Farm Credit Administration

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INFORMATIONAL MEMORANDUM

October 17, 2006

To: Chief Executive Officer
All Farm Credit System Institutions

From: Andrew D. Jacob, Director, Office of Regulatory Policy

Subject: Zero Percent Capital Risk Weighting of Guaranteed Portions of Loans Purchased in the Secondary Market

Purpose of this Informational Memorandum
The purpose of this Informational Memorandum (IM) is to clarify when a loan guarantee by a government agency is "unconditional" for purposes of riskweighting assets under Farm Credit Administration (FCA) capital regulation § 615.5211(a)(3). Farm Credit System (System) institutions may purchase guaranteed portions of loans in the secondary market using their investment authorities. When these purchases occur, the System institution is typically described as a "Holder" or "Registered Holder."

Targeted Audience of this Informational Memorandum
The targeted audience of this IM is System institutions who have purchased portions of loans guaranteed by U.S. Government agencies under various programs. Those institutions purchased instruments such as:

"Guaranteed Interest Certificates" of Small Business Administration (SBA) guaranteed loans, and Assignments of guaranteed portions of loans under United States Department of Agriculture (USDA) programs such as:

> Farm Service Agency – Operating Loans and Farm Ownership Loan Program,
> Rural Business Service – Renewable Energy Systems and Energy Efficiency Improvements Program,
> Rural Business-Cooperative Service – Business and Industry Program, and
> Rural Housing Service – Community Facilities Program.

System institutions that purchase SBA "Guaranteed Interest Certificates" are described as "Registered Holders" in SBA legal documents and regulations. System institutions that purchase the USDA assignments are described as "Holders" in USDA legal documents and regulations. This list is non-exclusive; System institutions may purchase guaranteed instruments under other similar government agency guarantee programs.

If you are an originator (described by SBA and USDA as a “lender”) of a loan that is guaranteed by the SBA or USDA and you retain an interest in and service the loan, associated risk-weighting issues are beyond the specific focus of this IM.

FCA’s Regulation § 615.5211(a)(3)
In order for System institutions to arrive at a “risk-adjusted asset” amount, § 615.5211 assigns balance sheet assets to various risk categories (e.g, 0, 20, 50, 100, 200 percent). That risk-adjusted asset amount is then used to calculate various capital adequacy ratios.

As provided by paragraph (a)(3) of that section, System institution assets that represent “direct claims on, and portions of claims *unconditionally guaranteed* by, the U.S. Treasury, government agencies, or central governments in other OECD countries,” are assigned to the zero percent risk category.

Requirements for Assigning a Zero Percent Risk Rating
System institutions that purchase instruments guaranteed by U.S. Government agencies, such as those described above, may assign those assets to the zero percent risk category as long as the guarantee is “unconditional.” For purposes of this regulation, a U.S. Government agency guarantee is unconditional if both the applicable regulations governing the loan guarantee program and the applicable loan, assignment, and secondary market documents provide the following:

- The guarantee is an obligation supported by the full faith and credit of the United States.
- The guarantee is incontestable except for fraud or misrepresentation that the holder participates in, condones, or has knowledge of.
- The validity of the guarantee is not dependent on any affirmative action (such as servicing or reporting) by the purchaser of the guaranteed portion of the loan in the secondary market.

If a U.S. Government agency guarantee does not satisfy the above factors, it is considered to be a conditional guarantee. Under § 615.5211(b)(5), portions of loans and other claims that are conditionally guaranteed by the U.S. Treasury, government agencies, or central governments in other OECD countries are assigned to the 20 percent risk category.

Applicability to Government Agency Guarantee Programs
The above listed SBA and USDA programs are examples of programs that provide unconditional guarantees to secondary market investors (also called “Registered Holders” or “Holders”) and thus are suitable for zero percent risk weighting. Additional government agency programs with similar characteristics may exist. Also, the characteristics of the programs listed above may change in the future. Therefore, it is necessary for System institutions investing in SBA certificates, USDA assignments, and guaranteed loan portions under other government agency programs to ensure that the above factors are satisfied for a particular asset before assigning a zero percent risk rating.

Under § 615.5210(f), the FCA reserves its authority, on a case-by-case basis, to determine the appropriate risk weight for any guaranteed loan portion, or a security that is backed by a guaranteed loan portion, that imposes risks that are not commensurate with a zero percent risk weighting. Additionally, future amendments to our capital regulations may affect risk weightings.

FCA Contacts

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