

July 16, 2021

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

RE: Proposed Rule – Collateral Evaluation Requirements – RIN 3052- AC94/ Federal Register Vol. 86, No. 96 (May 20, 2021)

Dear Mr. Kramp,

The Review, Audit, and Appraisal Workgroup of the Farm Credit System (RAAW) appreciates the opportunity to comment on the Farm Credit Administration's (FCA) Proposed Rulemaking published in the May 20, 2021 Federal Register (Proposed Rule) addressing Collateral Evaluation Requirements. Our workgroup is an 18-person team of System professionals from each district representing all four Banks and Associations across the country. We appreciate our strong working relationship with the Agency, and we acknowledge the excellent risk-based, practical nature of most of your recent updated guidance. However, we write today with significant concern regarding the Proposed Rule as it does not align with your other risk-based, best practice guidance and significantly impedes the System's ability to serve the Farm Credit mission. We strongly support and align with the System ad-hoc workgroup's comment letter coordinated by the Farm Credit Council. This 17-person group of experts from across the System did an excellent job of coordinating, communicating, and summarizing critical concerns with the Proposed Rule and its detrimental impacts to the Farm Credit System.

The Proposed Rule is overly prescriptive and has provisions which would lead to increased risk in lending practices and/or significantly greater operating expenses and inefficiencies. The extra costs and risk would have to be passed on to our borrowers through higher interest rates or lower patronage. Young, Beginning, and Small farmers and ranchers would be disproportionately impacted as they have the smallest amount of borrowings for absorbing these higher fixed costs. As a result, we join with the FCC in asking for FCA to significantly redraft or rescind the Proposed Rule and work with the System in addressing needed updates to the existing rules.

Contrary to achieving the stated objectives of the Proposed Rule, the amendments proposed are a significant step backward in modernizing the appraisal rules and creating a level playing field with the System's competitors. As proposed, the additional requirements would make the System less competitive by placing unnecessary and undue regulatory burdens on System institutions that are not required by the other Federal regulators for their regulated institutions.

The Proposed Rule imposes requirements which should be better considered in the credit

decision. Specifically, the Proposed Regulation, Section 614.4245 requires institutions to complete a formal appraisal or evaluation on all collateral used to secure an extension of credit. This requirement would not be workable in loans where blanket liens are taken. It would be unreasonable and cost prohibitive to establish a value on all assets of a borrower. For collateral with *de minimis* value, it would be cost prohibitive to complete collateral evaluations. Accordingly, the decision on collateral taken to support a loan extension is a credit decision and should be determined by the institution depending on many factors including its size, capital level, risk appetite, portfolio composition and economic conditions. Also, when collateral is taken in an abundance of caution the institution may want to use the book or reported value of the collateral as a conservative estimate of collateral coverage, knowing the actual value may be significantly higher. The value of completing a collateral evaluation in those cases would be minimal in relation to the cost.

The Proposed Rule also does not recognize the competitive factors faced by Farm Credit Institutions by non-Farm Credit lenders and that some debts are FSA/USDA-guaranteed, which carry their own collateral evaluation requirements. The Proposed Rule is more stringent or exceeds the requirements under which other lenders or persons must operate, which places Farm Credit Associations in a difficult competitive position.

The following sections provide a section by section summary of concerns with the Proposed Rule:

§ 614.4245 General (a) Required appraisals and evaluations. 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.

The Proposed Rule requires System lenders to obtain appraisals or evaluations on all collateral used to secure an extension of credit. This standard creates unnecessary burden and ultimately will create additional expenses for borrowers or increased credit risk. Collateral is routinely taken as a credit control where the value of the collateral is not a determining factor. Specifically, the System often takes blanket liens as a sound credit practice, but if appraisals/evaluations are required then that credit practice would become excessively expensive. In all likelihood, this credit control would have to be eliminated, thus potentially increasing credit risk. In addition, collateral taken out of an abundance of caution is by definition not being taken to rely on the value of the property, but to establish a sound credit control. For example, that property could not be pledged as collateral on another loan without notifying the System institution.

As proposed, an appraisal or evaluation is required when the System institution removes a lien, which serves no purpose in accordance with safety and soundness. When the lien is removed, the account is typically paid in full.

For those reasons we believe the decision on whether to complete an appraisal or evaluation should be a part of the overall credit decision and left to the System institution to manage,

unless the appraisal is required by statute. The prescriptive requirements in this section does not add value to the credit decision and would likely increase credit risk as the use of blanket liens would be discontinued. We are not aware of any undue risks being taken by a System institution when the current flexibility is allowed.

§ 614.4245(d) Using appraisals of another lender *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.*

The obligation to obtain an agreement to transfer an appraisal performed by another lender goes beyond the requirements of any other Federal financial regulator, putting System institutions at a distinct competitive disadvantage. If the other lender is another System institution then the steps required seem excessive and burdensome. If the other lender is not a System institution then the requirements of their regulator will dictate their actions and requirements. The rules for sharing appraisals should be consistent with the other Federal financial regulators' requirements.

614.4240 Definitions *Automated Valuation Model or AVM means 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.*

The proposed definition of Automated Valuation Model or AVM is outdated and lacks necessary specificity. This definition does not recognize the difference between appraiser/evaluator-assisted valuation tools (like Maven) and true AVM's that lack significant user interaction and transparency. AVMs may use regression, adaptive estimation, neural network, expert reasoning, and artificial intelligence programs. However, the Proposed Rule does not utilize the term of concept of an AVM consistently or appropriately in all respects. The concept of an AVM should be reflective of what it is, define it appropriately, and distinguish the role of an appraiser and the use of an AVM. The limits in the Proposed Rule 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.

Additionally, the term "business chattel" as introduced and defined in this section invites other areas of 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 processing and manufacturing and other agribusiness operations. It is difficult to discern whether these would be considered business chattel assets or personal property. This confusion

is further 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. *See, e.g.*, UCC §§ 9-102 & 9-109. We do not believe that creation of this new class of collateral is necessary.

614.4265 Valuing real property (1) Non-business loan transactions. An evaluation of real estate may be used instead of an appraisal for a nonbusiness loan with a transaction value at or below \$250,000.

The Proposed Rule leaves the current *de minimis* levels at \$250,000 for consumer loans and commercial property, while other Federal financial regulators have moved this to \$400,000 and \$500,000, respectively for their regulated institutions. This difference is especially problematic to residential consumer transactions whereby retaining a \$250,000 *de minimis* as compared to other regulatory agencies residential *de minimis* at \$400,000 places System institutions at a competitive disadvantage. Accordingly, we recommend aligning FCA regulations with the other Federal financial institution regulators, including, but not limited to commercial real estate transactions, transactions involving an extension of credit and transactions that are wholly or partially insured by other GSEs.

§ 614. 4270 Appraisal and evaluation tools A System lender may use a variety of analytical methods and technological tools in developing an appraisal or evaluation, provided the lender can demonstrate that the method(s) used is consistent with safe and sound lending practices and contains sufficient information and analysis to support the resulting market value conclusion. The tools by themselves do not constitute either an appraisal or evaluation.

Preamble comment on this section: As proposed, analysis tools may not be used as a standalone appraisal or evaluation because these tools are intended for use in assisting appraisers and evaluators in the collateral evaluation process, not replacing them.

The Proposed Rule commentary for AVM's to be used as an assist tool fails to recognize the rigorous model testing, validation, and documentation requirements required in the regulatory framework and directly contradicts the statements in 614.4270. Further, placing an expectation that it may only be used as an appraiser or evaluator assist tool limits and discounts continued data and technology developments that continue to improve these tools and models. Collateral risk is a credit risk consideration and the decision on whether and how to use an AVM or a full appraisal should be based on a credit risk evaluation and not dictated by regulation. Finally, the proposed definition of AVM's introduces a lack of clarity on whether an appraiser or evaluator may rely upon an AVM as the basis for an appraisal or evaluation if the appraiser or evaluator believes the output to be credible for use (USPAP, AP-37). We propose removing the expectation for AVM's to be used only as an appraiser or evaluator assist tool.

Overall, we believe the Proposed Rule needs substantial changes and would best be rescinded and resubmitted. Our workgroup, the commenting workgroup, and others in the System would be open to working with FCA to develop a rule which puts us on a level playing field with our competition. We thank the FCA for the opportunity to provide comments on the proposed rule and for considering our concerns and related requests.

Sincerely,

A handwritten signature in cursive script, appearing to read "Staci Brown".

Staci Brown, Chair
Review, Audit, and Appraisal Workgroup (RAAW)