November 5, 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/Tier 2 Framework – RIN 3052-AD27/ Federal Register Vol. 85, No. 176 (September 10, 2020)

Dear Mr. Grahn:

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

Compeer supports the letter being submitted on behalf of the Farm Credit System by the Farm Credit Council ("System letter") and offers this letter and comments as a supplement to the System letter. To be clear, Compeer generally supports the proposed rule and FCA's intent to update and codify provisions of the Tier1/Tier 2 capital rule. That said, FCA can improve the proposed rule by incorporating the comments in the System letter and our comments below either in this rulemaking or through additional interpretative guidance.

Treatment of Allocated Retained Earnings

The System letter does an excellent job analyzing the current shortcomings in FCA's capital rules related to the treatment of allocated retained earnings. Compeer is one of the System associations that has historically allocated its retained earnings and the current treatment of these retained earnings is inconsistent with the Basel III framework. We believe that improving the treatment of allocated equities is important to managing the capital of our member-owners long term. As described below, the combined actions of holding periods, tiers of quality, and lack of flexibility for retirement, which all have no support in Basel III, have very clearly put allocated equities at a disadvantage to other forms of capital with similar loss absorption characteristics. The buildup of unallocated retained earnings at System Associations is also inconsistent with the approach taken by many other cooperatives. Allocated equities, in relation to cash patronage, provide the institution a way to account for challenges that clients have over time vs. the more immediate cash patronage while also promoting an ownership mentality vs. a transaction based mentality with clients which is more consistent with cooperative principals.

Minimum Holding Period for Allocated Retained Equities

As is set forth in the System letter, the minimum holding period requirements for allocated retained equities is inconsistent with the Basel III framework and treats certain System retained earnings very differently than how the U.S. banking regulators treat similar earnings. There is no

sound policy basis for the differing treatment and it has a negative impact on the member owners of System institutions.

As noted in the System letter:

> Basel III does not establish tiers of retained earnings; it does not subtract from retained earnings the amount that a bank has announced that it plans to distribute to shareholders in the normal course of business; it does not apply a discount factor to retained earnings to reflect public market pressures to make quarterly dividend distributions (even when a bank's failure to make a dividend could ultimately increase its cost of funds or threaten its liquidity). Indeed, retained earnings are categorically included in a commercial bank's CET1 notwithstanding that the bank is generally free to distribute in a given year the sum of its total net income for that year plus its retained net income for the preceding two years.
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> Under FCA's current capital regulations allocated retained earnings must have a minimum term in order to be treated as CET1. While we understand the importance of "permanence" with respect to CET1, there is no basis in Basel III for a holding period for retained earnings. Moreover, an allocated equity with an express minimum term is no more permanent than an allocated equity that is perpetual on its face, particularly when a separate rule requires FCA consent when distributions result in CET1 declining year over year. Accordingly, while it may be beyond the scope of this proposed rule, we ask FCA to consider eliminating the minimum term/revolvement period for allocated equities. As discussed above, allocated equities are simply retained earnings and should be included in CET1 without qualification. In stark terms, the current rule treats an institution's "allocation" of retained earnings as a capital distribution rather than a retention of earnings in the form of capital.

Compeer has had over $50 million of capital that could potentially be used to support our clients sitting outside of our regulatory capital due to the minimum hold period requirement. At all times this capital is available for loss absorption, similar to other allocated equities, but it nonetheless has been excluded due to FCA's constructed "permanence" requirement. What the history with the FCA's new capital regulations has demonstrated is that the five- and seven-year hold periods do not in fact the create permanence in our capital base. Instead, they simply make it more difficult to return member borrowers' own capital to them when they are struggling and the association is performing well and highly capitalized. The existing limitation on distributions, i.e., distributions must meet the safe harbor or be approved by FCA, provide adequate control for the agency to ensure that System institutions remain prudent with any capital distributions. Eliminating the artificial holding periods would allow association boards to determine when, to whom, and in what form the distribution of retained earnings are made in accordance with cooperative principals and corporate bylaws while still ensuring adequate levels of capital are maintained.

Retirement of Statutory Borrower Stock

FCA's purported clarification on our ability to retire statutory borrower stock perpetuates an excessive burden with no material or meaningful benefit. Forcing associations to apply the five- or seven-year holding period to de minimis levels of borrower stock will create significant additional costs for technology integrations, compliance monitoring and reputation risk. In the NPRM, FCA purports to clarify that:

For any statutory borrower stock that exceeds $1,000 or 2 percent of the loan amount, whichever is less, the minimum holding periods apply (7 years for CET1 and 5 years for Tier 2) if an institution plans to include the additional stock in tier 1 or tier 2 capital.

As a practical matter, borrower stock represents a tiny fraction of the overall capital held by System associations. Indeed, in many cases it equals approximately 0.25% of capital. FCA's supposed clarification is narrower than what is required by the Farm Credit Act's borrower stock requirement. The Act establishes a minimum amount of borrower stock, not a maximum, which must be held by someone obtaining a loan from an association. Historically, System associations have issued the minimum amount of borrower stock necessary.

If FCA chooses to follow the interpretation of the capital regulations it is "clarifying" in this NPRM, associations will continue to be burdened to properly account for and correctly apply any amount between the 2% "floor" and any additional borrower stock above the minimum it may choose to require. There may be technology system, operational or other reasons an association may choose to require, for example, an across-the-board requirement that borrowers own $1000 in stock. In these situations, the capital subject to the holding periods will be extremely minimal but represent a very large number of clients and stockholders. FCA's interpretation creates significant technical and compliance burdens by forcing associations to more actively monitor these very small dollar amounts rather than allow existing or forthcoming systems to work efficiently.

Furthermore, FCA is also effectively creating additional hurdles to serving low loan balance customers, who are commonly small, young and beginning farmers. The reputation risk associated with nonpayment of what has traditionally been a very routine transaction is disproportionately high compared to any risk associated with allowing these normal course of business distributions to occur without delay. Indeed, the practical effect of FCA's interpretation is likely to be that Associations will simply remove borrower stock from regulatory capital creating a wider gap between regulatory capital and GAAP capital which will further confuse stakeholders.

Compeer requests that FCA amend its interpretation and allow these de minimis amounts to be included in regulatory capital to avoid potential borrower confusion, high technology and compliance costs and reputation risk for non-return of paid-in capital on what has been historically a very routine transaction.

Retirement of Allocated Equities When Borrower's Default Results in a Loss

To the extent FCA continues to require the holding period for inclusion of allocated equites in Tier 1 or Tier 2 capital, Compeer requests that FCA broaden, through this rulemaking, a separate rulemaking, or interpretative guidance, the authority of System institutions to retire allocated equities issued to a borrower to offset losses when a borrower defaults on the borrower's loans. In those rare circumstances where a borrower defaults and the association incurs a loss, associations' loan and stock documents typically allow for the association to recover any patronage or allocated equities issued but not yet paid to the borrower. However, in the case of allocated equities which have been designated for inclusion in Tier 1 or Tier 2 capital, FCA's current interpretation of the

regulation is that the association must leave those allocated equities outstanding until the holding period has expired.

FCA's interpretation of the regulation causes significant compliance and operational burdens for associations. It also increases reputational risk for the association and the System because it requires the association to continue to communicate with the borrower about allocated equities the borrower will never receive after the loss has been written off and, presumably, the relationship with the borrower has terminated. Today, the only relief available to an association is to seek approval from FCA to cancel the allocated equities in advance of the expiration of the holding period. This creates an unnecessary administrative burden for the association and unnecessary work for the agency.

Indeed, in these situations the capital will not be leaving the association. Instead an association "redeems" the allocated equities and they become unallocated retained earnings. However, if an association transfers the allocated equities to URE without FCA's permission, it could be found to have violated the holding period requirements and put its overall capital treatment at risk. In Compeer's experience, FCA understands and has been willing to act on these requests when they occur, but there is simply no substantive policy reason why System institutions should need to seek approval to make what is, in essence, merely a timing issue. And by allowing associations to retire allocated equities as soon as a loss is recognized, the association is able to expeditiously offset a portion of the loss and avoid the potential reputation risk that may arise if the association is required to continue to communicate about allocated equities which the borrower owns but will lose as soon as the holding period runs.

Thank you for the opportunity to provide comment on FCA's NPRM. We believe incorporating the comments above and those from the System letter will further improve FCA's capital regulations. If you have questions, feel free to contact the undersigned at jase.wagner@compeer.com.

Sincerely,

Jase Wagner
Chief Financial Officer