

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

INFORMATIONAL MEMORANDUM



May 16, 2012

To: The Chairman of the Board
The Chief Executive Officer
All Farm Credit System Institutions

From: Gary K. Van Meter, Director
Office of Regulatory Policy

A handwritten signature in black ink that reads "Gary K. Van Meter". The signature is written in a cursive style and is positioned to the right of the typed name.

Subject: Association Investments

We wish to remind Farm Credit System (System) associations that, pursuant to FCA Regulation § 615.5142, they may hold eligible investments for only two purposes:

1. Reducing interest rate risk (IRR), and
2. Managing surplus short-term funds.

System associations may hold investments for other purposes only with the FCA's approval under § 615.5140(e). The FCA has approved various mission-related investment pilot programs, including the Rural America Bond program and the Agricultural and Rural Community bond program, under this provision.

Although we have never defined the phrase "surplus short-term funds," our view is that "short-term" refers to investments with maturities of weeks or months—not years. Also, "excess borrowing capacity" should not be considered "surplus" funds. Accordingly, investments in longer-term instruments that are primarily made for the purpose of using "excess borrowing capacity" are inconsistent with § 615.5142.

Recently, our examiners have noted an increase in System association investments for purposes other than those set out in § 615.5142. Frequently these investments involve securities that are fully insured or guaranteed by the United States Small Business Administration (SBA). System association managers have offered several purposes for buying these securities: generating earnings, diversifying assets, diversifying income streams, managing (rather than reducing) IRR, and enhancing liquidity. None of these purposes are consistent with § 615.5142. System association managers have also stated that investments such as eligible SBA-guaranteed investments reduce IRR and are a way of managing surplus short-term funds, but they have not supported these assertions. Recent examinations of SBA-guaranteed investments concluded these investments actually increased IRR. Moreover, these

investments generally have terms 10 years or longer. System associations must not acquire investments that are inconsistent with § 615.5142.

All System associations should review their existing investments and commitments to purchase to determine if they are held or would be held, as applicable, for permissible purposes under § 615.5142 or have been approved under § 615.5140(e). In the past, the FCA has not required institutions to divest of existing investments that are eligible but that are held for impermissible purposes, as long as the investments pose no safety and soundness risks. However, failure to comply with § 615.5142 for future purchases of investments could result in the FCA's Office of Examination citing your institution for violating § 615.5142 and requiring appropriate corrective action, including divestiture.

We also wish to remind System banks of their obligations under § 615.5142 to approve the investments of and to review annually the investment portfolio of every System association that they fund.

This memorandum provides information relative to current FCA regulations. FCA issued a proposed rule to revise the regulations applicable to investments in August of 2011.¹ We are still reviewing the comments on that regulation, and the FCA Board has not made any determination on a final rule. As a result of that rulemaking process, we may provide additional guidance or make regulatory changes in this area in the future.

If you have questions in regard to this guidance, please contact the Examiner-in-Charge for your institution, or Paul Gibbs, Senior Accountant, Office of Regulatory Policy, at (703) 883-4203 (gibbsp@fca.gov).

¹ We proposed to revise the rules regarding investments made by System institutions at 76 FR 51289 (August 18, 2011).