United FCS

4401 Highway 71 S • PO Box 1330
Willmar, MN 56201-1330
Phone: 320-214-5018 • 800-450-1771
Fax: 320-235-1433

February 13, 2015

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

RE: Proposed Rules on Regulatory Capital – Federal Register 79 (September 4, 2014) 52814

Dear Mr. Mardock:
United FCS, ACA (United FCS) appreciates the opportunity to comment on the Farm Credit Administration's (FCA) proposed rulemaking to make major revisions to the regulations governing regulatory capital and related requirements for Farm Credit System (FCS or System) institutions. These proposed changes will help to implement a Basel III tiered approach to regulatory capital requirements that will result in significant alignment of FCS with other federally regulated financial institutions. This alignment will, in turn, enhance the System's capability to effectively participate in financial markets for the ultimate benefit of its member-customers. However, in doing so, these changes must be consistent with and support FCS' fundamental cooperative structure and must meet the requirements of the Farm Credit Act.
We strongly support the comments and suggestions submitted by the Farm Credit Council (FCC) as they reflect the consensus view of the entire Farm Credit System on this extremely important matter. FCC has completed and submitted a very thoughtful and thorough analysis of the issues and concerns that need to be addressed in this proposed rulemaking. We find that FCC makes a compelling case for proposed changes and modifications and we urge FCA to address them prior to issuing the final regulatory capital rules.

Additionally, we find the following subjects addressed by this rulemaking to be worthy of special comment and emphasis:

Eliminate the Requirement for Capitalization Bylaw Changes.
The proposed provisions are fundamentally unworkable, unnecessarily costly and legally problematic. This requirement results in a meaningless vote that puts the institution and its member-customers in an impossible situation. If member-customers do not approve the bylaw changes, the institution faces capitalization challenges because affected equities will not qualify as regulatory capital. If member-customers approve the bylaw changes, they undermine the institution's ability to function consistent with cooperative principles for the reasons more fully detailed in FCC's comment letter. FCS institution bylaws provide the board of directors significant discretion for managing capital and complying with applicable regulations. Rather than being forced to adopt capitalization bylaw changes, board policies, directives, loan documentation or capital plans should be used to clearly disclose the nature, rights and attributes for all FCS equities. Such board direction, taken pursuant to existing capitalization bylaw provisions, along with appropriate shareholder disclosures, is more than sufficient to implement FCA's proposed Basel III framework.

Reduce the Mandatory 10-Year Revolvement Period.

The proposed revolvement period for Common Equity Tier 1 (CET1) should be reduced from 10 years to 7 years and the normal revolving features of loan-based cooperative equity plans should be permitted. There is no basis in Basel III for the proposed 10-year revolvement cycle of an individual share, and it is overly stringent and fundamentally inconsistent with cooperative principles. It is also unnecessary given the numerous other proposed capital controls and limitations which effectively eliminate any reasonable member-customer expectations for the distribution of income or retirement of stock and essentially makes cooperative shares permanent. Given these controls, a 7-year revolvement cycle on a loan basis is easily justified. For cooperative capital, the length of time a share is outstanding is irrelevant to permanence. Rather, permanence is determined by member-customers' clear understanding that their shares are at-risk and committed to the long-term financial stability of their cooperative. Although we do not allocate equities as part of our patronage program and instead make cash distributions, we know a number of System institutions do use allocation programs and we support their right as cooperatives to do so. Also, we may decide at some future time to similarly employ allocation as part of our capitalization program and we need to have reasonable regulatory treatment as just described to effectively be able to do so.

Exclude Bank Capitalization Plans from the Proposed New Revolvement Requirements.
The concept of 10-year revolvement cycles for association investments in their funding bank to qualify for CET1 is unnecessary, inefficient, ineffective, and without any discernable benefit. Each affiliated association's capital investment is understood and legally structured as a permanent capital contribution to the bank that is fully at risk and available to absorb losses. The law requires affiliated associations to capitalize and obtain funding from a Farm Credit Bank, which means they need to maintain a permanent investment in the bank which is very different from the relationship of a "retail" borrower who is free to select the lender of choice. It results in a permanent relationship that continues until liquidation, re-affiliation or termination of System status, each of which requires FCA prior approval. At the same time, the ability to adjust this investment is critical for ensuring that associations share proportionately and appropriately in bank capitalization and risk of loss. Each of the four banks and their respective district associations have distinctly different structures and operating philosophies. These districts need the flexibility to implement and maintain capital programs that fit their unique circumstances consistent with law and cooperative principles and without compromising CET1 treatment.

Permit the Continued Use of Allocation Agreements.
As stated above, one of the fundamental requirements that must be met in this rulemaking is compliance with the Farm Credit Act. Section 4.3A(a)(1)(B) of the Farm Credit Act (and current FCA regulations) permits Farm Credit Bank equities allocated to an association to be counted as permanent capital by the association if so agreed to by the Farm Credit Bank and the association. This statutory right should be recognized by and incorporated into the proposed rules. The Basel III framework allows for some deviation to be made for "local" jurisdictional rules. Such is the case here. The FCA should permit the continued use of allocation 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 association level should be counted based on the treatment of the bank equity (e.g., CET1, AT1 or T2). If allocation by agreement is not permitted in the final rules, then FCA should allow a phase-in period of at least 5 years to give affected banks and their affiliated associations a reasonable period of time to adjust allocated investments to comply with the new rules.

Eliminate the Proposed Capitalization of Unfunded Commitments Under Bank Direct Notes.
Amounts available to associations on their FCS bank direct loans should not require another layer of capital. There is already dual capitalization in place: the 20% risk-weighted loan to the association capitalized by the bank to fund the 100% risk-weighted loan to the retail borrower which is capitalized by the association. The close relationship between banks and their affiliated associations is very different than between an association and its borrowers. Under a General Financing Agreement (GFA) the bank provides additional funds for the making or acquisition of association loans and authorized investments. In doing so additional high quality collateral is generated to secure the direct note and to open additional borrowing base capacity to support association asset growth. Given the interdependencies between the bank and its affiliated associations, collaboration is required to manage capital and liquidity districtwide. These features are entirely different from those present in an unfunded

loan commitment to an association borrower that can ordinarily be drawn upon at will and frequently for any general business purpose. Unnecessarily adding this additional capital layer as FCA proposes can only result in placing FCS association lenders at a competitive disadvantage in the marketplace and thereby unjustifiably impede FCS mission fulfillment.

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

Clarify Risk Weighting For High Volatility Commercial Real Estate (HVCRE).
The proposed definition of HVCRE is unclear with respect to agricultural mortgages where the value of the land exceeds production value. We are concerned here that as so defined traditional agricultural mortgages could be found to be HVCRE by FCA examiners which we do not believe should be the case. Also, we are concerned that project financing for rural infrastructure or processing/marketing facilities could similarly be found to be HVCRE. In either case the proposed regulation would increase the assigned risk-weighting for the loan from 100% to 150% which would make it more difficult to continue to serve these mission-related sectors. We do not believe that this was intended by the proposed definition. We ask FCA to clarify that no restriction or reduction to otherwise currently permitted System financing in these areas will result from adoption of this definition.

Other Areas of Concern:

Safe Harbor Rules.
The proposed "safe harbor" provision that authorizes limited distributions, including stock retirements, without FCA prior approval should be revised to be consistent with similar provisions implemented by European bank regulators. The proposed limit of no reduction in CET1 provides no reasonable room for boards to manage capital without first seeking FCA prior approval. FCA should follow the same standards as the European bank regulators and allow up to a 2% reduction in CET1 as long as capital ratios remain above the conservation buffer. In addition, as there is no basis for this in Basel III, the "haircut deduction" for early distributions (resulting in 30% exclusion of remaining otherwise eligible capital) from CET1 is punitive and should be eliminated from the proposed regulations and any concerns handled through examination.

URE Sublimit Requirements.
The unallocated retained earnings (URE) sub-limit embedded within the proposed Tier 1 leverage requirement should be eliminated or refined. There is no basis for this requirement within Basel III either directly or in the context of a minimum URE standard embedded within CET1. Basel III did not see a safety and soundness need to establish URE as a "superior" class of CET1 and FCA has no basis for deviating from Basel III in this area. It is also significantly more stringent than FCA's current URE requirement given it is measured on total, unweighted assets. If FCA sees a need for a URE standard, it should simply follow its current requirements and calculate the URE ratio on a risk-adjusted basis.

Reduce the 5% T1 Leverage Ratio.
The proposed Tier 1 leverage requirement should be reduced to 4% to be consistent with Basel III standards implemented by regulators across the globe. The proposed 5% standard is an arbitrary and capricious deviation from Basel III. There is simply no quantitative analysis or loss experience that justifies a 5% Tier 1 leverage ratio

for the FCS while all other regulated financial institutions regardless of structure are subject to a 4% requirement. To single out FCS for this additional constraint does not seem warranted given the System's successful navigation through the severe stresses of the recent economic downturn, especially as compared to commercial lenders in the United States and elsewhere. Finally, this inconsistency with Basel III and with the approach taken by regulators around the globe may raise questions about the System's risk profile compared to other lending institutions. Such questions would harm the FCS and its mission achievement. FCA should adopt the Basel III standard of a 4% Tier 1 leverage requirement for FCS institutions.

Potential Changes to the FIRS Rating System.
The potential ramifications of these proposed rules as and when finally issued are substantial and far-reaching. We are concerned about how the final rules will impact the FIRS standards which have a profound impact on individual System institutions. As noted in the FCC comment letter, we simply ask that the FCA provide draft guidance as soon as practicable so that FCS institutions understand what metrics and measures examiners will apply in determining an FCS institution FIRS rating under the final rules.

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We join the FCC in asking FCA to fully consider and adopt all submitted comments and suggested changes. Doing so we believe 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. As members of the United FCS Board of Directors we feel that it is crucial to achieve these objectives in this rulemaking in order to ensure that the System is strong, stable and successful in serving U.S. agriculture and rural America - not only for the next generation, but also for those yet to come.

Please contact the undersigned (the Chairman or any of the other members of the United FCS Board of Directors), or President and Chief Executive Officer Marcus Knisely, if you wish to discuss our comments or require any additional information.

Sincerely,

Bradley Sunderland, Board Chair

Suzanne Allen, Appointed Director

Stan Claussen, Member

Scott Gerbig, Member

Ed Hegland, Member

Greg Jans, Member

James Jarvis, Member

William Oemichen, Appointed Director

Donn Peterson, Member

Richard Pooley, Appointed Director

Richard Price, Member

Jeffrey Thompson, Member

Mary Kay Van Der Geest, Member

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