Federal Farm Credit Banks Funding Corporation

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Via Federal Express and E-Mail

March 22, 2007

Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
Docket Number 06-15
250 E Street, SW.
Mail Stop 1-5
Washington, DC 20219

Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
Docket No. R-1238
20th Street and Constitution Avenue, NW.
Washington, DC 20551

Federal Deposit Insurance Corporation
comments@FDIC.gov
Regulatory Information Number 3064-AC96
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal
550 17th Street, NW.
Washington, DC 20429

Office of Thrift Supervision
regs.comments@ots.treas.gov
No. 2006-49
Regulation Comments
Attention: No.2006-49
Chief Counsel's Office
1700 G Street, NW.
Washington, DC 20552

Dear Sirs:

The Federal Farm Credit Banks Funding Corporation (Funding Corporation), on behalf of the Farm Credit System Banks, appreciates this opportunity to comment on the proposed rule concerning risk-based capital guidelines published in the December 26, 2006 Federal

Register. This comment letter was developed based upon input from the Farm Credit System Banks.

In the Basel IA NPR, the banking agencies propose continuing to assign the debt securities of government-sponsored enterprises (GSEs) and banks located in the Organization for Economic Co-operation and Development (OECD) countries the same 20% risk-weighting as in Basel I. However, in the supplemental information, the agencies raise certain questions as to whether the GSEs should be separately identified for closer scrutiny. You have requested input as to whether Moody's bank financial strength ratings or Standard & Poor's risk to the government ratings (collectively, financial strength ratings) of the GSEs should determine the risk-weighting and whether the financial strength ratings should be mapped to the non-sovereign risk-weights.

We do not believe it is appropriate to risk-weight the GSEs at any level greater than 20% for the following reasons:

- It discriminates against the GSEs and could significantly damage their ability to fulfill their missions.
- While some of the banks in the OECD countries are financially weaker than the GSEs, they would receive a better risk-weighting and thus better pricing in the capital market.
- It would be harmful to the small financial institutions (community banks, credit unions) that are investors in GSE debt.
- It would create inconsistency between Basel I and Basel IA.

Additionally, if used, we do not believe that financial strength ratings are the appropriate measure because they are relatively new and untested. Further, it is questionable whether a GSE can be separated from its statutory attributes and responsibilities.

<u>It is not appropriate to risk-weight the GSEs at a level higher than a 20% risk-weighting.</u>

Risk-weighting GSEs at a level higher than 20% would discriminate against GSEs and could significantly damage the ability of GSEs to fulfill their missions. In the case of the Farm Credit System, market discipline would result in a higher cost of funds if a risk-weighting at a level higher than 20% were applied. This increased cost would be passed on to the farmers, ranchers and agricultural cooperatives and, accordingly, would have a negative impact on the U.S. agricultural industry that the System serves.

Risk-weighting GSEs at a level higher than 20% would put the GSEs on unequal footing with the banks located in the OECD countries, some of which would receive a better risk-weighting, even though they are financially weaker than the GSEs. If risk-weighting were required, GSE debt securities would be subjected to a greater level of scrutiny than the securities of weaker banks. Freddie Mac's A- bank financial strength rating gives it a rating higher than 97.5% of the banks that have bank financial strength ratings. Fannie Mae's B+ rating puts it above 92% of the rated banks. Therefore, it is not appropriate and even discriminatory to promulgate a regulation that could potentially risk weight a riskier OCED bank at a lower risk rating than a GSE with less risk.

<u>It may be harmful to the small financial institutions that are investors in GSE debt.</u>

GSE debt securities are important to community banks. Large banks may prefer investments, such as an MBS, because they believe they can manage the extra option risk embedded in the investment. However, community banks, representing an integral segment of the U.S. banking industry, prefer the more predictable cash flows of GSE debt securities, which are less risky and have less optionality. Therefore, changing the risk-weighting of GSE securities in a version of risk-based capital guidelines intended for community banks without empirical justification is not only unwise, but may serve to place a significant and unnecessary financial burden on community banks, while providing an advantage to large money-center banks.

<u>It would create inconsistency between Basel I and Basel IA.</u>

Since it is contemplated that non-Basel II banks would be provided the option of using either Basel I or Basel IA, subjecting the GSEs to an additional level of scrutiny in Basel IA would introduce an unnecessary distinction between Basel I and Basel IA. We believe there is a basic need for consistency between Basel I and Basel IA with respect to risk-weighting the GSEs. Banks that are not required to adopt Basel II will have the choice between Basel I and Basel IA. Therefore, Basel I and Basel IA should use the same method for determining the risk-weighting for the securities issued by banking institutions in the U.S. and in OECD countries. Making a distinction between the two risk-weighting methods for the GSEs introduces unnecessary inconsistency and confusion between the two methods.

<u>Financial strength ratings are not the appropriate measure for risk-weighting purposes.</u>

First, not all of the GSEs have a bank financial strength rating from Moody's or a risk to the government rating from Standard & Poor's. The Farm Credit System and the Federal Home Loan Banks have neither rating. As a result, the answer to the question of how the risk-weighting would be determined remains uncertain and unclear. It is possible that any alternative sought for the Farm Credit System would result in a different risk-weighting than Fannie Mae, Freddie Mac, or the Federal Home Loan Banks, thereby drawing a risk distinction between the GSEs that does not exist in reality.

Additionally, financial strength ratings are relatively new and, therefore, untested in varying economic environments. Also, financial strength ratings have not been widely applied and are potentially confusing. While the investing community is familiar with the 21 point credit rating scale used by Moody's and Standard & Poor's, the bank financial strength ratings scale used by Moody's is a 13 point scale from A to E. Furthermore, while the financial strength ratings by the rating agencies attempt to evaluate the GSEs without their GSE attributes, as a practical matter, it is not possible to do so. A GSE without GSE status would not be the same entity; its structure, authorities, and operations would be markedly different. For example, Sallie Mae, as a private entity, significantly expanded its business operations and thus has a completely different structure and business model than Sallie Mae as a GSE. Therefore, relying upon financial strength ratings to measure the financial strength of a GSE is not a useful exercise.

The rating agencies consider the GSEs to be government-related issuers and they recognize the considerable support provided to the GSEs by the federal government. Additionally, the federal government has created the GSEs, and in so doing, has defined their statutory duties and responsibilities. All GSEs, including the Farm Credit System, are federally regulated. Our regulator, the Farm Credit Administration (FCA), oversees the Farm Credit System and ensures that the Farm Credit System meets its statutory duties and responsibilities. In this role, FCA ensures the safety and soundness of the operations of the Farm Credit System and examines each of the Farm Credit System entities at least every 18 months. These facts strongly support a risk-weighting no higher than 20% for the Farm Credit System. Further, if a risk-weighting is to be determined using financial strength ratings, these considerations indicate that the GSEs should use the sovereign risk-weights.

In summary, we believe GSEs should be risk-weighted at a level no higher than 20%. Based upon the factual characteristics of the GSEs and their senior unsecured debt ratings of AAA, a risk-weighting at a level higher than 20% is not justified. Also, to introduce a distinction between GSEs or between Basel I and Basel IA will be confusing to the institutions required to implement the regulations. Furthermore financial strength ratings are not the appropriate measure. Financial strength ratings are relatively new and untested, and because they have a different scale than the traditional credit rating scale, they may be confusing. Moreover, we believe it is extremely difficult to separate out the characteristics inherent and embedded in its federal charter and, accordingly, we believe a financial strength rating would not be an accurate indicator of risk in GSEs.

We appreciate this opportunity to provide comments on the proposed regulation. We would be happy to discuss any of the points with you.

If you have any questions, please feel free to contact John Marsh (201-200-8071) or me (201-200-8001).

Sincerely,

Jamie B. Stewart, Jr.
President and Chief Executive Officer

cc: Presidents and CEOs and Chief Financial Officers,
System Banks
H. John Marsh, Jr., Funding Corporation