Farm Credit
SOUTHWEST GEORGIA

February 13, 2015

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

Dear Mr. Mardock:

On behalf of the board and management we appreciate the opportunity to comment on the pending capitalization rule. We do believe it is in the best interest of the Farm Credit System (FCS or System) and our association to be consistent with Basel III capital standards and those of other financial institutions. Adopting Basel III standards will enhance investor understanding and confidence in the FCS's financial strength and increase debt marketability, particularly in periods of volatility, thereby ensuring we can continue to fulfill our congressionally mandated mission in any economic environment.

Clearly, the Agency has conducted extensive research in drafting the proposed rules. We are concerned, however, that in some cases the proposed rules do not maintain the appropriate balance between our cooperative structure and the Basel III concepts drafted for publically or privately held companies. And most unfortunately, we view parts of the Agency's proposal to actually undermine the cooperative structure and our business model. As a result, we ask that the FCA reconsider certain aspects of the proposed rule to make them more workable with our congressionally mandated cooperative structure. Our suggestions are as follows:

1. Eliminate the requirement that institutions obtain shareholder ratification on the capitalization bylaw changes required by the proposed rule. This requirement is a needless expense and results in a pointless vote that puts the institution and our members in an untenable position. Should the stockholders fail to approve the changes, then significant capitalization issues could result. On the other hand, if the members approve the changes, they curtail the institution's ability to function according to cooperative principles. Admittedly, we can appreciate the Agency's desire for effective communication, there are, however, ample alternatives besides bylaw changes for such communication. To this matter, a board communication or similar directive can accomplish the same outcome as a capitalization bylaw vote.

2. As proposed the extension of the revolvement cycle to 10 years to be considered as Common Equity Tier 1 (CET1) essentially denudes the organization's ability to function as a cooperative. As such, we would suggest shortening the proposed revolvement period for Common Equity Tier 1 (CET1) to 7 years, so that the normal revolving features of loan-based cooperative equity plans are maintained as effective capital management options. From what we can determine, there is no basis in Basel III for the proposed 10-year revolvement cycle and it is highly

inconsistent with cooperative principles based upon user capitalization. Also, given the other proposed capital controls and requirements within the rule, it appears very heavy handed and unnecessary. Specifically, the proposed rule limits distributions to current year earnings unless specifically approved by the FCA. Furthermore, the Agency already places sufficient restrictions should capital levels fall below the conservation buffer. These restrictions coupled with the Agency's prior approval authority effectively eliminate any presumed member expectation for a distribution or stock retirement. We have had direct experience in our own association where members understood the necessity of curtailing revolvement cycles and distributions to ensure safe and sound levels of capitalization. For two successive years we did not distribute or revolve allocated surplus because of adverse credit quality. Even such, we did not encounter borrower flight or even any inkling of undue pressure to reinstate the programs. Given our experience, we would suggest that a 7-year revolvement cycle is more than reasonable and sufficiently justified. For cooperatives with a high degree of patient capital, the length of time a share is outstanding is irrelevant as to its permanency. Permanence is much more aligned to a members' understanding that their equity is at-risk and thus junior to the financial stability of the cooperative. Unfortunately, the consequence of any lengthening from 5 years is going to encourage associations to pay all cash which provides management and the board little flexibility to manage capitalization when they might most need it.

3. The concept of 10-year revolvement cycles for association investment in their funding bank to qualify for CET1 capital treatment should be eliminated. Given that the capital structure between the banks and associations' is inextricably tied, requiring a revolvement cycle for association-held bank equities is unnecessary, inefficient, ineffective, and without any apparent benefit. When an association invests in a bank, it is understood and legally structured as a permanent capital contribution to the bank that is fully at risk. By statute affiliated associations must obtain funding from a Farm Credit Bank, which means they need to maintain a permanent investment in the bank. Moreover, the ability to alter this investment level is critical for ensuring associations share proportionately in bank capitalization and the risk of loss. It is unnecessary and burdensome to require each association's individual bank shares to be outstanding for 10-years to qualify as CET1. More importantly, this requirement will restrict a Farm Credit Bank from functioning as a cooperative and equalizing capital investment as use ebbs and flows. In fact, the permanence of the bank capital is entirely unaffected by how capital is equalized among affiliated associations. Consequently, we would ask that the FCA reconsider their position and provide flexibility for banks to equalize capital investment among associations without compromising CET1 treatment.

4. As proposed the "safe harbor" language that limits distributions and stock retirements, without FCA prior approval, inhibits the board's ability to manage capital, seemingly for the sole purpose of being consistent with regulations implemented by European bank regulators. As proposed, the regulation essentially hand-cuffs the board and provides no maneuvering room for them to manage capital

without first receiving approval. This requirement appears to be is far more restrictive than the approach taken by the foreign regulators for the cooperatives under their oversight. We would suggest the FCA follow the same standards as these regulators and allow up to a 2% reduction in CET1 as long as capital ratios exceed the conservation buffer. Moreover, the "haircut deduction" for early distributions is punitive and should be eliminated from the proposed regulations and handled through the examination process as there is no basis for it in Basel III.

5. Eliminate the unallocated retained earnings (URE) sub-limit proposed within the Tier 1 leverage requirement. Presumably the sub-limit implies URE is of higher quality than CET1, for which there is no basis that we can discern. Basel III did not pronounce a safety and soundness need to establish URE as a "superior quality" class of CET1 and we can find no justification for the FCA to deviate from Basel III. Along these same lines, it is also far more stringent than the current URE requirement given that it is measured on total un-weighted assets. We believe it is more appropriate that the FCA authorize Farm Credit institutions' boards to manage the components of CET1, including URE. If the Agency still sees a need for a URE standard, it should simply follow the current requirements and calculate the ratio on a risk-adjusted basis.

6. Given the fact that one principle objective of the proposed regulations was to achieve consistency with Basel III, we question why there is such a desire on the part of the Agency to deviate from that objective. If consistency is desired and we agree with that premise, then just reduce the Tier 1 leverage proposal requirement to 4% to be consistent with Basel III. From our perspective, the proposed 5% standard is an arbitrary and unjustified deviation from Basel III and only sends the wrong message to System debt investors. Moreover, it appears that consistency is only desired when the outcome leans towards the conservative end of the spectrum. We have certainly not been privy to any analysis or actuarial evidence that justifies a 5% Tier 1 leverage ratio, while all other regulated financial institutions are subject to 4%. Quite frankly, it appears the FCA's proposal is over-reaching and without substantiated analytical support and actually creates inconsistency with Basel III instead of reducing it. And, unfortunately in the end it would just result in higher borrowing costs to our members. Of even greater concern, the same inconsistency with Basel III will have the undesired effect of raising questions about the System's risk profile compared to other lending institutions. Investors and rating agencies will most certainly want an explanation as to why our safety and soundness regulator desired this capital treatment. Thus in this case failure to maintain consistency with Basel III on such an issue could irreparably harm our ability to compete and achieve our congressionally mandated mission.

7. We would request the Agency retain the risk-weight treatment of rural electric cooperative assets consistent with the current regulatory framework. The unique characteristics that portend a low risk profile for the electric cooperative industry have not changed. Rural electric cooperatives have specific attributes that set them apart from other business lines in terms of risk profile. These characteristics

effectively shield electric cooperatives from many of the credit-related risks experienced by other utility providers. Unless maintained at current levels, it will negatively affect the System and will place it at a severe competitive disadvantage compared to other lenders. We hope the FCA will continue to maintain the 50% and 20% risk-weighted asset treatment so the System can continue to meet its mission to rural areas.

The revisions described prior make the proposed capital rules more consistent with the implementation of Basel III by other regulators. In addition, we believe none of our suggestions would adversely impact the safety and soundness of the System or its risk bearing capacity. In fact, in several cases as noted if left unchanged the proposed regulations could actually harm our ability to fulfill our mission and function within the cooperative principles for the benefit of our members as Congress so clearly intended.

We strongly believe that our responsibilities as board and management are to protect the System's cooperative structure which is the core of our value proposition and that has set us apart from other financial institutions for nearly a century.

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

Sincerely,

Richard S. Monson
President and CEO
Southwest Georgia Farm Credit

Cc Board of directors
AgFirst
Corporate records