American AgCredit
MONEY FOR AGRICULTURE

July 15, 2021

Mr. Kevin J. Kramp
Director, Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Comment Letter on Proposed Rule – 12 CFR Part 614 – RIN 3052-AC94;
Collateral Evaluation Requirements; 86 Federal Register 27308-27323

Dear Mr. Kramp:

American AgCredit ("AAC") has reviewed the Farm Credit Administration's ("FCA") Proposed Rule regarding Collateral Evaluation Requirements published in the May 20, 2021 *Federal Register* (the "Proposed Rule"), and appreciates the opportunity to submit this comment letter offering AAC's position on the Proposed Rule.

AAC participated in a workgroup organized by the Farm Credit Council ("FCC") to review the Proposed Rule and prepare a response on behalf of the Farm Credit System. AAC also endorses the insights and recommendations provided in the FCC comment letter.

Summary

It is AAC's position that the provisions of the Proposed Rule do not allow for reasonable methods of valuation differentiation between transactions. Such methodology differentiations should be influenced by the size and risk of each transaction. Additionally, the Proposed Rule imposes requirements that encompass broader credit considerations, rather than being focused solely on that of collateral evaluation considerations. Each Farm Credit Institution ("Institution(s)") has its own unique risk capacity depending on many factors, including, but not limited to, its size, capital, and portfolio diversity. To serve our customers and assure a return to our shareholders, Institution credit procedures are required to consider the Farm Credit Regulations and the Institution's risk capacity, as well as the full extent of the 5 C's of credit. When done effectively, as we believe that our Institution and the broader Farm Credit System ("System") has historically demonstrated, this approach has allowed us to effectively serve our customers, provide a consistent return to our shareholders, and ensure the ongoing safety and soundness of AAC. Ultimately, a differential, risk-based approach, one which has prudently embraced many technological advancements over the last decade, enables Institutions to meet the Farm Credit mission of improving the lives of farmers and ranchers across the nation, regardless of size and location.

AAC understands the importance of having sufficient internal controls and values the role such controls play in safety and soundness. Having sufficient controls for collateral evaluation requirements, however, does not require rewriting the collateral evaluation requirements that have served the System well and for which substantive abuses have not been shown. Good internal controls exist and provide the check on safety and soundness needed without the Proposed Rule. The proposed regulatory changes well exceed the requirements under which any other regulated lending institution must operate, and impose additional and/or inconsistent requirements on Uniform Standards of Professional Appraisal Practice ("USPAP") reports and fee appraisers who must comply with such guidance.

Upon review, AAC does not consider the background provided by FCA to either justify or support the extensive changes being proposed, especially when such changes invite new classifications of collateral that are inconsistent with Article 9 and other state laws governing asset classification, collateral description requirements, lien perfection, and filing requirements. These changes are inconsistent with other regulatory requirements under which regulated lending institutions must operate. These changes do not recognize the role that standards of conduct and other FCA regulations play in supporting safe and sound collateral evaluation requirements under existing guidance (*e.g.*, independence, agent retention and control, and vendor management). Finally, these changes are inconsistent with other regulations, such as confidentiality, exceptions to confidentiality, credit review committees, and borrower rights. *See, e.g.,* 12 CFR §§ 617.7300, *et seq.*, 618.8300, & 618.8325; *see generally* 12 CFR part 617.

In summary, AAC appreciates the need to ensure that regulations continue to provide safe and sound guidance for Institutions in an evolving world. However, the background and objectives provided in the Proposed Rule do not support the wide reach of the proposed changes and are simply not consistent with existing laws governing collateralization. The changes proposed are a significant step backward in modernizing the appraisal rules and would eradicate many of the enhancements that our Institution and the broader System have accomplished in recent years. These enhancements have prudently advanced our differentiated risk-based lending approach and enabled us to better serve all segments of agriculture despite size and remote geographical location, all while maintaining strong financial results and a foundationally safe and sound Institution and System. Finally, as more specifically noted below, the step backward that would result from this Proposed Rule would make collateralization and compliance more difficult, more costly, and more inconvenient, while simultaneously reducing the System's ability to remain competitive and satisfy the mission of providing reliable, cost effective lending and leasing to eligible borrowers and the agricultural community. This result is exacerbated by the lack of evidence of existing systemic abuse or elevated risk in current collateral evaluation practices. For these reasons, as more specifically supported below, AAC respectfully requests that FCA withdraw the Proposed Rule.

Specific Comments Regarding the Proposed Rule

Risk Tolerance and Other Credit and Lending Factors

Existing lending practices are appropriately based on the five C's of credit, which inherently include collateral appraisals and evaluations. The Proposed Rule, however, does not seem to take the other four credit considerations into account nor appreciate the interrelationship between these factors when making lending decisions. It also appears not to allow for any proper and reasonable delineation of transactional risk and size for Institutions. The Proposed Rule also imposes many requirements on the collateral appraisal and evaluation process that should remain as credit considerations rather than collateral considerations. Each Institution has its own unique risk capacity, depending on many different factors, including its size, capital, and portfolio diversity. Each Institution is required to establish and maintain procedures that satisfy existing FCA regulations and the five C's of credit, ensuring acceptable levels of safety and soundness, while also providing a reasonable return to shareholders. A risk-based approach allows for Institutions to meet the Farm Credit mission of improving the lives of farmers and ranchers across the nation, regardless of size and location.

Blanket Liens

The Proposed Rule requires an Institution to assign a value to all collateral, even nominal collateral taken under a blanket lien basis. Blanket liens are critically important to all lenders and are expressly authorized and permitted by law. By receiving a blanket lien, an Institution is provided a priority lien on all available personal property related collateral, as agreed to by the customer. This not only allows for maximum collateralization of System loans, but it allows for it to be accomplished in a manner that is efficient, convenient, and agreeable to the customer.

For example, blanket liens allow for collateral to be taken for different purposes and at different points in time (*e.g.*, loan modifications, distressed loan restructuring plans, cross-collateralization). This allows for collateral to be substituted or replaced in the ordinary course of business, with appropriate language in the security instrument to reflect those substitutions and replacements (without being required to place a value on same, which is impossible at the outset and would be extremely cost-prohibitive to monitor, update, and maintain over time). This further allows such collateral to secure the entire operation without assigning a value on all of same.

State law requires a creditor to identify collateral with reasonable specificity and to identify all collateral being taken. If an Institution is unable to take a blanket lien on collateral unless it assigns a value as to each piece of collateral taken, it would be forced to prepare and rely upon multiple security instruments over a period of time, forego taking all collateral being offered, run afoul of the Proposed Rule's requirements on valuing all collateral, or lose priority of a security interest by failing to specify the collateral as required. In other words, an Institution would be forced to choose between compliance with the Proposed

Rule, on the one hand, or effectuating a prudent and market standard security interest on the full extent of the collateral offered by the customer, on the other hand.

No state or federal law requires a lender to value collateral taken on a blanket lien basis and doing so would be both more expensive and impractical. It is ideal, if not imperative, for a secured Institution to describe all the collateral that has been agreed to be provided by the customer, and all evolutions or permutations of the collateral, on a blanket lien basis from the outset to ensure it remains fully and properly perfected throughout the life of the loan and to ensure that such collateral is ultimately available, should it need to be relied on for secondary payment support.

As collateral can evolve, its value may not be fully ascertainable at the time the collateral is pledged or taken. Assigning a value to all collateral at the outset may be unreasonably expensive if not impractical, especially under the requirements being proposed. The inconveniences on the Institution and the customer add to the cost and inefficiency associated with this approach. Moreover, the value and accuracy associated with each valuation is of potentially limited duration for the reasons noted.

Inconsistent with Other Laws and Guidance

The Proposed Rule is inconsistent with other FCA regulations, published guidance and other professional rules. The Proposed Rule also ignores many technological advancements made over the last decade that allow Institutions to truly meet their mission in a cost-efficient manner. It is reasonable to expect that there would be significant cost increases to convert or require a new report format (especially with AVM's), to educate appraisers and chattel evaluators on the new requirements, and to update internal controls, policies, and procedures and train on the same. This all comes with little to no additional risk mitigation or value to the Institution or the customer.

With increased cost and difficulty of compliance, the Proposed Rule encourages (if not invites) a shift to an increased utilization of unsecured loans. This would ultimately elevate the lending risk on the Institution, as it opens the opportunity for another lender to make loans to the same borrower on a secured basis. For example, if a borrower/debtor is not required to pledge collateral to the Institution lender, then it would be able to pledge collateral to another lender and take on additional debt, increasing the risk borne by the Institution lender. This would greatly reduce the likelihood of collection upon default. Alternatively, operating costs on secured loans would increase, which effectively embeds an ongoing and reoccurring charge-off ultimately impacting net income, capital, and shareholder return in a negative manner.

Further, the Proposed Rule does not take into account the Food Security Act and other laws that require certain language and certain filings or notices to be made to protect the secured creditor against buyers in good faith or buyers in the ordinary course of business, who can purchase farm products without being subject to the Institution lien unless certain requirements by that lender are met. The Proposed Rule may impact the ability to meet those requirements, which would come at a great cost to an Institution's

collateralization, its ability to avoid being primed by another lien, or avoid defenses being made by a buyer in good faith, among other things. Given the difficulty of satisfying the Food Security Act and avoiding defenses made by buyers in good faith, the additional hurdles imposed by the Proposed Rule would make compliance under the Food Security Act difficult, if not impossible.

Comments on Proposed Rule Definitions

In addition to the general comments above, AAC submits the following comments regarding certain definitions of the Proposed Rule:

Automated Valuation Model.

In the Proposed Rule, the term "Automated Valuation Model or AVM" is defined to mean "a computer program that estimates a property's market value based on market, economic, and demographic factors using a quantitative method, system, or approach applying statistical, economic, financial, or mathematical theories, techniques, and assumptions. *Hedonic* models generally use property characteristics (such as square footage and room count) and methodologies to process information, often based on statistical regression. *Index* models generally use geographic repeat sales data over time rather than property characteristic data. Blended or hybrid models use elements of both hedonic and index models." *Proposed Rule 12 CFR § 614.4240.*

The proposed definition of AVM is outdated and lacks necessary specificity. For example, the proposed definition does not recognize that there is a difference between appraiser/evaluator assisted valuation tools (like Maven) and true AVM's that lack significant user interaction and transparency. AO-18 of USPAP describes an AVM as a "computer software program that analyzes data using an automated process. For example, AVMs may use regression, adaptive estimation, neural network, expert reasoning, and artificial intelligence programs." *Proposed Rule 12 CFR § 614.4240*. USPAP's definition recognizes that an AVM is a computer software program and provides examples of its use. The limited scope and applicability of the Proposed Rule's definition does not provide the additional clarity or insight sought in the objectives of the Proposed Rule.

Business Chattel.

In the Proposed Rule, the term "Business Chattel" is defined as "livestock (*e.g.* any creature not in the wild which is regarded as an asset such as those to produce food, wool, skins, fur or similar purposes) and crops (growing, harvested, or in storage) kept for production or use in the farming of land or the carrying on of any agricultural activity. The term also encompasses equipment used in business operations, including agricultural equipment." *Proposed Rule 12 CFR § 614.4240.*

In utilizing this definition, the Proposed Rule creates a new asset class with the intent of improving clarity of expectations on this asset. However, the creation of this asset class invites other confusion. For

example, the definition is specific to "carrying on of any agricultural activity, such as production or use in the farming of land." However, such a definition does not recognize that some loans (*e.g.*, agribusiness loans) include other forms of chattel business assets within processor and manufacturing and other agribusiness operations. It is difficult to discern whether these would be considered business chattel assets or personal property assets. This confusion is compounded by the Proposed Rule's definition of "personal property," which excludes "real property and its fixtures or business chattel." *Proposed Rule 12 CFR § 614.4240*. Under existing law, the term "personal property" refers to "any asset other than real estate," whether such assets secure business or non-business loans, which is consistent with Article 9 and other applicable laws.

Personal Property.

In the Proposed Rule, the term "personal property" is defined to mean "all tangible and movable property not considered real property and its fixtures or business chattel." *Proposed Rule 12 CFR § 614.4240*. As noted above, this definition is inconsistent with how personal property is defined under other laws, including Article 9, and how other lending institutions define such property. Creating a new definition that is inconsistent with how other laws and lending institutions define the term invites more ambiguity and confusion than it purports to resolve. The term "personal property" should be consistent with other laws, especially laws that govern secured credit, priority of interests, and UCC filings, among others, and should be consistent with other lending institutions.

General Comments on Proposed Rule's use of Appraisals and Evaluations

Required Appraisals or Evaluations.

The Proposed Rule in 12 CFR § 614.4245(a) provides that: "System lenders must obtain appraisals or evaluations of all collateral used to secure an extension of credit (including leasing activities) or the purchased interest in credit extended by another lender. System lenders must maintain appraisals or evaluations reflecting current market conditions. At a minimum, every item of collateral must be appraised or evaluated both at the time a lien is obtained and when the System lender expects to liquidate its lienhold interest."

In certain instances, collateral is taken for control purposes and not for providing needed collateral value. Such decisions are often credit-based decisions, which provide not only risk mitigation to the Institution but may also have a cost benefit to the customer in the form of potentially more competitive pricing and/or flexibility in the terms and structure of the credit.

Requiring all collateral taken as security to be valued does not take into consideration any *de minimus* values, which are especially important when valuing chattel under blanket lien purposes. Requiring all collateral to be valued as contemplated under the Proposed Rule, will sacrifice the accuracy, cost, and convenience associated with such appraisals or evaluations and the appraisal process.

Such costs and inconveniences would not be offset by improved accuracy or reduction in risk, but instead, would be made at the expense of the Institution and the customer (*e.g.*, the time it would take and the burden it would impose on the customer).

There are costs associated with each appraisal or evaluation. As the nature of certain types of collateral evolves or as collateral is added, modified, substituted, replaced, or sold, a cost will be imposed on the Institution and/or the customer, which adds to the overall cost of lending and creates a disincentive to utilize the System. This is especially true if an Institution were required to conduct a new appraisal or valuation when it removes or releases a lien, which is often when the account is paid down, if not paid in full. Safety and soundness would not be furthered by such mandates, at least not in proportion to the burdens and costs imposed.

Current practice allows for exclusions based on value to ensure an effort and risk return and limit the need for appraisals and evaluations to be made consistent with both the size and risk inherent in the transaction. Requiring an evaluation in every instance will drive up the cost of borrowing, including the cost to young, beginning, and small borrowers, and further prohibit Institutions to be more competitive.

Collateral is just one of the five factors of credit considered in making loan decisions. With the other four factors, the regulatory framework allows for risk-based standards and guidelines to be established. The Proposed Rule places the collateral consideration into a separate category, requiring increased attention above the other four factors. This approach fails to consider the fact that collateral is not the primary repayment source of a loan.

Age of Appraisal or Evaluation Reports.

The Proposed Rule in 12 CFR § 614.4245(c) provides that: "It is the responsibility of the System lender to monitor market conditions and trends, loan risk, and collateral conditions to appropriately determine the frequency for performing new or updated collateral appraisals or evaluations in keeping with regulatory requirements. When making credit decisions or approving new or additional funds, the System lender may use existing collateral appraisals or evaluations reports only if the appraisals or evaluations reflect current market conditions at the time of use." Proposed Rule 12 CFR § 614.4245(c).

The Proposed Rule appears to recognize, in some respects, that the Institution should have procedures for determining when and whether appraisals and evaluations are required to be made with regard to certain credits. However, the balance of this provision of the Proposed Rule limits such discretion or the ability to rely on existing appraisals or evaluations by adding in the "only if" requirement at the end, nullifying that discretion.

In most instances it may only be important to determine that the current value is no less than when the transaction was originally put on the books. Given acceptable risk at the time of origination and then considering typical loan paydowns (via typical amortization), it would be unusual, based on historic trends,

for agricultural property values supporting the majority of a portfolio, to significantly deteriorate ahead of the paydown. And, with many agribusiness and more complex loans, the terms and conditions of the loan are adjusted to reflect the risk, including any special use collateral (where loan to value requirements or debt coverage ratios may be imposed), collateral subject to fluctuations in price, number, or type (where margin requirements might be required), pricing or payment terms that may adjust (*e.g.*, variable rates, payment frequency, annual renewals, balloon feature), and events of default classifications. In short, the existing regulations allow for Institutions to make risk-based determinations regarding the frequency of collateral appraisals or evaluations. Institutions may account for risk through any number of appropriate ways, including loan terms and conditions and the ability to inspect, appraise, or value the collateral when appropriate, with proper guidance supporting the same based on the type of collateral, the amount at issue, and USPAP-compliance, among other things.

Using the Appraisals of Another Lender.

The Proposed Rule in 12 CFR § 614.4245(d) provides that: "An appraisal ordered by another financial institution on assets of a loan applicant may be transferred to a System lender when: (1) The System lender will complete the credit transaction instead of the other financial institution; (2) The other financial institution and the applicant agree in writing to transfer the report; (3) The other financial institution is either subject to Title XI of FIRREA or a System lender; and (4) The System lender receiving and using the appraisal assumes full responsibility for the integrity, accuracy and thoroughness of the appraisal, including the methods used by the other financial institution to establish collateral values."

Current regulatory guidance is consistent with USPAP and other regulatory requirements regarding the use and purpose of an appraisal. Such consistency is important as the requirements must work together to provide a sufficient framework in which qualified and reputable vendors (appraisers) may provide a USPAP-compliant report that satisfies regulatory requirements, without further limiting persons who can provide appraisals for the System.

USPAP is very clear that a party receiving a copy of an appraisal report to satisfy disclosure requirements does not become an intended user of the appraisal. USPAP is also clear that appraisal reports need only contain sufficient information to enable the intended user(s) to understand the report. The Proposed Rule goes beyond USPAP's requirements and imposes an obligation that the report satisfy any "reader" of the report, including any future, unknown reader. This places an impossible burden on an appraiser without any commensurate benefit. There is no way for an appraiser to ascertain the knowledge and sophistication of any "reader" beyond the Institution, as the intended user. Exceeding the requirements of USPAP in this regard will limit the pool of available qualified and reputable appraisers who can provide a report to satisfy this requirement, let alone be willing to do so.

Further, the Proposed Rule conflicts with other regulations, such as 12 CFR §§ 617.7300, *et. seq.*, by requiring collateral evaluations or appraisals to be provided, without a request, to an eligible borrower.

In short, the Proposed Rule language goes above and beyond the requirements of other published regulatory guidelines and will add significant cost as well as regulatory inconsistency.

Valuing Business Chattel, Personal, and Intangible Property.

The Proposed Rule in 12 CFR § 614.4260 relates to valuing business chattel and personal and intangible property. The proposed changes represent several new requirements that appear to come at a significant cost and impair an Institution's discretion regarding the valuations needed for a particular credit.

There also could be significant cost increases associated with reporting in this new format, especially regarding AVM's, with little to no additional value or risk mitigation realized by the Institution or the customer. As previously noted, the costs invited by these proposed changes will likely invite a shift to more unsecured loans, or, in the alternative, increase operating costs to the Institution, effectively increasing the cost and pricing of lending. If the cost to lend in the System is increased, then the Institution's ability to effectively compete becomes more difficult, leading to reduced profitability and long-term sustainability, negatively impacting the ability to meet the mission of providing reliable, cost effective lending and leasing to eligible borrowers and the agricultural community.

Additionally, some of the requirements being proposed ignore some of the flexibility of existing regulations or guidance that would allow an Institution the ability to value chattel assets at the "Lesser of Cost or Market" as a value conclusion. While Fair Market Value is applicable in most cases, it's exclusive requirement in the valuation of chattel assets is inconsistent with the industry and competition. Similarly, the proposed changes would no longer enable an Institution to assign classifications of collateral and adjust internal LTV or margin requirements through its own policies and procedures, which allows for a better reflection of risk and market change.

Valuing Real Property.

The Proposed Rule in 12 CFR § 614.4265 relates to valuing real property collateral. The proposed changes contained in this provision exceed the regulatory requirements imposed on any other regulated lending institution without any explanation or benefit associated with such limitations. Each additional burden being proposed reflects an additional cost or loss for the Institutions, making it more difficult to provide agricultural financing at a relatively low cost to eligible borrowers and others who are served by the Farm Credit mission.

For example, the Proposed Rule requires an evaluation of all collateral taken out of an abundance of caution. This provision of the Proposed Rule appears to generally ignore FCA's current definition of "abundance of caution," collateral; namely collateral that is recognized as unnecessary for the support of the credit decision (revenue or collateral) or for regulatory or other compliance. The Proposed Rule could impact the customer and the various Institutions' overall risk profile by, among other things: (i) increasing unsecured lending, which will increase the cost to the borrower by means of increased interest rates due to

higher risks associated with credit; (ii) requiring evaluations on collateral that is being taken for control purposes only, which will increase the costs associated with the loans in terms of higher appraisal fees and render a less favorable customer experience; (iii) increasing the related costs substantially, making it cost-prohibitive to serve certain aspects of the market, which impacts the mission while providing nominal, if any, enhanced risk mitigation to the Institution or the System as a whole; (iv) diminishing competitive advantage by not adjusting *de minimis* levels to align with other regulatory agencies; and (v) limiting proactive portfolio risk management tools, including blanket chattel liens, especially impactful for smaller lending relationships (specifically YBS).

Regarding appraisals and collateral evaluations that are subject to USPAP, Institutions should be able to rely on USPAP and any changes made by or within USPAP as opposed to having regulatory changes that limit or otherwise impact USPAP. The potential unintended consequences of being unable to rely on and utilize USPAP could also impact an appraiser's ability to satisfy their licensure or other professional requirements. The Proposed Rule also requires a greater level of analysis to support a reported value conclusion, failing to realize that, in some instances the value of what's described is inherent to the land, or the land/structures are reported as one value, which is common with ranch property.

In short, with the changes proposed in this provision of the Proposed Rule, Institutions are faced with choosing compliance at a cost, with a burden that makes lending more costly and more inefficient, rendering Institutions less competitive, or choosing to make more unsecured loans to avoid the enormous burdens associated with new and unnecessary requirements that supplant existing guidance and controls that appropriately and acceptably recognize risks and reward.

Appraisal and Evaluation Tools.

The Proposed Rule in 12 CFR § 614.4270 relates to appraisal and evaluation tools. The background of the Proposed Rule recognizes that FCA "expects the lender to include controls addressing the accuracy and integrity of the inspections" when "considering how and in what manner to conduct property inspections." It also recognizes that "industry practices continue to place increased reliance on various types of technology to enhance or replace the physical inspection process." AAC recognizes that the use of tools may invite additional guidance or controls to ensure that certain tools do not replace or supplant existing appraisal and evaluation requirements and best practices. However, AAC also believes that the Proposed Rule goes beyond that which is necessary to provide safe and sound guidance.

For example, existing guidance does not allow for the substitution of an AVM for any appraisal or evaluation required to be performed by a fee appraiser or chattel evaluator. AVMs and other similar tools may enhance an appraiser or evaluator's ability to provide an appraisal or evaluation in a more cost effective or efficient manner, while remaining compliant with USPAP and other guidance. FCA has already provided model guidance on expectations for testing, validation, and documentation regarding AVMs and

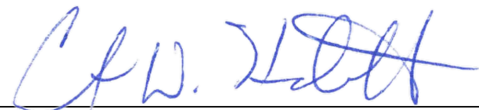
other tools, which allows for their permissible use under existing regulations. The Proposed Rule unnecessarily impairs the value of that guidance.

The Proposed Rule's commentary to the effect that AVM's are to be used as an assist tool fails to recognize the rigorous model testing, validation, and documentation requirements of the existing regulatory framework and directly contradicts certain aspects of 12 CFR § 614.4270. Additionally, placing an expectation that an AVM may only be used as an appraiser or evaluator assist tool limits continued data and technology developments that continue to improve these tools and models. Without the ability to effectively utilize AVM's as intended, cost increases could be significant and well more than the potential benefit of physically verifying assets, especially in smaller-sized transactions. The lending process may also be slower and uncompetitive. The use of AVM's, under the direction of a qualified appraiser or evaluator, is intended to provide a reliable value conclusion in a format and level of detail consistent with the property type and is USPAP compliant.

In short, the Proposed Rule's limits on who can use an AVM or how it can be used are not reflective of what an AVM is and are not consistent with other published guidance.

Conclusion

AAC appreciates the opportunity to comment on the Proposed Rule and to present the above concerns to FCA for its consideration. For at least the reasons stated herein, AAC respectfully requests that FCA withdraw the Proposed Rule. Alternatively, AAC supports the FCC request to have an opportunity for System representatives and industry experts to meet with FCA to see if improvements can be made to existing guidance to accomplish the stated objectives of the Proposed Rule and/or to further safety and soundness with regard to appraisals and collateral evaluations in another way.



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