loan volume would materially reduce earnings, thereby adversely affecting safety and soundness. While too much leverage is problematic for financial institutions, FCA should recognize that too little leverage is equally problematic, particularly for mission-based lenders. The Basel III 4% minimum Tier 1 leverage ratio strikes the right balance in this regard. We ask that FCA not create an inequitable and adverse capital treatment given there is no difference in risk at the loan level between a commercial bank and a FCS institution to a specific agricultural borrower. This requirement fundamentally undermines the FCS's mission. Moreover, imposing a 5% minimum leverage ratio creates economic incentives for shifting ownership of loans from associations to System banks.

For the foregoing reasons, we ask FCA follow Basel III and the U.S. banking regulators by imposing a 4% Tier 1 leverage ratio requirement rather than the proposed 5% minimum. We understand that FCA may have a perspective that higher levels of Tier 1 capital generally provide additional capital to protect against adversity within the FCS. While we disagree with FCA's perspective that FCS institutions require a higher level of Tier 1 capital relative to other lenders in the marketplace, FCA should support its perspective by conducting a study that demonstrates and quantifies that the proposed significant deviation from Basel III is justified by facts. After considering the results of such a study, if FCA remains focused on imposing higher leverage ratio requirements, a less burdensome alternative might be to adopt within the proposed framework a 4% Tier 1 leverage ratio regulatory minimum with an additional 1% Tier 1 capital conservation buffer. While this deviates from Basel III at a fundamental level, it would address FCA's apparent preference that FCS institutions maintain higher Tier 1 capital levels compared to commercial banks.

In considering this alternative, the Tier 1 leverage ratio capital conservation buffer should be made up of Tier 1 capital and not CET1 as applied under Basel III relating to the unleveraged (i.e., risk-weighted) ratios. The additional flexibility is important, given that it still provides sufficient high-quality capital on a leveraged basis (i.e., non-risk weighted) and does not arbitrarily result in additional CET1 buffer requirements that deviate even further from Basel III. Similarly, the 1% Tier 1 leverage capital conservation buffer would be pro-rated across the payout categories based on 40% of the proposed 2.5% buffer applicable to the other capital ratios (i.e., the 40% is based on the ratio of 1% relative to the 2.5%). Overall, a capital conservation buffer approach would support the objective of the proposed higher leverage ratio without unduly penalizing those FCS banks primarily engaged in wholesale lending to associations.

While this alternative bears further review, we recommend FCA not complicate its proposed rulemaking with a 5% Tier 1 leverage ratio or a Tier 1 leverage ratio capital conservation buffer.

Threshold Issue Number 5 – Minimum Unallocated Retained Earnings (URE) Requirement

The existing 1.5% URE requirement should not be included in the new capital framework for the FCS. FCA has proposed a minimum URE level in the Tier 1 leverage ratio, which we believe calls into question the cooperative structure of the FCS. The proposed URE requirement declares that URE is higher quality capital than CET1. Identifying a "super" or "superior" CET1 subclass is an unmistakable message to the marketplace that the System's CET1 does not match up with CET1 of commercial banks. The result is reduced comparability and transparency.

Implementation of the 1.5% URE standard within the Tier 1 leverage requirement results in a minimum 3% URE held against each dollar of loans made by associations to member-owners, given the dual capitalization resulting from the System's cooperative structure. The proposed "super" CET1 class essentially violates the cooperative principle of user-ownership whereby the owners bear the risk and reward of their cooperative institution. With respect to joint stock companies, Basel III respects the basic principle that stockholders are at-risk and bear the losses of the entity. Functionally, this ownership principle is the same for cooperatives, including FCS institutions. FCA should respect this fact and not impose a "super" CET1 subclass requirement.

Historically, FCA has indicated that FCS institutions need to maintain a minimum URE due to possible variability in operating results. Under FCA's logic, URE would buffer cooperative equities from a direct impact if minor losses occurred. Thus, FCA suggested that higher URE levels improved financial flexibility and avoided situations where member-owners may feel compelled to protect their purchased and allocated equity investments by seeking protection from Congress.

FCA's basis for imposing a minimum URE requirement is not supportable. First, the FCS has managed its capital resources to include an appropriate mix of different types of equity, from URE to third-party capital. Second, Congress has already made it clear that FCS member-owners are at-risk and will suffer the losses of the FCS cooperative. Congress' action with respect to the housing Government Sponsored Enterprises (GSE) emphasizes its resolve to allow significant common shareholder losses regardless of personal impact. Finally, FCA's "buffer" logic shows that too much URE undermines the user-control and user-ownership cooperative principles, contrary to Section 1.1 of the Act, and demonstrates that allocated retained earnings are at least equal to, if not superior to unallocated retained earnings.[17]

FCA should not require System institutions by regulation to retain URE at a specific level within a Basel III framework. This undermines an institution's ability to operate consistent with cooperative principles and the related IRS rules on taxation of cooperatives. As proposed, the rule appears to also unnecessarily infringe on a System institution's flexibility to implement governance processes that best support member-owners' ownership, control and engagement. Basel III did not establish

[17] 12 U.S.C. 2001

URE as a "superior" class of CET1, and FCA has little basis to disagree given the at-risk and permanent nature of cooperative equities included in CET1. FCA should modify the proposed URE requirement to require FCS institutions to manage the components of CET1, including retaining a sufficient amount of URE, appropriate for the effective business operations through economic/business cycles. If FCA remains determined to require a minimum URE standard, then it should at least apply the URE standard on a risk-adjusted basis consistent with FCA's current regulatory requirements. This approach would minimize unintended consequences for System institutions operating as cooperative financial institutions. FCA's current regulatory requirements are the only instance globally of a regulatory URE capital requirement relating to cooperative financial institutions. There is no factual or logical basis for FCA to continue to impose this requirement, let alone expand its impact on FCS institutions.

Threshold Issue Number 6 – Safe Harbor Requirement

Based on the premise that cooperative equities are included in CET1, we respect in principle that there must be restrictions on capital distributions. Nevertheless, the capital distribution "safe harbor" is too strict. Limiting capital distributions to the past year's net retained income and not allowing for any reductions in CET1 from the prior year-end provides no reasonable room to manage capital without seeking FCA prior approval. This burdensome requirement is far more restrictive than the implementation of Basel III by foreign bank regulators for the cooperatives they regulate and U.S. banking regulators for the commercial banks they regulate. FCA should recognize that foreign bank regulators provided flexibility to allow up to at least a 2% reduction in CET1 as long as regulatory capital ratios remained above the conservation buffer and all other requirements were met. U.S. banking regulators also recognized this flexibility in implementing capital distribution restrictions applicable to commercial banks. Under 12 CFR 208.5(c), commercial banks may distribute up to the sum of their current year net income, plus retained net income for the prior two years. Importantly, §208.5(c) is applicable to commercial banks with capital ratios above the capital conservation buffer requirement and that are not otherwise under supervisory remedy imposed by a U.S. banking regulator. FCA should be consistent with foreign and U.S. banking regulators and provide FCS greater flexibility to distribute capital.

Threshold Issue Number 7 – Higher Risk Weighting for Rural Electric Cooperative Assets

FCA should maintain the 50% and 20% risk-weight treatments of exposures to electric cooperative assets consistent with the treatment under the current regulations.[18] There has been no change in the unique characteristics and low risk profile of these loans. As previously acknowledged by FCA, the loans present a lower risk profile 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 encompassing rural America. These unique characteristics insulate the rural electric cooperative industry from many of the credit-related risks experienced by investor-owned utilities, as demonstrated by the industry's minimal loss history and sound credit ratings through time and over many adverse business cycles.

Along with the low credit risk of this rural electric industry segment, the key institutions that provide financing to this segment, other than CoBank and the U.S. government, are not regulated. Therefore, it is critical that FCA's capital rules not affect the FCS's ability to compete and collaborate with the other lenders in meeting the financing needs of rural electric cooperatives. In fact, the Act is clear that the FCS's mission is to be a dependable source of credit and financial services for these cooperatives. For these reasons, FCA should continue the 50% and 20% risk-weight treatments to ensure the FCS can continue to meet its mission to serve the rural electric

[18] Under BL-053, FCA permitted the 50% risk-weight based on certain conditions and 20% risk weight based on AAA or AA rating by an NRSRO. We recognize that FCA is not able to rely on NRSRO ratings in regulatory capital provisions. Regardless, it is still clear that high-quality rural electric cooperatives should qualify for a 20% risk-weight based on their strong financial profile. One approach may be to rely on the FCS institutions' internal ratings for this specific industry.

industry as it does today. If FCA does not make this change, it is clear that the proposed rule will adversely affect the FCS's capital capacity to serve this industry, even though there is no loss or other risk justification for the proposed change. In the event FCA is unwilling to change the regulatory language, the final rule should reaffirm the current treatment that is established by Bookletter and permissible under the provisions of the proposed rule.

Threshold Issue Number 8 – Treatment of High Volatility Commercial Real Estate

FCA needs to clarify the treatment of High Volatility Commercial Real Estate (HVCRE) as it pertains to traditional agricultural mortgages and eligible project finance transactions. The proposed definition of HVCRE and the associated 150% risk weight is unclear with respect to agricultural mortgages where the value of the land exceeds production value. While we do not believe FCA intended to imply that traditional agricultural mortgages are HVCRE, we are concerned that examiners will determine any financing that exceeds the agricultural production value needs to be risk weighted at 150%. Such a determination would compromise the FCS's ability to meets its statutory mission and is inconsistent with the realities of today's agricultural mortgage marketplace. Similarly, we are concerned that FCA examiners will characterize processing/marketing or rural infrastructure project financing as HVCRE. While we do not believe this is the intent of the provision, we are concerned that any such determination would undermine our lending mission going forward. We therefore ask FCA to provide clarity in its final rule on this issue.

Threshold Issue Number 9 – Direct Loan "Unfunded Commitments"

The proposed requirement to treat FCS bank direct loans to affiliated associations as having an "unfunded commitment" amount that requires capitalization is inappropriate and not supported by the facts. As discussed in detail in response to FCA's question on this matter (see the response to question 7 in Appendix A), the entire concept is without merit and inconsistent with the FCS cooperative structure. FCS banks and their affiliated associations closely manage commitments to extend credit made to specific borrowers and the current regulations address capital requirements for such commitments. By requiring capitalization of an association's available liquidity under a FCS bank direct note, FCA would be adding to the already multiple levels of capitalization in the FCS. We strongly disagree with this premise. FCA should remove the proposed requirement in its entirety and focus on commitments to "retail" borrowers.

Threshold Issue Number 10 – Treatment of Member Held Stock

We believe that all purchased stock in a System institution held by a member should count as Tier 2 capital, to the extent it does not count as Tier 1 capital, provided the stock lacks an explicit term or maturity. Under the Basel III criteria for Tier 1 and Tier 2 capital, we cannot envision a capital instrument that is characterized as equity under GAAP and that lacks an explicit maturity as falling completely outside of the definitions of Tier 1 and 2 capital. Member-held stock that is purchased as a condition of obtaining a loan or as part of an "H" stock program is fully at risk. Because such stock lacks an explicit maturity, it is redeemable solely at the Board's discretion and constitutes equity under GAAP. The Farm Credit Act recognizes member-held stock as regulatory capital through the statutory permanent capital requirement. It is our view that the Proposed Rule effectively supersedes the permanent capital ratio and, in so doing, excludes a large share of member-held stock as regulatory capital. We believe this aspect of the Proposed Rule thwarts congressional intent that allows all member-held, at-risk equity to count as regulatory capital. It also lacks the transparency sought in the Basel III framework by effectively ignoring legitimate at-risk capital investment in the association.

Conclusion

We appreciate the opportunity to comment on FCA's proposed capital regulation for the FCS. We also appreciate FCA's efforts in developing the proposed rule. The proposed rule is important to modernizing FCS's regulatory capital framework to make it comparable to the standards applied to other regulated financial institutions. While FCA has done an admirable job of adopting a Basel III framework for the FCS, it still needs important refinements to make it workable for the cooperative structure and mission mandate of the FCS.

The business structure of a cooperative, by definition, means it is a user-owned and user-controlled business that distributes benefits in proportion to use. The underlying principles of this definition are user-owned, user-controlled and user-benefits. The threshold issues in aggregate demonstrate our concern that the proposed regulatory capital requirements incentivize FCS institutions to rely on URE rather than cooperative forms of equity. This outcome is likely predisposed given the inherent regulatory bias against cooperative shares embedded within the numerous prospective criteria. In the end analysis, it will simply be easier for FCS institutions to limit member cooperative stock to the minimum purchase requirement of the lesser of 2% of the loan balance or $1,000 and rely on URE to meet capital requirements. We understand that FCA has argued that many FCS institutions already rely on URE to achieve compliance with current regulatory standards. Therefore, FCA concluded the proposed regulatory capital requirements would not be a hardship. We disagree.

While many FCS institutions have high levels of retained earnings, these are often either directly or indirectly allocated to members and distributed to members pursuant to a specific plan or through board discretion. Moreover, FCS institutions do not follow one approach to capitalization. Many institutions retain earnings in the form of allocated stock or allocated surplus. Under the proposed capital rules, these institutions would not be able to continue current cooperative capitalization practices, but rather would need to significantly restructure their capitalization approach. This outcome is not appropriate given there has been no indication that the current retention approach (e.g., allocated surplus or stock) has not provided loss-absorbing capability during periods of stress consistent with Basel III's expectations.

For many System institutions who have historically built capital with cooperative equities, there will be greater pressure to migrate to a model that relies on lower spreads as a substitute for revolving cooperative equities, effectively accelerating the pay-out to members. For these institutions, the first line of defense against losses—strong earnings—is unquestionably weakened. We don't think FCA should adopt a regulatory capital framework for the System that contains provisions that would disregard cooperative principles and weaken a System institution's loss absorbing capacity. It is clear that that the proposed rule does not adequately recognize the high-quality, at-risk, and permanent nature of cooperative equities within the context of the System's cooperative structure. It is imperative that FCA revise the proposed rule to recognize that cooperative equities are equivalent to CET1 of joint stock financial institutions and that cooperative equities are fully available to absorb losses during stressful periods. Otherwise, FCS institutions' most logical approach to capitalization to provide an adequate return to member-owners would be to minimize capital positions to the greatest extent practicable.

We ask FCA to fully consider our comment and adopt all of our suggested changes. These changes will: (1) position the final rule as consistent with Basel III in a functionally convergent way; (2) provide for FCS capital adequacy for the long run; and (3) ensure the FCS can be true to its cooperative structure in meeting its public policy mission as a GSE. Along with the threshold issues highlighted, the comment letter includes Appendix A that responds to FCA's questions in the proposed capital rule and Appendix B that provides section-by-section comments on the proposed rule.

We appreciate the opportunity to comment and FCA's consideration of our comment letter. We would be happy to meet with FCA to discuss our comments or provide any additional information that FCA may deem helpful. If you have questions or require additional information, please call me or Chris Doherty at (916) 780-1166.

Sincerely,

Mark D. Littlefield, President & CEO
Farm Credit West

Appendix A – Response to FCA's Questions
Appendix B – Section-by-Section Analysis

Appendix A

Response to FCA's Questions

As requested by FCA, the FCW is providing specific responses to each question the Agency asked in the proposed rule. The questions and responses are provided below.

(1) <u>Alternatives to Including Common Cooperative Equities in CET1 or Tier 2 Capital</u>
We seek comment on using alternative terms or conditions that FCA could apply to common cooperative equities. Is a 10-year revolvement cycle long enough to reduce the expectation of redemption and increase the permanence of such equity instruments so that they may be included in CET1 capital?

FCA has proposed a criterion that a FCS institution may not create through any action or term an expectation that a CET1 capital instrument will be redeemed in any manner before 10 years. The concept of a term for cooperative equities is inconsistent with the clear regulatory and statutory prohibition of retiring these equities when needed by a FCS institution to maintain compliance with regulatory requirements and continue as a going concern. From a cooperative principle perspective, past and current member-owners have contributed capital to the cooperative for its ongoing success. This capital contribution is fully at risk and available to absorb losses. The tenure of the capital does not diminish in any manner the at-risk nature of the member-owners' capital contribution. While it is true that cooperative principles also require that current cooperative members contribute to a higher amount of capital proportionate to their use of the cooperative, this principle does not reduce in any manner the capacity of past member capital contributions to absorb losses. Essentially, the FCS institution has the undisputed legal right to retain members' capital contributions regardless of revolvement cycles or expectations of members otherwise. Therefore, the 10-year revolvement cycle criterion is unnecessary.

A reasonable alternative to this criterion is to require disclosures by FCS institutions to member-owners that are explicit as to the at-risk nature of the stock investment. Such a disclosure could clearly state that a FCS institution is under no legal obligation to retire the stock and the FCS institution may retain any cooperative equities regardless of revolvement cycle if needed for capital adequacy, safety and soundness purposes, or going concern purposes. The disclosure could also state that as members of the cooperative, the member-owners have been explicitly notified about the absolute discretion FCS institution boards have with respect to the retirement of cooperative equities in any manner and regardless of stated revolvement targets. For CET1 treatment, the disclosures would be required on the issuance of any form of cooperative equity or retirement thereof. Beyond disclosure, the criterion could include a specific requirement that each FCS institution's board adopt a resolution that states the board will not retire any cooperative share if such retirement would: (1) compromise the long-term safe and sound financial operations of the cooperative; or (2) result in the non-compliance of regulatory capital requirements.

The FCS's experience since the late 1980's has shown that clear disclosures coupled with the current statutory requirements that support absolute board discretion over cooperative equity retirements effectively manage member-owners' expectations. There have been several instances recently where FCS institutions have tested the effectiveness of current disclosures and the existing legal regime with respect to member expectations for the retirement of cooperative equities or the distribution of current earnings as patronage. In all instances, these institutions were able to suspend patronage distributions or significantly reduce allocated surplus redemptions to maintain the permanence of capital that is available to absorb losses during a stressful period despite existing revolvement plans with terms less than 10-years and a past practice of consistently making cash patronage distributions (refer to the table in the Threshold Issues section of this letter). In the past, FCA has suggested that suspending patronage distributions and equity redemptions would result in high credit quality borrowers refinancing with other lenders or cause negative marketplace reactions creating reputation risk that impacts overall safety and soundness. While there is little doubt that suspending patronage distributions and equity redemptions is a negative event for a cooperative, such action does nothing to diminish the quality of cooperative shares to absorb losses during financial stress. While FCA has argued that FCS institutions are incented to maintain patronage distributions and equity redemptions to avoid possible negative member-owner reactions, this specific linkage demonstrates the user-control cooperative principle and ensures management acts in a manner consistent with shareholder value. Importantly, this same linkage exists in joint stock financial institutions. Given the proposed regulatory controls over patronage distributions and equity redemptions, including the inability to reduce CET1 without FCA approval, FCS institutions are effectively unable to dissipate capital in a manner that puts capital adequacy in jeopardy.

FCS's real life experiences demonstrate that the revolvement period is not relevant from a practical perspective. While it may be appealing to theorize that a longer revolvement cycle means greater permanence of cooperative shares, actual experience does not support that conclusion, because it ignores the strong existing legal framework under the Act that makes FCS cooperative equity at-risk at all times. FCA should recognize the absolute nature of the law as provided for by Basel III, which states that prudential regulators should consider the legal constraints imposed on cooperatives when implementing the capital framework.[19] Considering the facts and FCS's legal structure, FCA can reasonably drop the proposed revolvement cycle requirements. Based on over 20-years of experience, the current FCS practices in managing cooperative equity (e.g., retirements, issuances, etc.) and patronage payments have not created any retirement expectations in the collective "minds" of member-owners based on a reasonable person perspective.

Likewise, the criterion that FCS institutions must apply the 10-year revolvement cycle at the individual capital instrument level is unworkable and unsupported. On a going concern and capital pool basis, cooperative equities are permanent in nature, regardless of revolvement plans. Earmarking individual cooperative shares by date makes the ongoing management of the cooperative equities inherently difficult and costly without any practical benefit. To make the criterion workable, we ask FCA to recognize the going concern nature of cooperative equities and focus on the effective permanence of cooperative equities.

If FCA remains determined to differentiate allocated retained earnings based on revolvement periods, the criterion should not focus on the individual cooperative share with respect to the revolvement cycle, but the intent of a FCS institution to revolve over some established period and allow the institution to determine how best to achieve that intent. For instance, as also discussed in the Threshold Issues section, a FCS institution that is following a loan-based capital revolvement plan should be able to treat that capital as CET1, AT1 or T2 based on the loan-base period. Under such a plan, the level of cooperative shares held would be determined based on the average loan volume outstanding over a period of years (e.g., 5 years) and retained or retired following that methodology regardless of when the FCS institution first issued the cooperative share. The loan-based revolvement plan methodology effectively results in member-owners maintaining their cooperative equity in the FCS institution over a revolvement period that is effectively equivalent to revolvement approaches based on equity issuance date when evaluated at the capital pool level. Either methodology effectively results in the retention of cooperative equity over the stated revolvement period under a going concern perspective. From a perspective of other than a going concern, the legal requirements of the Act result in stopping the revolvement of cooperative equities regardless of any revolvement plan intentions of a FCS institution.

(2) <u>Capital Treatment of MSAs</u>
We seek comment on whether FCA should risk weight Mortgage Servicing Assets (MSAs) at 100 percent or require deduction of MSAs from CET1, as we propose to do for non-mortgage servicing

[19] See footnote 12," Basel III: A global regulatory framework for more resilient banks and banking systems", published in December 2010 and revised in June 2011.

rights. At the present time, FCA does not consider any type of servicing asset material to a System institution's or the System's consolidated balance sheet.

We appreciate FCA's analysis on MSAs with respect to the FCS. As FCA stated in the preamble, it believes no FCS institution would meet the Basel III deduction threshold of MSAs from CET1.[20] Therefore, FCA is proposing to risk weight any MSA at 100 percent rather than follow the more complex and not relevant Basel III deduction approach. We applaud FCA's approach of not encumbering the capital regulations with irrelevant and complex provisions relating to MSAs. Given the FCS's long-standing business model and lending authorities, the creation or purchase of MSAs is minimal and not material in nature.

(3) <u>Accounting for Defined Benefit Pension Fund Assets</u>
Given System institutions' differing methods of reporting defined benefit pension fund assets, what is the best way to require adjustments for defined benefit pension fund assets in the CET1 capital computation?

The U.S. banking regulators do not require insured depository institutions to deduct pension fund assets from CET1 based on Federal Deposit Insurance Corporation's (FDIC) determination that it has access to such institutions' prepaid pension assets in the event of receivership.[21] We believe that the Farm Credit System Insurance Corporation (FCSIC) has authority to reach the same determination with respect to prepaid pension fund assets reported on the balance sheets of FCS institutions. While FDIC and the FCSIC have different enabling statutes, the clear intent of the law is to provide these agencies unfettered authority to resolve the affairs of an institution placed in receivership. From our perspective, the FCSIC has significant authority to carry out its receivership mandate to take control of all assets of a FCS institution and repudiate various contracts. In that regard, defined benefit pension fund assets recorded on the books of a FCS institution are reasonably available and accessible in the event of receivership. The FCSIC would have the capacity to make a claim on the excess contributions at the point of receivership when the FCSIC makes the final accounting with respect to the FCS institution's business activities. FCA could amend § 627.2725, which specifies the powers and duties of the receiver, to include the authority to gain access to excess pension fund assets not required to fund the plan at the time of the receivership.

Overall, we conclude that there is sufficient basis under current law for FCA to treat prepaid pension fund assets as available to the FCSIC. For this reason, we ask FCA to modify the proposed rule so that defined benefit pension fund assets recorded on the books of a FCS institution are not required to be deducted from CET1, but rather risk-weighted at 100% as currently done under the existing capital regulations. This would also align FCA's treatment of defined benefit pension fund assets for capital computation purposes with that of FDIC-insured depository institutions.

(4) <u>Third-Party Capital Limits</u>
We seek comment on alternative third-party limits to ensure that System institutions remain capitalized primarily by their member borrowers.

Certain System institutions, particularly the System banks, rely on third-party capital to supplement member capital in order to ensure they can fulfill their mission and meet the credit needs of their member-owners during periods of growing or volatile financing demand or stress within the agriculture sector. Access to third-party capital has been invaluable in supporting the FCS in fulfilling its mission in a financially prudent manner. As stated in the preamble of the proposed rule, FCA is essentially concerned that third-party capital above some threshold may compromise the

[20] Basel III requires the deduction of MSAs net of associated Deferred Tax Liabilities exceeding the threshold of 10% of CET1 and 15% of CET1 in aggregate with other deducted items and a 250% risk weighting of MSAs not subject to deduction under the thresholds.
[21] Regulatory Capital Rules, Interim Rule, 78 Fed. Reg. 55340-55598 (September 10, 2013) page 55375, footnote 78.

user-control cooperative principle. Regardless of the amount of third-party capital issued by a FCS institution, the member-owners fundamentally retain user-control. Third-party capital investors never obtain any basic ownership rights over a FCS institution under its cooperative structure. While it is true that the third-party capital investors can influence a FCS institution if financial problems arise, the ability to exert this influence is not tied to the level of third-party capital issued. Therefore, we submit that FCA is concerned with the wrong cooperative principle with respect to use of the third-party capital.

We believe the applicable cooperative principle is user-benefit. The use of third-party capital to support loans to members means that a portion of the earnings generated is paid to the third-party capital investor that could otherwise be available to pay the member-owners. While this would appear to be a concern, it is not, because member-owners authorize the issuance of third-party capital and often are willing to allow their cooperative to access third-party capital when needed to support growth needs beyond what members can immediately and directly contribute. Member-owners generally understand that when a FCS institution needs additional capital, it is often the time when capital is least available from member-owners or the future retention of earnings will not fully meet the capital needs and still provide an appropriate balance with user-benefit. It is at this point in the management of capital adequacy that third-party capital becomes an invaluable tool for FCS institutions.

FCA's formulas limiting third-party capital are arbitrary. Limiting third-party capital to 25% of Tier 1 capital is far too restrictive. While we understand FCA's desire to protect user-control, the level of third-party capital issued should be a member-owner issue, not a regulatory matter. By placing regulatory controls on third-party capital, FCA is essentially limiting the member-owners' control over the affairs of their FCS institution. FCS should not compromise member-owner control without a well-defined safety and soundness reason.

Capital diversification is financially prudent. Therefore, limiting the level of third-party capital is not objectionable in and of itself. These limits, however, should not force FCS institutions to rely more heavily on cooperative equity or unallocated retained earnings in situations where third-party capital would be preferable (e.g., the need to raise capital during anticipated periods of significant volume growth). As a result, FCA should not retain the third-party capital limit formulas, but allow member-owners to determine how much of the overall capital structure may be composed of third-party capital. If FCA decides to retain the third-party limits, the percentages should be increased to allow greater flexibility for user-owners to direct the capital structure of their institutions and ensure FCS institutions have access to needed capital during periods of growth, volatility or stress. For instance, FCA could revise the total capital formula to allow for third-party capital up to 50% of total capital or 100% of AT1 capital. Similarly, FCA should revise the Tier 1 inclusion formula to allow third-party capital to make up 50% of Tier 1 capital. Given the criteria for CET1, we recognize that third-party capital would not be includable in CET1. Nonetheless, the overall result would increase flexibility of System institutions and maintain diversification in capital sources given that CET1 would be 50% or greater of Tier 1, considering the various capital standards and the capital conservation buffer.

(5) Risk-weighting – Exposures to OFIs
We seek comment on our proposed capital treatment of exposures to OFIs. Specifically, what factors or other information would be relevant if we consider assigning an intermediate risk-weight to a System institution's exposure to an OFI, recognizing that the same exposure to the same OFI would receive a 100-percent risk weight from a banking organization regulated by a Federal banking regulatory agency?

Under current capital requirements, OFIs are risk weighted: (1) 20% if they are a regulated commercial bank or credit union; (2) 50% if the OFI meets similar capital, risk identification and control, and operational standards; or (3) 100%.[22] FCS's very low loss experience on OFI loans demonstrates that the current risk-weighting regime has worked effectively. When coupled with requirements for underwriting OFIs found in Subpart P of §614, the overall current regulatory approach appropriately implements the Act's authority and expectation for FCS banks to provide financing to creditworthy OFIs. Based on the success of the current regulatory regime, FCA should continue to allow the risk weighting of OFIs that otherwise meet similar capital, risk identification and control, and operational standards as regulated financial institutions that qualify for the 20% risk weight and endorse all obligations with full recourse. It is unnecessary for FCA to add factors to the current regulation. FCS banks will be able to support the appropriate risk weight (20%, 50%, or 100%) based on their underwriting of the OFI credit. Overall, it is important FCA maintain the same risk-weighting regime for OFIs so that these institutions are not adversely impacted by the proposed rulemaking. Importantly, OFIs have not been shown to be more risky because of the 2008 financial crisis. Continuation of the current risk-weighting regime is fundamentally appropriate. Loans to OFIs are also different from loans to agricultural producers or agribusiness entities. OFIs are fully capitalized financing institutions that make loans and provide capital to support the underlying extension of credit. Therefore, FCS banks' exposure to OFIs is protected by two levels of capital, at the OFI level and individual OFI borrower level. Moreover, FCA has proposed significant regulatory requirements with respect to assured access and treatment of OFIs in Subpart P of Part 614 given the requirements found in the Act. Therefore, the proposed 100% risk weight regulatory capital treatment appears inconsistent with FCA's past policy position on OFIs. Finally, OFIs are unique to the FCS based on statutory requirements, so there is no comparable analysis under Basel III or U.S. banking regulators' rules. As provided in Basel III, FCA has discretion and authority to implement capital requirements tailored to the unique legal requirements and structure of the FCS. Therefore, the FCA should use its authority to ensure the proposed capital requirements are appropriate to the FCS and conceptually consistent with Basel III. Maintaining a 50% risk-weight achieves that outcome.

(6) <u>Risk-weighting – Exposures to Certain Electrical Cooperative Assets</u>
We seek comment as to whether we should retain this risk weighting [for exposures to certain electrical cooperative assets], being mindful of the Dodd-Frank Act section 939A requirement that we must eliminate the credit rating criteria.

In 2007, FCA used its reservation of authority to determine "that exposures to certain loans, leases, participation interests, and debt securities (Assets) of the electric cooperative industry warrant a lower regulatory capital risk weight".[23] FCA should maintain the current risk weighting approach for rural electric cooperative loans. The rural electric cooperative industry is strong and serves a vital mission in rural communities. The availability and cost of credit to rural electric cooperatives is critical to their ability to continue to fulfill their missions and serve their customers. We are very concerned that a decision to raise the risk weighting of loans made to electric cooperatives by FCS institutions would hurt credit availability to the industry and drive up borrowing costs for these cooperatives, which would ultimately hurt rural residents and businesses. The FCA should continue the existing risk weighting regime for electric cooperatives based on the continued lower risk profile of this industry group.[24] As FCA previously noted, the "lower risk profile is supported, in part, by the financial strength and stability of the underlying member systems, the ability to establish user rates with limited third-party oversight, and the exclusive service territories encompassing rural America -- all of which insulate the electric cooperative industry from many of the credit-related risks experienced by investor-owned utilities." The Agency referenced the industry's minimal loss history and its sound credit ratings as further justification, which continues to be true today and was entirely unaffected by the 2008 financial crisis and economic recession. As provided in Basel III, the FCA has discretion and authority to implement capital requirements tailored to the unique legal requirements and structure of the FCS. The FCS has a mission to

[22] For purposes of this discussion, we are ignoring current regulatory requirements relating to an OFI's rating by an NRSRO because reliance on such ratings is not acceptable. See § 615.5211(b)(16) and (c)(5).
[23] FCA Bookletter BL-053, dated February 12, 2007.
[24] Ibid.

serve the rural electric cooperative industry, which is vital to the success of rural communities. Therefore, FCA should ensure the proposed capital requirements are appropriate to the FCS and conceptually consistent with Basel III. Thus, FCA should maintain the current risk-weighting regime for rural electric cooperatives to accomplish that outcome. See Threshold Issue Number 7 for additional discussion in response to this question.

(7) Credit Conversion Factors for Off-balance Sheet Items – Exposure Amount of a System Bank's Commitment to an Association
We invite comment on this determination [regarding our determination of the exposure amount of a System bank's commitment to an association].

FCA has expressed a view that requiring a FCS bank to hold capital against the unused portion under the borrowing base of an affiliated association's GFA is analogous to unused commitments on loans to borrowers of such associations. Yet, FCA further states that the treatment of commitments is consistent with that of outstanding loans at the association level, which FCA and others have well-documented as regulatory double capitalization. Therefore, FCA's preamble statement that the proposed requirement does not result in a double counting of commitment exposures is unclear. The proposed capital treatment of available borrowing base essentially requires a FCS bank to capitalize the future growth in the district based on an inapplicable legal commitment concept for loans not yet made or assets not yet purchased. Besides being irrelevant, it effectively results in double capitalization given that FCS banks build additional capital in anticipation of loan growth, including true existing legal commitments to lend, within the district and on its own balance sheet. Moreover, it undermines well-established capital adequacy management disciplines used within the FCS because it confuses the concepts of capital for growth purposes and capital needed to fund existing commitments.

FCA further suggests that requiring FCS banks to hold such capital does not result in the double counting of commitment exposures within a FCS district given that the GFA and association loan to a borrower are separate risks. To support the separate risk statement, FCA suggests an affiliated association can draw on its GFA for purposes other than funding a loan to a borrower. While we can follow FCA's logic, it clearly ignores significant FCS interdependencies and practical differences between a GFA and a loan to an association borrower. A FCS bank effectively works collaboratively with affiliated associations on lending activities. If the capital or liquidity of a FCS bank becomes an issue, the FCS bank and affiliated associations will modify lending activities in an appropriate manner, which is an inherent outcome of the FCS cooperative structure and supported by past appropriate business practices. In the interdependent and interconnected structure of a FCS district, the FCS bank and affiliated associations cooperatively manage overall district growth within available capital capacity. Moreover, FCS banks require an affiliated association to fully and regularly capitalize the increase in its direct loan. An association borrower is not required to capitalize any increase in the outstanding loan balance. As a result, affiliated association direct loans with their funding bank differ significantly from association retail loans to their borrowers with an undrawn commitment. Such a borrower can often draw the entire available commitment on a moment's notice without regard to the impact on the lending institution, particularly for unsecured revolving lines of credit established for general corporate purposes. From a practical perspective, affiliated associations are simply not in the same position as individual association borrowers.

Recognizing FCS's structural interdependencies, FCS banks adjust the GFA borrowing base to reflect the underlying quality of assets and available capital to support the direct loan. The net result is that the FCS bank's direct loan to the affiliated association is supported by high quality collateral and affiliated association capital, including the capital held for borrower loan commitments. Under a GFA structure, FCS banks primarily link additional draws to an association making a new loan or fulfilling a commitment to an existing borrower. As a result, there is no incentive for an association to draw on its borrowing base simply to retain more cash. In fact, a FCS bank could deny such a request were the purpose to retain excess cash at the association level rather than to fund a legitimate loan or authorized investment. If the FCS bank denied such a request, the affiliated association would be in the untenable position of having to demand funds be provided under the GFA for a questionable purpose. Moreover, the FCS banks have existing settlement arrangements with associations that sweep excess cash balances that the FCS bank then applies to reduce the direct loan. Therefore, the direct loan is not analogous to a loan to an association borrower, and FCA should not treat the excess borrowing base as an unfunded commitment. Importantly, over the entire existence of the FCS, the unused borrowing base has never resulted in a capital shortfall at the FCS bank level because affiliated associations unilaterally decided to draw funds available under the GFA. As a result, FCA's logic for treating the excess borrowing base as a commitment is fundamentally flawed. The treatment is inappropriate and appears designed to arbitrarily cause FCS banks to hold higher levels of capital than supported by actual risk exposures and un-cancelable commitments to lend.

(8) <u>System Institution Acting as Clearing Member</u>
We invite comment as to whether we should adopt such provisions [contemplating that System institutions would act as clearing members].

We applaud FCA's overall philosophical approach of not including complicated provisions that are not currently applicable and, as a result, are unnecessary. We know of no plans for a FCS institution to seek clearing member status, which would be a significant effort that would require FCA involvement. Therefore, FCA should continue to omit capital provisions specifically applicable only to clearing members.

(9) <u>Collateralized Transactions – Own Estimate of Haircuts</u>
We seek comment on whether we should adopt a regulation that would permit the use of an institution's own estimates.

FCA has proposed a simple approach and a collateral haircut approach for loans, repurchase agreements, and other transactions backed by financial collateral (i.e., collateralized transactions). As proposed, a FCS institution may substitute the risk weight of an exposure collateralized by cash on deposit, gold bullion, U.S. Government securities, short-term investment grade debt instruments, publicly traded equity and convertible bonds, and daily quoted money market funds. The substituted risk weight associated with the financial collateral will depend on if a FCS institution decides to use the simple approach or the collateral haircut approach based on standard supervisory haircuts. We note that the FCA-proposed simple approach, collateral haircut approach, and supervisory haircuts are identical to the requirements implemented by U.S. banking regulators. These regulators, however, also implemented a provision to allow a commercial bank to use its own internal estimate for haircuts when applying the collateral haircut approach. While the U.S. banking regulators provided additional flexibility, it requires regulatory written prior approval of a submission that meets strict, cumbersome, and complex requirements that appear most applicable to large money center banks.

At this time, we see no need for FCA to expand its proposed collateral haircut approach to collateralized transactions to allow FCS institutions to use their own internal estimates for haircuts. The proposed supervisory haircuts along with the simple approach appear currently workable for the FCS. Again, we applaud FCA for not including provisions in the proposed capital rule that are not currently applicable or not expected to be needed anytime soon.

(10) <u>Exposures to Asset-backed Commercial Paper Programs</u>
We seek comment as to whether we should include provisions in our risk-based capital rules regarding ABCP programs that are comparable to those adopted by the Federal banking regulatory agencies.

FCA stated in the preamble to the proposed capital rule that:

> ". . . we believe it unlikely that a System institution would establish an ABCP program, because if the Funding Corporation's ability to issue debt ever was impeded, we believe the ability of an ABCP program to issue commercial paper would face the same difficulties."

FCA's statement seems reasonable and logical relative to the FCS's access to the debt markets as a GSE. Today, it seems unlikely that the FCS would establish an ABCP at the consolidated Systemwide level or an individual FCS bank would seek to establish an ABCP for its own purposes. Therefore, adding ABCP provisions to the proposed capital regulations is unnecessary. Moreover, we believe that FCA would be able to address the ABCP matter on a case-by-case basis in the unlikely event that the FCS or FCS institution sought to implement such a program.

(11) Disclosures
We invite comment on the appropriate application of these proposed disclosure requirements to System banks.

For FCS banks only, FCA is proposing disclosures that are identical to the requirements implemented by U.S. banking regulators for entities with $50 billion or more in assets. While we understand FCA's desire to follow Basel III in this regard, the disclosures are excessive for FCS banks. The bifurcation of disclosures among FCS institutions results in a disclosure program that is not harmonized across the System. As proposed, associations would have one set of disclosures, banks would have another, combined district disclosures would be different from those of the bank, and the Systemwide disclosure would be different yet again. The 10 tables of detailed quantitative and qualitative data may be suitable for large publicly traded banks, but such a disclosure regime does not appear to be a good fit for the federated cooperative structure of the FCS. From our perspective, the disclosures pertaining to FCS capital adequacy required by existing Part 620, along with the proposed amendments, are sufficient to provide a meaningful and consistent disclosure across the FCS. For this reason, we ask that FCA eliminate proposed FCS bank disclosure requirements at this time. Rather than include disclosure requirements by regulation, the FCA should work with FCS banks on appropriate enhancements in disclosures that reflect the new capital requirements through other guidance, such as an Informational Memorandum. This approach would be more flexible and not encumber the regulations with excessive requirements that apply to only four entities.

Section-by-Section Feedback

Beyond the threshold issues and specific responses to FCA's questions, FCW has also identified various conceptual and technical issues in the proposed regulatory language. The identified issues are explained below through a section-by-section discussion.

1. § 614.4351 Computation of lending and leasing limit base.

FCA has proposed a conforming change with respect to the lending and leasing limit base to exclude from permanent capital preferred H stock issued by some FCS institutions to their members. Under the proposed conforming change, FCS institutions must deduct any preferred stock excluded from Tier 2 capital from the lending and leasing limit base. Unfortunately, this approach could result in the exclusion of preferred stock from total capital as a result of the proposed limit on third-party capital pursuant to § 628.23. While we understand the existing policy position of excluding preferred H stock for the lending limit, the exclusion of other forms of preferred stock previously included in the lending and leasing limit base based on permanent capital is inappropriate and an unexplained adverse proposed change to the existing rule. The adverse outcome occurs because there is no limit on third-party capital in the existing regulatory capital requirements. FCA should retain the current policy position of only excluding preferred H stock issued to members from the lending and leasing limit base.

2. § 615.5200 Capital planning

FCA has proposed to modify the capital planning requirements to conform to the proposed CET1, Tier 1, total capital, and Tier 1 leverage requirements. In making these conforming changes, FCA modified paragraph (b) to delete the following existing text:

"If the plan provides for retirement or revolvement of equities included in core surplus, in connection with a loan default or the death of a former borrower, the plan must require the institution to make a prior determination that such retirement or revolvement is in the best interest of the institution, and also require the institution to charge off an amount of the indebtedness on the loan equal to the amount of the equities that are retired or canceled."

We support deletion of this sentence given it appeared to place additional requirements on the absolute statutory right of FCS institutions to retire cooperative shares in the event of loan default and restructuring.[25] While we understand that FCA has proposed significant restrictions on the retirement of cooperative shares, FCA still recognizes in § 615.5270 a FCS institution's right to retire cooperative equities without regard to restriction proposed in Part 628. As proposed, it is unclear if FCS institutions will also be able to retire cooperative equities in connection with the death of a member borrower without regard to restriction proposed in Part 628. We ask that FCA retain the long-standing position that such redemption in the event of death continues to be permitted. Similarly, FCS institutions should have the right of offset for cooperative shares purchased as a condition for obtaining a loan without regard to restriction proposed in Part 628. The Act clearly intended FCS institutions to have the option of offsetting such purchased stock in the event of default or restructuring. We note that, under the proposed CET1, AT1 and T2 framework, respecting this statutory right of offset does not weaken the quality of capital or safety and soundness of FCS institutions. FCA should respect the right of offset by recognizing equity retirements that arise from bankruptcy proceedings, estate settlements and similar events as fully allowable and not requiring FCA prior approval. If FCA is concerned that such events may result in excess capital dissipation, the agency could set a limit for such retirements, such as less than 1% of outstanding capital in any given calendar year.

[25] 12 U.S.C. 2154a. Sec 4.3A(g).

In 2012, FCA made significant changes to regulatory business planning requirements in § 618.8440, including the addition of a provision for a human capital plan that requires an assessment of management strengths and weaknesses.[26] The human capital provision overlaps and is redundant to the capital planning provision found at § 615.5200(b)(1). FCA should allow the capital plan to simply refer to the human capital plan with respect to management capabilities or vice versa. The proposed regulatory capital planning and strategic planning provisions are duplicative, thereby causing unnecessary burden for FCS institutions.

3. § 615.5201 Definitions

The proposed definition of permanent capital excludes accumulated comprehensive income from surplus. Under this revised definition, it is now unclear if the exclusion also applies to accumulated comprehensive loss. We note that FCA proposed the permanent capital definition change to align with the treatment of accumulated comprehensive income or loss under the proposed Basel III framework. We ask FCA to clarify that the definition of permanent capital excludes the impacts of accumulated comprehensive income and loss.

4. § 615.5208 Allotment of allocated investments

FCA has proposed an implementation of the Basel III framework that effectively ignores statutory provisions that provide for the allotment of allocated investments between FCS banks and affiliated associations. FCA accomplishes this by essentially proposing two parts for regulatory capital: (1) permanent capital consistent with statutory requirements; and (2) Basel III framework appropriate for the FCS. In implementing the second part, it is unclear if FCA has the authority to ignore statutory provisions pertaining to permanent capital. Under the statute, all equities categorized under a Basel III framework must also qualify as permanent capital, otherwise the Act would not legally allow FCS institutions to count such capital under any regulatory framework. It follows, then, that any equities counted in part 2 of FCA's proposed structure must adhere to statutory provisions. As proposed, allocated investments are excluded from part 2 in violation of Section 4.3A(a)(1)(B). Whether or not allotment of allocated investments is preferred by any particular person or under a Basel III framework is not relevant to the analysis. FCA should adhere to clear statutory requirements in any implementation of regulatory capital, regardless of form. The Bank for International Settlements (BIS) in developing the Basel III framework expected that "local" jurisdictions would need to deviate from the Basel III framework based on specific statutory requirements within individual countries. Therefore, accommodating the Act's requirements within the Basel III framework should not be challenged or result in substantive convergence questions. In fact, prudential regulators across the globe have deviated slightly in the technical implementation of the Basel III framework to accommodate local requirements. We ask FCA to modify the proposed rule to allow for the application of allotment agreements in the proposed CET1, Tier 1, and total capital framework. To support the overall intent of the framework, the allotted capital investment at the affiliated association level should be counted based on the treatment of the cooperative equity by the FCS bank (e.g., CET1, AT1 or T2).

If FCA decides not to allow agreements for the allotment of allocated investments between FCS banks and affiliated associations with the proposed Basel III framework, there would be an immediate and significant negative impact on regulatory capital ratios for some FCS institutions. Therefore, at a minimum, the FCA should provide for a 5-year period during which FCA would permit the allotment of allocated investments within the Basel III framework, consistent with the treatment permitted under existing regulatory capital requirements. This transition period provides needed time for FCS banks and affiliated associations to adjust allocated investments to comport with the requirements.

5. § 615.5220 Capitalization bylaws

[26] See § 618.8440(b)(7)

As discussed previously, the requirement that the capitalization bylaws restrict the revolvement of allocated equities for inclusion in CET1 or T2 is excessive and burdensome. As demonstrated in the proposed technical revisions to § 615.5220, capitalization bylaws are generally written in a manner to provide appropriate flexibility for boards of directors to manage cooperative shares consistent with cooperative principles and the financial needs of the institution. We believe that FCA should recognize that the implementation of the bylaws within the discretion afforded to a board of directors is legally binding. Therefore, if a board determines to bind itself to a particular approach to managing capital resources, the proposed regulatory capital requirements should recognize and accept that board determination. For instance, if the board establishes a resolution to revolve allocated cooperative equity over a certain period, the FCA should recognize that resolution in the proposed CET1 criterion. To ensure board actions are legally binding under the regulations, FCA should add a clarifying provision to § 615.5220. For instance, FCA could add a paragraph (c) that states FCA recognizes that board official actions to implement the bylaws are legally binding for regulatory purposes, including for regulatory capital provisions.

6. § 615.5255 Disclosure and review requirements for sales of other equities

The FCA stated that it proposed technical changes in § 615.5255 to reference Part 628. The review of proposed § 615.5255 did not identify any new reference to Part 628. It would be appropriate to include a reference to Part 628 in subparagraphs (f) and (g) as was done for Part 615 and subpart H. We also ask FCA to revise the 30-day notification timeframe found in subparagraph (h), to 5-days and the 60-day timeframe found in subparagraph (f) to 30 days to allow the FCS to effectively issue third-party capital in uncertain market conditions. The current timeframes are unworkable and result in unnecessary uncertainty for third-party capital issuances that are common and not novel in nature.

7. § 628.10(b)(4) Minimum capital requirements

As discussed previously, we strongly disagree with the proposed requirement that "at least 1.5 percent must be composed of URE and URE equivalents" of the 5% Tier 1 leverage ratio. For the reasons presented in Threshold Issue Number 4 this proposed requirement is entirely inappropriate, not supported in Basel III, and creates a "super" subclass of capital within CET1. FCA should drop the proposed URE requirement entirely. If FCA insists on this provision, it should incorporate the URE concept on a risk-adjusted basis within the proposed 4.5% CET1 requirement. Such an approach would minimize disruption to FCS institutions, but would maintain current regulatory support for holding some level of URE.

FCA defines URE equivalents in proposed § 628.2 as:

> "…nonqualified allocated surplus not subject to retirement except upon dissolution or liquidation. URE equivalents does not include equities allocated by a System institution to other System institutions."

It seems reasonable to conclude that as long as a FCS institution intends to retire non-qualified notices of allocation (or a portion thereof) only upon liquidation, then the proposed definition for URE equivalent is satisfied. As long as the FCS institution has taken appropriate steps to document this intent, then it has complied with the definition of URE equivalents. Such reasonable steps fall short of requiring a bylaw amendment and can be achieved through other means, such as board resolution.

8. § 628.2 Definitions

The FCA has proposed various definitions. Overall, such definitions are logical and understandable, but some require clarification. First, the definition of "discretionary bonus payments" and subparagraph (3), which states the senior officer must have no contractual right, whether express or implied, to the bonus payment. We are unclear as to the meaning of an "implied" contractual right within this part of the definition and ask FCA to provide clarification of what FCA considers as “implied” within a contractual arrangement. We are concerned that the use of “implied” would be subject to inconsistent or arbitrary interpretations in practice.

Second, FCA has proposed a definition for “Government-sponsored enterprises” that excludes FCS institutions. While FCA appears to have done this for convenience in applying the definition in proposed Part 628, the definition is still fundamentally incorrect and subject to misinterpretation. We ask that FCA revert to the existing definition found in § 615.5201 to avoid any possible confusion with FCS’s GSE status.

Thrid, FCA has proposed a definition for “member” based on a borrower or former borrower holding voting or nonvoting common cooperative equities. While the definition is clear, we ask FCA rename the term to “member-owner” as more descriptive and accurate.

9. § 628.11(a)(2)(i) Eligible retained income

While FCA has proposed a definition for eligible retained income that is identical to the U.S. banking regulators definition, the proposed approach needs refinement to make it logical and applicable to cooperative FCS institutions. Unlike joint stock companies, FCS institutions as cooperatives typically pay patronage distributions for the prior year in the first quarter of the current year. For example, 2013 patronage distributions were made in the first quarter of 2014. As proposed, eligible retained income is defined as net income for 4 calendar quarters preceding the current calendar quarter net of any capital distributions. For FCS institutions, the result is an excess deduction based on prior year distributions from current eligible retained income based on patronage distribution requirements of a cooperative, which creates a far more restrictive requirement than applicable to commercial banks. For example, in first quarter of 2015, eligible retained income would be net income based on first, second, third, and fourth quarters of 2014 less the patronage distribution of 2013 paid in the first quarter of 2014. Clearly, this is an inappropriate and excess deduction for distributions of capital based on income earned in the prior 4-quarter requirement in the proposed eligible retained income definition. Consistent with the current intent of eligible retained income, deduction for patronage distributions should be aligned with when the earnings were generated. Thus, FCA should modify the eligible retained income definition so that in the first quarter of 2015, eligible retained income would be net income based on first, second, third, and fourth quarters of 2014 less any patronage distribution paid from 2014 net income. In this way, there would be no deduction from eligible retained income calculated for the first quarter of 2015 because the 2014 patronage distribution has not yet been paid, but will be paid, if allowed and subject to the capital conservation buffer payout limits, in the first quarter of 2015.

10. § 628.20 Capital components and eligibility criteria for regulatory capital instruments other than permanent capital

We strongly disagree with the proposed provisions that require bylaw changes in order to meet eligibility criteria for various capital instruments. FCA can accomplish appropriate distinction between capital instruments through other means.

11. § 628.20(b) CET1 Capital

The FCA has proposed that common equity instruments must meet 13 separate criteria in order to be counted as CET1. As discussed more fully in our comment letter, we disagree with a minimum 10-years revolvement cycle proposed in criteria § 628.20(b)(1)(iv). To reiterate, the existence of a revolvement cycle does not create an expectation for revolvement or create a moral or legal obligation for a FCS institution to retire a cooperative equity instrument. Moreover, such a revolvement requirement does not recognize the difference between FCB capitalization arising from affiliated association investments in their funding bank and capitalization of an association and of an ACB with respect to non-affiliated association lending activities.

FCA also proposed in § 628.20(b)(1)(x) that the direct or indirect funding of purchases of the common equity capital instrument is prohibited, with the exception that the minimum borrower stock required as a condition for obtaining a loan is not considered as direct or indirect funding. We applaud FCA's approach given the Act requirement that member-owners purchase stock as a condition for obtaining a loan.[27] What is unclear is how this exemption applies to affiliated association stock in their funding bank. With respect to an affiliated association direct loan, the minimum statutory investment requirement is not analogous to association member-owner's purchase requirement given the financial interdependency of funding banks and affiliated associations. As provided for by statute, associations purchase stock in their funding bank at a level the FCS bank determines appropriate and such association purchased stock investments are only counted at the funding bank level for regulatory capital purposes (i.e., no double capital counting or leveraging). We ask that FCA clarify that association stock in its funding bank is not considered as funded either directly or indirectly. We believe this treatment is appropriate given the cooperative and financially interdependent structure of the FCS. The FCS structure results in funding banks and affiliated associations having a perpetual financial relationship. As a result, the direct note is a perpetual instrument and the affiliated association purchased capital in their funding bank is likewise perpetual capital. This result is logical because associations are required by law to borrow from their funding bank and have no substantive alternatives for obtaining funds. Under the Act, there is a permanent commitment by the association to capitalize its funding bank. Functionally, association stock investments in their funding bank are seldom retired but excess capital needed to support the direct loan is addressed through equalization programs that are consistent with cooperative principles.

FCA also proposed in § 628.20(b)(1)(xiv) that a FCS institution's bylaws must prohibit retirement of common capital instruments in the event of loan default and that such instruments will not be redeemed for a period of at least 10 years after issuance. As discussed in detail previously, the bylaw requirement is excessive and unnecessary to create a clear legal distinction. The requirement that the right of offset be waived fundamentally violates Section 4.3A(g), which provides that capital requirements will not affect the privilege to retire or cancel stock against defaulted or restructured loans. In proposing regulatory capital requirements that inherently stem from the Act, the FCA should not frustrate or block clear statutory rights and privileges. Basel III does not require such a provision. FCA should not propose criteria where the only practical way to achieve capital adequacy through cooperative equities is to waive rights or forego cooperative principles. FCA's approach is inherently coercive and, therefore, inappropriate.

We also object to the minimum 10-year life for CET1 instruments as proposed in § 628.20(b)(1)(xiv). The 10-year standard is excessively long and inconsistent with cooperative principles. In addition, the proposed 10-year requirement harms members. Considering the deep discount associated with the present value of a 10-year capital distribution, the 10-year holding period imposes excessive costs on members and puts cooperative FCS institutions at a competitive disadvantage. For example, the present value of a 10-year fixed value (e.g., $5) cooperative share results in a deep discount of more than 60% (e.g., $1.93) from face value assuming a modest required investor return (e.g., 10%). Given there is no appreciation in cooperative shares and patronage distributions are discretionary in nature, the proposed rule imposes an economic cost on members that is excessive and inappropriate for a cooperative business structure.

Further, the standard that a FCS institution must date stamp individual common equity instruments at issuance and hold the instrument for a set period is not logical in a cooperative structure.

[27] FCA proposed rule is unclear if member-owner purchase requirements in excess of statutory minimums could be treated as AT1 under § 628.20(c) if they otherwise meet the Tier 1 criteria. It would seem that some amount of cooperative shares purchased as a condition for obtaining a loan should reasonably qualify for AT1 just as it does for CET1 and T2. For example, FCA could allow a reasonable amount, such as up to 4% of the borrower's loan, to qualify as AT1. We assert that some additional recognition of purchased cooperative shares is logical and supportable from a user-benefit perspective. The amount included in AT1 would still be minimal to the overall capitalization of a FCS institution in light of proposed CET1, AT1, T2, and total capital requirements along with the capital conservation buffers.

Having to determine when an individual instrument flows into or out of the capital structure does not recognize the portfolio nature of cooperative equities. For example, if a long-time borrower is required to retain equity holdings of a certain percentage against the 5-year average loan balance outstanding, it does not matter if one share is held for 2 years and another share is held for 10 years. Functionally, the borrower has a stable and predictable level of investment related to their business activity with the cooperative. The borrower also understands that it must maintain this commitment. Finally, a date-stamped based revolvement cycle would require significant unnecessary administrative burden to manage as compared to a loan-based approach to member capitalization of their cooperative. Therefore, we ask that FCA provide flexibility to allow both a loan-based approach to equity revolvement and a date-stamped approach.

The “after issuance” term in proposed § 628.20(b)(1)(xiv) is vague. As written, the issuance date could be the board approval date, the date on the notice sent to shareholders, or the date stamp when transferred on the FCS institution’s books. FCA should clarify what “after issuance” means if it decides to retain a “date stamped” revolvement period requirement in the final rule. A logical date would be when the board approves the distribution of patronage to member-owners that gives rise to the allocated equities to member-owners.

If FCA decides to retain a minimum revolvement period for cooperative common equities to be counted as CET1, the final rule must grandfather existing allocated equities because past record-keeping on issuances may not be sufficient to demonstrate compliance on the effective date of the rule. We ask the FCA to grandfather all existing allocated equities at the time the final rule becomes effective and take a going-forward perspective with respect to future allocated cooperative equity issuances.

12. § 628.20(c) AT1 Capital

FCA has proposed that instruments and related surplus other than common equity must meet 14 separate criteria in order to be counted as AT1 capital. We note that § 628.20(c)(viii) is materially inconsistent with the similar requirement implemented by U.S. banking regulators. The U.S. banking regulators’ provision states:

> “Any distributions on the instrument are paid out of the [BANK]'s net income, retained earnings, or surplus related to other additional tier 1 capital instruments.”

FCA did not follow this language and seemed to duplicate the similar requirement found in CET1. FCA’s proposed Tier 1 criterion is:

> “Any distributions on the instrument are paid out of the System institution's net income, unallocated retained earnings, or surplus related to other AT1 capital instruments and are not subject to a limit imposed by the contractual terms governing the instrument;”

Essentially, there should be no limits on dividends on AT1 capital instruments. If retained, the language would appear to exclude AT1 capital instruments with stated coupons, such as preferred stock. In our view, this is simply a drafting issue. We ask FCA to delete “and are not subject to a limit imposed by the contractual terms governing the instrument” from the proposed criterion.

13. § 628.20(d) Tier 2 Capital

FCA has proposed that instruments must meet 11 separate criteria in order to be counted as Tier 2 capital. We note that under § 628.20(d)(i) and (viii) member-owner purchased equity beyond the minimum required as a condition for obtaining a loan is considered Tier 2 capital. This concept as to borrowers other than affiliated associations is appropriate, but applying this provision to association-purchased investments in their funding bank is inappropriate. As discussed previously (see Number 11 “CET1 Capital” of this Appendix B), the FCS bank and its affiliated associations are financially and operationally interdependent. The affiliated association must obtain funds from its funding bank and the FCS bank is required to provide funding. It is not an open market by statutory design. The purchased investment in the FCS bank and the direct loan to the association are permanent features of the FCS since it began in 1916. Capitalization at the bank level has stood the test of time because affiliated associations fully understand that their investment in the bank is at-risk and permanent in nature. Therefore, it is functionally equivalent if a FCS bank is capitalized by purchased or allocated equities issued to affiliated associations. There is no practical or legal difference in permanence and loss absorbing availability between purchased or allocated FCS bank stock issued to affiliated associations. FCA should specifically permit affiliated association investment in their funding bank to qualify as CET1. This treatment is necessary to the federated cooperative structure of the FCS.

Proposed § 628.20(d)(1)(xi) requires FCA prior approval for the redemption of common cooperative equity included in T2 capital for a period sooner than 5-years after issuance. We ask that FCA drop the proposed T2 approval language and simply allow all common cooperative equity not included in CET1 or AT1 to count as T2 capital regardless of revolvement cycle. In this context, common cooperative equity would include all "at risk" member-purchased stock as well as allocated equities. This way all equity instruments authorized in an entity's bylaws and reported to shareholders as capital are likewise included in the construct of regulatory capital.

14. § 628.20(f) FCA prior approval of capital redemptions and dividends included in Tier 1 and Tier 2 capital.

FCA has proposed a regulatory prior approval requirement for distributions and retirements relating to Tier 1 and T2 capital instruments, including an exception under which distributions and retirements may occur without prior approval. We ask that FCA make the proposed prior approval approach more timely and efficient. For FCS institutions with solid financial performance and healthy Financial Institution Rating System (FIRS) ratings, FCA should provide a streamlined prior approval process, possibly even as short as one day. It is burdensome and unworkable for FCA not to take a risk-based approach to the approval process as FCA currently does for FCS bank funding approvals. Given FCA's close examination oversight of FCS institutions, it has intimate knowledge of the strengths, weaknesses, and financial performance of FCS institutions. Rather than place a burden on FCS institutions by imposing a strict 30-day requirement, FCA should provide itself flexibility and well-managed FCS institutions a quick prior approval process relating to distributions and retirements of Tier 1 and T2 capital instruments. Under a streamlined and risk-based approach, the FCA can pre-approve all contemplated capital distributions under a FCS institution's board-approved capital plan. This approach is particularly important if FCA does not provide additional flexibility within the proposed safe harbor provision, as discussed previously.

We also appreciate FCA providing some flexibility for distributions and retirements without FCA prior approval. We note that § 628.20(f)(5) allows for the retirement of certain common cooperative equities and cash distributions provided the distribution does not reduce CET1 to a level below that as of the previous calendar year-end. While the flexibility to retire certain common cooperative equities is logical and makes good sense, the limit on CET1 distributions is simply too narrow as essentially capped at current earnings. This approach makes management of regulatory capital exceedingly challenging and inflexible. We ask that FCA consider the approach taken by foreign and U.S. banking regulators. These regulators allow greater flexibility for capital distributions.[28] This or some similar language would provide reasonable flexibility for FCS institutions to effectively manage their capital positions without causing any issue from a safety and soundness perspective, particularly given that the capital conservation buffer restrictions would still apply and further limit FCS institution discretionary reductions in CET1. This approach also results in a significantly more effective and efficient risk-based approval regime. Essentially, FCA would not be inundated with requests for routine and non-material patronage distributions and common cooperative equity

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[28] The EBA provides advance permission for the redemption of net CET1 (i.e., net of new CET1) not to exceed 2%. EBA/RTS/2013/01, EBA FINAL draft Regulatory Technical Standards on own funds [Part 1] under Regulation (EU) No 575/2013 (Capital Requirements Regulation - CRR) July 26, 2013, Article 29.

retirement activities that are common practice for cooperative institutions, while retaining the capacity to exercise its supervisory authority for non-routine distributions or retirements.

15. § 628.22 Regulatory capital adjustments and deductions

FCA has proposed capital adjustments and deductions consistent with the final U.S. banking regulator rules implementing a Basel III framework, appropriately refined for the FCS cooperative structure in most regards. Nevertheless, there are two areas that require further comment. The first, as discussed previously, is the omission of allotment of the association allocated capital investment in their funding bank. The second is § 628.22(a)(8) that proposes a 30% haircut deduction if a FCS institution redeems or revolves equities without FCA prior approval and does not meet the FCA consent provisions. This is an entirely new concept that is not found within the Basel III framework or the implementation by other regulators. We appreciate FCA's use of discretion to implement a Basel III framework applicable to the FCS. Unfortunately, we find the proposed haircut approach illogical from a policy perspective and a concept that requires significant clarification.

As currently drafted, a FCS institution could trip the haircut through a recordkeeping error, other de minimis redemptions, redemptions to a borrower's estate or redemptions pursuant to a bankruptcy court order. Moreover, it is entirely unclear if this haircut for a three-year period is applied one time only, is repeated on a going-forward basis, is cumulative in some manner, or is overlapping in application. It is also unclear if the haircut is cumulative for repeated mistakes or inappropriate redemptions. Finally, from a financial reporting perspective, the haircut introduces a non-financial movement in the capital ratios that will be confusing to external parties. The haircut further results in excluding shareholder equities under GAAP from regulatory capital, a nonsensical outcome. We ask that FCA delete the proposed haircut provision. It is unprecedented to include a penalty in the regulations. Remedies should be left to the discretion of the examiner using well-tested and effective FCA supervisory authorities. As a possible alternative, the 30% haircut could be a standing deduction to CET1 with revolvement periods less than prescribed periods provided for in the proposed rule and inclusion of such deducted allocated equities in T2. Such an approach would eliminate the confusing nature of the proposed haircut if FCA chooses not to delete this provision.

In § 628.22(c)(2) and (5), the FCA also proposed that a FCS institution investment be deducted from CET1, Tier 1, or T2 following a corresponding deduction approach. We ask FCA to clarify this proposed treatment of FCS institutions' equity investments in FCS entities not engaged in lending or leasing activities. Our interpretation of the proposed rule is that FCS institution investments in service corporations, the Federal Farm Credit Banks Funding Corporation FFCBFC), and FCS Building Association are subject to the proposed corresponding deduction approach. We believe that this approach is inconsistent with Basel III, which would apply a risk weight to such investments rather than a full deduction. We ask FCA apply a risk weighting approach to equity investments in service corporations, the FFCBFC and the FCS Building Association. A risk weight approach is logical and appropriate given these entities are not permitted to leverage the provided capital through lending or leasing activities.

16. § 628.23 Limits on third-party capital

As discussed in the response to question 4, we believe that FCA can clarify and increase the flexibility of third-party capital in FCS institutions' capital structure.

17. § 628.32 General risk weights

Overall, we find the proposed risk weights consistent with the implementation of Basel III by U.S. and foreign banking regulators. We have not noted significant technical issues with FCA's proposed general risk weight provisions. One area that requires clarification, however, is § 628.32(j) relating to high-volatility commercial real estate (HVCRE) exposures. While we are not concerned with the proposed 150% risk weight, we are concerned that the proposed definition could be misinterpreted to include financing for traditional utility and agribusiness capital expenditures and processing/storage related financing. In the context of the FCS, the proposed definition states that a credit facility that finances the development of real property should apply to land in transition and construction of housing developments or shopping centers. Such an interpretation would be consistent conceptually with the listed exceptions in the HVCRE definition that includes agricultural land. FCA should clarify the HVCRE definition to exclude all forms of FCS institution project finance not related to the development of residential properties or commercial shopping centers. This clarification is critical to supporting the System's ongoing mission fulfillment. Moreover, it is clear that the proposed definition was meant to capture the problem asset classes from the 2008 financial crisis, which was commercial development of residential housing and shopping centers, and not project finance for utilities or capital expenditures for agribusinesses.

We are also concerned with the application of § 628.32(j) relating to past due loans. While the proposed risk weight is consistent with the implementation of U.S. banking regulators, a significant difference is the FCA's examination direction with respect to loans moving out of past due and nonaccrual status. As a matter of examination practice, the FCA has been prescriptive and slow to recognize the performance of a loan that is in past due or nonaccrual status. The result has been a significant level of cash-basis nonaccrual loans. Under the current regulation, the impact of this situation has been minimal given the existing risk weight for nonaccruals and accrual loans are identical. Under the proposed rule, the risk weight for nonaccrual loans would be 150% compared to 100% for accrual loans. As a result, the capital impact from slow recognition requirements for moving performing nonaccrual loans to accrual status is problematic. We ask the FCA provide improved examination direction for the movement of loans from nonaccrual to accrual.

18. § 628.33 Off-balance sheet exposures

Overall, we find the proposed treatment of off-balance sheet exposures consistent with the implementation of Basel III by U.S. and foreign banking regulators, including appropriate recognition of commitments to agricultural producers. We are highly concerned with the proposed treatment of available capacity under a FCS bank's direct loan to an affiliated association as a commitment under § 628.33(a)(5). We already provided significant comment on this proposed requirement in our response to question 7 in Appendix A. As the proposed rule is written, the supposed bank "unused commitment" to an association would appear to be multiplied by a credit conversion factor of effectively 100% and then risk weighted at 20%. If FCA maintains the concept that direct loans have commitments that require capitalization at the FCS bank level, we ask that FCA clarify the calculation for the credit conversion factor and obligor risk weight. First, we ask FCA to confirm that a 20% credit conversion factor be applied to the wholesale unused commitment. Second, we ask that FCA confirm that a 20% risk weight be applied to the association obligor.

19. § 628.41(c) Due diligence requirements

The proposed due diligence requirements for investment securities significantly overlap with the existing regulatory requirements on investment management in subpart E of part 615. The result is significant redundancy and regulatory burden. We ask that FCA make conforming changes to either the proposed capital regulations or the existing investment management regulations to eliminate duplication and potentially conflicting requirements.

20. Other matters

FCA has stated that it is planning for a January 1, 2016 effective date, meaning all FCS institutions must comply with the proposed capital requirements in 2016. We are concerned that the effective date expectations are too optimistic and unworkable, particularly for FCS associations. Even under the most optimistic scenario, FCA would not be able to publish a final rule until the end of 2015. After publication, FCS institutions would need to: (1) review and understand the new rules; (2) design and develop new policies, procedures, and controls; (3) train staff; (4) develop new disclosures; (5) make necessary changes to software applications and data collection processes; and (6) seek FCA clarification on the numerous implementation issues that are likely to occur for such a comprehensive and far-reaching rule. We note that FCA has taken well over 4 years to develop the proposed rule. It may not be realistic to achieve a January 1, 2016, effective date across the entire FCS. We ask FCA to carefully consider an appropriate and prudent implementation date for what is the most significant rulemaking conducted by the Agency in decades. Moreover, there is no pressing reason for FCA to target its implementation of a Basel III framework within the timeframe for implementation of commercial banks. While we respect FCA's desire to accelerate its regulatory capital rulemaking efforts, such acceleration is burdensome given FCA started its rulemaking process after the banking regulators. It is also unnecessary considering the FCS has been in the situation for many years where its regulatory capital requirements differed in subtle ways (e.g., capital categories) from those applicable to commercial banks. No adverse outcome will result from FCA taking the time it needs to appropriately refine the proposed rule through notice and comment rulemaking relative to the Basel III implementation timeframe of U.S. banking regulators.

Beyond the implementation date, the proposed rule has far-reaching ramifications for well-established regulatory and examination guidance that are currently well understood by FCS institutions. Probably the most significant of these from a FCS perspective are FIRS standards. FCA should take care to design and integrate the new regulatory capital regime with the FIRS standards that FCS institutions use consistently for monitoring and management purposes. We ask that FCA provide draft guidance as soon as practicable so FCS institutions understand what metrics and measures examiners will apply in determining a FCS institution's FIRS rating.

FCA's implementation expectations are also unclear regarding legacy notices of allocation, qualified or nonqualified. For example, we do not know if FCA will expect FCS institutions to modify prior notices to comport with required bylaw amendments, which would be a significant cost, a large effort, and may raise potential legal issues. From a legal perspective, it may be problematic to change legacy notices given many of the holders may not have voted on bylaw changes (i.e., no longer voting stockholders) and they may view the change as an adverse impact on their rights under the notice. An example of a potential adverse change is the fact that redemption is no longer in the sole discretion of the board of directors for a FCS institution since FCA prior approval would be required. To address legacy notices of allocation, it would seem logical to provide a grandfathering approach and permit them to be treated consistent with allocations arising on a going forward basis under the proposed capital rules for regulatory capital purposes.

We ask that FCA retain the current definition of risk funds with one clarification as described below. As stated in the Uniform Call Reporting System, the FCA currently defines risk funds as follows:

> "Sum of Permanent Capital Amount and Allowance for Losses (Loans) = Permanent capital amount (outstanding) + Allowance for losses on loans
> (TABLE CALLRC1: PERMCAPA) + (TABLE CALLRC_RI: + ALLNLOSS)"

We believe that the proposed capital rule and the final capital rule when adopted by FCA should not affect the definition of risk funds. Risk funds are meant to capture the total funds available to absorb losses. Based on the current regulatory requirements relating to permanent capital and proposed technical changes to these requirements, risk funds should continue to recognize the total funds available to FCS institutions to absorb losses, which would include the liability for unfunded commitments. We ask that FCA clarify that the definition of risk funds includes the liability maintained for unfunded commitments given it is essentially an allowance for potential loan losses if such commitments are funded.

In its regulatory flexibility determination, FCA notes that: "Each of the banks in the Farm Credit System, considered together with its affiliated associations, have assets and annual income in excess of the amounts that would qualify them as small entities." We question the appropriateness of this determination. While there may be some regulatory subjects where such a view may be appropriate, we do not consider it applicable here. Indeed, the FCA emphasizes the need for each institution to maintain its own regulatory capital adequacy independent of other FCS associations. Moreover, each institution will be responsible for the costs it incurs in implementing the proposed regulatory capital rule, including the capitalization bylaw amendments. We believe that these implementation costs for smaller FCS institutions may have a significant impact that FCA should recognize.