

7/16/2021

Page 1

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 – 12 CFR Part 614 – RIN 3052-AC94; *Collateral Evaluation Requirements*;
86 Federal Register 27308-27323

Dear Mr. Kramp:

Farm Credit of Western Oklahoma (“FCWO”) appreciates the opportunity to comment on the Farm Credit Administration’s (“FCA”) Proposed Rule regarding Collateral Evaluation Requirements that was published in the May 20, 2021 *Federal Register* (the “Proposed Rule”).

In the following comments, we hope to express our concerns the proposed rule would have on our day-to-day operations and what the impact would be to our borrowers should the rule proceed as written.

General Comments

The proposed changes will impact current loan programs offered by FCWO and in some cases, prevent the Association from lending in certain areas because we cannot remain competitive should the changes materialize. In other areas, the proposed rule will require appraisals in instances that they are or may not be required currently, causing increased cost to the Association. In many cases, that cost will be passed on to the borrower. The proposed rule will impact the services we are able to supply to YBS borrowers and will, without a doubt, increase the cost of originating loans to this segment and this cost will be incurred by the borrower. The Association strives to produce competitive lending programs that remain within our risk tolerance, provides a needed service to our borrowers, and keeps the cost of originating a loan as low as possible for borrowers. The proposed rule will make certain loan programs uncompetitive in the market and will prevent the Association from affectively servicing customer needs. In addition, the proposed rule will increase borrower cost in obtaining loans and will increase borrower cost on certain loan servicing actions. Outlined below are more specific comments that illustrate the negative effects of the proposal.

1. Opening Comment

FCWO, like every other cooperative, strives to provide the very best service to our customers. In order to accomplish that and remain competitive in the market, the Association has worked diligently and structured the Association to be as efficient as possible. Doing that in today’s regulatory environment has been a challenge. The cost of complying with regulatory requirements, audit, managing non-credit functions, and hiring employees outside credit to manage and comply with new financial/audit standards has increased exponentially over the last decade. Prior to the new regulatory environment, the Association emphasized every day and to every employee, that our “job” was to provide needed services to our borrowers on a timely and competitive basis. We did everything possible to keep interest rates low, to keep originating and

servicing costs low, to manage risk, and to assist agriculture and rural America in being as successful as possible. We viewed this as our core purpose. As the regulatory environment changed, we had to change with it. This change has forced us to divert resources from our core purpose to new areas that deal with audit and regulatory requirements that continue to become increasingly burdensome. This burden has increased costs to our borrowers and this cost continues to increase. The proposed rule will not only increase the cost to our borrowers, it will greatly affect the level of service that we can offer and in some cases, prevent us from servicing borrowers in certain areas. The combined effects of the proposed rule will greatly move the Association away from our core purpose without providing a benefit to our stockholders.

Currently, FCA regulates the appraisal process for each Association through the Farm Credit Act of 1971, as amended, and through FCA regulations. Financial institutions are bound by Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). This act created the Appraisal Subcommittee within the Federal Financial Institutions Examination Council ("FFIEC") which provides for federal oversight of state appraiser regulatory programs and requires certain federally regulated lending institutions to use appraisers that are either state certified or state licensed under the Uniform Standards of professional Appraisal Practice ("USPAP"). USPAP provides standards and qualification for real estate appraisers and provides guidance on recognized valuation standards and techniques for all evaluation professionals. FCA recognized the relationships between these regulatory entities and the current FCA regulations works within this framework to provide sufficient guidance to mitigate risk in the collateral valuation area. In addition to the FCA regulations, FCWO appraisers are bound by USPAP. Regardless of the proposed rule, FCWO will continue to follow USPAP and will continue to be subject to existing FCA regulations, both of which, provide standards for appraisers and appraisals and, specifically by FCA regulation, requires that real estate loans under Title 1 be a first lien and are limited to 85% loan to value. As such, Title 1 loans are valued and will continue to be valued in line with USPAP and FCA regulation notwithstanding the proposed changes. Title 1 lending is the overwhelming majority of the FCWO portfolio.

FCWO recognizes that reliance on fee appraisers and technology has changed since FCA collateral evaluation requirements were implemented over 25 years ago. Regarding fee appraisers, FCWO reliance has remained minimal as we continue to house an appraisal department and have every intention of continuing that practice. FCWO has evaluated area appraisers based on experience, qualifications, quality of work, and reputation and maintains a select few that perform fee appraisals from time to time. On appraisals that are performed by fee appraisers, FCWO requires that fee appraisers and the appraisals they provide conform to USPAP. Regarding technology, FCWO recognizes the need for guidance and examination of new technology, specifically AVM's (Automated Valuation Models) to require that they do not violate existing regulation and that they comply with USPAP. USPAP already provides sufficient guidance on AVM's and it's use by licensed appraisers. New FCA guidance in this area should recognize USPAP and incorporate such in any new regulations regarding AVM's. This area is no different that attorneys, closing agents, abstractors, surveyors, environmental inspectors, or Department of Environmental Quality, all of which have their own regulatory bodies and are bound by these regulations and by the professional organizations they belong. All of these play an integral role in mitigating risk to the Association. FCA recognizes the entities that regulate these providers. FCA should likewise recognize the standards dictated by USPAP.

Finally, FCWO recognizes the importance of controls and the role such controls play in safety and soundness. Existing FCA regulations and USPAP provide for a robust evaluation environment and one that contributes to the Association's control environment and to the safety and soundness of the Association. Due to current FCA regulations, USPAP, and Association valuation policies and procedures, the valuation process has served its purpose effectively by providing valuations that are in line with the market and with USPAP guidance, and protects the valuation process from abuse. Guidance in this area is not needed but if enacted, should consider the size of the association, USPAP standards, and existing regulations. New regulation in this area should not create requirements that are inconsistent with USPAP and/or do not take association size into consideration.

FCWO fully supports the system comments below as outlined by the Farm Credit Council.

2. The Proposed Rule

a. Risk Tolerance and Other Credit and Lending Factors

Lending is based on the five C's of credit, which includes collateral appraisals and evaluations. The Proposed Rule, however, does not seem to take the other considerations into account or appreciate the interrelationship between these factors when making lending decisions or allow for any proper and reasonable delineation of transactional risk and size for System institutions. The Proposed Rule also imposes many requirements on the collateral appraisal and evaluation process that should be credit considerations rather than collateral considerations. Each System institution has its own unique risk appetite depending on many different factors, including its size, capital, and portfolio diversity, and each System institution is required to establish and maintain procedures that satisfy existing FCA regulations and the five C's of credit and reflect appropriate risk tolerance, as well as assure a return to shareholders. A risk-based approach allows for System institutions to meet the Farm Credit mission of improving the lives of farmers and ranchers across the nation, regardless of size and location.

b. Blanket Liens

Critically, and without any justification, the Proposed Rule requires a System institution to assign a value to all collateral, even collateral taken on a blanket lien basis.³ Blanket liens are critically important (and valuable) to a System institution (let alone any lender), are commonly obtained whenever possible, and are expressly authorized and permitted by law. By receiving a blanket lien, a System institution is allowed to tie up all available personal property (and fixture) collateral and take a priority lien on same. This allows, among other things, for maximum collateralization of a System loan.

³ A blanket lien is generally described as a security interest in, or a lien on, all of the debtor's assets.

For example, blanket liens allow for better security of specific debts, as well as all debts, that collateral can be taken for different purposes and at different points in time (*e.g.*, loan modifications, distressed loan restructuring plans, cross-collateralization), that collateral can be substituted or replaced in the ordinary course of business and otherwise, 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 is impossible to cost effectively monitor, update, and maintain over time), and that collateral can be taken to secure the entire operation, which encourages securing a broader relationship, all without assigning a value on all of same, among other things. State law requires a creditor to identify collateral with reasonable specificity and to identify all collateral being taken. *See, e.g.*, UCC § 9-108. If a System institution is unable to take a blanket lien on collateral unless it assigns a value as to each piece of collateral taken as proposed, then 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 or the security interest by failing to specify the collateral as required. In other words, a System institution would be forced to choose between compliance with the Proposed Rule, on the one hand, and maximizing its collateral security (and reduce risk) by being able to take a security interest in, or being able to place a lien on, as much property (*i.e.*, collateral) as possible, on the other hand.

No state or federal law requires a lender to value each piece of collateral taken on a blanket lien basis and doing so would not only be incredibly expensive but also incredibly impractical for a number of reasons. For example, collateral can change and evolve over time. Seeds can be taken as collateral, can then turn into become growing crops (which may constitute fixtures), can be converted into goods or inventory, and can be converted into proceeds; such collateral must be described in different ways, may require perfection in different ways and by filing in different locations, may constitute farm products and be subject to other laws, may require subordinations, and/or may be subject to different prioritizations and competing liens, if not properly described or perfected or if not made earlier in time. With these notions in mind, it is ideal, if not imperative, for a secured System institution lender to describe all of the collateral that it can possibly get, and all evolutions or permutations of such collateral, on a blanket lien basis from the outset to better ensure it remains fully and properly perfected throughout the life of the loan and to ensure that such collateral is even available.

And, because property (and its classification) can evolve over time, all of the available collateral is not (or may not be) fully ascertainable at the time it is pledged or taken; its value, therefore, may be incapable of determination at the outset of the loan. And, assigning a value to each piece of collateral at the outset may be unreasonably expensive if not impractical, especially under the requirements being proposed. The inconveniences on the System institution and the customer add to the cost and inefficiency associated with this approach, and the value and accuracy associated with each valuation is of potential limited duration for the reasons noted.

All in all, requiring a System institution to assign a value to each piece of personal property collateral is impractical, is not required as a matter of law or practice in any other context, is contrary to existing guidance and practice that allows, supports, and encourages lenders to take as much collateral as possible at the outset of the lending relationship, would be incredibly harmful, inefficient, and costly to impose, and would nullify the concept (and benefit) of taking collateral

out of an abundance of caution – all without any justification or support under existing regulations or otherwise.

c. Inconsistent with Other Laws and Guidance

The Proposed Rule is inconsistent with other FCA regulations, published guidance, or other professional rules and ignores many technological advancements made over the last decade that allow System institutions to truly meet their mission in a cost-efficient manner. There would also 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 same, all with little to no additional value to the System institution or the customer.

With an increased cost and difficulty of compliance, the Proposed Rule encourages (if not invites) a shift to more unsecured loans, which increases the lending risk on the System institution, while opening up an opportunity for another lender to make loans to the same System borrower on a secured basis (*e.g.*, if a borrower/debtor is not required to pledge collateral to the System institution lender, then it would be able to pledge collateral to another lender and take on additional debt, all increasing the risk borne by the System institution lender). Alternatively, operating costs would be increased, which effectively embeds an ongoing and reoccurring charge off in the form of reduced net income, and capital and patronage would be negatively impacted, which reduces the strength of the System institution and its competitiveness (*e.g.*, with increased costs and pricing, a System institution would be less competitive in the market and face slower rates of growth).

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 System institution (secured creditor) 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 a System institution's collateralization, 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.

d. Requirements Imposed by Other Programs or Guarantees

The Proposed Rule does not recognize the competition faced by System 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 System institutions in a difficult position competition-wise and exposes them to risk when additional collateral is needed but may no longer be available. The goals of the Proposed Rule can be accomplished through the existing rule or through published guidance without the downsides or limitations being imposed in the Proposed Rule.

e. Terminology

The Proposed Rule creates new terms and utilizes other certain terms that are confusing, misplaced, or invite ambiguity. For example, the Proposed Rule creates new classifications of collateral that are not found in Article 9 and are internally inconsistent and confusing with other terms on which System institutions must rely in order to ensure that their security interests attach, are properly perfected, and are appropriately maintained (*e.g.*, “business chattel” is not a defined term under Article 9 or other lien perfection laws and conflicts, or creates ambiguity, with other terms, such as “personal property” and consumer/non-consumer requirements and terminology). Similarly, the term “director,” which is used throughout certain provisions of the Proposed Rule, is at odds with the terminology used internally, in the regulations, or elsewhere.⁴ A “director,” as that term is ordinarily used, does not perform collateral evaluations or appraisals in connection with any transaction.

f. Loss of Flexibility

There is a certain amount of flexibility needed in the regulations with regard to appraisals and collateral evaluations to allow lending institutions to accomplish the goals of the regulations through policies and procedures – through safe and sound practices – based on their size and makeup, among other things. The Proposed Rule minimizes, if not removes, the flexibility found in the existing regulations and published guidance, including interagency guidance, by exceeding the requirements imposed by any other regulator on appraisals and collateral evaluations and by limiting the areas in which policies and procedures can supplement the regulatory requirements to accomplish the objectives of good valuation practices.

For example, in the Interagency Appraisal and Evaluation Guidelines made available through www.fdic.gov, the guidance recognizes that some separation between the lending and collateral functions may not always be possible due to an institution’s size. In such circumstances, the lending institution “should be able to demonstrate clearly that it has prudent safeguards to isolate its collateral valuation program from influence or interference from the loan production process” and ensure that those who are involved in the appraisal process are not involved in the lending approval process. *See, e.g.*, Interagency Appraisal and Evaluation Guidelines, 5000 – Statements of Policy, Art. V., Independence of the Appraisal and Evaluation Program; *see also id.*, Art. IV., Appraisal and Evaluation Program. If such flexibility were not possible, then regulators would be able to effectively eliminate an entire population of available lenders from the marketplace – *i.e.*, the smaller lending institution. Such guidance also recognizes that appraisals or evaluations may not always be needed in all circumstances and that the same regulatory risks do not exist when collateral is not required to be taken (*e.g.*, when collateral is taken as supplemental collateral or when taken out of an abundance of caution). *See, e.g., id.*, Appendix A – Appraisal Exemptions; *see also* 12 CFR § 614.4245 (existing regulation). The Proposed Rule does not recognize (or seem to allow for) such instances, which imposes costs and burdens on System institutions for which no commensurate benefit is obtained. For these and other reasons,

⁴ It is acknowledged that the term “director” is found in certain interagency guidance; however, in such circumstances, the term “director” appears to refer to a management member (*e.g.*, a Credit Director) as opposed to a member of the Board of Directors.

the Proposed Rule threatens the viability and competitiveness of certain System institutions unnecessarily and beyond the scope needed for safety and soundness.

Specific Comments

In addition to the general comments noted above, and the comments made by FCC to the Proposed Rule to the extent not inconsistent herewith, FCWO supports the following comments with regard to certain provisions of the Proposed Rule:

1. Preamble – Stated Goals and Approach to the Proposed Rule.

According to the Preamble, the objectives of the Proposed Rule are to: (i) improve the organization and readability of FCA appraisal and evaluation regulations; (ii) clarify expectations for internal controls in appraisal and evaluation practices; (iii) expand authorities on using various sources of appraisers and evaluators as well as specifically authorizing use of automated valuation tools; and (iv) update existing terminology and make other grammatical changes. FCC agrees that the stated goals are goals worth achieving with regard to collateral evaluation requirements and other laws; however, FCC believes that the Proposed Rule invites more challenges than it purports to resolve and believes that the existing regulations along with USPAP and other applicable authority provide better guidance for the System with regard to evaluation and appraisal requirements for the reasons set forth in this comment.

2. Proposed 12 CFR § 614.4240 Definitions.

a. 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 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. Advisory Opinion 18 (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.” USPAP Advisory Opinions, AO-18. 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.

b. 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 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.

c. 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 the guidance imposed on other regulated lending institutions in this regard.

3. Proposed 12 CFR § 614.4245 General.

a. 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 lien hold interest.” Proposed Rule 12 CFR § 614.4245.

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 System institution but may also have a cost benefit to the customer in the form of potentially more competitive pricing.

Requiring all collateral taken as security to be valued does not take into consideration any *de minimis* values, which are especially important when valuing chattel under blanket lien purposes. If all collateral is required to be valued as contemplated under the Proposed Rule, then the accuracy, cost, and convenience associated with such appraisals or evaluations and the appraisal process would be sacrificed. 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 System institution and the customer (*e.g.*, the time it would take to value such collateral and complete the required report(s) and the burden it would impose on the customer).

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

Current practice, by comparison, allows for exclusions based on value to ensure an effort and risk return and to allow for appraisals and evaluations to be made consistent with both the size and risk inherent in the transaction. Requiring an evaluation in every instance would drive up the cost of borrowing, including the cost to young, beginning, and small borrowers, leasing and loan transactions, and loan syndications, loan participations, and other secondary market purchases, where a lot of work has been done to diversify System institution portfolios for safety and soundness and to allow System institutions to be relevant players in these areas.

Collateral is just one of the five factors of credit considered in making loan decisions. With regard to 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 is further challenged when considering collateral is not the primary repayment source of the loan and is a secondary source of repayment.

For at least these reasons, this provision represents an incredible and unnecessary cost and burden on the System without any precedent cited for same.

b. 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 System institution should have procedures for determining when and whether appraisals and evaluations may be 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. Such limitation swallows the rest of the Proposed Rule whole.

In many (if not 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 the acceptable risk at time of origination, considering loan paydowns occurring, it may be unusual for agricultural property values in a current market condition to significantly deteriorate ahead of the paydown, depending upon the terms and conditions of the loan. And, with many agribusiness and more complex loans, the terms and conditions of the loan are adjusted to reflect the risk in the loan, 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 System institutions to determine the frequency of appraisals or collateral evaluations in many respects, and System 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 needed or otherwise appropriate, with appropriate guidance supporting same based on the type of collateral, the amount at issue, and USPAP-compliance, among other things.

c. 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.” Proposed Rule 12 CFR § 614.4245(d). This provision is inconsistent with published guidance and invites other considerations for the System institution.

First, current regulatory guidance is consistent with USPAP and other regulatory requirements when it comes to the use and purpose of an appraisal. Such consistency is important as the requirements must work together to provide a sufficient framework where qualified and reputable vendors (appraisers) are able to provide a USPAP-compliant report that satisfy the System institution’s regulatory requirements, without further limiting persons who can provide appraisals for the System.

Second, USPAP is very clear that a party receiving a copy of an appraisal report in order to satisfy disclosure requirements does not become an intended user of the appraisal and that appraisal reports need only contain sufficient information to enable the intended user(s) to understand the report. The Proposed Rule ventures beyond USPAP's requirements and imposes an obligation that the report satisfy any "reader" of the report, including any future, unknown reader. This simply 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 System institution, as the intended user. Exceeding the requirements of USPAP in this regard could 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.

Third, the obligation to obtain an agreement to transfer an appraisal goes beyond the requirements of any other Federal Financial Institution Regulatory Agency, putting the System institution at a distinct disadvantage. For many reasons, including business and legal reasons, the likelihood that another lending or financial institution (*e.g.*, an OFI) would agree in writing to transfer an appraisal report is very remote and would run afoul of USPAP. The consequence of this requirement will be increased costs to the borrower for an additional appraisal and increased time to close the loan transaction.

Further, the Proposed Rule conflicts with other provisions, 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, and be inconsistent with, other regulatory requirements and guidance, including 12 CFR §§ 617.7300, *et seq.*, and 618.8300, *et seq.*

d. Releasing Appraisals or Evaluations to Applicants and Borrowers.

The Proposed Rule in 12 CFR § 614.4245(e) provides guidance on releasing appraisals or evaluations to applicants and borrowers.

First, this provision is unnecessary and conflicts with the guidance contained in 12 CFR § 618.8325(b), which sufficiently (and consistently) addresses the circumstances under which collateral evaluations must be provided to the borrower.

Second, the requirements contained in this provision invite significant cost increases on the real estate side without greater clarification, and an evaluation of a blanket lien on all assets relies on the standard of least cost model with greater adaptability, which is needed to serve this industry outside any required fair market value conclusion. Specifically, in this provision of the Proposed Rule, a System institution would be required to provide a "copy of an appraisal or evaluation" that contains, "at a minimum," the "final opinion of value, the information required under [12 CFR § 614.4245(b) of the Proposed Rule], and, as appropriate to the type of asset being valued, the information required under [12 CFR § 614.4260 or 12 CFR § 614.4265(d), (e), and (f) of the Proposed Rule]." Proposed Rule 12 CFR § 614.4245(e). For at least the reasons noted in this

comment, such level of detail and such level of valuation should not be required in all instances. And, requiring that a System institution provide a copy of an appraisal or collateral evaluation that satisfies all of these conditions, regardless of the reason for taking the collateral or the credit involved, is the proverbial tail that wags the dog. In other words, to satisfy this provision, a System institution would have to ensure that all appraisals and collateral evaluations meet all of these proposed requirements when credit or risk factors or other guidance would not otherwise require such an appraisal or collateral evaluation to be made. The cost of meeting such a requirement is not warranted in most (if not all) circumstances, and the Proposed Rule exceeds not only the requirements imposed under existing FCA regulations but also other regulatory requirements that may apply to the same credit, as well, such as the Equal Credit Opportunity Act. *See, e.g.*, 12 CFR § 1002.14.

Finally, the proposed turnaround time on releasing valuation documentation (*i.e.*, seven days) also places an increased burden on System institution processes and conflicts with other regulations that provide for the qualified lender to provide the requested evaluation “as soon as practicable” (under 12 CFR § 618.8325(b)), which can vary depending upon the facts and circumstances associated with the request, or “promptly upon completion [or within three business days prior to consummation or the transaction], whichever is earlier” (under 12 CFR § 1002.14(a)). *See* 12 CFR § 618.8325(b); 12 CFR § 1002.14(a).

The inconsistencies and burdens created by this proposed provision exceeds any benefit to be gained.

4. Proposed 12 CFR § 614.4250 Policies, Standards, and Internal Controls for Valuing Collateral.

The Proposed Rule in 12 CFR § 614.4250 provides for new and additional requirements concerning policies, standards, and internal controls regarding valuations of collateral. Such requirements impose burdens on the System institution that are not seen or imposed under other regulations concerning other lending institutions.

In the Proposed Rule, FCA has made one request for comment on the potential conflict between proposed 12 CFR § 614.4250(c) and existing 12 CFR § 618.8430 with regard to internal controls. The Proposed Rule is prescriptive with a directive of “how” management should establish internal controls over the collateral function. By comparison, 12 CFR § 618.8430 requires internal controls over the function; however, it allows a System institution to determine how to establish and maintain an effective internal control environment. The Proposed Rule requires specific internal control mechanisms that may or may not fit the size and complexity of each System institution’s business model. This provision, therefore, would outstrip the purpose and existing guidance of 12 CFR § 618.8430 and would threaten to upset how System institutions develop, maintain, and test their internal control environment, creating an anomaly for appraisals and collateral evaluations alone.

5. Proposed 12 CFR § 614.4255 Appraiser and Evaluator Qualifications and Independence.

The Proposed Rule in 12 CFR § 614.4255 relates to appraiser and evaluator qualifications and independence. While appraisers and evaluators should be qualified and independent, the Proposed Rule imposes burdens beyond those under existing regulations without any support for why such proposed changes are needed.

For example, the Proposed Rule also requires a robust secondary review process of staff who are not completely independent of the credit decision either before credit approval or soon after closing. Such a requirement would represent an additional burden to review if the appraisal or evaluation was performed outside of the appraisal or evaluation team.

This provision also does not seem to take into account the size of the System institution, the availability of resources, standards of conduct, vendor management, or the ability to demonstrate independence and competence in ways other than those prescribed in the Proposed Rule, among other things. Such a single lane approach places burden on System institutions of various sizes and in various locations, making compliance more difficult without any commensurate benefit being obtained or demonstrated.

6. Proposed 12 CFR § 614.4260 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 a number of new prescriptions and requirements that appear to come at a significant cost and impair a System institution's discretion regarding the valuations needed with regard to a particular loan or credit, including its risk profile.

For example, this provision impairs a System institution's ability to use its discretion to address the question of "how much is enough information to arrive and document an adequately collateralized valuation conclusion" on chattel collateral evaluations. Commercial banks and other regulated lending institutions all have discretion to arrive at risk-based underwriting standards under their existing guidance, and current FCA regulatory guidance provides for similar discretion with regard to such evaluations.

There also could be significant cost increases associated with reporting in this new format, especially with regard to AVM's, with little to no additional value being observed or realized by the System institution or the customer. The costs and prescriptions invited by these proposed changes could invite a shift to more unsecured loans, which impacts risk, where other lenders, *e.g.*, are able to make secured loans to the System institution's unsecured customers. Alternatively, operating costs to the System institution will be increased, which effectively increases the cost and pricing of lending and System institution overhead and/or embeds an ongoing and reoccurring charge off in the form of reduced net income. Capital and patronage will be negatively impacted. If the cost to lend in the System is increased, then the System institution's ability to compete becomes more difficult, which impacts (if not impedes) growth, creates lost opportunities

for the System and each of its System institutions, and may ultimately challenge sustainability, especially for smaller System institutions.

7. Proposed 12 CFR § 614.4265 Valuing Real Property.

The Proposed Rule in 12 CFR § 614.4265 relates to valuing real property collateral. The proposed changes contained in this provision of the Proposed Rule exceed the regulatory requirements imposed on any other regulated lending institution without any explanation or benefit associated with such limitations. Each and every additional burden being prescribed reflects an additional cost or loss for the System institution, 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 proposes to continue the current *de minimis* levels of \$250,000.00 established in the 1990's with regard to consumer loans, while other banking regulations have moved the *de minimis* amount to \$400,000.00 for consumer loans and \$500,000.00 for commercial real estate loans. Maintaining a reduced *de minimis* level of \$250,000.00 on consumer loans as compared to other lending institutions places System institutions at a comparative disadvantage from a cost and convenience perspective, especially given the burdens and costs associated with other regulatory changes being proposed. At the very least, the \$250,000.00 threshold for real estate transactions that require an appraisal should be increased to \$400,000.00 for residential real estate transactions and \$500,000.00 for commercial real estate transactions to be in line with the thresholds established by other regulated lending institutions for the same or similar loans. FCC believes that this change would provide a meaningful burden relief from existing appraisal requirements without posing a threat to the safety and soundness of System institutions.

The Proposed Rule also 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," whereby "abundance of caution" collateral is recognized as being that which was not needed for the support of the credit decision (revenue or collateral) or needed for regulatory or other compliance. The Proposed Rule can impact the customer and the various System institution's overall risk profile in, 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 System institution or the System as a whole; (iv) diminishing competition by not adjusting *de minimis* levels to align with other regulatory agencies; and (v) limiting proactive portfolio risk management of obtaining blanket chattel liens, especially for smaller lending relationships (specifically YBS), as System institutions are relational and cash flow lenders, not transactional and net worth lenders.

Additionally, some of the prescriptions being proposed ignore the flexibility of existing regulations or guidance that would allow a System 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, its exclusive requirement in the valuation of chattel assets is inconsistent with the industry and the broader regulated lending marketing. Similarly, the proposed changes would no longer allow a System institution to have the ability to assign classifications of collateral and adjust internal loan-to-value or margin requirements through its own policies and procedures, which allow for a better reflection of risk and market change and allow for a more appropriate examination of the System institution on a microeconomic level.

Further, some of the requirements, terms, and definitions do not provide additional guidance that are helpful in this area. For example, “material” changes to the property are equal to a new appraisal or evaluation; “adverse market conditions” should be considered in the Proposed Rule as opposed to obvious or material changes if a System institution is satisfied with the value in an existing appraisal; “determining value” is unnecessary and is already addressed within USPAP, and requiring this level of development for evaluations impairs many of the efficiencies inherent within alternative valuation solutions to an appraisal; and “additional report content requirements” is overly burdensome and unnecessary as it is addressed within USPAP, and these requirements, in particular, will cause significant delays and will far exceed the appraisal or evaluation requirements of other regulated lending institutions.

With regard to appraisals that are subject to USPAP, System institutions and appraisers alike should be able to rely on USPAP for current appraisal practices as it evolves and is vetted through a lengthy public exposure process (*e.g.*, traditionally, every two years). Seemingly similar appraisal practice language codified in FCA’s regulations today may starkly contrast with future USPAP requirements, placing appraisers in conflict with laws or standards that regulate their licensure and professional requirements. And, 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, as improved, which are reported as one value, such as a ranch property.

In short, with the changes proposed in this provision of the Proposed Rule, the System institution is faced with choosing compliance at a cost, with a burden that makes lending more costly and more inefficient and makes the System institution less competitive, on the one hand, or choosing to make more unsecured loans to avoid the enormous burdens associated with new requirements and unnecessary prescriptions that supplant existing internal guidance that recognizes risks and reward – a balance favoring loan control versus value control, on the other hand. In the context of appraisals and collateral evaluations, the System would be better served by continuing to operate under existing FCA guidance or match-pair with regulations and guidance (*e.g.*, USPAP) applicable to other lending institutions with whom the System competes (or who guarantees System loans) to better ensure consistency, flexibility, and safety and soundness, without placing the System at a competitive disadvantage.

6. Proposed 12 CFR § 614.4270 Appraisal and Evaluation Tools.

The Proposed Rule in 12 CFR § 614.4270 relates to appraisal and evaluation tools. In the background of the Proposed Rule, FCA recognizes that it “expect the lender to include controls addressing the accuracy and integrity of the inspections” when “considering how and in what

manner to conduct property inspections.” FCA also recognizes that “industry practices continue to place increased reliance on various types of technology to enhance or replace the physical inspection process.” As with FCA, FCC 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, unlike the Proposed Rule, FCC 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 an appraiser or chattel evaluator. AVM’s 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 provided model guidance on expectations for testing, validation, and documentation with regard to AVM’s and other tools, which allow for their permissible use under existing regulations.

Further, 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 certain aspects of 12 CFR § 614.4270. Alternatively, 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, cost increases could be significant and well in excess of the potential benefit of physically verifying assets, especially in smaller-sized or lower-risk transactions. Additionally, the lending process may be slower, non-competitive, and financially burdensome to the borrower (and/or the System institution). 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, when appropriate, is USPAP compliant.

In addition, the Proposed Rule has the potential to stifle young, beginning, and small farmer and rancher lending activity at a time when System institutions are looking for ways to expand lending in this area in a cost-effective manner that is founded on a risk-based approach. This can be better accomplished in many respects through the use of tools and technologies in accordance with good practices and clear guidance, which are subject to examination for safety and soundness.

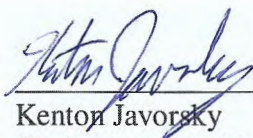
Finally, the proposed definition of AVM introduces a lack of clarity on whether an appraiser or evaluator may rely upon an AVM as the basis for an appraisal or evaluation if the appraiser or evaluator believes the output to be credible for use as allowed by USPAP (*e.g.*, Advisory Opinion 37 of USPAP). The Proposed Rule also does not utilize the term or 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 evaluator, on the one hand, and the use of an AVM, as a tool, on the other. The term AVM should be re-defined and/or the commentary in this regard should be removed.

In short, the 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.

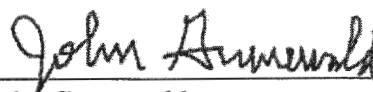
Conclusion

FCWO appreciates the opportunity to comment on the Proposed Rule and to present some of its concerns to FCA for its consideration. For at least the reasons stated herein, FCWO respectfully requests that FCA withdraw the Proposed Rule. Alternatively, FCWO requests 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.

Sincerely,



Kenton Javorsky
Chairman of the Board
Farm Credit of Western Oklahoma



John Grunewald
President/CEO
Farm Credit of Western Oklahoma