December 4, 2024

Autumn R. Agans, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Response to Advance Notice of Proposed Rulemaking – *Loans to Similar Entities*, Farm Credit Administration, Agency; 12 CFR Part 613; RIN 3052-AD58; 89 FR 72759 (Sep. 6, 2024)

Dear Ms. Agans:

On behalf of Farm Credit System (the "System") funding banks and associations, the Farm Credit Council (the "FCC") appreciates the opportunity to comment on the Farm Credit Administration's (the "FCA") Advance Notice of Proposed Rulemaking (the "ANPRM") that was published in the *Federal Register* on September 6, 2024, relating to similar entity lending activity. *See* 89 FR 72759.

In response to FCA's ANPRM, FCC assembled and coordinated a multi-disciplinary System workgroup of experts (the "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, the Farm Credit Act of 1971, as amended (the "Act"), existing FCA regulations, published guidance, and experiences with, and knowledge of, similar entity lending practices, congressional intent, and safety and soundness considerations. This endeavor included direct outreach to all System regulatory contacts to solicit individual institution inputs and suggestions as each 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 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 may submit their own comment letters to further detail their thoughts on the issue.

I.

Summary of Relevant Background

A. Statutory/Legislative History

Section 1.1 of the Act provides that the purpose of the Act is to improve "the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit…" by establishing "a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers…" through the provision of "equitable and competitive interest rates…." While Congress has stated numerous objectives for the System, all have a central purpose – to ensure that American agriculture has access to the credit and financial support it needs to maintain and improve upon its position as the world's most efficient and prolific agricultural industry. Congress has ensured that the System has adapted and changed to address the multiple risks facing American agriculture. One of the most drastic periods of change for the System was borne out of the farm crisis of the 1980s. At its core, this crisis resulted from a concentration of risk, primarily the plummeting values of agricultural real estate combined with record levels of farm debt, high interest rates, and historically low commodity prices.

The 1992 and 1994 Acts

It is against this backdrop that Congress, among other things, granted similar entity authority to the System, first to the banks for cooperatives in 1992,[1] then to the remainder of the System in 1994.[2] The stated purpose of the 1992 Act was "[t]o enhance the financial safety and soundness of the banks and associations of the Farm Credit System…." The 1992 Act defined "similar entity" as "an entity that, while not eligible for a loan [from the bank for cooperatives], is functionally similar to an entity eligible for [such] a loan… in that it derives a majority of its income from, or has a majority of its assets invested in, the conduct of activities functionally similar to those conducted by the [eligible] entity." The 1994 Act extended similar entity authority to the rest of the System, including to the Farm Credit banks and its associations. This act defined "similar entity" in a manner nearly identical to the 1992 Act, with the exception that a "similar entity" need only be a "person" as opposed to an "entity."

The legislative history behind the 1994 Act sheds light on Congress' intent for granting similar entity authority to the entirety of the FCS. In fact, the Chair of the House Agriculture Committee, Representative de la Garza from Texas, offered the following comments on the purpose of HR 4379, the bill that would become the 1994 Act, stating that the bill "would allow Farm Credit System banks and associations to better manage risk in their loan portfolios… [b]y authoriz[ing] Farm Credit Institutions to purchase and sell loan participations with non-system lenders, thus reducing their concentration of risk by geography and industry." Chairman de la Garza continued, noting that "the common goal of… this legislation is to help American

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[1] The Farm Credit Banks and Associations Safety and Soundness Act (the "1992 Act").
[2] The Farm Credit System Agricultural Export and Risk Management Act (the "1994 Act").

agriculture and our rural communities better compete in today's global economy." Further, the House Agriculture Committee's own analysis of HR 4379 found that a "primary benefit" of similar entity authority would be the facilitation of relationships between System lenders and non-FCS lenders, reflecting a desire by Congress that the commercial banking industry and the FCS should work together to fund American agriculture. Finally, it is worth pointing out that HR 4379 passed the House without objection.

Having passed the House, HR 4379 was taken up by the Senate. In the Senate, the bill was described as authorizing System institutions to work with commercial banks "for the purpose of improving loan management capability and reducing the concentration of risk… [and] enhanc[ing] credit opportunities for important rural ventures by… providing incentives for" cooperation and risk sharing between the System and commercial banks. Chairman Leahy stated that both the System and commercial banking sector viewed similar entity authority as helping to "reduce their concentration of loan loss risk in terms of geography, industry, and account exposure." Ranking Member Lugar also commented on the bill, finding that it "clarif[ied] legal authorities for Farm Credit institutions to manage risk…" and that it ensured that the System kept "pace with evolving banking industry practice" and reduced its risk concentration. As was the case with the House, the bill passed out of the Senate without objection.

On September 11, 1995, the FCA proposed a rule to implement the similar entity provisions of the 1992 Act and the 1994 Act (the "Rule"). This proposed rule included certain limitations on the type of similar entities to which System institutions could lend and solicited comments from the System about the possibility of including a list of types of similar entities that qualified for financing under the authority. On August 13, 1996, the FCA re-proposed the Rule, but did not include the restrictions found in the original proposed rule, nor did it enumerate the types of entities that would qualify as similar, noting "the inherent difficulty of anticipating every type of entity that might qualify…." The absence of the proposed restrictions and a list of qualifying entities reflects the FCA's understanding that similar entity authority was intended to be broad and flexible to adapt to changes in the agriculture economy. Consistent with this understanding, FCA should continue to approach the similar entity authority broadly and allow flexibility in its application by System institutions from a guidance and regulatory perspective.

Congress revisited the System similar entity authority in the 2002 Farm Bill, in which it removed territorial approval requirements for similar entity participations, making it easier for all System institutions to utilize their similar entity authority. The FCA implemented conforming changes in the Rule adopted at that time to "make similar entity participation transactions less burdensome…." Consistent with congressional intent and actions, the FCA should continue to approach similar entity authorities as diversifying risk concentrations, being broad in its interpretations, and to be less burdensome through regulatory and other guidance.

B. Financial Strength to Serve Farm Credit's Mission

For more than three decades, System entities have consistently and responsibly used similar entity lending authorities to partner with non-System entities to more fully support the agricultural value chain from producer to consumer and strengthen System entity balance sheets while diversifying earnings and portfolios geographically and across industries.

Similar entity lending has increased more than twofold since 2013, from under $10 billion to over $25 billion. As of December 31, 2023, "[t]he System had $26.3 billion in net similar-entity loan participations with non-System lenders…." Notwithstanding recent growth, as a percentage of the System's combined total assets ($507 billion), similar entity loans made up less than 5.2% and each Farm Credit institution reports compliance with the 15% threshold set forth in the Act.[1], [2] (See Figures 1 and 2).

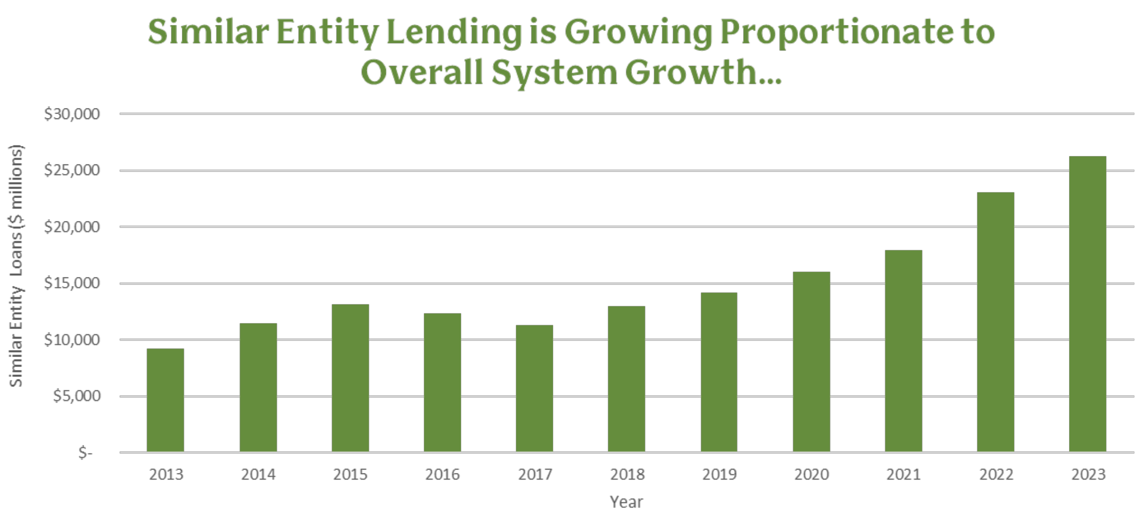

Figure 1 *(Source: FCA Call Report Data)*

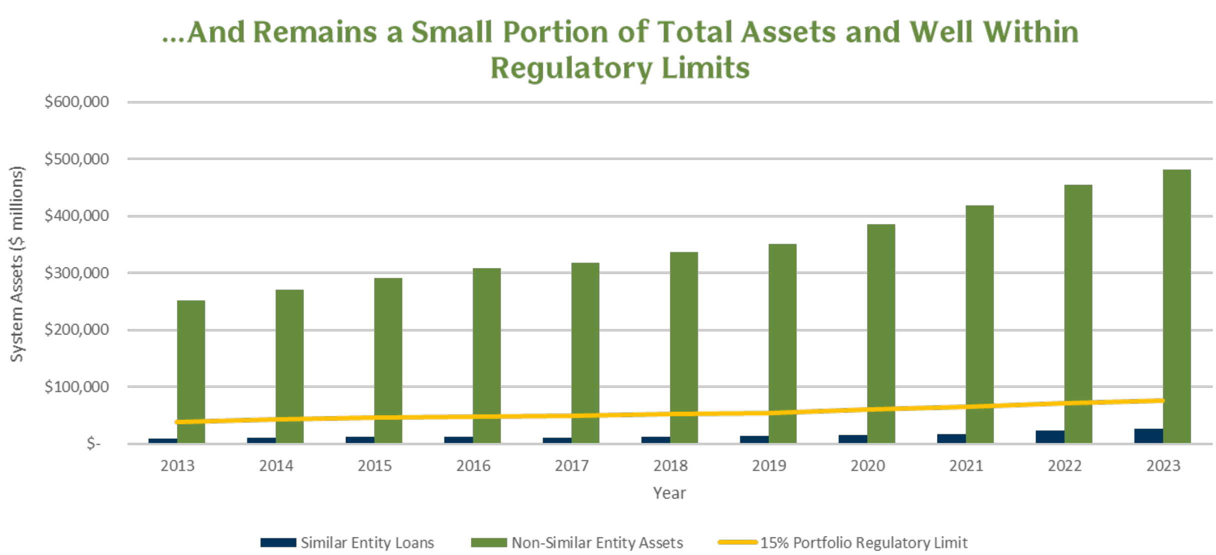

Figure 2 *(Source: FCS Funding Corp Annual Information Statements; FCA Call Report Data)*

Similar entity participations provide a highly valuable risk management diversification tool, and as such, are completely consistent with the System's mission to enhance the well-being of America's farmers and ranchers. The portfolio and earnings diversification benefits are substantial and directly contribute to the System's support of farmers and ranchers and the rural communities in which they live. Loans to qualified similar entity borrowers generate bottom-line income that provides a non-patronage-eligible source of earnings for Farm Credit institutions to retain as capital, support patronage returns to directly eligible borrower/owners, and investment in mission-based lending like young, beginning, and small producer programs.

Since 2013, the System has returned nearly $25 billion in patronage. In 2023 alone, over $3 billion in patronage was distributed to eligible borrowers, including farmers and ranchers, eligible electric generation and distribution cooperatives, water/waste disposal borrowers, agricultural cooperatives, and rural communications borrowers. See Figure 3. These patronage distributions provide significant financial support not only for the eligible borrowers in direct receipt, but also for their employees, members, patrons, and the rural communities they serve.

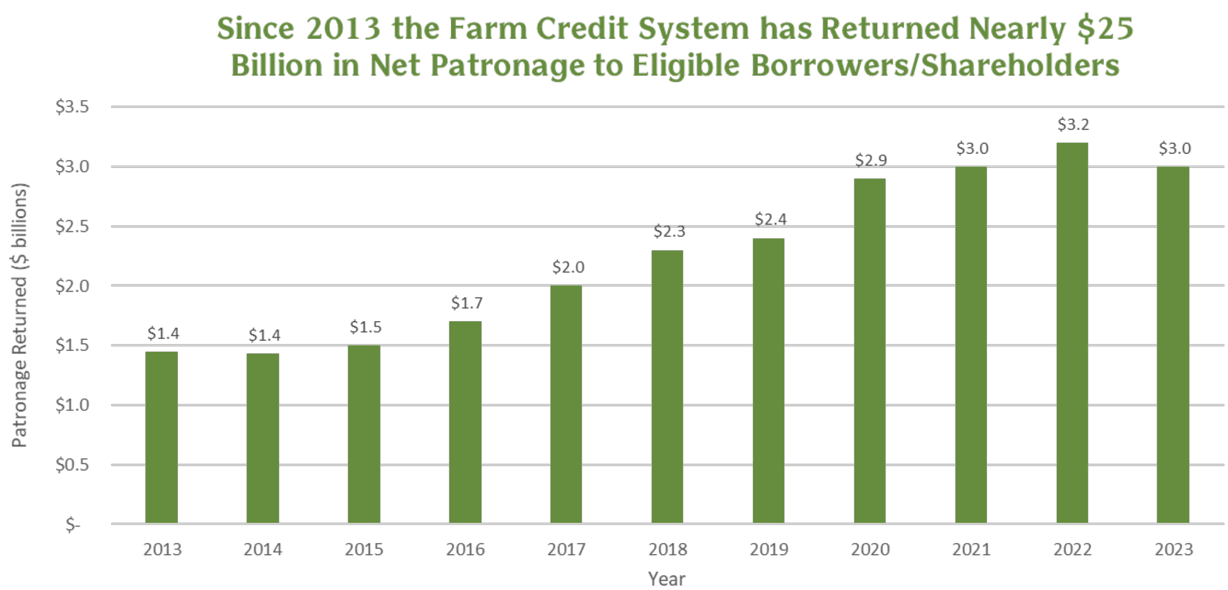

Figure 3 *(Source: FCA Annual Reports)*

Furthermore, in 2023, the System made over 250,000 new loans to young, beginning and small farmers totaling over $121 billion. Additionally, System entities defray various costs related to loan origination and commit significant resources to grants, scholarships and educational opportunities to assist this important group of customer-owners access the capital they need to pursue a future in agriculture. The total value of services provided to YBS farmers and ranchers in 2023 was $358 million.

Managing risk is a challenge for all lenders but especially for those who must lend to limited sectors of the economy --- in the System's case, agriculture and rural infrastructure. As the overall agricultural economy becomes more susceptible to additional stress and acute weakness, it is more important than ever that System entities be allowed to use their statutorily granted similar entity authorities to diversify credit risk, strengthen earnings capacity and leverage opportunities that provide returns and essential services to our directly eligible customer-owners.

Simply put, any revision to existing regulatory guidance that seeks to limit the opportunities for System entities to leverage this tool would be imprudent at minimum and might be characterized as arbitrary given the positive impact these authorities have had on the System. The cascading negative effects would almost certainly be felt by directly eligible customer-owners and the lending markets that rely on the System as a consistent market participant. Similar entity loans serve not only the intended purpose of risk management and diversification, but also as highlighted in FCA's 2023 Annual Report, promote opportunities for System and non-System lenders to cooperate in lending structures that support the broader agricultural value chain and rural areas.[3]

C. Reputation Risk Management

In evaluating the need for further regulation of the System's similar entity participation authority, the FCA should not conflate compliance with regulatory and legal requirements with reputation risk management. Reputation risk is an important risk factor for any business. As a Government Sponsored Enterprise, System institutions pay particular attention to monitoring, managing, and mitigating reputation risk. Furthermore, outside parties and stakeholders can have different perceptions about what types of lending activities the System should be involved in, even when those activities meet regulatory and statutory criteria and congressional intent. System institutions fully understand that lending activity under similar entity participation authorities can present elevated reputation risk, and have separately established prudent policies and procedures, robust due diligence practices, approval processes, board reporting, and internal controls to govern the reputation risk associated with similar entity participations. As the System's safety and soundness regulator, it is certainly appropriate for the FCA to expect robust reputation risk management processes at System institutions, and these are routinely included in agency audit scopes.

That said, System institutions do not believe it would be appropriate for the FCA to further limit the System's similar entity participation authority based on arbitrary perceptions of reputation risk associated with this activity. While System institutions welcome additional dialogue with the FCA on reputation risk management processes, as reflected in our responses to the FCA's ANPRM questions, we will not support further requirements or definitional changes that would diminish the value of this important diversification tool provided by Congress to further the System's mission achievement.

[3] See FCA 2023 Annual Report, Pg. 21

II.

General Comments

The ANPRM poses many questions that seek to elicit granular detail on a broad swath of fact-specific hypotheticals. In many cases, the questions conflate legal requirements, reputational considerations, questions regarding how the System can fully fulfill its mission, and safety and soundness concerns. We appreciate the opportunity to provide context to why the System does not believe it is necessary or even appropriate to propose a regulation that would seek to limit the System's ability to utilize its statutory authorities in the ways contemplated by the questions.

III.

Questions Presented by the ANPRM and System Responses

A. Functionally Similar Activity

1. What quantitative and qualitative criteria are being used or being considered for determining a "functionally similar" activity of an eligible borrower?

The past three decades of the System's responsible use of this important authority have shown that there is not one set of criteria, other than what the statute provides, that works across the board for similar entity analysis and thus each prospective similar entity borrower is analyzed on a case-by-case basis with its activities compared to the activities of current or past directly eligible customers. The existing statute and regulation set forth the required quantitative metrics for qualifying "functionally similar" activities. To that end, the majority of income and/or assets tests provide consistent metrics to measure the activities that are functionally similar. Requiring more significant ties between eligible borrower activities and those of qualifying similar entities would result in fewer entities meeting the regulatory thresholds and thus reducing the opportunities for diversification of portfolio credit and eroding the statutory intent

2. Could there be different factors based on market segments (e.g., industry, commodity, regional markets, etc.) that would necessitate differentiating criteria used to determine a "functionally similar" activity? If so, what factors should be considered?

By their very nature, customers in various market segments —whether they be agricultural producers, processors and marketers, farm-related service businesses, or rural infrastructure providers— are different and evolve. Accordingly, the factors considered in determining a "functionally similar" activity will necessarily vary. A regulation that would differentiate on factors by market segment would be overly prescriptive and not required or directed by statute. Setting segmented frameworks for "functionally similar activity" assumes market consistency. Agricultural markets change based on demand and innovation. For example, methods of production and the delivery of agricultural goods evolve. Setting criteria based on past or current market activity would reduce the ability for System institutions to utilize their similar entity lending authorities as eligible customer operations change.

3. How far could an activity (such as processing and marketing, including packaging), be removed from agricultural production and harvesting, and basic processing of raw products and still qualify as a "functionally similar" activity of a similar entity?

At the outset, it must be stressed that nothing in the Farm Credit Act prohibits "functionally similar" activities from being far removed from agricultural production and harvesting. Indeed, the addition of such a requirement, without congressional authorization, would undermine the intentions of Congress: since similar entity loans are intended to provide financial strength through diversification. Greater distance from agricultural production and harvesting may well be desirable, as it is more likely to result in a portfolio which is negatively correlated with or loosely correlated with the risks of production agriculture. That said, American agriculture benefits from all elements of the agricultural value chain which extends from producer to consumer. Activities that support the direct production of agriculture and those that allow for agricultural products to be brought to market are all integral parts of that value chain and support the American agricultural economy. In addition, past and current directly eligible companies (to which a similar entity is compared) often have various levels of integration along their operations, which results in multiple business activities. In many cases, activities such as packaging, cold storage, transportation, marketing/selling, and retailing are business activities that are integral in the operation and critical for the purposes of bringing agricultural and food products to market and could be considered qualified activities of a similar entity.

4. What would be the most effective way to document how the activities of both an eligible borrower and a similar entity are determined to be functionally similar?

System entities routinely and robustly document the correlation between eligible borrower activities and those of qualified similar entities to ensure conformance with the statutorily required similar entity thresholds for the majority of income and/or assets tests. The methods of documentation are not required by statute, so prescriptive standards would not provide meaningful benefit from a safety and soundness perspective and are likely to create undue operational inefficiencies. Sound customer and credit due diligence are already required components of a lending relationship and encompass an understanding of customer operations and activities.

i. <u>Similar Entity Consistency with System Mission</u>

1. What criteria would indicate that a similar entity's functionally similar operation(s) is most likely to benefit American agriculture or other activities in rural communities that are consistent with the lending authorities of System banks and associations?

The similar entity participation authority is separate and apart from the direct lending authorities established for the unique purpose of diversifying credit and portfolio risk and enhancing the financial safety and soundness of the System. While it is common for similar entity borrowers to have a close connection to the American food system and for their activities to directly benefit agricultural producers and rural communities, requiring arbitrary ties to either will negatively impact the System's ability to finance qualified similar entity borrowers. Requiring similar entity lending to account for criteria that indicate its impact on American agriculture or rural communities will likely impede the legislative purpose of the participation authority itself. The System does routinely consider rural benefits relative to reputation risk. Further, with marketplace-recognized expertise in agriculture and infrastructure lending, CoBank and System institutions seek out non-System lenders to partner on capital investments in agriculture and rural America, which would likely not occur without these important participation authorities.

a. What criteria and controls should we consider in a prospective rulemaking to ensure that similar entity lending is consistent with the scope of financing for loans to eligible borrowers?

The System disagrees that it is necessary or consistent with statutory intent to apply additional criteria or controls to similar entity authorities. As has been stated, the intent behind the similar entity participation authority is to differentiate it from loans to eligible borrowers, so some inconsistency can and should be anticipated. Additional criteria would further complicate the analysis, restrict the already small population of qualified similar entities, create inconsistencies with marketplace norms, and diminish the diversification benefits provided by this important authority. The more similar entity participations are forced to "look like" directly eligible lending, the greater the odds these loans may also "act like" those loans in terms of reaction to adversity, economic or industry deterioration, and credit quality migration. The existing regulation contains adequate scope of financing guidance (functional similarity), as well as a conservative exposure limitation (<50%) that provides clear guidance to System institutions and these considerations are analyzed from a reputation risk perspective on a case-by-case basis. Attempts to further limit similar entity participation authority appears counter to the stated goal of diversification of System loan portfolios. Ultimately, overly burdensome regulation would only serve to diminish the benefits derived from this important authority.

b. Under what circumstances would an activity such as processing/marketing or packaging be allowed to deviate away from being related to American agricultural goods or products?

The criteria, applied successfully for over 30 years, requires a majority of the income or assets of the entity being evaluated to be generated from operations that are functionally similar to the business activities of directly eligible customers. While a connection to American agriculture is beneficial from a reputational risk perspective, it is not, and should not be, legal criteria for determining whether a similar entity is qualified.

Contemporary agriculture is a diversified global business that requires flexibility to meet the global demands for agricultural products. There are plenty of circumstances where processing and marketing of non-domestic products can improve the markets for American agricultural goods. For example, in the event of significant domestic crop shortages or a declining producer industry, imported agricultural products may be available throughput to provide stability to processing and marketing or packaging companies that help to ensure their viability to support the American producers needs into the future. Likewise, seasonally fresh crops benefit from imported goods that support overall year-round consumer supply.

c. What consideration should be given to the ingredients of a similar entity's product(s) to ensure benefit to American agriculture?

The global nature of contemporary agriculture requires flexibility to meet the global demands for agricultural products. Considerations and/or bright line tests that utilize the percentage of American agricultural ingredients in products misses the proverbial mark by inserting standards that do not exist in the statute and would create arbitrary limits on the ability to use the statutory authorities. Such "considerations" also ignore the indirect benefits to American agriculture. For example, an American based coffee importer and roaster may source a majority of its inputs from non-domestic markets, but the product is a complementary consumer good for other American agricultural products like dairy and sugar.

While an analysis of the prospective similar entity's use of agricultural products in its operations may be completed, and its presence in and service to, American agriculture can be considered for reputational risk purposes, any specific percentage of ingredients requirements would be inflexible and unworkable. The factors outlined in this question, and those that follow, may be part of the reputation risk considerations in assessing a prospective similar entity borrower, but qualifying a similar entity is a case-by-case analysis and no single set of requirements can be consistently applied across all similar entities. Instead, the relevant analysis is whether the operations of the entity in question are functionally similar to the business activities of directly eligible borrowers. Any attempt to create a bright line test for ingredients of a similar entity's products would be onerous, nearly impossible to apply, incompatible with marketplace norms, and would only serve to remove the flexibility necessary to successfully utilize this authority.

i. What percentage of ingredients from the product(s) being produced should be composed of agricultural inputs?

The question presupposes that the activities of directly eligible companies must be composed of agricultural inputs. The answer is none, because in reality, there are many directly eligible companies engaged in activities that are meaningful to their business that are not "composed of agricultural inputs." For example, the distribution of agricultural products by directly eligible entities is vital to their operations but distribution is not "composed of agricultural inputs." Further, as recognized by the FCA, "there is no statutory restriction to agricultural or agriculturally related loans in Title III" of the Act, and the purpose of loans "need not be agriculturally related" to be eligible for direct financing by Banks for Cooperatives[4].

[4] *See* Letter dated August 17, 1994 to Hon. E. "Kika" de la Garza from Dorothy L. Nichols, Farm Credit Administration (the "Nichols Letter"), 140 Cong. Rec. H. 10323 (Sep. 29, 1994).

In addition to the technical reasons not to create such a standard, there are practical difficulties in applying a percentage standard. Gathering the information to make a specific percentage determination would be difficult, if not impossible, especially for information that a borrower may have no other reason to consolidate (for example, the percentage of agricultural inputs included in the value of an entity's products, which might include the value of the packaging, the cost of labor and production, storage costs, or transportation costs). The credit markets are competitive and time sensitive. If System entities impose atypical requirements on borrowers and/or arranging lenders that are inconsistent with marketplace norms, it should be expected that they will be bypassed when lending opportunities arise, especially for high-quality credits that are often oversubscribed.

ii. What percentage of sourced ingredients or inputs should come from U.S. farmers, ranchers, or producers of aquatic products?

Similar to the answer above, no bright line test will produce a result that is compatible with the contemporary state of agriculture, the agricultural economy, the credit markets, or statutory language for this authority. A percentage test ignores the realities of consumer food markets and the global agricultural market where consumer preferences and input availabilities shift. Supporting American producers and agricultural products may be a reputational risk consideration, but it is not and should not be a requirement for similar entity qualification. As with the above response, the practicality of gathering this information to make a specific determination would be extremely difficult, if not impossible, especially when a borrower has no other reason to consolidate this data for their own use. Furthermore, the proportion of domestically vs non-domestically sourced commodity ingredients can change with market conditions. Whatever benefits may be sought do not outweigh the cost associated with the complexity and burden on the System, the borrowers, and the market.

iii. Under what circumstances could primarily sourcing ingredients from outside the U.S. benefit American agriculture?

This question assumes a statutory intent regarding the ties to domestic agriculture for similar entity borrowers that does not exist. Nonetheless, consumer food products are often comprised of multiple inputs that are sourced across the globe. Sourcing ingredients not commonly grown in the U.S. benefits producers whose products are grown domestically when these inputs are used to produce end products for consumer markets. Additionally, contemporary agriculture is a global business that requires flexibility to meet the global demands for agricultural/food products. Many producers have operations in various areas around the world to meet the demands of U.S. consumers for food products throughout the year. Likewise, given production shortfalls in the U.S., imports are needed periodically to fulfill the domestic demands for agricultural products.

d. To what extent could a water or waste facility that operates in areas with more than 20,000 inhabitants pursuant to the requirements of 3.7(f) qualify as a similar entity? What limitations should be required to ensure that such lending is compatible with the System mission to provide water and waste facilities in rural communities?

If the entity derives a majority of its income from activities that are functionally similar to principal business activities of directly eligible water or waste facilities it is qualified as a similar entity. This would include activities that facilitate or are integral to the acquisition, construction, and/or operation of facilities and infrastructure for (1) water and sewer services, and/or (2) the collection, disposal, and/or recycling of waste. While it is relevant to consider what "rural benefits" are provided by the facility from a reputation risk perspective, there is no statutory or regulatory requirement that the facility operate in a rural area or serve a rural area. Further differentiation by population or based on an extent of service to rural inhabitants would render the authority unworkable and diminish the geographic diversification benefits intended by Congress. Rural infrastructure entities are uniquely susceptible to regional demographic and economic conditions and weaknesses. Utilizing similar entity authorities to participate in non-rural infrastructure transactions directly diversifies portfolio risks to achieve the intent of Congress.

The FCA has supported the view that the purpose of a "similar entity" loan participation need not have a rural component in order to be eligible. For example, when CoBank objected to the FCA's statement in the 1995 Proposed Rules that System institutions "could participate in loans to electric utilities that provide some service in rural communities," on the grounds that **"there is no statutory basis for limiting participations in similar entity loans to electric utilities in rural areas,"** the FCA in the preamble to the 1996 re-proposed rules "assure[d] CoBank that…[t]his illustration was not intended to limit the authority of title III banks to participate in loans to similar entities." Most notably, in testimony before the House Agriculture Committee, the General Counsel of the **FCA stated that the "similar entity" authority "is not a mission-directed type of authority," and that "there is no particular rural requirement on it or that kind of thing."**[5]

e. What limitations should be required to ensure that such lending is compatible with the System mission to provide water and waste facilities in rural communities?

Like other infrastructure similar entities, an analysis of the "rural benefits" provided by the prospective similar entity, including its presence in, and service to, rural America should be considered for reputational risk purposes but is not and should not be required for similar entity qualification. Congress did not require a rural test or service-to-rural-residents requirement for similar entity qualification and the FCA should not apply such a test or requirement as regulatory criteria. Further, applying a strict definition of rural can be problematic. Rural definitions often exclude truly rural communities that lie near larger urban areas. Without government or System support, many of these fringe communities would not receive adequate infrastructure services given the cost to expand outside the urban areas, despite close proximity. Thus, no rural qualification limitations are appropriate with respect to the System's similar entity authorities. Adding a rural requirement would in most cases mean that the entity would be directly eligible, negating infrastructure similar entity lending altogether, which would be entirely inconsistent with Congressional intent in granting similar entity authorities to the System for portfolio diversification.

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[5] Hearing to Review the Farm Credit System Before the H. Comm. on Agriculture, 114th Cong. (2015).

f. To what extent could an electric or telecommunications utility that is not eligible to borrow under section 3.8(b)(1)(A) of the Act qualify as a similar entity?

If the entity derives a majority of its income from activities that are functionally similar to the business activities of directly eligible electric or telecommunications utilities it is qualified as a similar entity. This would include, but is not limited to:

- An activity that facilitates and/or is integral to (1) the provision of telecommunication services; and/or 2) the acquisition, construction and/or operation of facilities and infrastructure for the provision of telecommunications services.
- An activity that facilitates and/or is integral to the acquisition, construction, and/or operation of facilities and infrastructure for (1) the provision of electric services, and/or (2) electric generation from renewable energy resources, including solar, wind, hydropower, biomass or geothermal sources of energy, (3) energy-related services, and/or (4) energy storage.

g. To what degree do utilities that are not directly eligible under title III need to provide public utility services to rural communities to be considered a similar entity?

This is not and should not be a requirement for a similar entity to be qualified. As mentioned above, this is a reputation risk consideration. It is general practice to evaluate the extent to which a similar entity provides "rural benefits" beyond the end-users of the utility services. Requiring a certain degree of service to rural communities would render this authority unworkable and diminish the geographic diversification benefit clearly identified by Congress when this authority was added for the System. For new infrastructure construction to be viable, locations are often selected that provide coverage for more densely populated areas along with rural areas. Providing infrastructure exclusively to rural areas in most cases would not be practical or economically feasible given the enormous costs of large-scale projects. As a result, rural areas often must be secondary or ancillary beneficiaries of rural utilities to fall within the workable scope of System financing. Otherwise, rural areas would be at risk of falling further behind and suffering from obsolete technology.

2. What would be the most effective way to document how a similar entity's functionally similar activities/ operations benefit either American agriculture or rural communities?

With contemporary agriculture and infrastructure companies involved in various different business activities, the FCA should not attempt to require a one-size-fits-all documentation standard, as the rationale varies by industry, segment, geographic location, etc. Attempting to outline how this must occur would only serve to limit the flexibility needed to apply this authority in a rapidly changing business environment. Accordingly, System institutions utilize varying methods of documenting the qualifications of similar entity borrowers. Many institutions include analyses on the benefits to U.S. agriculture and rural communities, but these considerations are reputational risk considerations and not similar entity qualification criteria.

Similar entity qualification is based on the majority of income/assets test for "functionally similar" activity of the borrower. That is the only statutorily authorized constraint for qualification. Therefore, each System institution should be allowed to develop its own policies, procedures, and controls on how to properly analyze and document reputation risk on a case-by-case basis.

B. Parents, Subsidiaries, and Affiliates

1. Under what circumstances could a single entity simultaneously qualify as both an eligible borrower and similar entity (ineligible party)?

The System's ability to make loans to the same borrower or to related borrowers under multiple financing pathways is consistent with the Act, legislative history, and doing so advances the System's mission. Legislative history does not squarely discuss to what extent a single borrower that engages in more than one type of authorized activity may qualify for financing under different pathways. However, there is nothing in the Act that prevents it, and it is consistent with the System's mission to allow an entity to obtain all of the financing that may be available to it under the various provisions of the Act. To read the Act as prohibiting a company from qualifying as a similar entity because it is eligible for a loan under another section of the Act would improperly limit the System financing available to that company and would, in fact, unfairly penalize such a company by limiting its potential System financing.

There are several scenarios where an entity may be eligible, but also qualify as a similar entity, including but not limited to the following example specifically directed by FCA regulations and existing guidance:

- Title III Similar Entity and Title I/II Eligible: A non-cooperative company ("Company A"), which processes and markets agriculture products, qualifies as a similar entity by engaging in business activities that are functionally similar to the activities of an eligible Title III cooperative borrower. Company A is also directly eligible for a loan from a Farm Credit Association ("Association") under Title I/II as a processing and marketing entity (with "some" throughput). In this scenario, CoBank could participate in a similar entity loan with a commercial bank to Company A, and an Association could make a loan to Company A on a directly eligible basis. FCA has recognized the likelihood of this scenario in part (d) of FCA regulation 613.3300[6], which requires a bank for cooperatives or agricultural credit bank (CoBank) to obtain approval from an Association before participating in a similar entity loan if that borrower (i.e., Company A) has a loan or loan commitment outstanding with an Association. Since territorial concurrence is not required for similar entity participations, this regulation infers in this scenario that Company A is eligible under Title I/II while also qualifying as a similar entity under Title III. FCA has provided guidance for Call Reporting under this type of scenario via FAQ's

[6] FCA Regulations 613.3300(d) Approval by other Farm Credit System institutions. A bank for cooperatives or agricultural credit bank may not participate in a loan to a similar entity under title III of the Act if the similar entity has a loan or loan commitment outstanding with a Farm Credit Bank or an association chartered under the Act, unless agreed to by the Farm Credit Bank or association.

on FCA.gov: https://www.fca.gov/about/faq/similar-entity-reporting. As directed by the FCA's FAQs, if an Association purchases a participation from CoBank in a loan that is similar entity for CoBank, but directly eligible for the Association, the Association is directed to report the loan as directly eligible, while CoBank reports the loan as similar entity.

2. Under what circumstances could an entity in a corporate family (multi-organizational structure) qualify as a similar entity if another entity within the same corporate family is eligible to borrow, and vice versa? Please explain your reasoning and provide supporting information and suggestions.

   There is no element of the Act that would prevent an entity from obtaining financing from System institutions based on the eligibility/similar entity qualification status of another entity within its corporate family. Given the complexity of modern corporate structures and the potential for multiple lines of business within a corporate family, it would not be unusual for individual entities within a single corporate structure to have different eligibility or qualification determinations. Notably, FCA's Bookletter BL-067 ("BL-067"), which outlines policies and procedures pertaining to similar entity lending, states that each System institution must show that the entity requesting the loan (not the parent or subsidiary of the entity) must be engaged in functionally similar activities. Thus, assessing whether any other entity in a corporate structure is directly eligible in connection with determining whether another entity in the corporate structure is a qualified similar entity would be inconsistent with FCA's existing guidance on this topic and impractical.

3. What criteria or requirements (e.g., corporate, operational, or financial interdependence) should our regulations place on the various entities in corporate families to ensure that the System only extends credit to qualified similar entities that meet the income, asset, and functionally similar requirements of the Act?

   The guidance provided by the FCA in BL-067 suggests that each entity should be analyzed separately for qualification. However, there are times when that guidance does not comport with the realities of the complex modern corporate structuring often seen today. Legal and tax implications often result in multi-layered organizational structures that separate interdependent entities with corporate affiliation through entity structures. For example, operating and real estate assets are often separated into subsidiaries with lease-back structures to support tax and liability strategies. Moreover, acquisition entities and financing subsidiaries are often utilized in merger strategies. Additional narrowly focused requirements would only serve to limit or eliminate the System's ability to function properly in the modern business environment to provide financing to entities and groups of entities that are engaged in functionally similar activities but have been more complexly structured for tax and legal reasons. In reality, any additional guidance on this topic must be adaptable to complex business situations and allow for <u>more flexibility</u> in modern corporate structures that are overall engaged in the conduct of activities functionally similar to directly eligible System borrowers.

C. <u>Incorporation of "Other Extensions of Credit" within Similar Entity Lending Authorities</u>

At the onset, it is important to note that the similar entity lending authorities within the Act define "the term 'participate' or 'participation [as] multilender transactions, including syndications, assignments, loan participations, subparticipations, or other forms of the purchase, sale, or transfer of interests in loans, other extensions of credit, or other technical and financial assistance" § 3.1(11)(B)(iii). By deliberately using such expansive language, Congress authorized System institutions to participate in a broad range of financing transactions. It did not express an intent to limit the types of financing transactions in which System institutions can participate, nor did it specifically authorize the FCA to provide by regulation a definition of the terms "other extensions of credit" or "other technical and financial assistance." It is reasonable to assume that Congress intended these words to be interpreted broadly and to allow System institutions to participate in a variety of financing transactions with similar entities to gain the diversification benefits of similar entity business and to adapt to evolving market norms and banking industry practices. Attempting to further define or restrict the definition of "participate" under the similar entity provisions of the Act would frustrate compromise the clear intent of Congress to provide an expansive definition that allows the System to provide various forms of financial support to qualified similar entities.

1. What factors would your institutions consider as part of the credit evaluation process if participating in bonds through similar entity authorities?

Prior to the purchase of a bond, as with the purchase of any loan participation or syndication, System institutions complete all necessary due diligence and underwriting to make an informed and independent credit judgment on the transaction. This process is similar to the process used to underwrite a loan transaction. System institutions comply with all regulatory and statutory limits (obligor and portfolio) on similar entity participations.

   a. What is the difference, if any, in the factors or credit evaluation process that should be considered if purchasing bonds on the secondary market versus participating in direct offerings?

The credit evaluation process for bonds purchased on the secondary market is the same as when participating in direct offerings. Prior to the purchase of a corporate bond, as with the purchase of a loan participation or syndication, System institutions complete sufficient due diligence and credit analysis to fully evaluate the credit risk in the transaction and have successfully done so for many years.

   b. How would you ensure compliance with the similar entity qualification and loan purpose requirements as outlined in § 613.3300(b)?

There is no difference in the similar entity qualification process in the case of a bond purchase versus a loan purchase. In both instances, System institutions analyze the borrower's qualification as a similar entity based on their "functionally similar" activities as compared to those of directly eligible borrowers and have successfully done so for many years.

c. If purchased on the secondary market, how would you monitor compliance with the statutory lending limits in § 613.3300(c) and ensure the selling party is a non-System lender with authority to extend credit?

System institutions have agreed to have a System-designated lead for similar entity shared credits that is tasked with monitoring System compliance with statutory limits. The System has established mechanisms for evaluating counterparties and ensuring exposures are reported consistently.

2. Are there any instruments, other than bonds, that would qualify as "other extensions of credit" that System institutions are utilizing, or are considering utilizing, within the similar entity lending authorities?

    a. If so, what types of financial instruments are being used or considered?
    b. What is the existing, or proposed structure of such instruments and what criteria and controls are being, or could be used to ensure safety and soundness?

Given the broad nature of the language in the Act, it is not appropriate to attempt to further define the term "other extension of credit". In fact, limiting the broad definition of "credit" would serve only to limit the ability of System institutions to further diversify their risk profiles by participating in different credit structures. Congress intended to allow System institutions to diversify both by extending credit to different types of entities and by doing so in a broad range of credit structures. Further defining the term also ignores that the debt/credit markets evolve dynamically and often give rise to alternative credit structures that meet market needs. Defining "other extensions of credit" today would likely preclude the System from opportunities that will emerge tomorrow.

In any "extension of credit," System institutions adhere to the same controls needed and utilized to ensure safety and soundness, which are no different than those needed and used for loan transactions. Proper due diligence on credit metrics, counter-party risk, and structure risk are all applicable to any current or future loan or "other extension of credit."

3. What would qualify as "other technical and financial assistance" that System institutions are utilizing, or considering utilizing, within the similar entity lending authorities?

The phrase "other technical and financial assistance" should not be further defined so as to limit its broad scope and applicability to future, unknown, viable structures. Congress clearly intended this phrase to be a catch-all for all safe and sound technical and financial assistance that System institutions may provide to similar entities and to allow flexibility in approaches to financing and related assistance.

IV.

Conclusion

With respect to similar entity authority, Congress has repeatedly, unambiguously, and clearly stated that the authority was intended to be broad and to serve as a risk diversification and management tool designed to ensure that American agriculture has the credit availability and rural infrastructure necessary to continue to be the leader in the global agricultural economy.

To the extent the language used in the similar entity statutes is considered to be broad, this breadth is intentional and is consistent with the context in which Congress enacted the statutes; it is not vague or ambiguous. Tellingly, the intent expressly articulated by Congress, as well as subsequent amendments to governing acts by Congress, and FCA's own actions in adopting and subsequently amending the Rule, support the conclusion that Congress intended similar entity authority to be flexible and to accommodate the ever-changing agricultural and rural landscape and the financing needs of the entire food and fiber production chain and supporting infrastructure. Congress, acting in response to one of the worst periods for American agriculture, had the foresight to grant the System similar entity authority to ensure that the System could diversify its asset base, diversify its income sources, and ensure that American farmers, ranchers and aquatic producers, their cooperatives and the numerous companies that comprise the entirety of the agricultural production chain and supporting infrastructure have a reliable source of credit.

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

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

Sincerely,

Robert P. Boone III

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