clarify that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks applies to card-not-present transactions, clarify the requirements that Regulation II imposes on debit card issuers to ensure that at least two unaffiliated payment card networks have been enabled for debit card transactions, and standardize and clarify the use of certain terminology.¹

The proposal provided for a comment period ending on July 12, 2021. Since the publication of the proposal, the Board has received comments requesting a 30-day extension of the comment period. An extension of the comment period will provide additional opportunity for interested parties to analyze the proposal and prepare and submit comments. Therefore, the Board is extending the end of the comment period for the proposal from July 12, 2021 to August 11, 2021.

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority.

Ann E. Misback, Secretary of the Board.


II. Recent Updates to System Liquidity

A. Objectives of the Advance Notice of Proposed Rulemaking

FCA’s purpose in this Advance Notice of Proposed Rulemaking is to gather public input to:

• Determine if the Basel III Liquidity Framework is appropriate for FCS banks, and evaluate the impacts of augmenting FCA’s existing liquidity framework to incorporate appropriate aspects of the Basel III Liquidity Framework and the FBRAs’ implementation of the framework;² and

• Determine the respective costs and benefits of updating FCA’s liquidity framework for FCS banks.

B. Background on System Liquidity

In 1916, Congress created the System to provide permanent, stable, affordable,
and reliable sources of credit and related services to American agricultural and aquatic producers. The System currently consists of 3 Farm Credit Banks, 1 agricultural credit bank, 66 agricultural credit associations, 1 Federal land credit association, service corporations, and the Federal Farm Credit Banks Funding Corporation (Funding Corporation). Farm Credit banks (which include both the Farm Credit Banks and the agricultural credit bank) issue System-wide consolidated obligations in the capital markets through the Funding Corporation, which enable the System to extend short-, intermediate-, and long-term credit and related services to farmers, ranchers, aquatic producers and harvesters, their cooperatives, rural utilities, exporters of agricultural commodities products, and capital equipment, farm-related businesses, and certain rural homeowners. The System’s enabling statute is the Farm Credit Act of 1971, as amended (Act). In many respects, the FCS is different from commercial banks. In contrast to most commercial banks and other financial institutions, the System lends primarily to agriculture and other eligible borrowers in rural areas. Unlike most other lenders, FCS banks and associations are cooperatives that are owned and controlled by their member-borrowers. Their common equity is not publicly traded. The System also funds its operations differently than most commercial lenders. FCS banks and associations are not depository institutions, and for this reason, System-wide debt securities, not deposits, are the System’s primary source for funding loans to agricultural producers, their cooperatives, and other eligible borrowers. Although section 4.2(a) of the Act authorizes FCS banks to borrow from commercial banks and other lending institutions, lines of credit with such lenders are only used as a secondary source of liquidity. As a government-sponsored enterprise (GSE), the System depends on continuing access to the capital markets to obtain the funds necessary to extend credit to agriculture, aquaculture, rural utilities, and rural housing in both good and bad economic times. If access to the capital markets becomes impeded for any reason, FCS banks must have enough readily available funds and assets that can be quickly converted into cash to continue operations and pay maturing obligations. Unlike commercial banks, the System does not have a lender of last resort and does not have a guaranteed line of credit from the U.S. Treasury or the Federal Reserve.

As part of our ongoing efforts to ensure the FCS banks have sufficient liquidity to fund operations in the event of market disruptions, and in light of updated guidance and regulations published by the BCBS and FBRAs, we are soliciting comments on the best ways to enhance FCA’s existing liquidity framework.

II. Recent Updates to System Liquidity Regulations

FCA regulations governing Farm Credit banks’ liquidity were last substantially updated in 2013 in response to the 2008 financial crisis. FCA proposed amendments to its liquidity requirements in 2011 to improve the quality of liquidity and bolster the ability of the System banks to fund their operations during times of economic, financial, or market adversity. At the time, FCA considered the Basel III Liquidity Framework that was published in September 2008 and December 2010, but decided not to adopt the Basel III liquidity ratios. The final rule incorporated the liquidity coverage principles of Basel III as appropriate to the System, improved the System’s ability to withstand market disruptions by strengthening liquidity management practices at Farm Credit banks, and enhanced the liquidity of assets in their liquidity reserves.

The Basel III Liquidity Framework is not the only basis for the existing liquidity regulation. The regulation was also based upon the System’s own initiatives to improve liquidity.
management as well as the FCA’s experiences from examining liquidity risk management at Farm Credit banks and the Funding Corporation. In this context, the regulation implemented the best practices available for liquidity management at FCS banks at the time.

The Farm Credit System Insurance Corporation (FCSIC) may use its Insurance Fund as a backup source of liquidity for System banks through its assistance authorities. Additionally, subsequent to FCA adopting the rule, FCSIC entered into an agreement with the Federal Financing Bank (FFB) for a $10 billion line of credit. Pursuant to this agreement, the FFB may advance funds to FCSIC when exigent market circumstances make it extremely doubtful that: The Funding Corporation can issue new System-wide debt obligations to repay maturing obligations; and one or more insured System banks will be able to pay maturing debt obligations without selling available liquidity reserve assets at a material loss. If necessary, FCSIC would use the funds advanced by the FFB to increase amounts in its Insurance Fund to provide assistance to the System banks until market conditions improve.

The decision whether to provide assistance, including seeking funds from the FFB, is at the discretion of FCSIC, and each funding obligation of the FFB is subject to various terms and conditions and, as a result, there can be no assurance that funding would be available if needed by the System. This FCSIC–FFB revolving credit facility is subject to annual renewal. Additionally, the agreement only applies during exigent market circumstances, and can only be used if the amount needed to repay maturing System-wide insured debt obligations will exceed available Insurance Fund reserves. As such, FCA does not consider potential FCSIC assistance, including additional amounts available through its agreement with the FFB, when determining liquidity requirements or completing examinations of liquidity and related management practices at FCS institutions.

FCA has closely monitored how the FBRAs have adjusted Basel III and applied it to the System banks since 2013. In response to these developments and more recent adverse market conditions, FCA believes it is appropriate to consider updates to the existing FCA liquidity framework.

III. Potential Areas for Improvement

Our current liquidity regulation § 615.5134, which we finalized in 2013, responded to the 2008 financial crisis. More specifically, this regulation improves the System’s liquidity management and bolsters the ability of the System banks to fund their operations during times of economic, financial, or market adversity. At the time, FCA considered the Basel III Liquidity Framework and how to tailor it to the unique circumstances of System banks. The FBRAs had not yet enacted regulations that implemented Basel III, and we decided it would be premature for FCA to adopt similar liquidity regulations.

NSFR21 promotes stable funding and management at FCS banks. Section 5.17(a) of the Act authorizes the FCA to: (1) Approve the issuance of FCS debt obligations under section 4.2(c); and (4) of the Act: (2) establish standards regarding loan security requirements at FCS institutions, and regulate the borrowing, repayment, and transfer of funds between System institutions; (3) prescribe rules and regulations necessary or appropriate for carrying out the Act; and (4) exercise its statutory enforcement powers for the purpose of ensuring the safety and soundness of System institutions.

The Basel III Liquidity Framework encourages regulated entities to account for unfunded commitments and other contingent obligations in their liquidity reserve calculations, and for this reason, its concepts are relevant to this rulemaking and the maintenance of adequate liquidity at FCS banks. After careful consideration of the comments received on the 2011 liquidity proposed rule, FCA decided not to incorporate unfunded commitments into the existing regulation, however, FCA stated it may address unfunded commitments at a later time. As a result, FCA’s liquidity reserve requirement does not capture funds held or unfunded commitments on retail loans or on the direct note. While these unfunded commitments are generally captured as part of the liquidity stress tests incorporated into a bank’s CFP, the CFP in the existing rule gives System banks considerable discretion to determine the cash flow assumptions and discount factors used to determine the amount of liquidity reserves they should hold for these potential cash outflows.

Modifying FCA’s liquidity reserve requirement to capture unfunded commitments or adopting an LCR/NSFR framework may promote stronger liquidity profiles at System banks by improving how liquidity is measured and reported. Furthermore, this modification would help ensure that a System bank has enough liquidity to meet its unfunded commitments during a liquidity crisis.

The containment measures adopted in early 2020 in response to COVID–19 slowed economic activity in the United States. Financial conditions tightened markedly in March and April 2020 and sudden disruptions in financial markets put increasing liquidity pressure on certain credit markets. In response to this pandemic, the Federal Reserve Board established a number of funding, credit, liquidity, and loan facilities to provide liquidity to the financial markets.
system.\textsuperscript{23} One of these programs, the Paycheck Protection Program (PPP) Liquidity Facility, was directly available to System institutions, while other facilities indirectly increased the liquidity of System institutions’ assets held in their liquidity reserves.\textsuperscript{24} FCA provided System institutions with guidance to manage the challenges associated with the COVID–19 pandemic, including certain regulatory capital relief for PPP loans and PPP loans pledged to the PPP Liquidity Facility.\textsuperscript{25} Throughout the market turbulence in early 2020, System banks maintained satisfactory liquidity reserves, however; the market conditions caused by COVID–19 provided FCA the opportunity to observe the existing liquidity framework under adverse market conditions.

Based on these developments, FCA is considering whether changes to our liquidity regulations are appropriate or needed.

IV. Request for Comments

We request and encourage any interested person(s) to submit comments on the following questions and ask that you support your comments with relevant data, analysis, or other information. We remind commenters that comments, data, and other information submitted in support of a comment, will be available to the public through our website.

We have organized our questions into the following categories: (A) Existing FCA Liquidity Regulations and (B) Applicability of the LCR and NSFR.

A. Existing FCA Liquidity Regulations

Unfunded Commitments of FCS Banks

Each FCS bank has its own unique circumstances and risk profile and, therefore, exposure to unfunded commitments and other contingent obligations varies within the FCS. As part of each System bank’s general financing agreement (GFA) with its affiliated associations, System banks have an unfunded commitment to each affiliated association that is a possible outflow of liquidity. The unfunded commitment amount is the difference between the association’s maximum credit limit with the System bank under the GFA or promissory note\textsuperscript{26} and the amount the association has borrowed from the System bank.

The GFA permits a System bank to terminate an association’s loan or to refuse to make additional disbursements in the event of default. The Act prohibits an association from borrowing from commercial banks or other financial institutions without its funding bank’s approval.\textsuperscript{27} We believe there may be merit in incorporating these possible outflows for the bank’s unfunded commitment to its affiliated associations into the existing liquidity reserve requirement because the associations are fully dependent on the bank for funding its operations so it can fulfill its mission.

System banks also have unfunded commitments or other material contingent liabilities to other financing institutions (OFIs) that increase liquidity risk.\textsuperscript{28} System banks are required to provide funding, or provide similar financial assistance to any creditworthy OFI that meets certain requirements.\textsuperscript{29} Although the GFAs with OFIs may permit a System bank to refuse to make additional disbursements in the event of default, a System bank would likely be required to give prior notice to cancel unfunded commitments to OFIs. As part of their GFA with OFIs, System banks can be legally obligated to fund these commitments. These types of outflows may include retail funding, contractual settlements related to derivative transactions, pledging collateral, or other off-balance sheet commitments.

FCS banks may also have outstanding lines of credit to retail borrowers who may draw funds to meet their seasonal, business, or liquidity needs. A line of credit may be used as a liquidity facility to function as an undrawn backup that would be utilized to refinance debt obligations of a borrower in situations where the borrower is unable to rollover that debt in financial markets.

Alternatively, credit facilities provide a line of credit for borrower’s general corporate or working capital purposes. These lines of credit to retail borrowers may or may not be unconditionally cancellable. A sudden surge in borrower demand for funds under these lines may increase demands on the bank’s liquidity at a time when market access is becoming impeded. These unfunded commitments potentially expose both FCS banks and associations to significant safety and soundness risks.\textsuperscript{30}

To incorporate consideration of these unfunded commitments, the liquidity rules of the FBRAs apply a multiplier or “factor” to the gross notional amount to reflect assumptions on how exposures will result in “cash outflows.” These factors are multiplied by the total amount of each outflow item to determine the regulatory outflow amount. The factor applied is dependent on the type of exposure, and is consistent with the Basel III Liquidity Framework and the FBRAs’ evaluation of relevant supervisory information.

The factors applied consider the potential impact of idiosyncratic and market-wide shocks.\textsuperscript{31} While unfunded commitments at System banks should be analyzed in the GFP, banks have significant discretion about the assumptions (i.e., factor) applied. For example, to reflect varying drawdown assumptions System banks may apply a factor, similar to the factors applied in the FBRAs’ rules, to notional amounts outstanding. A higher factor reflects a higher drawdown potential of the undrawn portion of these commitments and results in a higher liquidity requirement in the GFP. For example, a $10 billion exposure at a 10 percent factor would add only $1 billion to the discounted outflows, while a 40 percent factor would add $4 billion to the outflows.

\textsuperscript{23} Section 1101 of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended section 13(3) of the Federal Reserve Act, 12 U.S.C. 343(3), to allow the Federal Reserve Board, in consultation with the Secretary of the Treasury, to establish by regulation, policies and procedures that would govern emergency lending under a program or facility for the purpose of providing liquidity to the financial system. Under section 13(3) of the Federal Reserve Act, as amended, the Federal Reserve Board must establish procedures that prohibit insolvent and failing entities from borrowing under the emergency program or facility. See Public Law 11–203, title XI, sec. 1101(a), 124 Stat. 2113 (Jul. 21, 2010).

\textsuperscript{24} To provide liquidity to small business lenders and the broader credit markets and to help stabilize the financial system, the Federal Reserve Board has created the PPP Liquidity Facility using its authority under section 13(3) of the Federal Reserve Act.

\textsuperscript{25} See FCA’s Supplement to the January 5, 2021, FCA Informational Memorandum: Guidance for System Institutions Affected by the COVID–19 Pandemic: Regulatory Capital Requirements for PPP Loans.

\textsuperscript{26} See § 614.4125(d).

\textsuperscript{27} Under section 2.2(12) of the Act, direct lender associations may borrow money from their affiliated Farm Credit bank, and with the approval of their funding banks, may borrow from and issue notes or other obligations to any commercial bank or financial institution.

\textsuperscript{28} OFI means any entity referred to in section 1.7(6)(3)(B) of the Act.

\textsuperscript{29} See § 614.4540(b) which specifies the criteria for assured access for certain OFIs.

\textsuperscript{30} The Tier 1/Tier 2 Capital framework regulation requires that System banks hold capital against this unfunded wholesale commitment due to the risk presented. See § 628.33 and preamble discussion—81 FR 49737 (July 28, 2016).

\textsuperscript{31} See 79 FR 61440, 61444 (October 10, 2014). Examples include those shocks that would result in: (1) A partial loss of unsecured wholesale funding capacity; (2) a partial loss of secured, short-term financing with certain collateral and counterparties; (3) losses from derivative positions and the collateral supporting those positions; (4) unscheduled draws on committed credit and liquidity facilities that a covered company has provided to its customers; and (5) other shocks that affect outflows linked to structured financing transactions and mortgages.
To evaluate this further, we are seeking comment to determine if we should incorporate unfunded commitments into the existing FCA liquidity framework and what type of factor would be appropriate to capture the drawdown risks.

1. How should FCA incorporate the liquidity risk of unfunded commitments on affiliated associations’ direct notes into the System banks’ liquidity reserve requirement?
   a. Should drawdown factors be applied to unfunded commitments?
   b. If so, what would be an appropriate factor to apply to the direct note unfunded commitments?

2. How should FCA incorporate the liquidity risk of unfunded commitments to OFIs into the System banks’ liquidity reserve requirement?
   a. Should drawdown factors be applied to unfunded commitments?
   b. If so, what would be an appropriate factor to apply to OFI unfunded commitments?
   c. Does the liquidity risk of unfunded commitments to OFIs pose a different risk than unfunded commitments to affiliated associations’ direct notes? If so, how should FCA incorporate this risk into the liquidity reserve requirement?

3. How should FCA incorporate the liquidity risk of unfunded commitments to bank retail borrowers into the System banks’ liquidity reserve requirement?
   a. What would be an appropriate factor to apply to retail borrower unfunded commitments?
   b. Should unfunded commitments to retail borrowers that are not unconditionally cancellable be treated differently from those that are unconditionally cancellable? Please explain why.
   c. Should we consider applying different factors to differentiate the risk between credit and liquidity facilities for association retail borrowers?
   d. Should FCA incorporate the liquidity risk of unfunded commitments to association retail borrowers through a “look through” approach or using the direct note unfunded commitment amount?

Voluntary Advance Conditional Payment Accounts

Section 614.4175 allows member-borrowers to make voluntary advance conditional payments (VACP) on their loans and allows institutions to set up involuntary payment accounts for funds held to be used for insurance premiums, taxes, and other reasons.\textsuperscript{32} VACP (where the advanced payment is not compulsory) accounts have the potential to expose the System to additional liquidity risk in a crisis. More specifically, some VACP accounts may be structured so that System member-borrowers may withdraw funds at their request (although prior notice for withdrawals may be required). A sudden surge in member-borrower draws from VACP accounts held at associations would increase the funding required from the bank to the association. This sudden increase in funding may increase demands on the bank’s liquidity at a time when market access is becoming impeded.

To evaluate this further, we are seeking comment on how we should mitigate the risk VACP accounts pose to the liquidity of System banks.

5. How should FCA incorporate the liquidity risk of VACP accounts at associations into the funding banks’ liquidity reserve requirement?
   a. What would be an appropriate factor to apply to these VACP accounts?
   b. If different factors should apply to different types of VACP accounts, please specify.

Continuously Redeemable Perpetual Preferred Stock

Some System associations have issued continuously redeemable perpetual preferred stock (typically called Harvest Stock or H Stock) to their members who wish to invest and participate in their cooperative beyond the minimum member-borrower stock purchase. H Stock is an at-risk investment; it is issued without a stated maturity and is retireable only at the discretion of the institution’s board. A common feature of H stock is that the issuing association will redeem it upon the request of the holder only if the association is in compliance with its regulatory capital requirements. Because of this feature, FCA considers the stock to be continuously redeemable. Some associations reduce the operational hurdles to redeeming H stock by delegating the board’s authority to retire such stock to management provided certain board-approved minimum regulatory capital ratios are maintained. FCA has determined that holders reasonably expect the institution to redeem the stock shortly after they make a request. A sudden surge in member-borrower redemptions of H Stock held at associations would increase the funding from System bank to its associations. This sudden increase in funding may increase demands on the bank’s liquidity at a time when market access is becoming impeded.

To evaluate this further, we are seeking comment on how we should mitigate the risk H Stock poses to the liquidity of System banks.

6. How should FCA incorporate the liquidity risk of H Stock redemptions at associations into the funding banks’ liquidity reserve requirement? What would be an appropriate factor to apply to H Stock?

Cash Inflows

As discussed above, modifying FCA’s liquidity reserve requirement to capture potential cash outflows, including unfunded commitments, may promote a stronger liquidity profile at System banks. To improve how liquidity is measured and reported, we are also considering incorporating cash inflows into the liquidity reserve requirement.

FCA’s existing liquidity regulation,\textsuperscript{32} Sections 1.5(6) and 2.2(13) of the Act authorize institutions to accept advance payments.
§ 615.5134, does not consider how expected cash inflows would affect the bank’s liquidity reserve requirement. Outside of CFP stress analysis (discussed below), FCA’s existing liquidity framework views the discounted market value of assets held in the liquidity reserve and supplemental buffer as the sole source of liquidity during a liquidity event.\footnote{FCA defined money market instruments to include short-term instruments such as (1) Federal funds, (2) negotiable certificates of deposit, (3) bankers’ acceptances, (4) Eurodollar time deposits, (5) non-callable term Federal funds, (6) Eurodollar time deposits, (7) master notes, and (8) repurchase agreements collateralized by eligible investments as money market instruments. 83 FR 27486, 27489 (June 12, 2018). Of the seven items, the FBRAs only include similar instruments in the LCR’s HQLA framework, such as mutual funds and money market funds. The FBRAs stated that certain underlying investments of the investment companies may include high-quality assets, however, similar to securities issued by many companies in the financial sector, shares of investment companies have been prone to lose value and become less liquid during periods of severe market stress or an idiosyncratic event involving the fund’s sponsor. Additionally, Securities and Exchange Commission (SEC) rules regarding money market funds may also impose some barriers on investors’ ability to withdraw all their funds during a period of stress. sensitive to interest rate fluctuations because they are exposed to less price risk. Conversely, the discount for long-term fixed rate instruments is higher because they expose FCS banks to greater market risk.}

However, in a liquidity event, certain borrowers will still be making payments on their loans, allowing money to flow into the institution that can be used to support ongoing operations. Cash inflows from sources other than the liquidity reserve typically include payments from wholesale and retail borrowers and coupon and scheduled principal payments from securities not included in the liquidity reserve.\footnote{34 See FDIC’s Liquidity Risk Management Standards. Inflow amounts are defined at 12 CFR 225.33.}

The CFP requirement at § 615.5134(f) allows System banks to consider inflows when analyzing how much contingent liquidity they must hold under a 30-day acute stress scenario. However, for the purposes of the CFP, System banks have considerable discretion to determine the assumptions pertaining to the amount of inflows that will offset potential outflows. To evaluate this further, we are seeking comment to determine if we should incorporate inflows into the existing FCA liquidity framework.

7. How should FCA incorporate the uncertainty of cash inflows into System banks’ liquidity reserve requirements?\footnote{35 Assets held in the supplemental liquidity buffer are not subject to the marketability standard in § 615.5134(d). However, investments held in the supplemental liquidity buffer are not subject to the same marketability standard. Thus, there is the potential that the supplemental liquidity buffer may include investments that are not marketable or liquid under certain circumstances. To evaluate this further, we are seeking comment to determine if we should hold investments in the supplemental liquidity buffer to the same or similar marketability standards as assets in the liquidity reserve.}

8. What would be an appropriate discount percentage to apply to the different types of inflows (such as payments from wholesale and retail borrowers, payments from securities not included in the liquidity reserve)?

9. What type of operational changes (such as data elements, general ledger requirements, and systems) would be required to accurately capture inflow and outflow information to calculate liquidity ratios on a daily or monthly basis?

Stability of a Bank’s Balance Sheet

The amount of liquid assets that a bank must maintain is generally a function of the stability of its funding structure, the risk characteristics of the

balance sheet, and the adequacy of its liquidity risk measurement program. System banks provide funding to their affiliated associations through the direct note which is a significant portion of the bank’s assets. The bank’s direct note assets are impacted by the funding and liquidity demands of their affiliated associations. However, System banks directly control the mix of funding for these assets, as well as the risk characteristics of other assets acquired. System banks issue System-wide debt securities as the primary source for funding loans and investments. As part of the examination process, FCA evaluates how each bank’s debt structure helps limit liquidity risks. For example, if a bank funds its balance sheet wholly with short-term debt, the resulting large amounts of debt maturing each week would cause the bank to be vulnerable to market disruptions and liquidity risk. Therefore, debt maturities should be structured in a manner that are extended and align with the tenor and composition of the bank’s assets. In addition, debt maturities should ensure longer-term stable funding.

FCA’s existing liquidity framework does not directly address the stability of a bank’s balance sheet and does not require compliance with specific debt structure ratios. To evaluate this further, we are seeking comment to determine if we should add requirements regarding the structure of a bank’s balance sheet into the existing FCA liquidity framework.

10. How should FCA amend its liquidity regulations to strengthen the stability of the balance sheet structure at FCS banks?

11. Under what circumstances might it be appropriate for FCA’s liquidity framework to better address funding methods such as discount notes and short funding?

Marketability of the Supplemental Liquidity Buffer

Currently, investments held in a bank’s liquidity reserve must be marketable in accordance with the criteria in § 615.5134(d). However, investments held in the supplemental liquidity buffer are not subject to the same marketability standard.\footnote{37 See SEC, ‘‘Money Market Fund Reform; Amendments to Form FF,” 79 FR 47736 (August 14, 2014).} Thus,
COVID–19 pandemic. For example, in March 2020, Commercial paper (CP) and Certificate of deposit (CD) markets both became stressed. Under normal market conditions, secondary trading volume in CP and CD markets is limited as most investors purchase and hold these short-dated instruments to maturity. However, in March 2020, as some market participants, including money market mutual funds and others, may have sought secondary trading, they experienced a “frozen market.” For liquidity purposes, both secondary trading and new issuances of CP and CD halted for a period of time during the pandemic.

FCA’s existing definition of “marketable” in §615.5134(d) makes an exception for money market instruments. Specifically, §615.5134(d)(4) exempts money market instruments from the requirement that investments in the liquidity reserve must be easily bought and sold in active and sizeable markets without significantly affecting prices. Additionally, money market instruments are not subject to FCA’s investment portfolio diversification requirements and are not limited in the liquidity reserve requirement. To evaluate the type of instruments and definitions allowed under the FCA liquidity framework, we are seeking comment to determine if we should align the instruments in FCA’s liquidity reserve requirement with the FRBAs HQLA framework.

13. Given the risks of money market instruments and diversified investment funds and that the FRBAs do not consider these instruments to be high quality liquid assets, why should FCA continue to permit these instruments to be included in an FCS bank’s liquidity reserve? If you believe that we should continue to allow money market instruments and diversified investment funds in the liquidity reserve requirement, how could FCA mitigate the risks they pose? 14. What factors should FCA consider in evaluating the risk of money market instruments and diversified investment funds in the context of the total liquidity reserve requirement? 15. Should FCA consider limiting money market instruments and diversified investment funds included in specific levels in the liquidity reserve to mitigate concentration risk? Please explain your reasoning.

FCA’s Liquidity Reserve and High-Quality Liquid Assets in Liquidity Coverage Ratio

The FRBAs’ HQLA allowed in the LCR differ from liquid assets allowed in FCA’s liquidity regulation. FCA’s regulation allows certain instruments to qualify as liquid assets even though they are excluded from the LCR, such as investment company shares (mutual funds and money market funds). However, the LCR allows certain instruments to be included in HQLA that are excluded from FCA’s liquidity regulation, such as municipal obligations and certain corporate bonds. There are also certain instruments in HQLA that System banks do not have the authority to purchase. FCA’s regulation also differentiates liquid assets by tenor while the LCR does not. Additionally, the LCR applies more substantial discounts or “haircuts” to HQLA than FCA’s liquidity regulation applies to the same assets. The FRBAs also limit certain assets to a percentage of the total eligible HQLA amount, whereas FCA does not. To evaluate this further, we are seeking comment to determine if we should consider aligning FCA’s existing requirements for liquid assets with the LCR’s HQLA.

16. Should FCA consider expanding the instruments eligible under the liquidity reserve to more closely align with the HQLA framework of the FRBAs? If so, which instruments should be considered and how would including the instruments add strength to the existing liquidity framework? 17. Should FCA consider reviewing tenor requirements in its existing liquidity regulations? If so, which instruments should be considered and how would the requirements add strength to the existing liquidity framework? 18. Should FCA consider changing discount values assigned to assets held for liquidity to more closely align with those applied under the LCR’s HQLA framework? 19. Should FCA consider limiting certain assets included in the liquidity reserve to mitigate concentration risk? If so, what assets should be limited and what percent should they be allowed to count towards the reserve requirement?

Liquidity and COVID–19

FCS banks withstood the recent economic and financial turmoil from COVID–19 with their liquidity intact. However, both the FCA and FCS continue to gain insights into the effects that sudden and severe stress have on liquidity at individual FCS institutions and in the entire financial system. For example, in March of 2020, financial markets experienced a “flight to cash” where demand for cash and the highest quality cash like instruments dramatically increased, while demand (and thus prices) for less liquid instruments declined. System banks are required to adopt a CFP to ensure sources of liquidity are sufficient to fund normal operations under a variety of stress events. Such stress events include, but are not limited to market disruptions, rapid increase in loan demand, unexpected draws on unfunded commitments, difficulties in renewing or replacing funding with desired terms and structures, requirements to pledge collateral with counterparties, and reduced market access.

As addressed above, we are reviewing our regulatory and supervisory approaches towards liquidity so that System institutions are in a better position to withstand whatever future crises may arise. As part of our ongoing efforts to limit the adverse effect of rapidly changing economic, financial, and market conditions on the liquidity of any FCS bank, we are seeking comment to determine if we should make updates to our regulations to better prepare for future liquidity crises.

20. How should FCA further incorporate the demand for cash and highly liquid U.S. Treasury securities during times of crisis into the System banks liquidity reserve requirement? 21. What type of updates should FCA consider to the CFP requirements in §615.5134(f)?

B. Applicability of the Liquidity Coverage Ratio and Net Stable Funding Ratio

System Banks and the LCR and NSFR

For the reasons discussed above, the FCA is exploring whether, and to what extent, the LCR and NSFR should apply to System banks now that the FRBAs

34651
issued final rules implementing the Basel III Liquidity Framework in the United States. More specifically, we are evaluating whether it is feasible to adjust the LCR and NSFR to the System’s cooperative and non-depository structures and its mission as a GSE, and we are seeking your input. In the alternative, we are considering whether to incorporate specific elements of the LCR and NSFR into our liquidity regulation, and we are interested in your ideas about how to do so.

22. What core principles would be most important in FCA’s consideration of the Basel III Liquidity Framework? How relevant is the Basel III Liquidity Framework to the cooperative and non-depository structure of the FCS?

23. To what extent should FCA propose a similar rule to the FBRA’s LCR and NSFR?

a. Should FCA completely replace its existing liquidity regulations with an LCR and NSFR framework or only augment existing regulations with certain elements of the LCR and NSFR framework? If so, please explain.

b. What specific modifications, if any, should FCA consider making to the LCR and NSFR ratios for application to System banks, and why?

c. If FCA proposed to incorporate the LCR and NSFR ratios as part of the CFP requirement in § 615.5134(f), what types of modifications would be necessary to include elements of the ratios, without being redundant or overly burdensome?

24. If the FCA closely aligned the LCR and NSFR to the FBRA’s regulations, and made only narrow modification to accommodate the System’s unique structure, would the results enable FCS banks to better withstand liquidity crises, or in the alternative, prove too costly or burdensome? Please explain.

25. How would the implementation of an LCR and NSFR impact the System’s funding structure, lending activities, or use of discount notes?

26. If FCA proposes an LCR, should FCA treat System institutions as financial sector entities and apply the relevant factor under the LCRs’ definition?

27. If FCA proposes an LCR, what would be an appropriate factor to apply to the Member Investment Bonds and why?

Voluntary Advance Conditional Payment Accounts

As discussed above, FCA regulation § 614.4175 allows member-borrowers to make VACP on their loans and allows institutions to set up involuntary payment accounts for funds held to be used for insurance premiums, taxes, and other reasons. A sudden surge in member-borrower draws from VACP accounts held at associations would increase the funding required from the System bank to the affiliated association at a time when market access is becoming impeded. To evaluate this further, we are seeking comment to determine if we propose an LCR, what the most appropriate factor for these investment bonds would be.

28. If FCA proposes an LCR, given the uniqueness of VACP accounts and the ability of member-borrowers to withdraw certain VACP account funds at their request, what would be an appropriate factor?

29. If different factors should apply to different VACP accounts, please specify.

46 Credit and liquidity facility are defined at 12 CFR 329.3. A credit facility is a legally binding agreement to extend funds at a future date and generally includes working capital facilities (e.g., revolving credit agreements for general corporate or working capital purposes). A liquidity facility is a legally binding agreement to extend funds for purposes of refinancing the debt of a counterparty when it is unable to obtain a primary or anticipated (financial sector entity or non-financial sector entity). The direct notes from System banks to System associations under the GFAs are credit facilities, not liquidity facilities. Unfunded commitments on a credit facility to a financial sector entity have a 40 percent factor, while the same commitment to a non-financial sector entity only have a 10 percent factor. Financial sector entities typically have shorter-term funding structures and higher correlations of drawing down commitments during times of stress which support a higher factor when compared to non-financial sector entities. A higher factor results in a higher liquidity requirement under the LCR.

The FBRA’s LCR regulation defines a financial sector entity to include a regulated financial company, but specifically excludes GSEs. The FCS is a cooperative system of financial institutions that the FCA charters and regulates in accordance with the Act. System associations lend directly to and provide certain financially-related services to eligible borrowers. The System’s lending activities to retail borrowers, and its structure are different than the activities and structure of other GSEs excluded from the FBRA’s definition of financial sector entity. Unlike the other GSEs, most FCS institutions lend directly to retail borrowers in a manner that is substantially similar to lenders that the FBRA defines as financial sector entities. To evaluate this further, we are seeking comment to determine if we propose an LCR, what the most appropriate factor for these investment bonds would be.

26. If FCA proposes an LCR, should FCA treat System institutions as financial sector entities and apply a 40 percent factor to the unfunded portion of the associations’ direct note commitments?

a. If so, what supports FCA treating System institutions as financial sector entities and applying a 40 percent factor on the unfunded commitments System banks have to associations?

System Bank Member Investment Bonds

Two System banks offer investment bonds to their member-borrowers and other specified individuals, such as bank employees (Member Investment Bonds). Both programs are similar in that each bank offers overnight or short-term, uninsured bonds to the bank’s members and other specified individuals. Member Investment Bonds are structured so that holders may redeem funds at their request (although prior notice for withdrawals may be required). Given their short maturity, a holder’s investment may be continuously rolled over until they provide notice to redeem the investment, which may be at any time. Member Investment Bonds present a liquidity demand similar to maturing System bonds. Accordingly, FCA treats Member Investment Bonds and maturing System bonds the same under the existing liquidity rules. Under the LCR, there are several different outflow categories that Member Investment Bonds could fall into. To evaluate this further, we are seeking comment to determine if we propose an LCR, what the most appropriate factor for these investment bonds would be.

26. If FCA proposes an LCR, should FCA treat System institutions as financial sector entities and apply a 40 percent factor to the unfunded portion of the associations’ direct note commitments?

b. If not, what supports FCA treating System institutions as non-financial sector entities and applying a 10 percent factor on the unfunded commitments System banks have to associations?
As discussed above, the FBRAs’ HQLA allowed in the LCR differ from liquid assets allowed in FCA’s liquidity regulation. To evaluate this further, we are seeking comment to determine if we propose an LCR, should FCA consider aligning FCA’s liquid assets with the LCR’s HQLA.

30. If FCA proposes an LCR, should we replace the current list of eligible instruments for the liquidity reserve with a list that is more closely aligned to the FBRAs’ HQLA instrument list (excluding common equities)? Please explain.
   a. Should FCA’s liquidity regulation continue to allow FCS banks to hold in their liquidity reserve instruments that are currently excluded from the FBRAs’ HLQA list? Which instruments and why?
   b. Should FCA allow FCS banks to hold in their liquidity reserves instruments that are included in the FBRAs HLQA list, but are currently excluded from FCA’s liquidity regulation? Which instruments and why?

Net Stable Funding Ratio Applicability

The BCBS introduced the NSFR to require banks to maintain a stable funding profile to reduce the likelihood that disruptions in a bank’s regular sources of funding will erode its liquidity position that may increase its risk of failure. Furthermore, during periods of financial stress, financial institutions without stable funding sources may be forced to monetize assets in order to meet their obligations, which may drive down asset prices and compound liquidity issues. The NSFR implements a standardized quantitative metric designed to limit maturity mismatches and applies favorable factors to a commercial bank’s primary funding source—deposits. The NSFR requires a bank to maintain an amount of available stable funding (ASF) that is not less than the amount of its required stable funding (RSF) on an ongoing basis. ASF and RSF are calculated based on the liquidity characteristics of a bank’s assets, derivative exposures, commitments, liabilities, and equity over a one-year time horizon.

The NSFR and its corresponding factors adopted by the FBRAs were established to measure and maintain the stability of the funding profiles of banking organizations that rely primarily on deposits. In contrast, FCS banks issue System-wide debt securities as the primary source for funding its operations. The System would potentially need to modify its funding structure to meet an NSFR by incorporating more long-term debt issuances. To evaluate this further, we are seeking comment to determine if the NSFR is applicable to the System’s funding structure, authorities, and mission.

31. What core principles would be most important in FCA’s consideration of the NSFR? How does the cooperative and non-depository structure of the System relate to the NSFR?
32. How could NSFR metrics replace any existing regulations, to ensure System banks have sufficiently stable liabilities (and regulatory capital) to support their assets and commitments over a one-year time horizon?
33. Is it beneficial or detrimental to replace existing regulations with NSFR metrics and why?

Other Considerations

The BCBS developed the Basel NSFR standard as a longer-term balance sheet funding metric to complement the Basel LCR standard’s short-term liquidity stress metric. In developing the Basel NSFR standard, the FBRAs and their international counterparts in the BCBS considered a number of possible funding metrics.49 The Basel guidance and FBA’s NSFR regulation incorporated consideration of these and other funding risks.50

34. What other approaches or methodologies to measuring and regulating liquidity not discussed above should FCA consider and why?

C. Other Comments Requested

We welcome comments on every aspect of this advance notice of proposed rulemaking. We encourage any interested person(s) to identify and raise issues pertaining to other aspects of the liquidity framework for FCS banks and associations that we did not address in this ANPRM. Please designate such comments as “Other Relevant Issues.”

* * * * *

Dated: June 10, 2021.

Dale Aultman,
Secretary, Farm Credit Administration Board.

[FR Doc. 2021–13556 Filed 6–29–21; 8:45 am]

BILLING CODE 6705–01–P

49 For example, the BCBS considered the traditional “cash capital” measure, which compares the amount of a firm’s long-term and stable sources of funding to the amount of the firm’s illiquid assets. The BCBS found that this cash capital measure failed to account for material funding risks, such as those related to off-balance sheet commitments and certain on-balance sheet short-term funding and lending mismatches.

50 See 86 FR 9120 (February 11, 2021). See supra footnote 19.