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August 30, 1996

To: The Chief Executive Officer

All Farm Credit System Banks

From: Marsha Pyle Martin

Chairman and Chief Executive Officer

Subject: Farm Credit Administration's Approval Requirements for the Global Debt Program

The Farm Credit Administration (FCA) has approved the Federal Farm Credit Banks Funding Corporation's (Funding Corporation) request to authorize the Funding Corporation to issue, on behalf of Farm Credit System (FCS or System) banks, global debt denominated in either U.S. dollars or foreign currencies. FCA's approval of the System's Global Debt Program (GDP) establishes criteria under which FCA will consider each System bank's request to issue global debt. This bookletter transmits a copy of the GDP approval and clarifies FCA's expectations regarding the issuance of foreign currency denominated debt (FCDD).

• Prior to requesting FCA approval to issue FCDD, each System bank should review and, if necessary, amend policies and procedures to ensure currency and counterparty risks are appropriately managed, monitored, and reported. FCA will evaluate each System bank's policies and procedures for monitoring, managing, and reporting counteparty and currency risk as part of the ongoing examination process. Based in this evaluation, FCA may deny a bank's request to issue FCDD. In evaluating policies and procedures, FCA examiners will expect the following:

• Each bank should establish policies and procedures that address currency risk. Examiners will expect policies to establish the maximum amount and maturity of FCDD that can be outstanding in any one currency and should incorporate country risk ratings. FCA's approval of the GDP establishes minimum country risk ratings that must be observed in each bank's policies and procedures.

• FCA's approval of the GDP requires that simultaneous with the issuance of FCDD, System banks, or the Funding Corporation on the banks' behalf, must execute a cross-currency swap to U.S. dollars that matches the underlying FCDD. Although FCA does not require that the Funding Corporation execute the cross-currency swap on behalf of the bank, procedures and controls must establish coordination with the Funding Corporation to ensure that the swap terms are consistent with the terms of the FCDD. On a case-by-case basis, FCA may approve issuance of FCDD that is not fully matched with a cross-currency if the FCDD obligation is used to offset other identified currency risk on the requesting bank's balance sheet. A bank requesting such approval should have procedures in place that clearly demonstrate and isolate the currency risks that are being hedged with the FCDD.

• FCA examiners will expect policies and procedures to require that cross-currency swaps be only with bank board-approved counterparties. FCA's approval of the GDP includes minimum credit ratings for cross-currency swaps that should be consistent with or incorporated into each bank's policies and procedures.

• Board policies should establish maximum counterparty exposure limits. The exposure limits should be based on the consolidated counterparty exposure for all derivative products (e.g., interest rate swaps, basis swaps, options, cross-currency swaps, etc.) and investments. Banks may wish to differentiate the exposure limits based on the credit rating of the counterparties and/or by whether or not the counterparty is subject to a collateralization agreement.

• Each bank's policies and procedures must address monitoring and reporting of counterparty risk. FCA examiners will expect banks to monitor both the current exposure position and peak (or potential) exposures under clearly defined stress tests. Peak exposures should be measured on a consolidated counterparty basis for all derivative products (e.g., interest rate swaps, options, cross-currency swaps, etc.) and investments. Each bank's procedures should include trigger points based on the peak counterparty exposures that would either limit further transactions with the counterparty and/or provide for implementation of strategies to reduce the peak exposure. Although banks may establish dollar exposure limits, FCA suggests that limits be expressed as percentages of permanent capital, total net worth, or unallocated surplus.

• Each bank's policies and procedures should address the impact of bi-collateralization agreements on the bank's free collateral position. FCA examiners will expect each bank to be able to compute, monitor, and report the peak (or potential) amount of collateral that the bank must pledge to counterparties under clearly defined stress tests and the impact such peaks will have on the bank's free collateral position. Each bank's procedures should include trigger points based on peak pledged collateral positions that would either limit further transactions and/or provide for implementation of strategies to reduce the peak pledged collateral.

• Each bank's policies or procedures should address the frequency of monitoring reports. FCA examiners will expect the bank's procedures to require more frequent monitoring of counterparty exposures and collateral positions in times of greater volatility and/or when the bank is approaching its established limits.

• Each bank must adopt appropriate policies and procedures for the accounting and reporting of transactions involving the issuance of FCDD. The FCA expects such policies and procedures to conform with the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 52, Foreign Currency Translation, and other authoritative literature governing the accounting and disclosure of transactions involving foreign currencies.

• Each bank's policies and procedures should be adequately supported. FCA examiners, for example, will expect the bank to be able to support the reasonableness of policies and/or procedure limits and guidelines.

Each System bank that anticipates issuing FCDD should review and, if necessary, amend its policies and procedures with the above expectations in mind. Prior to requesting FCA formal approval to issue FCDD, each bank is encouraged to consult with its local examination office to ensure that FCA examiners are fully informed and early communication occurs relative to program criteria as outlined in this bookletter.

If you have any questions or concerns with FCA's expectations or approval of the GDP, please contact either your local examination office, me, Jim Enzler or Andrew Jacob of FCA's Office of Examination at (703) 883-4483.

Attachment

**FARM CREDIT ADMINISTRATION APPROVAL OF GLOBAL DEBT PROGRAM**

The Farm Credit Administration (FCA) approves the Federal Farm Credit Banks Funding Corporation's (Funding Corporation) request to authorize the Funding Corporation to issue, on behalf of the Farm Credit banks, debt securities (global debt) under a Global Debt Program (GDP). Any changes to this approval require FCA Board action. As requested by the Funding Corporation, the GDP is limited to $5 billion in outstanding issues. FCA approval is subject to the GDP meeting the following FCA debt issuance conditions:

**I. FCA approval process for global debt issuances.** FCA's approval process for global debt issuances will distinguish between U.S. dollar denominated debt and foreign currency denominated debt (FCDD) as follows:

A. FCA will consider specific approval requests for U.S. dollar denominated debt issuances on a monthly shelf basis identical to the current medium term note (MTN) program.

B. The FCA will consider specific approval requests for FCDD issuances on a monthly shelf basis solely to facilitate timely action on investor inquiries (reverse inquiries), where the deal includes common FCDD terms, matching cross-currency swap to U.S. dollars, and final maturity of the FCDD does not exceed 5 years. Common debt terms are fixed rate, simple floating rate, callable, simple step-up, or amortizing securities.

C. FCA will consider individual prior-approval requests for all other FCDD issuances including reverse inquiries where the deal involves unique debt terms or unique variations of common debt terms. Any issuance with a maturity greater than 5 years, regardless of any optional redemption features, shall require FCA Board approval. Unique debt terms include complex floaters, specialized indexed, or other exotic structures such as inverse floaters, range floaters, stock indexed, exchange rate indexed, or complex step-up securities. If the Funding Corporation is uncertain of whether an individual or shelf approval is appropriate, it should contact the FCA. The banks' requests for approval of an FCDD issuance must include a draft term sheet and swap dealer confirmation listing the specific terms and conditions of the transaction.

Consistent with the MTN approval process, FCA may, at any time, require individual prior-approval requests for specific banks or types of securities. The Funding Corporation should provide the FCA with as much advance notice as possible of issuances under negotiation, particularly of FCDD issuances.

**II. Evaluation of risk management systems.** FCA will evaluate each Farm Credit System (System) bank's process for monitoring, managing and reporting counterparty and currency risk as part of the ongoing examination process. Based on this evaluation, FCA may deny a bank's FCDD funding request.

**III. Simultaneous swap of currency risk.** Simultaneous with the issuance of any FCDD security, System banks, acting in concert with the Funding Corporation, must execute a cross-currency swap(s) to U.S. dollars that fully matches the underlying FCDD. On a case-by-case basis, banks may request FCA approval to not fully match the foreign debt with a cross-currency swap if the FCDD obligation is used to offset and match other currency risks on the requesting bank's balance sheet. The cross-currency swap counterparty must be prior approved by each System bank's board.

**IV. Cross-currency swap counterparty credit rating requirement.** Counterparties to cross-currency swaps are limited to those counterparties considered to have an "upper-medium" credit rating. FCA defines an "upper-medium" rating as meeting at least two of the following: Moody's rating of A1 or better; Standard and Poor's rating of A or better; International Bank Credit Analysis, Inc. rating of A or better; and Thompson rating of B or better. Further, FCA requires System banks to obtain collateralization agreements for cross-currency swap counterparties that are rated below a "high" credit rating by a nationally recognized rating service. FCA defines a "high" rating as meeting at least two of the following: Moody's rating of Aa2 or better; Standard and Poor's rating of AA- or better; International Bank Credit Analysis, Inc. rating of AA- or better; and Thompson rating of A/B or better. A collateralization provision requires the swap counterparty to post collateral with a safe keeping agent when the net mark-to-market of all swap transactions exceeds a certain dollar threshold. Each System bank should negotiate reasonable thresholds as a function of the credit quality of the counterparty.

**V. Country risk rating requirement.** Issuances of FCDD are limited to currencies of countries with at least a Moody's sovereign country rating of Aa2 or a Standard and Poor's country foreign currency debt rating of AA.

**VI. Funding Corporation reporting to FCA.** The Funding Corporation will provide FCA a weekly detailed report of all issues under the GDP. The report should be consolidated with the weekly report on the MTN program and should include all global debt, MTN debt, unscheduled bond sales, and any swaps executed in conjunction with the debt issues.

**VII. Annual report on Global Debt Program.** Annually, the Funding Corporation must provide an analysis of the results of the GDP. The analysis should include the financing (including spread relationships) and operational costs of the GDP.

**Recommended for Approval by:**

Financial Analysts: \_\_\_\_\_\_\_\_\_\_\_\_\_\_

James E. Enzler and Andrew D. Jacob

Acting Director, Office of Examination:

William L. Robertson

**Recommendation is hereby approved:**

Marsha Pyle Martin

Chairman and Chief Executive Officer

Farm Credit Administration