Fact Sheet

Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

October 13, 2011

Contact: Michael Stokke or Christine Quinn,
703-883-4056
E-mail: info-line@fca.gov
Website: www.fca.gov

Fact Sheet on Farmer Mac Non-Program Investment and Liquidity Management: Notice of Proposed Rulemaking

The Farm Credit Administration (FCA) Board adopted a proposed rule on October 13, 2011, to revise its regulations governing non-program investment and liquidity management at the Federal Agricultural Mortgage Corporation (Farmer Mac). FCA first issued these regulations in 2005. The recent financial crisis and recent developments in best practices present several opportunities to update and strengthen these regulations.

In addition, in July 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 939A of the Dodd-Frank Act requires all Federal agencies to review their regulations that refer to or require the use of credit ratings, to remove those references and requirements, and to substitute other appropriate standards of creditworthiness. While this proposed rule does not propose new standards, it does discuss and seek comment regarding the best approach to setting creditworthiness standards for eligible investments purchased by Farmer Mac. Below is a summary of the proposed changes and a listing of the questions on which FCA seeks comment.

Summary of Proposed Changes

652.5 Definitions — We propose to add definitions for “cash,” “contingency funding plan,” “liability maturity management plan,” “liquidity reserve,” and “Office of Secondary Market Oversight (OSMO)” to introduce the terms or define acronyms for increased user-friendliness to the reader.

652.10 Investment Management — We propose additional Board policy requirements and enhanced internal controls of investments. We also propose to address investment eligibility through a section entitled “Due Diligence.” We propose to incorporate stress testing into the section. We also propose to strengthen our regulations over investment reporting so that the

-more-

Board of Directors would have sufficient information regarding investment portfolio practices and results.

652.15 Non-Program Investment Purposes and Limitation — We propose to add a new permissible purpose for non-program investments: investments that complement program business. This purpose would recognize that certain investments, such as investments with a rural focus that are backed by the full faith and credit of the United States Government, could advance Farmer Mac's mission. Farmer Mac would, however, need to seek FCA's prior approval for any investments not explicitly authorized on the list of eligible investments.

We propose to exclude from the calculation of the 35-percent-of-total-outstanding-loans portfolio maximum all investments posted as margin against derivative exposures. We propose this change because the Dodd-Frank Act may result in additional margin requirements for Farmer Mac, and we do not want to discourage the use of derivatives as an appropriate risk management tool. We propose to revise the maximum non-program investment limit to eliminate the outdated floor on that maximum of $1.5 billion which, given its growth, Farmer Mac should not need to rely on in the future.

652.20 Eligible Investments — We propose to reduce some of our maturity and portfolio concentration limits and eliminate commercial mortgage-backed securities from the list of authorized investments. The proposal would also make clear that subordinated debt is not a permissible investment. We further propose to revise single obligor limits; e.g., none for Treasuries and 15 percent of regulatory capital for all others – down from the existing 25 percent of regulatory capital.

652.25 Management of Ineligible and Unsuitable Investments — The existing rule requires Farmer Mac to divest of ineligible investments within six months unless FCA approves a divestiture plan for a longer period. Under the proposed rule, the eligibility of investments would be determined only at the time of purchase. Investments that are eligible at the time of purchase would remain eligible even if their credit quality deteriorates – though such events would trigger additional reporting requirements. The proposed rule specifies liquidity reserve treatment for investments with deteriorated credit quality. The proposed rule would also reserve FCA's authority to require divestiture for safety and soundness reasons.

652.30 Management of Interest Rate Risk — We propose to strengthen the interest rate risk management section by broadening its application to the whole investment portfolio. Under the proposal, Farmer Mac would have to establish policies and procedures to, among other things, consider the nature and purpose of derivative contracts and establish derivative counterparty limits.

652.35 Liquidity Management — We propose to add a requirement for a Liability Maturity Management Plan (LMMP) to emphasize the need to effectively manage the term structure of liabilities and the associated funding risk. We also propose to add a requirement for liquidity

Contingency Funding Plan (CFP) to ensure that well-conceived and sufficiently detailed plans are in place to deal with all aspects of response to a variety of liquidity stress scenarios.

652.40 Liquidity Reserve Requirement and Supplemental Liquidity — We propose to restructure the minimum liquidity standard as well as to increase the minimum from 60 days to 90 days of maturing obligations. The proposal would require Farmer Mac to hold cash and/or Treasury securities ("Level 1" assets) in an amount sufficient to meet obligations for 30 days. A second tier of liquid assets ("Level 2" assets) would be required to fund an additional 60 days of maturing obligations, for a total of 90 days of liquidity. Finally, "supplemental liquidity," above the 90-day minimum, would be made up of either Level 1 and 2 assets or a third-most-liquid tier of eligible asset classes.

We also propose to restructure discounts applied to non-program investments for purposes of calculating days of liquidity. The restructuring achieves a simplified approach but also deepens discounts on assets that represent the third-most-liquid tier of eligible assets.

652.45 Temporary Regulatory Waivers or Modifications for Extraordinary Situations — This provision authorizes FCA, if it determines that an extraordinary situation exists which necessitates a temporary regulator waiver or modification, to provide relief from FCA's eligibility and liquidity reserve requirements. We propose a provision that would authorize FCA, in such a situation, to also take other actions as deemed appropriate.

Questions Regarding Dodd-Frank Act Compliance—Substitutes for Credit Ratings

The rule suggests three alternative approaches, but welcomes public comment on how these might be used in combination as well as any others that might not be specifically discussed.

Questions: Should FCA regulations specify financial measurements, benchmark indexes, or other measurable criteria against which institutions could evaluate the creditworthiness of their investments?

- Should such a creditworthiness standard include specific standards for probability of default (PD) and loss given default (loss severity)?
- If so, why, and where could the agency obtain the data needed to derive such probabilities and loss severity standards?
- Also, should creditworthiness criteria vary by asset class and/or type of investment?
- Finally, would it be appropriate to combine this approach with one or more of the other approaches discussed below, and if so, which ones, and why?

Question: Should FCA develop regulations that would require Farmer Mac to develop its own internal assessment processes for evaluating creditworthiness of investments?

- If so, what principles should be applied in creating such a system, and why?
- Would the amount of resources needed to establish and maintain such a system potentially be overly burdensome to Farmer Mac?

- Would it be appropriate to combine this approach with one or more of the other approaches? If so, which ones, and why?

Question: Should FCA develop regulations that would require institutions to use third-party assessments to assess creditworthiness?

- What reliable third-party sources exist?
- Should creditworthiness criteria distinguish between issuer-paid third-party sources and investor-paid third-party sources? If so, how?
- How might we combine this approach with one or more of the other approaches to create an optimal regulatory structure?

###