February 13, 2015

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

Re: Proposed Rule: Regulatory Capital, Implementation of Tier 1/Tier2 framework;
79 Fed. Reg. 52813 (September 4, 2014)

Dear Mr. Mardock:

Thank you for the opportunity to comment on the Farm Credit Administration's (FCA's) proposed rule on regulatory capital and the implementation of a two-tiered approach similar to the Basel III framework. Capital Farm Credit (CFC) fully supports the comments submitted by the Farm Credit Council ("Council") and the Farm Credit Bank of Texas (FCBT), but because of the lack of regard for cooperative principles throughout the proposed regulations, we must submit our own comments as well. CFC submits these comments with the utmost respect because we recognize that great effort and thought that must go into such a process.

We are very supportive of FCA's concept to modernize the capital regulations and the implementation of the two-tiered approach from the Basel framework that will make our rules more similar to our commercial bank competition. We believe it is critical that all regulated financial institutions are treated similarly in this regard, so that there are no leverage advantages for any institutions. However, we believe the proposed regulations have missed the mark with regards to the distinct cooperative structure of the Farm Credit System (System).

It is obvious from the very beginning (Section 1.1) of the Farm Credit Act of 1971, as amended, (Act) that Congress intends for the System to be run as a cooperative. FCA recognizes this as well, with an article entitled "The Cooperative Way" on its website, which includes a list of the seven cooperative principles, including Members' Economic Participation. CFC's stockholders take pride in this cooperative nature and agree very strongly with the statement FCA makes in "The Cooperative Way" that the "System's cooperative business model sets it apart from most other commercial lenders." As a cooperative, we view ourselves as a financial partner with the farmers and ranchers who have pooled their resources to provide funding for their capital needs. Over the last 10 plus years, our Association's loan volume has grown by over 30 percent to almost $5.9 billion. We have sustained this growth at the same time by increasing our current regulatory capital ratios from around 12 percent to over 16 percent, all while distributing over $385 million in cash distributions through patronage refunds back to our member/borrowers. Over the last five years, our cash patronage refunds have effectively reduced our average member's cost of borrowing by over 1.10 percent per year. Please keep in mind that this financial performance was achieved at a time that included one of the worst economic crises of our Nation's history. Indeed, we believe we have been a very successful financial partner with our farmers and ranchers and have certainly set ourselves apart from other commercial lenders through our cooperative model.

It is because of these things: Congress' intention for the System to be run cooperatively, FCA's support for a cooperative business model, and our Association's success acting cooperatively with our farmers and ranchers, that we are perplexed with the proposed regulations and the detrimental effect they will have on System institutions and the farmers and ranchers who own them. The proposed capital rules severely restrict System institutions' ability to operate on a cooperative basis as follows:

1. the definitions of regulatory capital –
    a. for the treatment of allocated equities, and
    b. for the associations' investment in the funding bank,
2. the requirement to amend capitalization bylaws,
3. the limitations on the safe harbor for equity retirements,
4. the 30% haircut penalty for equity retirements made without prior approval,
5. the requirement that 1.5 percent of Tier 1 capital consist of unallocated retained earnings (URE) for purposes of calculating the leverage ratio,
6. the capitalization of an association's excess borrowing base in its direct loan with its Farm Credit banks, and
7. the imposition of a unique capital burden on the System through a leverage ratio 25% higher than what Basel III provides.

Nevertheless, we believe that the proposed regulations can be easily corrected to be consistent with the objectives of Basel III and the cooperative nature of the System and urge FCA to modify the proposed rule accordingly.

COOPERATIVE ISSUES:

1. <u>Definition of regulatory capital</u>
    a. Treatment of allocated equities – The treatment of allocated equities in the proposed rule appears to be based upon a misapplication of the 14 criteria for common shares in Basel III to be included as Common Equity Tier 1 (CET 1) capital. In FCA's commentary to the proposed rule, FCA assumes that these requirements should be applied to allocated equities, when in the Basel III framework, the definition of CET1 includes retained earnings as the equivalent of common shares without regard to the 14 criteria.

        Allocated earnings are by their very nature, retained earnings. They are a result of the earnings received from doing business with its members, and, after paying applicable expenses and setting aside necessary reserves, allocated to its members based on the patronage business they do with the cooperative. The allocation gives the member a right to distribution of these earnings, only at the discretion of the cooperative's board of directors. Until such redemption is authorized, they remain on the cooperative's books to appropriately capitalize the risks and absorb losses of the cooperative. There are no redemption rights of these allocations until the board authorizes their redemption.

        Common shares in a joint stock company are issued in a transaction that transfers a unit of legal and economic rights to an investor in return for payment of a specific consideration. They in no way represent earnings retained from its business operations. The quality of this capital depends upon the contractual terms surrounding the issuance transaction. Features of the stock may give the company legal obligations or rights or economic incentives, such as a put or call options, cumulative dividends, or step-up in dividend rates, or changes in distribution priorities, that would call into question the company's ability to meet the terms of the stock and maintain its value in the company. This is the concern of Basel III, that common shares may carry features that might lessen their availability to absorb losses.

The main difference between the operations of a System institution that allocates equities on a patronage basis and a bank operating as a joint stock company is that the primary source of capital for the joint stock bank is contributed capital, while for the System institution, it is retained earnings. A cooperative, in order to treat all members on an equitable basis, should ensure that the cost of capitalizing current risks presented by the business done with current members is borne by those members and not by past members. To not allocate earnings puts a disproportionate burden on past members, which is contrary to pure cooperative principles. In a joint stock company, the business risks of the company are always borne by current stockholders, who may freely sell their shares when they no longer wish to bear those risks.

The System's allocated retained earnings should be accorded capital treatment at least as favorable as commercial banks' retained earnings. Allocated equities have no maturity date, maintain no dividend rights, and grant no redemption rights that weaken their ability to absorb losses. Allocated retained earnings do not possess the features identified in Basel III as having the effect of reducing loss absorbency during periods of economic stress. On the contrary, the allocated retained earnings strengthen a cooperatives' ability to withstand economic stress. Consider our Association's recent capital management history:

	December 31,						
($ in millions)	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Permanent capital ratio	12.5%	13.2%	14.4%	16.4%	16.0%	16.4%	16.3%
Core surplus ratio	11.4%	12.2%	11.5%	13.6%	14.4%	15.9%	16.0%
Cash patronage refunds	$38	$23	$17	$32	$38	$42	$65
Allocations of Equity	$68	$40	$74	$88	$96	$79	$70
Redemptions of allocated equity	-	-	$15	$50	$55	$43	-

Note during the periods of financial adversity (2008 – 2010) that the board of directors curtailed the distribution of capital while it replenished its capital levels. The members had no legal right to force redemption of allocated equities during this time. The decision to redeem equities and manage the capital of the Association clearly remained at the discretion of the board of directors. As we resolved our credit and business issues, we increased our patronage distributions and redemptions of allocated equities. Also note the lack of allocated equity redemption in 2014 despite the very high levels of capital. The decision not to redeem any allocated equities was a direct effect of the proposed capital rule.

Therefore, we respectfully request FCA to modify the proposed regulations to include all System institution retained earnings as CET1, without application of any limiting criteria. All other U.S. banking regulators have included retained earnings in CET1 for the banks they regulate, including mutual banks.

b. Treatment of Association investment in the bank – FCA's application of a proposed minimum revolvement cycle to an association's investment in its funding bank is not workable and goes against cooperative principles. First of all, we question FCA's limitation to include in CET1 the minimum amount of stock required by regulation. Under the Act, It is each System institution's responsibility to determine an appropriate stock requirement through its capitalization bylaws. The Act does not say that borrowers are only required to purchase $1,000 or 2 percent of the loan amount. Accordingly, we think the language in the regulation referring to the minimum stock purchase should be changed to the "minimum borrower stock requirement under bylaws adopted under section 4.3A of the Act."

FCBT's bylaws require higher capitalization requirements that are based upon a percentage of the Association's direct loan amount. This amount is adjusted annually as the association's direct loan fluctuates and is vital to FCBT's ability to operate in accordance with cooperative principles with respect to its associations. Therefore, any capital rule that restricts a bank's ability to retire an association's stock investment would impose unnecessary capitalization costs on associations that cannot receive redemptions that they would otherwise receive, and would be contrary to the Act's intent that the System operate as a federated cooperative. System bank's and association's accounting systems and wire transfer systems are highly coordinated. This coordination and efficiency allow the banks to optimize their capital positions and thus improve the profitability of the associations. FCA's commentary states that the practice of equalization "also makes the stock less permanent because the bank routinely issues or redeems the stock." This commentary fails to recognize this federated cooperative structure of the bank and association relationship. The permanence of the association stock investment in the bank is a function of the permanence of the association-bank relationship under the Act. The Act authorizes the banks to fund only the associations in its district, and correspondingly authorizes associations to obtain funding only from the district bank, except with bank approval, and obligates them to purchase stock in the bank to capitalize their indebtedness to the district bank. The Basel III permanence criterion is satisfied under this relationship because stock in the required percentage of the direct loan will always be available to absorb losses in the bank. Regardless of any discretionary periodic adjustments in the amount of stock to reflect increases or decreases in the direct loan, the stock is statutorily required, has no maturity date, has no legal right to demand redemption, and the bank board at all times retains discretion to suspend or extend the equalization period.

The proposed rule is not workable as it is written. The rule appears to require that whatever stock balances exist at the time of the effective date of the regulation would have to be maintained for 10 years before any equalization whatsoever could take place. This delay will create a tremendous burden to an association experiencing a decline in loan volume. The minimum holding period would also restrict the ability of bank boards of directors to manage the bank's capital position to accommodate unusual events by reducing the equalization period. In addition, the banks would have to expend considerable effort to modify their accounting systems in a reliable way in order to be able to classify and track required stock by date, and avoid errors that could trigger the 30 percent haircut penalty. Furthermore, classification of bank required stock by date issuance or allocation will create tax consequences that would not otherwise exist, unnecessarily creating additional complexity in bank operations, and increasing the effective cost of bank capital to associations. These issues have nothing to do with the actual availability of the association's investment in the bank to absorb losses, and so, are not required by the Basel III framework. We urge FCA to eliminate these issues by modifying the proposed rule to allow all association investment in the bank required to be held under the bank's bylaws, whether purchased or allocated, to be included in CET1 without regard to any minimum holding period, and should allow that investment to be equalized at the bank board's discretion in accordance with those bylaws without prior FCA approval.

2. Capitalization bylaw amendments

The proposed rule requires for any instrument to be included in CET1 (other than the minimum statutory borrower stock requirement under 4.3A of the Act), that the System institution's capitalization bylaws provide that the institution will not offset the instrument against a member loan in default, and will not redeem the instrument less than 10 years after issuance or allocation, or reduce the original revolvement period, without FCA approval. Similarly, the proposed rule requires that the capitalization bylaws will not allow redemption of the instrument without FCA approval, and the proposed definition of Tier 2 capital requires capitalization bylaws to prohibit redemption of the equity for at least 5 years after allocation without FCA approval. FCA has not explained why it proposed these requirements for capitalization bylaw amendments, but the reason appears to be based on its fundamental assumption that System allocated equities are analogous to instruments of common shares in a joint stock company rather than as retained earnings.

For the reasons explained above in the discussion of the treatment of allocated equities, we believe that System allocated equities should be classified as retained earnings rather than as common shares. Since the Basel III framework confers CET1 status to retained earnings without regard to the 14 criteria applied to common shares, footnote 12 of the Basel III framework does not actually require application of these criteria to allocated equities in System institutions. In choosing to apply the 14 criteria to allocated equities in its approach to reconciliation of Basel III to System capital requirements, FCA has actually departed from the principles of Basel III.

Because FCA's existing capital regulations currently differentiate the capital treatment of allocated equities based on the length of the revolvement period, FCA was predisposed to find in Basel III a justification for continuing this differentiation, which it did through the "permanence" and "expectation" criteria for common shares included in CET1. This approach has created unnecessary administrative and conceptual complexity in order to make allocated equities look more like common shares in a joint stock company. Currently, no allocated equities are divided into classes based on revolvement periods. Consequently, without a change in the legal rights associated with these allocated equities, they cannot be assigned to different categories of regulatory capital. FCA's solution is to require stockholders to approve capitalization bylaw amendments that alter the legal rights of members in these equities in order to create classes of allocated equities based on a minimum revolvement period.

These bylaw amendment provisions raise a significant number of problems. First, the proposed bylaw requirements offer no alternative to stockholders considering whether to approve the bylaws required by the proposed rule. Members will face this conundrum: if the stockholders disapprove the bylaws, their institution may fail to meet regulatory capital standards, or if they approve the bylaws, they will be voting to limit their institution's ability to operate on a cooperative basis in the future and to reduce the value of the investment they currently hold in the institution. An even more significant problem is that, because members would be voting to approve amendments that adversely affect the rights holders of allocated equities who have repaid their loans and are no longer members with a right to vote, there would likely be legal challenges to any action that changes the rights of these non-member holders.

It is also concerning that the proposed rule, by requiring the bylaws to prohibit the offset of equities against a defaulted loan, appears to directly contradict Section 4.3A(g) of the Act, which preserves the right of System institutions to retire stock or other equities against a defaulted or restructured loan. While the minimum statutory stock requirement is excluded from this provision of the proposed rule, it would affect any required equities that happen to exceed the statutory floor and other allocated equities. The requirement is unclear in that it appears to prohibit offset against a defaulted loan altogether in perpetuity. Presumably, FCA intended to make this provision subject to the minimum revolvement period and allow offset against defaulted loans beginning 10 years after allocation or issuance, but the proposed rule does not actually say that. Also, the proposed rule does not make clear that the prohibition of offset against a loan in default does not apply to the minimum statutory stock requirement. In addition, as discussed previously, we think that the term minimum statutory borrower stock requirement should be modified to include any stock or allocations are required by an institution's bylaws to be held as a condition to obtaining a loan so that these equities will be encompassed by the exception from the minimum holding period and offset prohibition.

We believe that these troublesome issues could be completely eliminated if FCA were simply to characterize allocated equities as retained earnings, as they should be characterized, instead of characterizing them as instruments to be treated like common shares in a joint stock company. That change of approach would avoid altogether any perceived necessity to alter members' legal rights in existing and future allocations in order to create classes of instruments subject to differing capital treatment. Therefore, we respectfully request FCA to eliminate from the proposed rule any requirement that System institutions amend their capitalization bylaws.

3. <u>Limitations on the safe harbor for equity retirements</u>

Section 628.20(f) of the proposed rule requires FCA prior approval of cash patronage and dividend payments. This is an insult to the System and its proven ability to manage capital for the benefit of its members. FCA's claim that this requirement is necessary in order to make the System's regulatory capital framework comparable to the regulatory capital framework that applies to U.S. banking organizations is inaccurate. The proposed rule for System institutions is actually much more restrictive than those in the regulations applicable to non-System financial institutions. The Federal financial institution regulators generally permit U.S. financial institutions to make capital distributions in an amount that does not exceed net income for the year to date (less declared capital distributions) plus retained net earnings for the preceding two years. The FCA proposed rule, in contrast, would only permit capital distributions to the extent that, after the distributions, the institution's CET1 capital equals or exceeds the dollar amount of CET1 capital on the same date in the previous calendar year.

CFC believes the proposed rule is an unwarranted limitation on the ability of System institution boards to manage their institution's capital positions. There may be any number of sound reasons for a board to authorize distributions in excess of current year earnings. For example, assuming that an institution allocates roughly the same amount of earnings every year, an institution that decides to issue qualified allocated equities from current year earnings and pay a cash patronage of 20 percent, as required by tax law, would find itself unable under the safe harbor to revolve a series of non-qualified allocated equities issued 10 years before. Assuming that the institution's regulatory capital exceeds the capital conservation buffer limits, and no other supervisory limitations apply, there would appear to be little to be gained from a safety and soundness perspective in requiring FCA prior approval in this kind of situation. We request FCA to put no tighter restrictions on System institutions' ability to make capital distributions than other financial institution regulators.

We also think it is important for FCA to include in the safe harbor incidental redemptions of allocated equities held by the estates of deceased members. The retirement of allocated equities in this situation is a common practice in cooperatives generally, and has historically been followed in the System subject to bylaw and board authorization and compliance with capital requirements. To prohibit retirement of the equities can work a financial hardship on members' families and heirs and complicate the settlement of estates. To allow retirement in these situations, on the other hand, does not affect the rights of other holders of allocated equities. In addition, FCA should consider including in the safe harbor retirements that are ordered by a bankruptcy court. To prohibit retirement in these situations would be unreasonable because the institution is subject to the court's jurisdiction and is not in a position to defy it, and refusal could delay the resolution of the bankruptcy litigation, which is ultimately in both the institution's and the member's interests.

4. <u>30 Percent Haircut Penalty for Early Redemptions without Approval</u>

Section 628.22(a)(8) of the proposed rule would impose a "haircut" penalty on any institution that, during the previous 12 quarters, redeems or revolves allocated or purchased equities included in CET1 capital without the required FCA prior approval if the equities were issued or allocated within the previous 10 years. In this situation, the proposed rule requires the institution to deduct 30 percent of its purchased and allocated equities otherwise includable in CET1 for 3 years. We agree with FCBT that this penalty is completely unnecessary and that there is utterly no possible justification for it. First of all, it is not required to achieve comparability with Basel III principles. Moreover, it would certainly become unnecessary if allocated equities are properly classified as retained earnings as we have recommended.

FCA states that it is proposing the haircut deduction "to ensure proper management by System institutions of their members' expectations or redemption and to ensure that institutions are vigilant in their recordkeeping of the issuance and allocation dates of CET1 capital." It is difficult to understand what relationship a 30 percent reduction of CET1 capital has with management of member expectations or member education about longer revolvement schedules. FCA has also given no explanation how it concluded that the 30 percent figure over a 3-year period would be appropriate. Given that the penalty applies to any redemption without required approval, which could be quite isolated and minimal, the exclusion of 30 percent of all purchased and allocated equities over a 3-year period could easily be disproportionate to the amount of the equities improperly retired and is clearly excessively harsh, and could have adverse consequences on an institution and its borrowers that FCA has not foreseen. An institution that violates the safe harbor, even inadvertently, could suddenly find itself in violation of its capital adequacy ratios.

The consequences of triggering the penalty are so severe, and the circumstances in which it could be triggered are so uncertain that it appears that the penalty was designed for the very purpose of discouraging institutions from relying on allocated equities as CET1 at all. The primary effect of the proposed rule would thus be to discourage System institutions from operating on the basis of cooperative principles as the Act intends for us to do. If FCA capital regulations cause System institutions to abandon operations based on a cooperative basis, these regulations clearly undermine one of the central objectives of the Act. For this reason, and because the penalty becomes moot if allocated equities are classified as retained earnings as they should be, we urge FCA to remove the 30 percent hair-cut penalty from the proposed rule completely. At a minimum, if the penalty is retained, FCA should clarify how it is to be applied. FCA should also clarify that the penalty does not apply to inadvertent or de minimis mistakes or to transactions that qualify for the safe harbor.

5. Requirement for 1.5 percent of Tier 1 Capital be Unallocated Retained Earnings (URE)

This is another clear example in the proposed rule of a violation of cooperative principles. The fact that URE is not associated to a specific member disregards the cooperative principle of user-benefit and user-ownership. At the very core of operating cooperatively for the benefit of the member is that earnings, net of expenses and necessary reserves, are to be returned to the user-owners. URE should only be a result of non-patronage sourced earnings.

Furthermore, an over-reliance on URE in a cooperative's capital structure leads to disengagement from the membership in its governance of the cooperative. If members do not have a vested interest, they will certainly lose attentiveness to its operations. Over time, the cooperative will become an organization without a functioning owner. The System does not have to look too far back in its history to see that an over-reliance on URE can lead to the current membership looking to "cash-out" on its unallocated ownership. This result is contrary to the objective of the Act "to encourage farmer- and rancher- borrowers' participation in the management, control and ownership of a permanent system of credit for agriculture."

FCA's commentary in this regard states that URE "protects association members against association losses, associations against bank losses, and the System against financial contagion." This statement seems to go against the very intent of Congress. Since the inception of the System, borrowers have been required to have an at-risk investment in their institutions. We are quite confused that a regulator of cooperative-based System would propose capital regulations that discourage operating on a cooperative basis. Therefore, we respectfully request that FCA remove the requirement that a specific percentage of Tier 1 capital be URE.

6. Capitalization of an Association's Excess Borrowing Base

CFC believes the covenants of our general financing agreement (GFA) with FCBT governing the lending relationship between us and the bank, contain the necessary safeguards so that the bank does not need to hold additional capital to support unfunded commitments to an association. If funding banks are also required to capitalize the unused portion of direct notes, it would effectively double up on capital to cover what is essentially the same risk that has already been capitalized by the association. Furthermore, there is no financial risk for the bank to capitalize since the association's financial performance is dictating the amount the association can borrow on the direct note. The GFA has the proper parameters in place. Therefore, to require the bank to capitalize the excess borrowing base under the direct loan would only reduce the efficiency of the bank-association relationship without contributing materially to its safety and soundness and impose unnecessary burdens on the associations. Therefore, we request FCA to not treat the excess borrowing base of the direct loan as an unfunded commitment.

7. Five percent Leverage Ratio

The 5 percent Tier 1 leverage ratio requirement is excessive and unsupported. Under Basel III, the Tier 1 leverage ratio requirement is 4 percent. The 4 percent leverage requirement is consistent with what other financial institution regulators have proposed. Requiring a 5 percent minimum standard for the FCS results in an unnecessary inconsistency with Basel III and the requirements applicable to commercial banks and creates 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.

FCA's rationale essentially appears to be that the System's uniqueness makes it more risky than non-System financial institutions. We agree with FCBT that our uniqueness actually makes us a lesser risk. While it is true that System institutions are financially and operationally interconnected, member-owned cooperatives, that fact is probably a source of stability and strength as opposed to a risk factor. As the Council's comment points out, FCA ignores the fact that, with the System's two-tiered structure, it already capitalizes most credit risks at 120 percent. 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 percent 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 percent 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. As a result, far from being a hidden risk concealed in a 20-percent risk-weighting, this interconnectedness is already being reflected in the System's capitalization. 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.

Imposing a 5 percent minimum Tier 1 leverage ratio requirement instead of 4 percent 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 the System when offering a loan to a specific agricultural borrower. 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 System institution to a specific agricultural borrower. This requirement fundamentally undermines the FCS's mission and creates economic incentives for shifting ownership of loans from associations to System banks.

For the foregoing reasons, we respectfully ask FCA to follow Basel III and the U.S. banking regulators by imposing a 4 percent Tier 1 leverage ratio. 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.

OTHER ISSUES:

1. Higher Risk-Weighting for Rural Electric Cooperatives

We agree with the Council that the FCA should continue the 50% and 20% risk-weighting for exposures to electric cooperatives under current regulations in consideration of the favorable risk history of this particular sector and the fact that it is a clear part of the System's mission to serve these borrowers. Our ability to purchase participations from CoBank also improves our own portfolio risk profile. Increasing the applicable risk-weight for these assets would reduce our ability to diversify our credit risk.

2. Treatment of High Volatility Commercial Real Estate

Section 628.32(j) of the proposed rule would apply a higher 150-percent risk-weighting to High Volatility Commercial Real Estate exposures, defined at § 628.2 as including,

> The purchase or development of agricultural land, which includes all land known to be used or usable for agricultural purposes (such as crop and livestock productions), provided that the valuation of the agricultural land is based on its value for agricultural purposes and the valuation does not take into consideration any potential use of the land for non-agricultural commercial development or residential development. (Emphasis added).

Because this language appears to preclude the valuation from including any potential non-agricultural use of agricultural property for the foreseeable future, it could conceivably apply a higher risk-weight to much of the agricultural real estate that we finance today. In our region, we have a diversified economy and some of the largest and fastest growing metropolitan centers in the country. It is difficult to escape non-agricultural influences on valuations even where agricultural land is being used solely for agricultural purposes and there is no present intent on the owner's part to develop the land for any non-agricultural use. We agree, therefore, with the Council's comment that FCA should clarify that loans that are within the scope and eligibility requirements should not be risk-weighted more heavily under this provision just because of the possibility of some potential non-agricultural use or development at some point in the distant future. Farmers and ranchers cannot control demographic growth patterns or other non-agricultural influences that might happen to affect their land. Consequently it would be unfair to curtail their ability to obtain financing for eligible purposes merely because the valuation reflects some non-agricultural influences.

3. Effective Date

We agree with the Council that whatever FCA ultimately decides to do with the proposed rule, the proposed effective date should be changed from January 1, 2016 to at least January 1, 2017. As written, the proposed rule will require System institutions to make substantial modifications to their policies, capitalization bylaws, business and capital plans, business and patronage practices, member disclosures, financial disclosures, and computer systems in order accommodate the new requirements. Even if FCA made no revisions to the rule in response to public comments, it probably could not publish a final rule until well into the second half of 2015, and by then, there simply would not be enough time remaining for System institutions to be in compliance by the beginning of the next year. FCA should give the System ample time, preferably close to 12 months from the publication date of the final rule, to implement the new rules whatever they may be.

CONCLUSION:

We are pleased that FCA is aligning its capital regulations with Basel III but we believe the proposed rule will result in unintended consequences that will incent System institutions to not follow the basic cooperative principle of member economic participation. It is essential for the System's capital requirements to be comparable to those applicable to non-System financial institutions, not only to allow the System to market its securities to investors effectively, but also to enable all other stakeholders, including Congress, rating agencies, counterparties, as well as System borrowers, to assure themselves of the financial strength of the System and its institutions in terms that are commonly recognized and understood in the business community. We believe that Basel III principles could be more reasonably adapted, under footnote 12 of the Basel III framework, to the System in a manner that would be consistent with the principles and objectives of Basel III as well as the distinctive cooperative structure of the Farm Credit System.

Although the proposed rule nominally includes allocated equities as a component of CET1, it also places many significant burdens on the use of these equities as regulatory capital that, in our view, are completely unnecessary to achieve comparability to Basel III requirements. CFC has been paying patronage refunds and acting as a cooperative in its truest sense for about the past 15 years. During this time, we have seen the benefits of the cooperative model with improved financial results and an increasingly engaged membership. The high level of engagement is evidenced by the several hundred letters our stockholders submitted opposing this proposed rule. We believe the proposed rule, whether intentional or not, will actually discourage System institutions from allocating and redeeming retained earnings because the regulatory burdens associated with them will effectively act as a tax on the institution. Consider the 10 year minimum revolvement period for allocated equities. This will significantly reduce the value of such equities so that many associations will choose not to allocate in the first place. The proposed 30 percent haircut penalty is such a huge hammer hanging over the head of an institution with an active allocated equity plan, it will cause its board of directors to consider the regulatory risk associated with operating with such a plan. Just the regulatory burden of having FCA approve patronage distributions and allocated equity redemptions will be enough to dissuade many. Does FCA really want the System to abandon the cooperative principles Congress founded it upon?

In summary, for the reasons set forth in these comments and in order the make the proposed capital regulations consistent with the cooperative structure of the System and the principles of Basel III framework, we respectfully ask the FCA to modify the proposed rule as follows:

1. Classify allocated equities as retained earnings under the Basel III definition of CET1 capital.
2. Eliminate the 10-year minimum revolvement requirements for CET1 and the 5-year minimum requirements for Tier 2, and allow all allocated equities to be eligible to qualify as CET1 capital.
3. Include FCB attributed surplus in the definition of a URE equivalent, and include URE equivalents in the definition of URE.
4. Allow periodic equalization of the associations' investment in the bank.
5. Allow the minimum amount of stock required as a condition to borrowing under an institution's bylaws to be counted in CET1 capital, and include this amount in the safe harbor.
6. Exclude the associations' excess borrowing base in the direct loan with the bank from unfunded commitments that require capitalization.
7. Eliminate the requirement for capitalization bylaw amendments.
8. Modify the safe harbor for capital distributions to increase the amount that is distributable to a level that is more consistent with the regulations of the U.S. banking regulators.
9. Include in the safe harbor incidental redemptions for estates and pursuant to court orders.
10. Eliminate the 30 percent/3-year haircut for redemptions made without FCA approval and allow corrective actions to be case-by-case.
11. Eliminate the requirement for a specific percentage of URE and URE equivalents in Tier 1 capital for the purpose of calculating the leverage ratio in favor of a requirement that the CET1 capital should include the amount of URE and URE equivalents as an institution's board of directors determines is prudent and consistent with operating on a cooperative basis.
12. Reduce the Tier 1 leverage ratio from 5 percent to 4 percent in line with Basel III requirements.

Once again, we appreciate the opportunity to comment on these proposed regulations, and we thank you for your consideration.

Sincerely,

Phillip Munden
Chairman,
Capital Farm Credit Board of Directors

Ben R. Novosad

Ben Novosad
Chief Executive Officer