February 5, 2015

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

Re: Comments to the Proposed Capital Rule

Dear Mr. Mardock:

Thank you for the opportunity to comment on the Farm Credit Administration (FCA) proposed capital rule. We believe that adopting Basel III standards for the Farm Credit System (the System) will enhance investor understanding of the System's financial strength and increase marketability of third-party capital and debt securities, especially in periods of stress, thereby enabling the System to fulfill its mission to its member-customers and rural areas.

We appreciate FCA's efforts to carefully consider and accommodate the System cooperative structure in developing the proposed capital framework. We ask that FCA revise the proposed rule, as outlined below, to make it workable and supportive of the System's Congressionally mandated cooperative structure:

1. Eliminate the requirement for shareholder votes on the capitalization bylaw changes required by the proposed rule. Northwest FCS' capitalization bylaws are already expressly subject to FCA regulations. Changes to FCA regulations bind Northwest FCS accordingly. A shareholder vote can be costly and confusing for the voting members and requires a deployment of resources that is unnecessary. A negative vote by even a few system institutions would complicate FCA's objective. Rather than direct capitalization bylaw changes, the FCA could rely on its regulatory authority, current bylaws, board policies, directives, loan documentation and capital plans. Structurally, a board directive or similar document can accomplish the same outcome as a capitalization bylaw vote. Board direction, along with shareholder disclosures, are sufficient to implement FCA's proposed Basel III framework.

2. Reduce the proposed revolvement period for Common Equity Tier 1 (CET1). Northwest FCS believes it has appropriate capital controls. The proposed rule limits distributions to current year earnings, unless specifically approved by FCA. FCA also proposes additional limits if capital levels fall below the proposed conservation buffer that is far above minimum standards. These controls and FCA prior approval should eliminate expectations for the distribution of income or retirement of stock that member-customers might otherwise have. We believe the length of time a share is outstanding is not relevant to permanence. Rather, permanence is determined by member-customers' understanding that their shares are at-risk and committed to the long-term financial stability of their cooperative.

3. Eliminate the concept of 10-year revolvement cycles for association investments in their funding bank to qualify for CET1. Northwest FCS' investment in its funding bank is understood and legally structured as a permanent capital contribution to the bank that is fully at risk and available to absorb losses. The law requires affiliated associations to capitalize and obtain funding from a Farm Credit Bank, which means they need to maintain a permanent investment in the bank. The ability to adjust this investment is critical for ensuring associations share proportionately and appropriately in bank capitalization and risk of loss. The proposed requirement means that the bank will be unable to function as a cooperative or to equalize capital investments. The permanence of the bank capital is entirely unaffected by how capital is equalized among affiliated associations. We suggest that the FCA provide flexibility for banks to equalize capital investment among affiliated associations without compromising CET1 treatment.

4. Revise the proposed "safe harbor" provision limiting distributions, including stock retirements, without FCA prior approval to be consistent with provisions implemented by European bank regulators. The proposed limit of no reduction in CET1 restricts boards' ability to manage capital without first seeking FCA prior approval. This is far more restrictive than the approach taken by foreign bank regulators that implemented Basel III for cooperatives. We propose the same standards as these regulators and allow up to a 2% reduction in CET1 as long as capital ratios remain above the conservation buffer. In addition, the "haircut deduction" for early distributions should be eliminated from the proposed regulations and handled through examination.

5. Eliminate or refine the unallocated retained earnings (URE) sub-limit embedded within the proposed Tier 1 leverage requirement. The proposed sub-limit implies URE is of higher quality than CET1. Basel III did not see a safety and soundness need to establish URE as a "superior" class of CET1. The proposal is also significantly more stringent than FCA's current URE requirement, given it is measured on total, unweighted assets. We believe it is appropriate for FCA to authorize System institutions' boards to manage the components of CET1, including URE, consistent with current requirements and calculate the URE ratio on a risk-adjusted basis.

6. Reduce the proposed Tier 1 leverage requirement to 4% to be consistent with Basel III global standards. We do not desire any perceived inconsistency with Basel III and with the approach taken by regulators around the globe and do not want to raise questions (directly or indirectly) about the System's risk profile compared to other lending institutions. Any such questions relating to risk could increase borrowing costs for our member-customers. We recommend a 4% Tier 1 leverage ratio, consistent with the Basel III guidance.

7. 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 are unclear with respect to agricultural mortgages where the value of the land exceeds production value. While we do not believe the 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 essentially compromise the ability for the System to meets its statutory mission and it would be inconsistent with the

realities of today's agricultural mortgage marketplace. Similarly, we are concerned that the FCA examiners may include project finance transactions to build processing and marketing facilities or rural infrastructure as being HVCRE. Again, we do not believe that this is the intent of the provision, but we are concerned that any such determination would undermine our lending mission going forward. We are therefore asking the FCA to provide clarity in its final rule.

8. Maintain the 50% and 20% risk-weight treatment of rural electric cooperative assets consistent with the current regulatory treatment. There has been no change in the unique characteristics and low risk profile of the electric cooperative industry. The FCA previously acknowledged that 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 other utility providers. We strongly encourage the FCA to continue the 50% and 20% risk-weight treatment so the System can continue to fulfill its mission to finance the rural electric industry as it does today. If the FCA does not make this change, the proposed rule will adversely affect the System's capital capacity to serve this industry and place it at a competitive disadvantage compared to other lenders who finance this industry.

We believe the refinements described above would make the proposed capital rule workable and effective from a safety and soundness perspective and consistent with the implementation of Basel III by other regulators. Most importantly, the refinements we ask FCA to make ensure that the System can function consistent with cooperative principles for the benefit of its member-customers, as Congress intended.

Our cooperative structure sets us apart from other financial institutions and it has given us the ability to fulfill our mission for nearly 100 years.

We appreciate the opportunity to comment on this proposed rule and FCA's willingness to consider our feedback.

Sincerely,

Karen

Karen Schott
NWFCS Director
279 Brinkel Rd.
Broadview, MT 59015