FARM CREDIT
COUNCIL

April 24, 2023

Joseph T. Connor, *Acting Director*
Office of Secondary Market Oversight
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Response to Advance Notice of Proposed Rulemaking – *Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Risk-Based Capital Requirements*, Farm Credit Administration, Agency; 12 CFR Part 652; RIN 3052–AD51; 88 FR 4107 (Jan. 24, 2023)

Dear Mr. Connor:

On behalf of Farm Credit System ("System") funding banks and associations, Farm Credit Council ("FCC") appreciates the opportunity to comment on the Farm Credit Administration's ("FCA") Advance Notice of Proposed Rulemaking ("ANPRM") that was published in the *Federal Register* on January 24, 2023, relating to the risk-based capital requirements of the Federal Agricultural Mortgage Corporation ("Farmer Mac"). *See* 88 FR 4107.

In response to FCA's ANPRM on Farmer Mac's regulatory capital framework, FCC assembled and coordinated a multi-disciplinary System workgroup of experts ("Workgroup"), representing System associations and banks, who met over the course of several weeks to analyze and comment on FCA's inquiries in the ANPRM based on, among other things, existing FCA regulations, published guidance, and experiences with, and knowledge of, regulatory capital requirements, the relationship between Farmer Mac and other System institutions,[1] the Basel Framework (as defined below), and safety and soundness considerations. This endeavor included direct outreach to all System regulatory contacts to solicit individual institution inputs and suggestions as each such institution may have or otherwise want to present in response to the opportunity presented. A draft comment letter was circulated to all System associations and banks for review and final inputs prior to submitting this letter to FCA. This final letter represents the results of the Workgroup's efforts.

In addition to the analysis that follows, FCC expects that individual System associations and banks will submit their own comment letters to further detail their thoughts on the issue.

[1] The term "System institutions" shall mean and refer to System associations, System funding banks, and Farmer Mac and each of them.

I.
Executive Summary

Based on the inputs from the Workgroup, System associations and banks, and others, FCC believes that the regulatory capital framework for System institutions, including Farmer Mac, should be fair and consistent with the notions of the Basel Framework in its efforts to establish consistency among regulated financial institutions with regard to regulatory capital.

To this end, when considering Farmer Mac's regulatory capital requirements, FCA should: (i) consider the level of capital required in the System to sufficiently protect against reasonable expectations of business and market fluctuations, *e.g.*, while allowing the System to grow, remain competitive, and serve the mission established by Congress; (ii) determine whether additional (or other) capital requirements are needed in light of the tools available under the Basel Framework; (iii) consider the methodology utilized in determining the capital requirements of System associations and banks; (iv) utilize, where warranted, the same or similar methodology for determining the regulatory capital needs of Farmer Mac, as a System institution, in light of the market(s) it serves, without impairing other System institutions or placing them at a competitive disadvantage vis-à-vis one another and/or as compared to other regulated financial institutions; and (v) determine what can be learned from the recent banking crisis with regard to FCA's objectives under the ANPRM with regard to Farmer Mac and its regulatory capital needs.

II.
Summary of Relevant Background

A. Scope and Purpose of ANPRM

As a general measure, FCA has published an ANPRM to gather comments from the public on whether and how to amend and strengthen the regulatory capital framework in furtherance of safety and soundness of: (i) Farmer Mac's operations; and (ii) its role in promoting affordable and sustainable access to credit in agricultural and rural communities, which it carries out by providing liquidity and credit protection tools to rural lenders. According to the ANPRM, FCA's specific objectives in seeking public input on the regulatory capital framework, as applicable to Farmer Mac, are to: (i) "promote Farmer Mac's safe and sound operations through the ongoing maintenance of sufficient capital and reserves to absorb unexpected losses and support the growth and continued fulfillment of its role;" and (ii) "ensure that Farmer Mac operates under a clear, comprehensive, and transparent capital framework." *See* 88 FR at 4107.

As part of this effort, FCA had indicated that it would like inputs on: (i) "whether and how [FCA] should further incorporate elements of other established and emerging regulatory frameworks governing capital to enhance the regulatory capital framework for Farmer Mac and determine whether the application of those frameworks to Farmer Mac would require modifications to suit Farmer Mac's non-bank, rural-focused, secondary market business model, and if so what modifications would be needed; and (ii) "the costs and benefits of updating FCA's capital regulations for Farmer Mac, including the costs of potential unintended consequences, if any." *Id.* at 4107-4108.

Based on the responses received through its ANPRM effort, FCA has indicated that it will evaluate "whether and how it should adopt a capital framework similar to other recognized frameworks to enhance the safety and soundness of Farmer Mac, with adjustments as appropriate, that would take into consideration Farmer Mac's status as a secondary market financial institution focused on agricultural and rural utility markets." *Id.* at 4108.

B. Relationship between Farmer Mac and Other System Institutions

Farmer Mac is part of the System and is regulated by FCA through its Office of Secondary Market Oversight ("OSMO"). As a stockholder-owned instrumentality of the United States government, Farmer Mac is a government-sponsored enterprise ("GSE") that was established in 1988 to "create a secondary market for agricultural real estate mortgage loans and rural housing mortgage loans;" rural utility loans were later added to Farmer Mac's scope of lending. *See, e.g.,* Farm Credit Act of 1971, as amended (the "Act"), §§ 8.1 & 8.11; 12 USC §§ 2279aa-1 & 2279aa-11. Farmer Mac's role in the secondary market for agriculture and rural infrastructure loans has been likened to the roles of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") in the secondary market for housing mortgages.

In creating Farmer Mac, Congress sought to: (i) "provide a secondary market for agricultural real estate mortgages;" (ii) "increase the availability of long-term credit to farmers and ranchers;" (iii) "provide greater liquidity and lending capacity to primary lenders as they extend credit to farmers and ranchers;" (iv) "provide an arrangement for new lending to facilitate capital market investments in long-term agricultural funding;" and (v) "enhance the ability of individuals in small rural communities to obtain financing for moderate-priced houses." *See, e.g.,* Agricultural Credit Act of 1987, Public Law 100-233, 12 USC §§ 2279aa note.

FCA is responsible for the oversight and supervision of the safety and soundness of Farmer Mac's operations and the purposes it serves. *See* 88 FR at 4108. As part of its charge, FCA must consider the sufficiency of capital of the financial institutions it supervises, whether directly or through OSMO, which would include Farmer Mac. Sufficiency of capital helps to: (i) maintain safe, sound, and effective operations; (ii) absorb losses; (iii) protect against excessive asset growth; (iv) provide protection to debt investors; and (v) promote public confidence in the System. Due to the importance of capital in these and other regards, financial institution regulators have moved toward standards and measurements that provide and promote more transparency in capital adequacy and the ability to compare financial strength of the financial institutions they regulate. *See, e.g., id.*

In 2010, the Basel Committee on Banking Supervision ("BCBS") updated guidance relating to the Basel III framework, which was an internationally agreed-upon set of measures developed in response to the financial crisis of 2007-2009, in an effort to strengthen the regulation, supervision, and risk management of banks. Since then, the reforms made have been consolidated into what is now referred to as the "Basel Framework," which comprises all of the current and forthcoming BCBS standards. *See, e.g.*, http://www.bis.org/basel_framework/index.htm. The BCBS is made up of representatives from the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), and the Federal Deposit Insurance Corporation ("FDIC")(collectively referred to as the "FBRAs").

The Basel Framework seeks to strengthen the quality and quantity of a financial institution's capital primarily in one of two ways: (i) calculating risk-weighted assets for credit risk (known as the internal ratings-based ("IRB") approach, which includes the advanced IRB approach ("A-IRB") approach and the foundation IRB approach); and (ii) the standardized approach. *See, e.g.*, Basel Framework at CRE20.1 and CRE20.2 (version eff. Jan. 1, 2023); 88 FR at 4108. It also seeks to strengthen international capital standards on regulatory capital, as well. By making capital and related disclosure requirements more comparable between financial institutions, it is thought that improvements to market discipline may be obtained. *See* 88 FR at 4108.

Under the IRB approach, a financial institution calculates risk weights by "using its internal risk rating assignments, probabilities of default, and other inputs derived from its internal models." *See id.*; Basel Framework at CRE 30 through CRE 36. Under the standardized approach, a financial institution assigns fixed risk weights to exposures based on their relative risk characteristics. *See* 88 FR at 4108; Basel Framework at CRE 20.

The FBRAs adopted the Basel III framework to apply to the banking organizations they regulated in the United States (the "U.S. rule") in 2013-2014. The U.S. rule applies the A-IRB approach to the largest, internationally-active banking organizations, and the standardized approach to smaller banking organizations. *See* 12 CFR § 3.1(c)(3) (OCC); 12 CFR § 217.1(c)(4) (FRB); 12 CFR § 324.1(c)(3) (FDIC). However, under the U.S. rule, the largest banking organizations are also required to calculate their capital ratios under the standardized approach, ultimately requiring them to comply with whichever approach requires them to hold more capital.

Approximately two years later, FCA adopted a rule for System associations and banks comparable to the standardized approach of the U.S. rule, as appropriate, in light of their cooperative structure, GSE status, and mission, incorporating key aspects of the Basel III framework. *See* 81 Fed. Reg. 49720 (Jul. 28, 2016). FCA made revisions to the rule in 2021. *See* 86 Fed. Reg. 54347 (Oct. 1, 2021). The Federal Housing Finance Agency ("FHFA") followed the approach taken by the FRBAs in 2020 and 2022 and applied those to Fannie Mae and Freddie Mac. FCA has likened Farmer Mac to Fannie Mae and Freddie Mac in that they are all GSEs who serve as an important resource for liquidity in normal market conditions and as a critical resource for primary lenders under more stressful market conditions.[2]

Given the role of Farmer Mac, its safety and soundness are seen as key components to the overall safety and soundness in the System. In 2013, FCA adopted the capital planning rule with

[2] Since 2008, Fannie Mae and Freddie Mac have been in conservatorship status with their regulator as a result of the significant deterioration in the housing market in the subprime mortgage crisis. They, therefore, are not yet operating under the capital rule adopted by FHFA. It is anticipated, however, that they will operate under that rule when the conservatorship status ends.

regard to Farmer Mac, which included certain aspects of the Basel III framework and focused on, among other things, the capital planning process, board responsibilities for approving that process, and the required elements of the capital plan. *See* 12 CFR part 652 subpart B. Under that rule, Farmer Mac's capital plan must include a Basel-based tier 1 ratio, using tier 1 capital that satisfies the Basel III Framework definitions or the U.S. rule, using a risk-weighted assets approach in light of Farmer Mac's operations and activities, and requiring reports to FCA on other capital measures in accordance with an agreed-upon schedule. *See* 12 CFR § 652.61(b). Farmer Mac voluntarily discloses its: (i) tier 1 capital ratio in its Securities and Exchange Commission ("SEC" under the A-IRB approach) filings; and (ii) board-approved capital policy, which includes a 2.5% buffer above its minimum tier 1 capital ratio. *See, e.g.*, Farmer Mac's June 30, 2022 10-Q and December 31, 2021 10-K filings. *See generally* https://www.sec.gov.

Capital requirements have changed since 2013, with U.S. regulators making adjustments or enhancements to the capital required of its lending institutions, and Farmer Mac's business has become more complex in terms of volume, scope, and complexity.

C. Farmer Mac's Current Business Operations

With regard to its agricultural finance activity, Farmer Mac "purchases eligible loans directly from lenders, provides advances against eligible loans by purchasing obligations secured by those loans or assets that qualify as eligible agricultural real estate collateral, securitizes assets and guarantees the resulting securities, and issues long-term standby purchase commitments for eligible loans." 88 FR at 4109. And, with regard to its rural infrastructure financing activities, Farmer Mac "purchases, or commits to purchase, and guarantees, qualified rural electric and telephone utility loans, or securities backed by such loans, directly from cooperative lenders." *Id.* Since 2001, Farmer Mac has grown its total program volume to $23.6 billion, with an average growth of 9.0% per annum, 75% of which has been in agricultural finance and 25% of which has been in rural infrastructure finance. *See id.*

D. Farmer Mac's Current Capital Requirements

As Farmer Mac's regulator, FCA is authorized to provide for the "safe and sound performance of [Farmer Mac's] the powers, functions, and duties." 88 FR at 4110; *see also* the Act, § 8.11. Pursuant to Section 8.32 of the Act, FCA is required to "establish a risk-based capital test to determine the amount of regulatory capital that would be sufficient for Farmer Mac to maintain positive capital during a 10-year period under certain specified circumstances" and Section 8.33 of the Act "established [Farmer Mac's] minimum core capital (leverage) ratios," which is the sum of par value of outstanding common and preferred stock, paid-in capital, and retained earnings, as determined in accordance with GAAP. 88 FR at 4110; *see also* the Act, §§ 8.32, 8.33, & 8.31(5).

In 2001, FCA issued regulations governing Farmer Mac's capital, implementing the risk-based capital stress test ("RBCST"), and its minimum core capital (leverage) ratios. FCA has updated Farmer Mac's capital regulations three times since 2001, with the most recent update occurring in 2011. *See generally* 12 CFR part 652 subpart B.

Pursuant to FCA's capital planning rule, Farmer Mac is required to calculate and include a Basel-based tier 1 ratio in its capital plan, and the rule includes Basel-capital related terms that are also made part of the U.S. rule. *See* 12 CFR § 652.61(b). The capital planning rule requires Farmer Mac's Board of Directors to review the robustness of its process for assessing capital adequacy, correct any deficiencies in that process, and approve the annual capital plan, *e.g*. *See* 12 CFR § 652.61(c). It also provides for an annual assessment of Farmer Mac's capital plan by FCA and requires Farmer Mac to consider the results of the stress tests it performs and FCA's annual assessment of the plan as part of Farmer Mac's capital planning process, including specific stress scenarios required by FCA. *See* 88 FR at 4110.

E. System Association and System Bank Capital Requirements

In October 2021, FCA adopted a final rule, amending the regulatory capital requirements with regard to System associations and banks, which were made part of the 2017 capital rule. *See* Regulatory Capital Rules: Tier 1/Tier 2 Framework, *Federal Register* on October 1, 2021 (86 Fed. Reg. 54347); *compare* Regulatory Capital Rules: Regulatory Capital, Implementation of Tier 1/Tier 2 Framework, *Federal Register* (81 Fed. Reg. 49720); Tier 1/Tier 2 Capital Framework Guidance, FCA BL-068 (Dec. 22, 2016).

The 2017 capital rule was viewed by FCA as comparable to the capital rules published in October 2013 and April 2014 by the U.S. banking regulatory agencies for the banking organizations they regulate (*i.e*., the U.S. rule), which follow Basel III, when adjusted, as appropriate, for the System's cooperative structure, status as a GSE, and its mission in providing a dependable source of agricultural and rural credit and related services. The goal of that rule was to: (i) improve the quality and quantity of System institution capital and enhance risk sensitivity in calculating risk-weighted assets; (ii) provide a more transparent picture of System institution capital to the investment-banking sector, which could facilitate System institution securities offerings to third-party investors; and (iii) comply with section 939A of the Dodd-Frank Act by proposing alternatives to credit ratings for calculating risk weighted assets for certain exposures that are currently based on the ratings of nationally recognized statistical rating organizations (NRSROs). *See* Introduction, Regulatory Capital, Implementation of Tier 1/Tier 2 Framework, *Federal Register* (81 FR 49720).

Consistent with the U.S. rule, the 2017 capital rule incorporated key provisions of the Basel III tier 1 and tier 2 frameworks and includes, among other things: (i) minimum risk-based ratios of 4.5% CET1 capital, 6.0% of tier 1 capital, and 8.0% of total capital; and (ii) a capital conservation buffer of 2.5%, with a phase-in period of 3 years, ending on December 31, 2019. However, there are differences between the System's current capital requirements and those set forth in the U.S. rule. For example, the 2017 capital rule: (i) requires a tier 1 leverage ratio of 4.0%, of which at least 1.5% must be unallocated retained earnings (URE) and URE equivalents (*i.e*., nonqualified allocated surplus that is never revolved), as compared to the U.S. rule's minimum tier 1 leverage ratio of 4.0% with no minimum URE requirement; (ii) requires a tier 1 leverage buffer of 1.0%; (iii) does not include all accumulated other comprehensive income (loss) (AOCI) in CET1; and (iv) does not include any other Basel III or U.S. rule transition periods. *See id.*; 12 CFR §§ 628.1, *et seq.*

III.
<u>General Comments</u>

As part of the ANPRM, FCA has asked for input on 10 proposed questions. FCC, through the efforts of the Workgroup and the inputs of others, thought it would be helpful to provide some general comments up front, to better frame its responses to the questions presented below.

First and foremost, the regulatory framework should be fair and consistent for Farmer Mac and other System institutions in terms of methodology and thought, and the notions (and goals) of the Basel Framework support consistency, where possible, among regulated financial institutions. That is not necessarily the case now. In comparing the cost of regulatory capital between System associations and banks, Farmer Mac, and other regulated financial institutions in the United States, System associations and banks are paying far more, disproportionately, than other regulated financial institutions.

This is not to suggest that Farmer Mac pay more or shoulder a higher capital requirement; instead, it is meant to communicate that considerations should be made on applying the Basel Framework to System banks, associations, and Farmer Mac in a consistent manner to ensure that the mission is effectively served in all chartered lending territories. In short, the capital requirements, as applied to the System, should have the same, proportionate impact and accomplish the same goals across, among, and between all System institutions, when compared to other regulated financial institutions, not be disproportionately burdened as to threaten the ability to make available and provide access to reasonably priced agricultural and rural credit.

Second, when considering the capital requirements under which Farmer Mac operates or should operate, FCA should be sure that it is able to justify the cost of regulatory capital and why the level of capital being proposed or required is warranted, not only as to a particular segment of the System (*i.e.*, Farmer Mac) but across the entire System and each of its institutions. Otherwise, the unequal capitalization that results put some System associations and banks in an unfair position and may encourage unhealthy risk taking and/or discourage participations, syndications, or other relationships with Farmer Mac, in particular, and within the System as a whole.

Third, the Basel Framework has tools that allow financial institutions to adjust to market fluctuations. Annual assessments, stress tests, and capital planning all permit for adjustments to be made periodically, in real time, and on a per System institution basis, if and as needed, and examination activity and buffers are intended to capture this to some degree. FCA should consider the capital requirements needed to support System institutions in light of reasonable expectations of business and market fluctuations, *e.g.*, and whether additional capital requirements are needed in light of the tools available under the Basel Framework.

Fourth, over time, regulatory benchmarks, which create buffers on buffers, and other limitations and constraints have been added to minimize risk in the System, even where none may have been shown to exist. The System has evolved over time, as well, through, among other things, changes in lending practices, combining production credit associations with federal land credit associations and operating under an agricultural credit association model, and utilizing distressed lending and borrower rights to help better identify, address, and resolve distressed debts and reduce portfolio risk, while promoting the mission. As a result of these and other changes, less risk exists in the current System structure and its underwriting than before, with more options to address and minimize deteriorating and non-accrual debts.

Fifth, as it stands, the capital requirements under which System institutions operate must avoid impairing the System's ability to serve the mission. Higher capital requirements (and capital ratios) limit the ability for System institutions to grow to meet customer demand. They limit volume in terms of what can be held and in terms of how much volume can be added. They affect pricing to customers. Higher capital requirements may cause restraints on types of agricultural operations and borrowers that can be supported and may result in areas or operations that are underserved. These and other unintended consequences should be appreciated and avoided.

Last, as prior banking sector crisis events have illustrated, capital can be fragile if not effectively managed or where institutions are allowed to operate without sufficient buffers. The total equity of Farmer Mac was 4.83% and 4.65% of total assets as of 12/31/2021 and 12/31/2022 respectively. We encourage FCA to carefully evaluate Farmer Mac's capital adequacy and framework to ensure it remains aligned with the overall System structure, does not encourage excessive risk taking and has the capacity to withstand severe yet plausible macro-economic and agricultural credit stress events.

IV.
<u>Questions Presented</u>

1. What core principles are most important in FCA's consideration of whether capital regulations governing Farmer Mac should be more closely aligned with any of the existing capital frameworks?

When considering whether to align capital regulations governing Farmer Mac with existing capital frameworks, it would be recommended that FCA consider the core principles under which the System must operate, including safety and soundness, proportionality, consistency, market discipline, and domestic/international standards.

Specifically, FCA's primary responsibility is to ensure the safety and soundness of the System institutions it regulates. FCA should consider whether aligning capital regulations with an existing framework would enhance Farmer Mac's ability to manage risk and maintain its financial stability.

FCA should aim to ensure consistency in its regulations and supervisory practices and consider whether aligning Farmer Mac's capital regulations with an existing framework would help to promote consistency across the System institutions it regulates, which compete in the same marketplace for credit. The System has directly benefited from the application of the Basel III principles by providing disclosures that provide the consistency expected by our shareholders, bondholders, rating agencies, and other interested parties. Since Farmer Mac provides financial services to the same constituency as the System, it is particularly important for investors and other interested parties to have confidence in the consistency of financial information presented.

FCA should: (i) consider whether aligning Farmer Mac's capital regulations with an existing framework would promote greater transparency and disclosure, which could enhance market discipline; (ii) take into account domestic and international standards and best practices in its regulatory framework; and (iii) consider whether aligning Farmer Mac's capital regulations with an existing framework would be consistent with relevant domestic and international standards and best practices. Uniquely, Farmer Mac holds significant off-balance sheet obligations, which necessitate specific attention. Applying the Basal III framework principles could potentially address these issues.

2. What unintended consequences, if any, could result from the application of any of the existing capital frameworks to Farmer Mac?

Depending on the specific capital framework chosen, the application of existing capital frameworks to Farmer Mac may result in higher capital requirements that would restrict Farmer Mac's ability to meet its mission. This could reduce the amount of capital available to support its operations and growth, potentially limiting its ability to provide credit and liquidity support to agricultural lenders and rural communities, which would impact the mission and purpose of System associations and banks.

Further, applying an existing capital framework to Farmer Mac that is not sufficiently tailored to its unique risks and operations could result in reduced flexibility for Farmer Mac and adversely impact its ability to enter standby purchase agreements with other financial institutions, including other System institutions.

Also, applying an existing capital framework to Farmer Mac could: (i) increase its regulatory burden, resulting in increased regulatory compliance costs, without a commensurate benefit to safety and soundness; (ii) reduce Farmer Mac's competitiveness, resulting in the loss of market share and profitability; and (iii) lead to unintended risk-taking, adversely impacting the safety and soundness of Farmer Mac, as well as invite potential risks to broader agricultural credit markets.

In short, unintended consequences could potentially result from applying an existing capital framework to Farmer Mac if the risk that exists in the assets held on Farmer Mac's balance sheet and in off-balance exposures is not accurately identified and appropriately risk-weighted. This risk identification process could result in under or over-capitalization if not carefully considered and consistently applied. Investors and other interested parties may rely on information that is not comparable among secondary market lenders or the System and ultimately misprice the risk, either up or down.

3. Should FCA consider requiring Farmer Mac to comply with the standardized approach, the IRB approach, or both? If so, which approach or approaches should Farmer Mac be required to comply with, and why?

The decision of whether FCA should require Farmer Mac to comply with the standardized approach, the IRB approach, or both would depend on several factors. The standardized approach is a simpler and more straightforward method for calculating regulatory capital requirements, while the IRB approach is more complex and requires more data and expertise but has the potential to provide a more risk-sensitive and accurate measure of capital adequacy.

In the U.S. Rule, the Collins Amendment creates a significant difference as compared to the European Central Bank's ("ECB") implementation of the Basel Accord. There is no financial incentive for banks under the U.S. Rule to opt into an advanced approach. Due to the Collins Amendment, U.S. regulated institutions using the Basel Framework are required to use the greater of the two risk-weighted asset calculations. Thus, even if it provides the potential for a more risk-sensitive and accurate measure of capital, it is only used if it produces a higher capital requirement.

In contrast, should it produce a lower capital requirement in comparison to the standardized approach, it is to be ignored. As a result, banks are left with higher internal operational costs and flat-to-higher capital requirements. If FCA requires calculating both, then it should adopt the guidance from Basel III: "Finalising post-crisis reforms, BCBS, Standards," 07 December 2017 with regard to output floors. If adopted, then such guidance would allow financial institutions to utilize lower risk weights than calculated under the standardized approach so long as it does not go below the floored requirement amount that is derived from the standardized approach. This would align with the most recent Basel guidance; provided, however, as a result of the Collins Amendment, it would not align 100% with the U.S. Rule.

The System's regulatory framework applies Basel III principles, and the System has directly benefited from this regulatory capital framework. In developing this framework, FCA and System representatives worked in a collaborative manner to determine the appropriate approach for regulatory capital compliance and disclosures taking into account the System's unique cooperative business model prior to proposing new regulations. A similar approach would seem to make sense here, where FCA would approach Farmer Mac prior to proposing a new capital framework and take into account, among other things, Farmer Mac's unique secondary market business model and its relationship with, and impact on, other System institutions. By applying a collaborative approach, which allows for the open exchange of ideas, FCA would be in a better position to determine whether the standardized approach, the IRB approach, or a combination of the two is an appropriate fit for Farmer Mac. With either approach, it is the risk-weighting of assets and off-balance sheet exposures that are critical to the results in calculating the regulatory capital ratios.

4. What adjustments, if any, should FCA consider to tailor the standardized approach or an IRB approach to take account of Farmer Mac's smaller size, more limited financing authorities, or other unique aspects of its business model?

Farmer Mac, as a GSE and secondary market financial intermediary, has a unique business model. As a result, any decision to apply the standardized approach and/or an IRB approach must take into account all of the unique aspects of Farmer Mac's business model to achieve the transparency, consistency, and comparability principles embedded in the Basel III regulatory framework. These factors could be more fully developed by using a collaborative approach as discussed above in response to Question 3.

In its deliberative process, FCA should consider adopting the output floors in the Basel Framework instead of the Collins Amendment within the U.S. Rule given the U.S. Rule Advanced Approaches Capital Framework. The U.S. Rule for IRB only applies to large, internationally-active banking organizations. Such organizations are characterized generally as those with at least $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposure.

Should this output floor be adopted, the selection should be optional for the financial institution until it reaches a certain size that FCA believes warrants it as a mandatory requirement to calculate under both. This may also be an adjustment in comparison to the U.S. Rule as its size requirements may not be appropriate for the System.

5. If FCA were to require Farmer Mac to use both the standardized and an IRB approach to calculate its risk-weighted assets, how should differences between the two approaches' results be treated with respect to capital requirements? For example, the U.S. rule and FHFA both require the use of the greater of the two risk-weighted assets calculation.

Farmer Mac, as a GSE, was created by Congress under legislation that specifically required the establishment of a risk-based capital model, which is similar to an IRB approach. However, as discussed above, it is the risk-weighting of an institution's assets and off-balance sheet exposures that that are critical to the results in calculating the regulatory capital ratios, whether through a standardized or IRB approach.

If FCA were to require Farmer Mac to use both the standardized approach and an IRB approach to calculate its risk-weighted assets, then FCA should subject Farmer Mac to a floor requirement that is applied to risk-weighted assets. This helps reduce excessive variability of risk-weighted assets, as well as enhance the comparability of risk-weighted capital ratios amongst financial institutions. An output floor would better ensure that banks' capital requirements do not fall below a certain percentage of capital requirements when derived under the standardized approach.

6. If FCA adopts Basel Framework-based requirements, should it establish floors similar to those in the existing capital frameworks? If so, what should those floors be and why? Given the differences among the risk-weight floors established in the other capital frameworks, is there a policy among them that should be considered the most readily transferrable to a Farmer Mac capital framework, or should FCA develop Farmer Mac-specific risk-weight floors?

If FCA were to adopt Basel Framework-based requirements for Farmer Mac, then it should establish floors similar to those in the existing capital frameworks.[3] Establishing risk-weight floors would help better ensure that Farmer Mac maintains a minimum level of capital adequacy, which is essential for its safety and soundness. FCA would need to carefully evaluate the costs and benefits of developing Farmer Mac-specific risk-weighted floors against the already established and readily transferrable floors in existing frameworks.

7. Should capital buffers be required for Farmer Mac and, if so, what type should FCA consider?

FCA should consider aligning requirements with other System institutions. Both domestic and international standards should be taken into account. Accordingly, the need for capital buffers should be evaluated against the Basel III principles to ensure a level playing field exists in the marketplace for agricultural and rural infrastructure loans. For comparison, System associations and banks are not only subject to capital buffers, but their loans are also capitalized at the System bank level, creating an additional capital buffer not required of other financial institutions in the marketplace, including Farmer Mac. Capital buffers can be an important tool for ensuring action to shore up any capital deficiencies before they threaten the System institution. Potentially, capital buffers could be used to require corrective actions or enhance stockholder reporting.

8. What disclosures, if any, should FCA consider requiring for Farmer Mac?

The consideration of additional disclosures would depend on changes FCA makes to the Farmer Mac capital framework. As a publicly traded financial institution, Farmer Mac is required to make disclosures that comply with the requirements of the SEC. That said, Basel III also can serve as pillars for disclosures. In particular, since moving to the Basel III capital framework, the System continues to benefit from the increased comparability of its capital measures to other regulated financial institutions when engaging with investors and the rating agencies.

9. Should FCA consider leverage ratio requirements for Farmer Mac? If so, what leverage requirements should FCA consider? Should FCA consider a leverage buffer for Farmer Mac? If so, what type and structure should FCA consider?

FCA should consider aligning requirements with other System institutions. Both domestic and international standards should be taken into account. The need for leverage ratio requirements should be evaluated against Basel III principles to ensure a level playing field exists in the marketplace for agricultural and rural infrastructure loans. By comparison, System associations and banks are subject to leverage ratio requirements at both System association and bank levels, including buffers. Farmer Mac is highly leveraged, as compared to System associations and banks, and leveraged ratios provide a check or level of comfort in addition to, or instead of, relying on risk ratios.

10. What other approaches, risk categories (e.g., market risk and operations risk, including model risk), or methodologies not discussed above should FCA consider in updating its regulatory capital framework for Farmer Mac?

[3] *See* "Basel III: Finalising post-crisis reforms, BCBS, Standards," 07 December 2017.

Based on the direction FCA takes, it may be necessary to review/update a number of risk categories since the Basel Framework covers a wide array of risks (*e.g.*, credit risk, interest rate risk, operational risk, and other risks associated with financial activities). The need for other risk categories or other methodologies should be evaluated against Basel III principles to ensure a level playing field exists in the marketplace for agricultural and rural infrastructure loans.

That said, these types of risks evolve over time and are difficult to quantify. Accordingly, using FCA's regulatory and examination authority to evaluate these risks and provide for timely risk mitigation would seem more beneficial than arbitrarily establishing capital requirements. FCA has (or should have) the ability to issue capital directives if material risk are identified and threaten capital adequacy.

V.
Other Relevant Considerations

The questions propounded by FCA address some of the relevant considerations to make when considering regulatory capital as it applies to Farmer Mac. Other considerations should also be taken into account. It would seem that, when discussing regulatory capital and considering a proposed rule with regard to Farmer Mac in this context, FCA should take into account, among other things, Farmer Mac's comparability to other System institutions and other U.S. regulated financial institutions, the approaches taken with regard to each such institution in terms of regulatory capital (and why), be consistent in approach, where warranted, and be transparent in its considerations (*e.g.*, information, disclosure, financials) and the applicability and outcome of the same, as intended by Basel III.

Also, Farmer Mac has a scope of operations that differs from most System associations and banks. In some ways, Farmer Mac complements System associations and the loans they make and the services they provide. In other respects, however, Farmer Mac competes with other System institutions. Farmer Mac's role in the lending environment has evolved and expanded over the years, becoming more involved in areas traditionally served by other System institutions, particularly in agribusiness, rural infrastructure, and other larger syndicated or participated credits made to diversify and mitigate risk. These evolving lending practice changes should be evaluated in the analysis of risk weightings utilized for capital ratio calculations.

As agricultural and rural markets evolve and change, so do the needs of the borrowers. As a result, System associations and banks are required to rethink and revisit the loans that they make and the collateral on which they rely to support those loans. This is especially true in today's post-pandemic environment, where collateral values have proven difficult at times to predict and interest rate increases create barriers to lending. For these and other reasons, FCA should consider the impact that a change in Farmer Mac's regulatory capital would have on the System, its institutions, and the mission it serves.

Finally, while Farmer Mac supports the mission of rural and agricultural lending, it has fewer restrictions and barriers to entry than most other System institutions from the perspectives of scope and eligibility, diversification of assets, source of earnings, and investments and investment holdings. Its ability to diversify in these and other respects provides Farmer Mac support that is not available to most other System institutions. Its need to rely on capital, therefore, differs from that of most other System institutions. Conversely, Farmer Mac does not have the same coverages and protections as other System institutions. For example, Farmer Mac's senior unsecured debt is not covered by FCSIC insurance, which provides another layer of credit enhancement to System associations and banks in addition to their capital, and is not rated by the rating agencies. Instead, Farmer Mac's investors rely exclusively on Farmer Mac's capital as credit enhancements to their investments. FCA should require Farmer Mac to seek and maintain ratings on its debt from at least two nationally recognized rating agencies.

VI.
<u>Conclusion</u>

We appreciate the opportunity to comment on FCA's ANPRM regarding Farmer Mac's regulatory capital framework. We trust that our comments, as well as those comments submitted by individual System associations and banks, will assist FCA in such efforts.

If you have any questions, then please do not hesitate to contact me.

Sincerely,

Robert P. Boone III

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