AgriBank
FARM CREDIT BANK

November 9, 2020

Mr. David P. Grahn
Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

RE: Proposed Rule – Regulatory Capital Framework: Tier 1/Tier2 Framework – RIN 3052-AD27/ Federal Register Vol. 85, No. 176 (September 10, 2020)

Dear Mr. Grahn:

AgriBank, FCB ("AgriBank") appreciates the opportunity to comment on the Farm Credit Administration's ("FCA") Proposed Rule published in the September 10, 2020 Federal Register addressing requirements for the Tier 1/Tier 2 Regulatory Capital Framework ("Proposed Rule").

AgriBank participated in the System's Capital Workgroup, which includes individuals from the finance departments of each System Bank, representatives from several System Associations affiliated with each of the Banks, the Federal Farm Credit Banks Funding Corporation, and other System representatives. We support the comments and answers submitted by the Farm Credit Council ("FCC") on behalf of that Workgroup.

AgriBank generally supports the Proposed Rule and FCA's intent to update and codify provisions of the Tier1/Tier 2 capital rule that have been addressed through Bookletter 068 "Tier 1/Tier 2 Capital Framework Guidance" and call report instructions. However, certain aspects of this "clean up" regulation are problematic to AgriBank. These items are addressed in the FCC comment letter. In addition, AgriBank requests that FCA take this opportunity to address an inconsistency in the definition of unallocated retained earnings ("URE") and equivalents.

If FCA retains the URE requirement as part of the Tier 1 Leverage Ratio, we ask FCA to revise its definition of URE equivalent with respect to allocated Bank stock held by Associations. Allocated Bank stock arises when a Bank declares patronage in the form of stock for a portion of current period earnings. Associations recognize this stock patronage in their current period earnings, and this income becomes a component of the Associations' URE. The stock patronage also increases the Associations' investment in their funding Bank.

In determining regulatory capital, Associations appropriately eliminate their investment in their funding Bank from assets and from capital, including that portion of their URE that represents allocated stock patronage. When an Association purchases stock, it increases Bank capital. The Bank counts this capital as CET1 capital, and the Association appropriately eliminates the purchased investment and an equal offset from capital in the Association's calculation of its capital ratios. With allocated stock, a portion of the Bank's current period earnings are converted into stock and distributed as patronage to Associations. Because these earnings increase an Association's investment in the Bank, the investment and the increased retained earnings are eliminated for regulatory capital purposes by the Association. Under the current capital regulations, the Bank counts this capital in CET1 capital.

In the Preamble to the 2014 proposed regulations (Federal Register page 52822), FCA stated:

> "The FCA believes that it is especially important for System banks to hold sufficient URE and URE equivalents to cushion the third-party and common cooperative equities that make up the rest of tier 1 capital. URE and URE equivalents, when depleted, do not result in losses to a System's institution's members. URE protects against the interconnected risk that exists between System banks and associations; it protects association members against association losses, associations against bank losses, and the System against financial contagion. We are proposing to make the URE and URE equivalents a part of the leverage ratio because a URE minimum tied to risk adjusted assets may not be sufficient for the banks, which have a greater disparity between risk-adjusted assets and total assets."

In AgriBank's view, allowing the Banks to count allocated stock as URE equivalents is consistent with the concepts set forth in the Preamble to the 2014 proposed regulation. In a worst case scenario in which the Bank incurred losses and completely impaired the allocated equities, the Association would take a write-off through current period earnings, but its regulatory capital would not decrease. As a result of the Association's write-off through earnings, its investment in the Bank would also be written down. Since the investment is eliminated from capital and assets, the write-off reflects both a lower level of capital and investment in the Bank. Regulatory capital would not be impacted, including the retail borrower member stock. The value of retail borrower member stock is not at risk in the event of the impairment of an Association's investment in its funding Bank.

The preamble to the Proposed Rule (Federal Register pages 55791-55792) further provides that FCA "reexamined the attributes of allocated equities and determined that they fully meet the definition of paid-in capital: the allocated equities are received with finality by the allocating System institution when earned and issued; their value is reliably established as the dollar value of institution net assets allocated; they are fully under the institution's control because they can be revolved only at the discretion of the System institution, with the prior approval of the FCA; and the loss-absorbing capacity of the allocated equities is not dependent on the creditworthiness of the member-borrower. We do not expect the proposed clarification to have any impact on System institution practices with respect to allocated equities."

AgriBank agrees with the eliminations from Association capital for both allocated and purchased Bank stock. The elimination is appropriate because, under the System's capital structure, capital should only be counted once. The entity counting the capital should be afforded the appropriate regulatory treatment for the characteristics of that element of capital. In the case of Bank allocated stock, the appropriate regulatory treatment is as "paid in capital" as clarified in the preamble to the Proposed Rule. Unlike purchased stock, allocated stock sets aside Bank earnings with finality when earned and issued. The value of allocated stock can be reliably established by the Bank as the dollar value of the Bank's net assets allocated. Also, allocated stock is fully within the Bank's control because it can be revolved only at the discretion of the Bank, with the prior approval of the FCA, and the loss-absorbing capacity of the allocated stock is not dependent on the creditworthiness of the Association. Therefore, it is reasonable for allocated Bank stock to be considered a URE equivalent at the Bank, consistent with certain other paid-in capital, as discussed below.

In FCA Regulation Section 628.2, URE equivalents is defined to include paid-in capital under certain circumstances. Specifically, the regulation provides:

> "*Unallocated retained earnings (URE) equivalents* means nonqualified allocated equities, other than equities allocated to other System institutions, and paid-in capital resulting from a merger of System institutions or from a repurchase of third-party capital that a System institution:
>
> > *(1)* Designates as URE equivalents at the time of allocation (or on or before March 31, 2017, if allocated prior to January 1, 2017) and undertakes in its capitalization bylaws or a currently effective board of directors resolution not to change the designation without prior FCA approval; and
> >
> > *(2)* Undertakes, in its capitalization bylaws or a currently effective board of directors resolution, not to exercise its discretion to revolve except upon dissolution or liquidation and not to offset against a loan in default except as required under final order of a court of competent jurisdiction or if required under § 615.5290 of this chapter in connection with a restructuring under part 617 of this chapter."

While the existing definition of URE equivalents applies to paid-in capital resulting from a merger or repurchase of third-party capital, it is reasonable and appropriate to apply this definition to Bank allocated stock that is distributed to affiliated Associations. AgriBank supports the inclusion of Bank allocated stock in URE equivalents, conditioned on meeting the two criteria outlined in the regulatory definition above.

AgriBank concurs with FCA's decision to treat allocated Association stock as CET1 with characteristics of purchased stock. However, the relationship between the funding Bank and Associations is fundamentally different. There is a permanence to the Bank/Association relationship as a result of the Farm Credit structure, and this permanence needs to be taken into account. The Association investment in its funding Bank does not carry the same uncertainty that stock or allocated equities at Associations may carry. There is no expectation of revolvement, nor is there risk that an Association would obtain funding from a source other than its funding Bank without FCA approval.

Given the permanence of the relationship between the funding Bank and Associations, allocated stock, which is: (1) issued from current period earnings; (2) recognized in current period earnings at the Associations; and (3) eliminated from Associations' unallocated retained earnings in calculating regulatory capital, exhibits all the characteristics of paid-in capital and should be counted as an URE equivalent at the Bank, consistent with other similar types of paid-in capital. Moreover, the permanence of such capital meets the two criteria currently required for paid-in capital to be included in URE equivalents in section 628.2 of the Regulations.

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 contact me.

Sincerely,

Barbara Kay Stille
Chief Administrative Officer and General Counsel