

Farm Credit Administration

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

INFORMATIONAL MEMORANDUM



January 11, 2005

To: Chairman, Board of Directors
Chief Executive Officer
All Farm Credit System Institutions

From: Nancy C. Pellett
Chairman and Chief Executive Officer

Subject: Investments in Rural America—Pilot Investment Programs

You have told us in your comment letters, testimony, and in other forums that investments could enable the Farm Credit System (FCS or System) to play a greater role in stimulating economic growth and development in rural areas. We want to provide the System additional opportunities to make investments that meet the growing and changing demands of agricultural enterprises, agribusinesses, and rural communities for stable, dependable, affordable, and flexible financing. Further, we recognize that different investment strategies are needed to address the diverse needs of agriculture and rural communities across America.

FCS banks, associations, and service corporations (collectively, FCS or System institutions) are authorized by § 615.5140(e) of FCA regulations to hold investments that the Farm Credit Administration (FCA) approves on a case-by-case basis. An Informational Memorandum that the FCA issued on June 25, 2004, outlined what information FCS institutions should submit when they seek permission to hold investments, pursuant to § 615.5140(e), that advance their mission to finance agriculture and rural America. Some FCS institutions have expressed interest in creating pilot investment programs for this purpose, and they have requested more guidance.

This Informational Memorandum provides general guidance to System institutions on what factors the FCA would consider when it evaluates requests to approve pilot investment programs. This Informational Memorandum also discusses mission-related investment suggestions that could help agriculture and rural communities meet their ongoing debt and equity financing needs. We hope that this guidance is helpful as you develop pilot investment programs for further consideration by FCA.

WHAT INFORMATION SHOULD YOU SUBMIT?

The FCA will look at a variety of factors in determining whether to approve a pilot program. We have outlined several of those factors below.

Institution Rating

In evaluating your application, the FCA will consider the Composite Financial Institution Rating System rating that was assigned to your institution during the most recent examination.

Policies and Procedures

The FCA will review the written policies approved by your board of directors that will govern your pilot program. In developing policies for your pilot investment programs, we suggest that you review the investment management regulations at § 615.5133 and our June 25, 2004, Informational Memorandum on Investments in Rural America to determine the type of information that you might include in your application. Your policies should be appropriate for the size, type, complexity, and risks involved in your proposed pilot investment program. In particular, § 615.5133 requires that your investment policies establish appropriate credit risk limits (e.g., minimum issuer credit ratings, underwriting criteria, or counterparty exposure limits) and address liquidity and market risks. Additionally, your policies should address delegations of authority, valuation and reporting requirements, internal controls, and any other safeguards your board deems appropriate.

Issuers

Your request for approval should identify the types of issuers that your institution may invest in under the pilot investment program.

Qualifying Collateral

When appropriate, your request should describe the underlying collateral for the obligations that you plan to invest in under your pilot program. Primary collateral for your pilot program should be assets related to agriculture, agribusiness, and rural economic development and housing. Your request for approval should also address how your institution will treat collateral, such as loans and obligations that become past-due.

Overcollateralization

Your request should indicate whether, and under what conditions, your pilot program would require an issuer to continuously support its obligations by pledging qualifying collateral that exceeds outstanding obligations held by your institution. Your application should inform us whether and how frequently you plan to perform your own due diligence review to confirm that the collateral continues to qualify for your pilot program. You may also want to inform us of any other credit enhancements that you deem necessary or appropriate. The information that you submit to us should address the procedures, arrangements, and agreements that you will

establish to ensure that the issuer maintains the minimum collateral pledged to support its outstanding obligations.

Terms to Maturity

Your request for approval should specify the maximum term to maturity for investments that you plan to purchase and hold under your pilot program.

Program Limits

Your request for approval should specify the maximum dollar amount and percentage of total assets that your institution plans to place on investments held under your proposed pilot program. You should also specify the amount of total capital that your institution can invest in any single issuer, obligor, or counterparty.

Deterioration of Credit Quality in these Investments

Your request for approval should explain how your institution would treat pilot program investments that no longer meet the underwriting standards and other requirements in your policies. For example, in deciding whether to grant approval to your request, the FCA would consider whether, when, and under what conditions your policies require your institution to divest itself of such investments.

Duration of Pilot Investment Program

Your request should state the length of time (in months or years) that your proposed pilot investment program will last. You should also tell us the criteria that you intend to use to evaluate whether the proposed pilot investment program has met your institution's objectives at the end of this period.

EXAMPLES OF PILOT INVESTMENT PROGRAMS

Interested parties, such as rural residents, members of Congress and state legislatures, government officials, academicians, and financial institutions have expressed their views in various forums about the types of investments rural America needs for economic growth and development. Several FCS institutions have expressed interest in buying and holding certain types of mission-related investments. While we are not preapproving any particular program, this Informational Memorandum discusses various types of investments that you might want to submit for approval on a case-by-case basis. System institutions may also propose pilot programs that are based on other types of investments that are not discussed in this memorandum. We welcome your ideas and proposals.

Partnerships with Agricultural and Rural Community Lenders

Specifically, the FCA has heard many suggestions that agricultural and rural lenders need adequate and flexible funding to better serve the evolving and increasing needs of their communities. Pilot investment programs designed to foster partnerships and risk-sharing through investments in obligations issued by agricultural and rural community lenders that are secured by a pledge of the issuer's qualifying collateral could help fulfill this vital role. As discussed earlier, the primary collateral should be assets related to agriculture, agribusiness, or rural economic development and housing. Supplemental collateral may also include cash and highly marketable securities, such as U.S. Treasury securities or other obligations backed by the full faith and credit of the United States.

Rural Economic Development and Infrastructure

Rural economic development and infrastructure projects are another area where the System might significantly help rural communities prosper. FCS institutions may consider developing a pilot investment program that helps meet the financing needs of their local rural communities for infrastructure that supports sustainable economic development. If approved by the FCA, a System institution could invest in general obligation or revenue bonds of rural communities that do not meet the underwriting criteria of § 615.5140(a)(2). Your request for approval should establish specific underwriting standards that comply with policies adopted by your board of directors. For example, your request for approval of your pilot investment program should identify the criteria that you will use in evaluating credit risk, such as the issuer's credit rating and/or other evaluative criteria, such as debt service coverage, reserves, availability of government support, and bond insurance.

These investments might help rural communities build needed infrastructure, such as schools, fire stations, hospitals, and other health care facilities, and support economic development. Additionally, investments in these obligations might help build or extend utilities, including water, electricity, and telecommunications services in rural areas.

Rural Housing

System associations already have authority to make housing loans to eligible rural homeowners under sections 1.11(b) and 2.4(b) of the Act and § 613.3030 of the FCA regulations. Some System institutions have inquired whether they can hold investments in obligations and mortgage securities that increase the availability of affordable housing in rural America. Mortgage revenue bonds issued by state and local housing finance agencies are an example of investments that help provide funding for underserved markets. These agencies issue tax-exempt mortgage revenue bonds to finance (1) housing for low- and moderate-income borrowers, (2) housing for people with special needs, (3) home rehabilitation, (4) homes in Native American communities, and (5) multifamily housing in rural areas. FCS banks, associations, and service corporations may consider designing a pilot investment program to purchase mortgage revenue bonds issued by housing finance authorities where the proceeds are directly invested in rural communities.

FCS institutions may find other opportunities to help finance the housing needs of rural areas through investments in pools of rural residential mortgage loans that other lenders originate. In

particular, we are interested in examples of how FCS institutions might utilize their investment authorities to share risk with other rural housing lenders.

Equity Investments

The need for greater private equity capital investment in rural areas is well documented. For several years, FCS institutions have asked us for greater flexibility to make equity investments in agriculture and rural enterprises. We have considered petitions from various FCS institutions for approval to make noncontrolling equity investments in value-added agribusinesses, newly formed alternative energy businesses (e.g., biomass, ethanol, and wind), rural telecommunication businesses, community development financial institutions (and other entities that generate New Markets Tax Credits), and entities that help financial institutions market and deliver services over the Internet.

In addition to the information discussed above, requests for approval of pilot programs involving equity investments should address the following:

- How your institution plans to limit risks (including financial, business reputation, and legal risks)
- Structure, ownership, control, and capitalization of the entity through which your institution plans to conduct equity investment activities
- Types of enterprises in which your institution will hold equity investments
- Limits on equity investments, such as limits that may apply to ownership interests and voting equity
- Maximum duration of equity investments
- Qualifications of the management team that will oversee equity investment activities
- Valuation, reporting, and internal control processes
- Plans for disposal of assets that may be acquired through liquidation

APPLICATION PROCESS AND CONTACT INFORMATION

The FCA is open to your thoughts and suggestions on appropriate investments in rural America for System institutions. If your institution is interested in seeking FCA's approval to test your ideas through a pilot program, please submit your request to Edward Harshbarger, Acting Director, Office of Policy and Analysis, and send a copy to the FCA field office responsible for examining your institution. If you have any questions or would like to discuss possible investment opportunities or programs with the Agency, please contact Laurie A. Rea, Acting Assistant Director, Office of Policy and Analysis, at (703) 883-4232 or by e-mail at real@fca.gov.