

**Notices –
Public Comment
Period Closed**

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 652

RIN 3052-AC70

Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Farmer Mac Risk-Based Capital Stress Test, Version 5.0

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: In this advance notice of proposed rulemaking (ANPRM), the Farm Credit Administration (FCA, we, us, our) is requesting comments on alternatives to using credit ratings issued by nationally recognized statistical ratings organizations (NRSRO or credit rating agency) in regulations addressing the Risk-Based Capital Stress Test (RBCST or stress test) for the Federal Agricultural Mortgage Corporation (Farmer Mac or FAMC). Recent legislation requires every Federal agency to remove any references to credit ratings from its regulations and to substitute them with other standards of creditworthiness considered appropriate. Additionally, in response to this same legislative emphasis on ensuring appropriate prudential oversight of derivatives transactions, we are considering whether the RBCST should include a more explicit and comprehensive capital charge for counterparty risk stemming from derivative transactions. Lastly, through the ANPRM we are seeking public input on how we might revise the operational and strategic business planning requirements for FAMC to place greater emphasis on diversity and inclusion.

DATES: You may send comments on or before August 15, 2011.

ADDRESSES: We offer a variety of methods for you to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we no longer accept comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Select "Public Commenters", then "Public Comments", and follow the directions for "Submitting a Comment".
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Laurie A. Rea, Director, Office of Secondary Market Oversight, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or on our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Public Commenters", then "Public Comments", and follow the directions for "Reading Submitted Public Comments". We will show your comments as submitted, including any supporting data provided, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Joseph T. Connor, Associate Director for Policy and Analysis, Office of Secondary Market Oversight, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4280, TTY (703) 883-4434,

Or

Laura McFarland, Senior Counsel, Office of the General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objective

The purpose of this ANPRM is to gather public input on how FCA might:

- Revise existing Farmer Mac RBCST regulations to replace data from credit rating agencies.
- Comprehensively address derivative counterparty exposure in the RBCST; and
- Revise operational and strategic business planning requirements to place greater emphasis on diversity and inclusion.

II. Background

Farmer Mac is an institution of the Farm Credit System, regulated by FCA through the FCA Office of Secondary Market Oversight (OSMO). Farmer Mac was established and chartered by Congress to create a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utilities loans, and it is a stockholder-owned instrumentality of the United States. Title VIII of the Farm Credit Act of 1971, as amended, (Act) governs Farmer Mac.¹

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) was enacted.² Section 939A of the Dodd-Frank Act requires Federal agencies to review all regulatory references to NRSRO credit ratings and replace those references with other appropriate standards for determining creditworthiness. The Dodd-Frank Act further provides that, to the extent feasible, agencies should adopt a uniform standard of creditworthiness for use in regulations, taking into account the entities regulated and the purposes for which such regulated entities would rely on the creditworthiness standard.

The FCA uses credit rating agency data in its RBCST regulations for Farmer Mac. Section 8.32 of the Act required FCA to establish a risk-based capital stress test for Farmer Mac's portfolio.³ This stress test determines the level of regulatory capital necessary for Farmer Mac to maintain positive capital during a 10-year period where stressful credit and interest rate conditions occur. We first published regulations on the stress test, and other requirements related to section 8.32 of the Act, in the Federal Register at [66 FR 19048](#) (April 12, 2001). Since then, we revised the stress test several times, most recently to capture capital requirements for Farmer Mac's rural utilities authorities. The existing RBCST for Farmer Mac is contained in 12 CFR part 652, subpart B, and it currently relies, in part, on NRSRO credit ratings when calculating regulatory minimum capital requirements.

We have comprehensively reviewed our regulations that use or rely on credit ratings, including other sections in part 652 which govern Farmer Mac's non-program investments and liquidity reserve requirements. This ANPRM is one of several notices and proposed rules on which we will be seeking public input relating to use of credit ratings in our rules.

A. Farmer Mac Programs

Under the Farmer Mac I program, FAMC guarantees prompt payment of principal and interest on securities representing interests in, or obligations backed by, mortgage loans secured by first liens on agricultural real estate or rural housing. It also purchases, or commits to purchase, qualified loans or securities backed by qualified loans directly from lenders. Under the Farmer Mac II program, FAMC purchases and securitizes portions of certain loans guaranteed by the U.S. Department of Agriculture, including farm ownership and operating loans and rural business and community development loans. Farmer Mac also guarantees the timely payment of principal and interest on the securities created from these loans. In 2008, Congress granted Farmer Mac the authority to purchase and guarantee

securities backed by loans to rural electric and telephone utility cooperatives as program business.⁴ Farmer Mac also provides a secondary market for USDA-guaranteed farm program and rural development loans.

B. Risk-based Capital and Credit Ratings

Under our rules, Farmer Mac's regulatory capital must be sufficient so that it would remain positive during the 10-year time horizon of the stress test. One component of the RBCST accounts for the risk of loss on specific types of program investments (i.e., investments backed by agricultural real estate mortgage loans, rural housing loans, or rural utility cooperative loans) that include credit enhancement features. In this context, credit risk is adjusted downward based on the whole-letter credit rating of the counterparty on AgVantage and similarly structured assets. The adjustment is made to recognize the risk-reducing strength of the counterparty's general obligation backing of these securities. These securities are further backed by eligible loan collateral.

Another component of the RBCST estimates counterparty risk associated with non-program investments, e.g., corporate debt, asset-backed securities and mortgage-related securities. In this context, the RBCST reduces earnings at rates related to the cumulative historical default and recovery rates of corporate debt by whole-letter credit rating category as published by Moody's Investor Services.⁵ The RBCST's calculations in each of these two components use five whole-letter rating categories. It then assigns counterparties into these categories by referencing ratings issued by an NRSRO for the counterparty. The regulations, in turn, specify the change in expected cash flows during the stress period to reflect the risk of default by a counterparty based in part on the assigned ratings category. The changes in cash flows decrease projected losses on program assets and decrease earnings on non-program investments, which then translate to changes in equity over the modeling horizon and affect the required minimum regulatory capital calculated by the stress test.

FCA initially chose to use NRSRO ratings in the RBCST as a source of objective and neutral third-party assessments of the credit risk for particular instruments and counterparties. We used ratings because they were readily and publicly available. The use of NRSRO ratings was also, at the time, believed to offer enhanced consistency in credit evaluation across different components of the RBCST. In 2010, the Dodd-Frank Act addressed, in part, the structure of credit rating agencies, requiring revisions and imposing other requirements in an effort to resolve the conflicts of interest and other difficulties believed to be at the center of the 2008-2009 financial market crisis. The Dodd-Frank Act also questioned the value of these ratings when used as the primary data source in the assessment of the creditworthiness of a security or money market instrument. In connection with that, the Dodd-Frank Act requires every Federal agency to remove any reference to, or reliance on, credit rating agencies in its regulations and replace any such reference with an alternative standard of credit worthiness considered appropriate for the regulatory purpose. As a result, we are seeking suggestions on what alternative data sources would be most appropriate for the RBCST.

C. Considerations and Objectives for a New Approach to Quantifying Relative Creditworthiness

FCA believes that any new standard of creditworthiness should distinguish between different levels of credit risk, in an accurate and timely manner, and be transparent in its approach. We believe it should also be applied consistently across the multiple components of the RBCST and be reasonably simple, while not unduly burdensome to apply and not be easily subject to manipulation. FCA recognizes that any resulting system will likely involve trade-offs among these objectives, e.g., simple versus accurate and timely, accurate and timely versus not burdensome to apply.

To eliminate the use of NRSRO ratings in calculating risk-based capital requirements for Farmer Mac, we need to develop an alternative basis to assess counterparty risk. One approach may be to identify objective criteria that Farmer Mac could apply to categorize credit exposures into different risk classes and assess counterparty risk accordingly. The criteria may be broadly designated. For example, credit exposures could be divided into government and non-government, secured and unsecured, or other categories, such as maturity. Such a broad approach, however, may not be able to sufficiently and consistently account for difference in relative risk among exposures that fall into the same category. FCA may also consider adopting criteria that reference certain financial or other metrics related to the obligor or counterparty. To be meaningful, the criteria would need to account for or bear a reasonable correlation to the potential riskiness of default among different obligors or counterparties. Any criteria would also need to be readily obtainable for all relevant counterparties by FCA, Farmer Mac and the public

or it might not be sufficiently transparent and objective. The standards would need to ensure that the investment or position is not speculative, and carries credit risk appropriate for Farmer Mac's risk profile and the authorized purposes for non-program investments. As any new counterparty risk evaluation approach is initiated, there is the potential for increased risk as the new system is implemented.

FCA might also consider an approach that builds on Farmer Mac's internal credit review process and allows it to assign risk ratings to various categories and assess risk based on qualitative and quantitative standards set by FCA regulations. For example, FCA could assign loss rate estimates based on Farmer Mac's internal ratings or some modification of such, as reviewed or approved by FCA – or simply review or approve Farmer Mac's mapping of its assigned risk ratings to estimated loss rates. This approach would be more subjective than the alternative discussed above but could allow FCA to leverage the data collection and analysis already performed by Farmer Mac. Under this approach, FCA would likely rely heavily on the supervisory process to make sure that Farmer Mac is strictly following its internal guidelines and not assuming high levels of credit risk.

Questions (1) through (11) of Section III of this ANPRM address this topic.

D. Counterparty Risk on Derivatives

As part of our Dodd-Frank Act review and the increasing emphasis by the financial industry on ensuring appropriate prudential oversight of derivatives transactions, we are also considering whether the RBCST should include a more explicit and comprehensive capital charge for counterparty risk stemming from derivative transactions.

The RBCST produces a single comprehensive capital requirement for Farmer Mac by modeling changes in cash flows under a specific statutory stress scenario. We believe there may be opportunities to revise the RBCST to add a representation of counterparty default exposure on derivatives transactions by considering both net replacement cost as well as current exposure to individual cash flows based on an assessment of the counterparty's creditworthiness.

Questions (12) and (13) of Section III. of this ANPRM address this topic.

E. Capital and Business Planning

As part of this ANPRM, we are seeking input on how we might revise § 652.60(b) on operational and strategic business planning requirements to place greater emphasis on diversity and inclusion in both Farmer Mac's personnel as well as the borrowers and lenders who benefit from its secondary market activities.

We believe an integral part of promoting and achieving inclusion and diversity can be accomplished through an effective operational plan that includes strategies to seek out qualified loans from a diverse group of sources and provides rural lenders with financing products that serve a diverse array of borrowers, such as small, beginning, new, disabled, female, and minority farmers, ranchers, and rural homeowners, as well as cooperatives with diversity of ownership. We believe promotion of inclusion and diversity should also extend to non-traditional agricultural producers, such as local food systems, organic or specialty crop farmers, and community-supported agriculture.

Additionally, we are considering whether Farmer Mac's operational and strategic plans should include strategies and actions to achieve diversity and inclusion within FAMC's workforce, management, and governance structure, as well as an assessment of the progress FAMC has made in this area. We are also contemplating whether the plans should describe FAMC's succession programs.

Questions (14) and (15) of Section III. of this ANPRM address this topic.

III. Request for Comments

FCA regulations governing the Farmer Mac RBCST contain specific references to credit ratings issued by NRSROs for purposes of calculating regulatory minimum capital requirements. FCA is issuing this ANPRM to

identify standards that may be appropriate replacements for credit ratings issued by NRSROs, which maintain compliance with statutory design requirements for the RBCST. Other regulatory agencies have also issued ANPRMs as part of their process to address references to credit ratings in their capital regulations and prudential standards.⁶ We encourage any interested person(s) to submit comments on the following questions and ask that you support your comments with relevant data or examples. We remind commenters that comments and data submitted in support of a comment are available to the public through our rulemaking files.

1. What core principles would be most important in FCA's development of new standards of creditworthiness?
2. What qualitative and quantitative standards would FCA need to set to implement an approach that relied on the Farmer Mac to generate internal estimates of counterparty risk exposures? What are the strengths and weaknesses of such an approach?
3. Is it important that FCA's approach to replacing its reliance on credit rating agency data be consistent with that of other financial regulators or with those of other Farm Credit System institutions? If so, how important and why?
4. What specific creditworthiness or investment criteria should FCA use in its RBCST regulation?
5. What types of objective criteria should be used to differentiate credit exposures and apply meaningful counterparty risk estimates in the RBCST?
6. Should different criteria be used for different broad classes of investments or exposures? If so, what perverse incentives or other unintended consequences could that lead to? For example, could criteria that are perceived to be more flexible or subjective for a given asset class incent the regulated entity to accept a proportion of exposure to that asset class relative to its entire program (or non-program) portfolio that it might deem excessive without that incentive?
7. What approach would estimate a meaningful and consistent level of counterparty risk for a variety of exposures by employing publicly available qualitative and quantitative metrics, such as individual obligor credit spreads and/or financial ratio analysis to estimate probability of default and recovery rates?
8. Alternatively, could such estimates be reasonably made at the level of the market (e.g., identifying an index of industry sector spreads and stratifying spreads into certain ranges) and mapped to loss rates set by FCA?
9. How might a set of loss rates be developed for each spread stratum?
10. Are there any existing objective tools or approaches that could readily replace references to ratings issued by NRSROs in the RBCST?
11. What other approaches or methodologies not discussed above should FCA consider?
12. What methodologies or approaches should FCA consider to more explicitly incorporate a derivatives counterparty exposure charge into the RBCST?
13. What is the best manner of evaluating minimum capital requirements on derivative counterparty exposures in the RBCST and should a pre-processing model be constructed (i.e., a sub-model used to derive inputs into the RBCST) to represent this risk--both in terms of missed individual contractual cash flows as well the replacement cost on defaulted derivatives? If so, how should replacement costs be estimated?
14. Should Farmer Mac be required to include strategies in its marketing plans that address how its secondary market programs and products will be offered to all qualified borrowers, including:
 - (a) Minorities, the disabled, and women;
 - (b) Young, beginning, small, and family farms and cooperatives; or

(c) Non-traditional agricultural producers, such as local food systems, organic or specialty crop farmers and the lenders who serve them? Why or why not?

15. Should Farmer Mac's marketing plans set quantitative goals to increase purchases of, or commitments to purchase, loans to young, beginning, small, and family farms, and those owned or operated by minorities, the disabled, and women? If so, what would be the best method to apply such goals to rural utility cooperatives (e.g., minority-managed cooperatives or cooperatives that serve predominantly minority residential customers or minority-owned commercial customers)?

16. To what extent should FCA regulations require Farmer Mac to develop a human capital plan as part of its strategic and operational business plan to foster diversity in its workforce and succession planning?

Dated: June 10, 2011

**Mary Alice Donner,
Acting Secretary,
Farm Credit Administration Board.**

¹ Pub. L. 92-181, 85 Stat. 583, 12 U.S.C. 2001 et seq. (December 10, 1971).

² Pub. L. 111-203, 124 Stat. 1376, (H.R. 4173), July 21, 2010.

³ 12 U.S.C. 2279bb-1.

⁴ Section 5406 of Pub. L. 110-246, 122 Stat. 1651 (June 18, 2008)(repealing and replacing Pub. L. 110-234).

⁵ Emery K., Ou S., Tennant, J., Kim F., Cantor R., "Corporate Default and Recovery Rates, 1920 – 2009," published by Moody's Investors Service, February 2010.

⁶ See 75 FR 49423 (Aug. 13, 2010), 75 FR 52283 (Aug. 25, 2010), and 76 FR 5292 (Jan. 31, 2011).

Notices – Public Comment Period Open

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Chapter VI

RIN 3052-AD24

Statement on Regulatory Burden

AGENCY: Farm Credit Administration.

ACTION: Notice of intent; request for comment.

SUMMARY: The Farm Credit Administration (FCA, our, or we) issues this announcement to consider whether our existing regulations are ineffective or burdensome. We seek public comment on the appropriateness of the requirements we impose on Farm Credit System (System) institutions, including the Federal Agricultural Mortgage Corporation (Farmer Mac). We ask for comments on our regulations that may duplicate other requirements, are ineffective, are not based on law, or impose burdens that are greater than the benefits received.

DATES: Please send your comments to FCA by August 16, 2017.

ADDRESSES: We offer a variety of methods for you to submit comments on this notice. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or on our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Thomas R. Risdal, Senior Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4257, TTY (703) 883-4056,
or

Mary Alice Donner, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4033, TTY (703) 883-4056.

SUPPLEMENTARY INFORMATION:

I. Objective

The objective of this announcement is to continue our comprehensive review of regulations governing the System and to eliminate, consistent with law and safety and soundness, all regulations that are unnecessary, unduly burdensome or costly, or not based on the law.

We request public comment on FCA regulations that were effective prior to December 31, 2016, and are not currently on our Unified Agenda as a Notice of Proposed Rulemaking or Advance Notice of Proposed Rulemaking; and

- May duplicate other requirements;
- Are ineffective;
- Are not based on law; or
- Impose burdens that are greater than the benefits received.

II. Background

FCA is an independent Federal agency in the executive branch of the Government responsible for examining and regulating System institutions. System banks and associations primarily provide loans to farmers, ranchers, aquatic producers and harvesters, agricultural cooperatives, and rural utilities. Farmer Mac provides a secondary market for agricultural and rural housing mortgages and eligible rural utility cooperative loans.

III. Our Continuing Efforts to Reduce Unnecessary Regulatory Burdens

As stated in section 212 of the Farm Credit System Reform Act of 1996, "The Farm Credit Administration shall continue the comprehensive review of regulations governing the Farm Credit System to identify and eliminate, consistent with law, safety, and soundness, all regulations that are unnecessary, unduly burdensome or costly, or not based on law." This review is consistent with Presidential Executive Order (EO) 13771, dated January 30, 2017, on Reducing Regulations and Controlling Regulatory Costs, although the EO does not apply to independent regulatory agencies including FCA.

The regulations of FCA that are subject to regulatory review described in this notice are codified in title 12, chapter VI, of the Code of Federal Regulations. We are requesting your comments on any FCA regulations or policies that may duplicate other governmental requirements, are not effective in achieving stated objectives, are not based on law, or create a burden that is perceived to be greater than the benefits received. Please do not respond to this solicitation with comments concerning proposed regulations that are currently under review, or final regulations that did not become effective until after December 31, 2016.

Your comments will assist us in our continuing efforts to identify and reduce unnecessary regulatory burdens on System institutions. We will also continue our efforts to maintain and adopt regulations and policies that are necessary to implement the Farm Credit Act of 1971, as amended, and ensure the safety and soundness of the System. These actions will enable the System institutions to better serve the credit needs of America's farmers, ranchers, aquatic producers and harvesters, cooperatives, and rural residents, in the changing agricultural credit markets.

Date: May 15, 2017

**Dale L. Aultman,
Secretary,
Farm Credit Administration Board.**

Regulations – Public Comment Period Closed

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 652

RIN 3052-AC86

**Organization; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations;
Farmer Mac Investment Eligibility**

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, Agency, us, our, or we) proposes to amend our regulations governing the eligibility of non-program investments held by the Federal Agricultural Mortgage Corporation (Farmer Mac). We propose to revise these regulations to comply with section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or DFA) by removing references to, and requirements relating to, credit ratings. We are also proposing a delayed compliance date for the rule.

DATES: You may send us comments by April 25, 2016.

ADDRESSES: We offer a variety of methods for you to submit comments on this proposed rule. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Laurie A Rea, Director, Office of Secondary Market Oversight, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or on our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Joseph T. Connor, Associate Director for Policy and Analysis, Office of Secondary Market Oversight, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4364, TTY (703) 883-4056;

or

Laura McFarland, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4056.

SUPPLEMENTARY INFORMATION:

I. Objective

The purpose of this proposed rule is to replace references to credit rating agencies in existing Farmer Mac investment regulations with other appropriate standards to determine the creditworthiness of investments and to revise exposure limits for investments involving one obligor. Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or DFA) requires agencies to remove references to, and requirements relating to, credit ratings. This proposal would substitute other appropriate standards of creditworthiness. The proposed rule would also replace the table in existing regulations that sets forth criteria for non-program investment eligibility with standards that place a greater emphasis on management's due diligence responsibility in ascertaining credit quality of non-program investments so that only high quality investments are purchased and held. The proposed rule would also clarify how other non-program investments are treated and revise exposure limits for investments involving one obligor. We are also proposing a delayed compliance date for the rule.

II. Background

Farmer Mac is an institution of the Farm Credit System, regulated by FCA through the FCA Office of Secondary Market Oversight (OSMO). Farmer Mac was established and chartered by Congress to create a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utilities loans, and it is a stockholder-owned instrumentality of the United States. Title VIII of the Farm Credit Act of 1971, as amended, (Act) governs Farmer Mac.¹

On July 21, 2010, the Dodd-Frank Act was enacted, and section 939A of the Dodd-Frank Act requires Federal agencies to review all regulatory references to nationally recognized statistical organizations (NRSRO or credit rating agency) and replace those references with other appropriate standards for determining creditworthiness.² The Dodd-Frank Act further provides that, to the extent feasible, agencies should adopt a

¹ Pub. L. 92 181, 85 Stat. 583, 12 U.S.C. 2001 *et seq.*

² Pub. L. 111-203, 124 Stat. 1376, (H.R. 4173), July 21, 2010.

uniform standard of creditworthiness for use in regulations, taking into account the entities regulated and the purposes for which such regulated entities would rely on the creditworthiness standard.

The existing rules on non-program investments for Farmer Mac are contained in 12 CFR part 652, subpart A, and rely, in part, on NRSRO credit ratings to characterize relative credit quality of various instruments. On June 16, 2011, we issued an Advance Notice of Proposed Rulemaking (ANPRM) soliciting comments on suitable alternatives to NRSRO credit ratings.³ On November 18, 2011, as part of another rulemaking, we again requested comment on potential sources of market-derived information that could be used to replace NRSRO credit ratings in part 652 of our rules.⁴ In developing this proposed rule, we considered all suggestions from comments received and incorporated those we believed best addressed the objective of this rulemaking. In addition to these comments, we also considered the creditworthiness standards we proposed in a separate rulemaking for Farm Credit banks and associations⁵ in compliance with provisions in the Dodd-Frank Act directing agencies, to the extent feasible, to adopt a uniform standard of creditworthiness among regulated entities.

III. Section-by-Section

The proposed rule would revise portfolio diversification requirements and revise the credit quality standards for eligible non-program investments that Farmer Mac may hold by replacing the reliance on NRSRO credit ratings and clarifying terminology.

A. Definitions [existing § 652.5]

In § 652.5, we propose removing existing terminology, adding new terms, and revising existing definitions. We propose removing as obsolete several terms from the list of definitions in § 652.5. We also propose removing three terms from § 652.5 because they do not require a separate definition. The specific terms we propose removing are:

- “Contingency Funding Plan (CFP)”,
- "Eurodollar time deposit",
- "Final maturity",
- "General obligations",
- “Liability Maturity Management Plan (LMMP)”,
- "Liquid investments",
- “Liquidity reserve”,
- "Nationally Recognized Statistical Rating Organization (NRSRO)",
- "Revenue bond", and
- "Weighted average life (WAL)."
-

We propose making conforming changes to § 652.20 to remove these terms where they appear.

We next propose adding two new terms to the list of definitions to address other proposed changes in this rulemaking: “Diversified investment fund” and “Obligor.” We propose to define a

³ 76 FR 35138, June 16, 2011.

⁴ Refer to Proposed rule, “Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Farmer Mac Investments and Liquidity Management” (76 FR 71798, Nov. 18, 2011).

⁵ 79 FR 43301, July 25, 2014.

“diversified investment fund” (DIF) as an investment company registered under section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a-8. We selected this definition based on our current use of it in § 615.5140(a)(8) of our investment rules for Farm Credit banks and associations. We propose to define the term "obligor" because our current regulations use this term but do not define it. We propose defining “obligor” as an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded. This definition would include the debtor or immediate party that is obligated to pay a debt, as well as a guarantor of the debt. The proposed definition would also clarify that both a DIF and the entity or entities obligated to pay the underlying debt are treated as a single obligor. This clarification is intended to ensure DIF investments do not become an excessively concentrated part of the investment portfolio.

Lastly, we propose changing three existing terms and their definitions to improve clarity: "Government agency", "Government-sponsored agency", and "mortgage securities." We propose replacing the existing term "Government-sponsored agency" with "Government-sponsored enterprise (GSE)" and defining a GSE as an entity established or chartered by the U.S. Government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. Government. We also propose replacing "Government agency" with "U.S. Government agency." The proposed definition for U.S. Government agency would explain that it means an instrumentality of the United States Government whose obligations are fully guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. Finally, we propose replacing the term "mortgage securities" with "mortgage-backed securities (MBS)" as this term is more widely used in the financial sector. We propose applying the existing definition for "mortgage securities" to the new MBS term. We propose a conforming change to the definition of “asset-backed securities”, which uses “mortgage securities” in its definition.

B. Concentration Risk [new § 652.10(c)(5)]

We propose revising existing § 652.10 to address concentration risk through portfolio diversification and obligor limits in new paragraph (c)(5). Portfolio diversification is crucial to safe and sound investment management and is achieved by the appropriate distribution of risk exposures across reasonably uncorrelated industries and obligors. When a portfolio is properly diversified, a crisis within one industry sector or the sudden weakening or default of one obligor should not significantly destabilize the financial condition of the investor. In new § 652.10(c)(5), we propose specifying that Farmer Mac’s investment policies address concentration risk by setting diversification standards. We propose that the diversification calculation used when setting these standards be based on the carrying value of the investment on Farmer Mac’s balance sheet. By carrying value, we mean the amount an investment contributes to the asset section of Farmer Mac’s balance sheet under GAAP, net of any impairment estimate or valuation allowance. We believe the carrying value would, when applied for this purpose, appropriately capture the value of capital at risk for an investment at any given time. We also propose the following parameters for Farmer Mac’s establishment of these standards:

- Basing calculation of an investment’s compliance with diversification requirements on the investment’s carrying value;
- Limiting investments in one obligor to no more than 10 percent of regulatory capital, unless the investments are obligations backed by U.S. Government agencies or GSEs; and
- Limiting the percentage of GSE-issued mortgage-backed securities that may comprise Farmer Mac’s entire investment portfolio to 50 percent.

We believe these parameters will not require changes in the current investment portfolio held by Farmer Mac and discuss them more fully below.

We believe by placing specific diversification limits within the section that generally requires Farmer Mac to set diversification limits will improve the organization of the rule.

We also propose removing the reference to geographic areas in existing § 652.10(c)(1)(i). Farmer Mac should consider diversification by geographic location of issuer as appropriate based on the nature of its investment portfolio. For example, in the case of investments in municipal securities, geographic location might be an important consideration. However, we propose removing this specific category in the regulation to avoid misinterpretation. For example, we do not see the need to restrict obligors solely on the basis of where they happen to be headquartered or the location of an issuer's operations. The proposed change in the level of the single obligor limit is discussed below in section III.B.1.

1. Obligor Limit

We propose to move the obligor limit from § 652.20(d)(1) and reduce the current limit to 10 percent of regulatory capital. The proposed 10-percent obligor limit in new § 652.10(c)(5)(i) would enhance Farmer Mac's long-term safety and soundness by ensuring that if an obligor were to default, only a modest portion of capital would be at risk. Currently, the proposed 10-percent obligor limit equates to an amount that is less than Farmer Mac's capital surplus and well within its risk-bearing capacity based on its current level of regulatory capital. Whereas, the current 25-percent obligor limit could expose Farmer Mac to financial challenges if it experienced an event of multiple defaults in its liquidity portfolio during a short time period (e.g., such as during the 2008 financial crisis), given the historical relationship between Farmer Mac's capital surplus over the minimum requirement and the dollar value of the 25-percent limit. Thus, we expect that the proposed 10-percent maximum will provide reasonable assurance that a single default will not significantly increase the risk of Farmer Mac's being unable to comply with the minimum capital requirement.

This proposed obligor limit would recognize that the credit performance of a single obligor (unlike, for example, a single industry sector) is binary in nature, (i.e., the investment is either performing or it is in default) with potentially very low recovery rates. For that reason, we believe a cautious approach is warranted regarding the management of exposure concentrations in an individual obligor. We also believe the proposed obligor limit retains sufficient flexibility for Farmer Mac to manage its investment portfolio and still maintain adequate diversification. While the proposed obligor limit would be a regulatory maximum, Farmer Mac should consider establishing lower obligor limits to fit its overall risk profile and risk-bearing capacity, including earnings capacity, as well as the risks in individual types and classes of investments.

We seek specific comments and suggestions on how FCA might modify or adjust the obligor limit to make it more risk sensitive while achieving the overarching objectives of the limit for example, by scaling or risk-weighting assets based on internal or standardized models or other criteria such as the magnitude of Farmer Mac's surplus over the minimum capital requirement.

The proposed § 652.10(c)(5) would retain the existing exemption from the obligor limit, currently located in § 652.20(d)(1), for investments that are backed by a U.S. Government agency or GSEs.

2. Asset Class Limits

Existing § 652.20(a) contains a table identifying nine asset classes with different investment portfolio limits. These nine asset classes are:

- Obligations of the United States,
- Obligations of GSEs,
- Municipal Securities,
- International and Multilateral Development Bank Obligations,
- Money Market Instruments,
- Mortgage Securities,
- Asset-Backed Securities,
- Corporate Debt Securities, and
- DIFs.
-

Of these, some asset classes have investment portfolio limits of 15 percent, 20 percent, 25 percent, and 50 percent.

a. GSE-Issued Mortgage-Backed Securities Limit

We propose moving to new § 652.10(c)(5)(ii) the current § 652.20(a)(6) 50-percent limit on the volume of GSE-issued mortgage-backed securities that may be held in Farmer Mac’s investment portfolio. We believe the risk posed by GSE-backed MBS is significantly lower than other asset classes both in terms of default risk and liquidity risk, which supports retaining this relatively high limit. We also believe this limit is better situated within our rules with other risk tolerance provisions.

b. Other Asset Class Limits

In section III.C.1 of this preamble, we discuss the proposed removal of the investment table at § 652.20(a), while retaining some of its requirements. We have not proposed retaining any of the asset class portfolio limits contained in the table except the previously discussed 50-percent portfolio limit for GSE-issued securities. This is because existing § 652.10(c)(1)(i) already requires Farmer Mac to establish within its investment policy concentration limits for “asset classes or obligations with similar characteristics.” We expect that Farmer Mac will review their investment policy limits at least annually and make adjustments based on their current risk profile and risk-bearing capacity, which may suggest lower limits than the current regulatory parameters. Nonetheless, we recognize there may be value in maintaining regulatory limits and, therefore, invite specific comment on whether the following existing asset class limitations should be retained in full or part:

- Municipal Securities: Revenue bonds limit of 15 percent,
- Money Market Instruments: Non-callable term Federal funds and Eurodollar time deposits limit of 20 percent,
- Money Market Instruments: Master notes limit of 20 percent,
- Mortgage Securities: Non-Government agency or Government-sponsored agency securities that comply with 15 U.S.C. 77d(5) or 15 U.S.C. 78c(a)(41) and Commercial mortgage-backed securities combined 15-percent limit,
- Asset-Backed Securities limit of 25 percent, and
- Corporate Debt Securities limit of 25 percent.

We are also interested in whether any of these limits should be changed and, if so, to what degree. We ask that your comment on this issue include the rationale for your suggestion(s).

C. Non-Program Investments [existing §§ 652.20 and 652.25; new § 652.23]

1. Eligible Non-program Investments [§ 652.20]

We propose replacing the existing § 652.20, including removing the “Non-Program Investment Eligibility Criteria Table,” with investment eligibility requirements that place greater responsibility on Farmer Mac management. The replacement of this section will result in removal of all references to NRSRO credit ratings from § 652.20.

a. Eligible Non-Program Investment Categories [§ 652.20(a)]

Our existing regulation at § 652.20(a) contains a detailed listing of eligible investment asset classes and types of investments within each asset class. The existing regulation imposes final maturity limits, investment portfolio limits, and other requirements for many of these investments, including credit rating requirements that are based on NRSRO credit ratings. To replace this provision, we propose general categories of eligible non-program investments that Farmer Mac may purchase and hold. The proposed general categories are:

- Non-convertible senior debt securities,
- Certain money market instruments,
- Certain ABS/MBS backed by a U.S. Government-agency or GSE guarantee,
- Certain senior position mortgage related securities,
- Obligations of development banks where the United States is a voting member of the bank, and
- Certain diversified investment funds.

As proposed in new § 652.20(a)(1), non-convertible senior debt securities (*e.g.*, investments in senior debt securities that cannot be converted to any other type of securities) would be eligible under the proposed provision. This investment category would include non-convertible U.S. Government agency senior debt securities, including U.S. Treasury securities, and senior non-convertible GSE bonds. Senior debt securities could be secured by a specific pool of collateral or may be unsecured with priority of claims over other types of debt securities of the issuer, but would not include those that are convertible into a non-senior security or an equity security.

In proposed new paragraph (a)(3) and (a)(4), fully government-guaranteed ABS or MBS that are guaranteed as to the payment of principal and interest by a U.S. Government agency or GSE would be eligible securities because of their high credit quality. Farmer Mac would have to verify that securities labeled "government guaranteed" are fully guaranteed as to the payment of principal and interest. Similarly, a GSE "wrap" (guarantee) would not make a security eligible under this proposed provision unless it is a guarantee of all principal and interest of the security. While partial guarantees would not satisfy this proposed requirement, they could be eligible under other criteria.

We propose in new paragraph (a)(5) permitting investments in ABS and MBS that are not fully guaranteed, but only the senior-most position of such instruments. By senior-most position, we mean the tranche of a structured instrument that is last to experience losses in the event of default and that such losses be shared on a pro rata basis by investors in that tranche. In addition, we propose that for a position in an MBS to be eligible, the MBS must satisfy the securities law definition of "mortgage related

security".⁶ Collateralized debt obligations (CDOs), which are re-securitizations that have evolved for the MBS market, would be eligible under this criterion if their underlying collateral is comprised only of the senior-most positions of other securitizations. The underlying collateral of most CDOs consists of lower-rated tranches from other securitizations, and these CDOs would not be eligible under this criterion. Further, private placements may be eligible under this proposed criterion, as long as they satisfy all of the proposed investment eligibility requirements.⁷ We note, however, that private placements are generally not liquid and would therefore need to be acquired for an authorized purpose unrelated to liquidity.

We also propose in new paragraph (a)(7) that shares of a DIF would be eligible if the DIF's portfolio consists solely of securities that are eligible under these eligibility criteria. While the proposal for DIF eligibility is unchanged from the existing regulation, we are proposing more restrictive portfolio diversification limits on DIF investments than currently exist.

b. Investment Quality [§ 652.20(b)]

We want to retain high creditworthiness standards for Farmer Mac eligible non-program investments.⁸ Accordingly, we propose in § 652.20(b)(1) requiring that obligors (whether debtor or guarantor) have strong capacity to meet the financial commitment for the expected life of the investment. This standard would apply to all investments, including those that are currently not subject to a NRSRO credit rating requirement. In general, we would view an investment as having met this standard if the expected average cumulative default rate of issuers of similar credit quality is low based on historical default data.⁹ We would expect Farmer Mac to document the source of its historical data and basis for investment criteria.

In addition to imposing standards on obligors, we also propose in § 652.20(b)(2) requiring an eligible investment to exhibit low credit risk and other risk characteristics consistent with the purposes for which it is held. We are not proposing to require that other risks in the investment be low in all cases. Instead, the risk characteristics in the investment must be consistent with the purposes for which the investment is held. For instance, if an investment is held for the purpose of liquidity, it would have to be readily marketable¹⁰ and would generally have to have low price volatility. On the other hand, an investment that is high quality but has high price volatility and questionable marketability may not be appropriate for a liquidity investment. Instead, it might be used effectively to manage interest rate risk. Finally, we propose moving to paragraph (b)(3) the existing requirement that the denomination of all investments must be in U.S. dollars.

2. Other Non-Program Investments [new § 652.23]

⁶ 15 U.S.C. 78c(a)(41).

⁷ Private placement refers to the sale of securities to a relatively small number of sophisticated investors without registration with the Securities and Exchange Commission and, in many cases, without the disclosure of detailed financial information or a prospectus.

⁸ Our existing regulations governing Farmer Mac require that certain eligible investments meet the highest or the second highest whole-letter NRSRO rating (e.g., "AAA" or "AA" for Standard & Poors ratings, without regard to "+" or "-" levels within individual whole-letter ratings).

⁹ One potential source of historical data for this purpose is the publicly available report entitled "Annual Default Study: Corporate Bond Default and Recovery Rates" which includes data since 1920 and is published by Moody's Investors Service. However, other sources including internally modeled forecasts could be used.

¹⁰ Under § 652.40(b), investments used to satisfy the liquidity reserve requirement must be "readily marketable," as defined by that provision.

We propose moving the existing § 652.20(e) provisions on seeking FCA approval for non-program investments that are not already identified in the regulation as an “eligible non-program investment” to new § 652.23. The proposed new § 652.23 explains the minimum considerations we give to such requests and reiterates our authority to impose in writing and enforce conditions of approval. We also add clarifying language that these investments, once approved, will be considered “eligible non-program investments” for purposes of applying the provisions in subpart A of part 652. We believe moving this aspect of the rule to its own section will make the provision easier to find and, along with the proposed clarifications, will facilitate the process by which such requests are submitted and reviewed.

3. Ineligible Investments [existing § 652.25]

We are proposing revisions to existing § 652.25 to conform with other proposed changes in this rulemaking and to add clarity. We propose adding language to clarify that this section applies to both those eligible non-program investments identified in the rule and to individual non-program investments that we approved on request. We also propose clarifying that those investments that were ineligible when purchased may not be used for liquidity purposes, but must still be included as part of the investment portfolio limit until their divestiture. We further propose removing the quarterly reporting requirements for investments that lose their eligibility after purchase.

4. Reservation of FCA Authority [existing § 652.25(d); new § 652.27]

We propose moving the existing § 652.25(d) provisions addressing FCA-required divestiture of an investment to new § 652.27. We believe moving this aspect of the rule to its own section will make the provision easier to find and reduce confusion on its applicability. In addition, we propose to make explicit our authority, on a case-by-case basis, to determine that a particular investment imposes inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria. The proposal also provides that FCA will notify Farmer Mac as to the proper treatment of any such investment. We also propose conforming changes due to other proposed changes in this rulemaking to clarify that FCA-required divestiture may be based on a failure to comply with applicable regulations or written conditions of approval issued in connection with individual non-program investments that we approved on request.

D. Liquidity Reserve Requirements [Table to § 652.40(c)]

We propose to make conforming changes in the Table to § 652.40(c). These changes would incorporate the proposed terminology changes of § 652.5. In addition, we propose changes to clarify that MBS must be fully guaranteed by a U.S. Government agency to qualify for Level 2 liquidity and fully guaranteed by a GSE to qualify for Level 3 liquidity.

IV. Compliance Date

In order to provide Farmer Mac with sufficient time to bring itself into compliance with these new requirements, we are proposing a 6-month compliance transition period. We invite your specific comments on this compliance timeframe.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), FCA hereby certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities. Farmer

Mac has assets and annual income in excess of the amounts that would qualify it as a small entity. Therefore, Farmer Mac is not a "small entity" as defined in the Regulatory Flexibility Act.

List of Subjects

12 CFR Part 652

Agriculture, Banks, banking, Capital, Investments, Rural areas.

For the reasons stated in the preamble, part 652 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 652—FEDERAL AGRICULTURAL MORTGAGE CORPORATION FUNDING AND FISCAL AFFAIRS

1. The authority citation for part 652 is revised to read as follows:

Authority: Secs. 4.12, 5.9, 5.17, 8.11, 8.31, 8.32, 8.33, 8.34, 8.35, 8.36, 8.37, 8.41 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2252, 2279aa-11, 2279bb, 2279bb-1, 2279bb-2, 2279bb-3, 2279bb-4, 2279bb-5, 2279bb-6, 2279cc); sec. 514 of Pub. L. 102-552, 106 Stat. 4102; sec. 118 of Pub. L. 104-105, 110 Stat. 168; sec. 939A of Pub. L. 111-203, 124 Stat. 1326, 1887 (15 U.S.C. 78o-7 note) (July 21, 2010).

2. Amend § 652.5 by:

a. Removing the definitions for "Contingency Funding Plan (CFP)", "Eurodollar time deposit", "Final maturity", "General obligations", "Government agency", "Government-sponsored agency", "Liability Maturity Management Plan (LMMP)", "Liquid investments", "Liquidity reserve", "Mortgage securities", "Nationally recognized statistical rating organization (NRSRO)", "Revenue bond", and "Weighted average life (WAL)";

b. Revising the last sentence to the definition for "Asset-backed securities (ABS)"; and

c. Adding alphabetically five definitions to read as follows:

§ 652.5 Definitions.

For purposes of this subpart, the following definitions will apply:

Asset-backed securities (ABS) * * * For the purpose of this subpart, ABS excludes mortgage-backed securities that are defined below.

* * * * *

Diversified investment fund (DIF) means an investment company registered under section 8 of the Investment Company Act of 1940.

* * * * *

Government-sponsored enterprise (GSE) means an entity established or chartered by the United States Government to serve public purposes specified by the United States Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

* * * * *

Mortgage-backed securities (MBS) means securities that are either:

(1) Pass-through securities or participation certificates that represent ownership of a fractional undivided interest in a specified pool of residential (excluding home equity loans), multifamily or commercial mortgages, or

(2) A multiclass security (including collateralized mortgage obligations and real estate mortgage investment conduits) that is backed by a pool of residential, multifamily or commercial real estate mortgages, pass through MBS, or other multiclass MBS.

(3) This definition does not include agricultural mortgage-backed securities guaranteed by Farmer Mac itself.

* * * * *

Obligor means an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded. For a DIF, both the DIF itself and the entities obligated to pay the underlying debt are considered a single obligor.

* * * * *

U.S. Government agency means an instrumentality of the U.S. Government whose obligations are fully guaranteed as to the payment of principal and interest by the full faith and credit of the U.S. Government.

3. Amend § 652.10 by:

- a. Removing the word “four” in the last sentence of the paragraph (c) introductory text;
- b. Removing the phrase “geographical areas,” in paragraph (c)(1)(i); and
- c. Adding a new paragraph (c)(5) to read as follows:

§ 652.10 Investment management.

* * * * *

(c) * * *

(5) Concentration risk. Your investment policies must set risk diversification standards. Diversification parameters must be based on the carrying value of investments.

(i) The Corporation’s maximum allowable investments in any one obligor may not exceed 10 percent of Regulatory Capital. Only investments in obligations backed by U.S. Government agencies or GSEs may exceed the 10-percent single obligor limit.

(ii) Not more than 50 percent of the Corporation's entire investment portfolio may be comprised of GSE-issued MBS.

* * * * *

4. Section 652.20 is revised to read as follows:

§ 652.20 Eligible non-program investments.

(a) Eligible investments consist of:

- (1) A non-convertible senior debt security.
- (2) A money market instrument with a maturity of 1 year or less.
- (3) A portion of an ABS or MBS that is fully guaranteed by a U.S. Government agency.
- (4) A portion of an ABS or MBS that is fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE.
- (5) The senior-most position of an ABS or MBS that is not fully guaranteed by a U.S. Government agency or fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, provided that the MBS satisfies the definition of "mortgage related security" in 15 U.S.C. 78c(a)(41).
- (6) An obligation of an international or multilateral development bank in which the U.S. is a voting member.
- (7) Shares of a diversified investment fund, if its portfolio consists solely of securities that satisfy investments listed in paragraphs (b)(1) through (b)(4) of this section.

(b) Farmer Mac may only purchase those eligible investments satisfying all of the following:

- (1) The obligor(s) of the investment have strong capacity to meet financial commitments for the life of the investment. A strong capacity to meet financial commitments exists if the risk of default by the obligor(s) is very low. Investments whose obligors are located outside the U.S., and whose obligor capacity to meet financial commitments is being relied upon to satisfy this requirement, must also be fully guaranteed by a U.S. Government agency.
- (2) The investment must exhibit low credit risk and other risk characteristics consistent with the purpose or purposes for which it is held. At a minimum, obligors must have strong capacity to meet financial commitments and generally have a very low probability of default throughout the term of the investment even under severely adverse, stressful conditions in the obligors' business environment.
- (3) The investment must be denominated in U.S. dollars.

5. Add a new § 652.23 to read as follows:

§ 652.23 Other non-program investments.

(a) Farmer Mac may make a written request for our approval to purchase and hold other non-program investments that do not satisfy the requirements of § 652.20. Your request for our approval to purchase and hold other non-program investments at a minimum must:

- (1) Describe the investment structure;
- (2) Explain the purpose and objectives for making the investment; and
- (3) Discuss the risk characteristics of the investment, including an analysis of the investment's impact to capital.

(b) We may impose written conditions in conjunction with our approval of your request to invest in other non-program investments.

(c) For purposes of applying the provisions of this subpart, except § 652.20, investments approved under this section are treated the same as eligible non-program investments unless our conditions of approval state otherwise.

6. Section 652.25 is revised to read as follows:

§ 652.25 Ineligible investments.

(a) *Investments ineligible when purchased.* Non-program investments that do not satisfy the eligibility criteria set forth in § 652.20(a) or have not been approved by the FCA pursuant to § 652.23 at the time of purchase are ineligible. You must not purchase ineligible investments. If you determine that you have purchased an ineligible investment, you must notify us within 15 calendar days after such determination. You must divest of the investment no later than 60 calendar days after you determine that the investment is ineligible unless we approve, in writing, a plan that authorizes you to divest the investment over a longer period of time. Until you divest of the investment, it may not be used to satisfy your liquidity requirement(s) under § 652.40, but must continue to be included in the § 652.15(b) investment portfolio limit calculation.

(b) *Investments that no longer satisfy eligibility criteria.* If you determine that a non-program investment no longer satisfies the criteria set forth in § 652.20 or no longer satisfies the conditions of approval issued under § 652.23, you must notify us within 15 calendar days after such determination. If approved by the FCA in writing, you may continue to hold the investment, subject to the following and any other conditions we impose:

- (1) You may not use the investment to satisfy your § 652.40 liquidity requirement(s);
- (2) The investment must continue to be included in your § 652.15 investment portfolio limit calculation;
and
- (3) You must develop a plan to reduce the investment's risk to you.

7. Add a new § 652.27 to read as follows:

§ 652.27 Reservation of authority for investment activities.

FCA retains the authority to require you to divest of any investment at any time for failure to comply with applicable regulations, for safety and soundness reasons, or failure to comply with written conditions of approval. The timeframe set by FCA for such required divestiture will consider the expected loss on the transaction (or

transactions) and the effect on your financial condition and performance. FCA may also, on a case-by-case basis, determine that a particular non-program investment poses inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria or received prior approval from us. If so, we will notify you as to the proper treatment of the investment.

8. Amend § 652.40 by revising the table in paragraph (c) to read as follows:

§ 652.40 Liquidity reserve requirement and supplemental liquidity.

* * * * *

Table to § 652.40(c)

Liquidity level	Instruments	Discount (multiply market value by)
Level 1	<ul style="list-style-type: none">• Cash, including cash due from traded but not yet settled debt	100 percent
	<ul style="list-style-type: none">• Overnight money market instruments, including repurchase agreements secured exclusively by Level 1 investments	100 percent
	<ul style="list-style-type: none">• Obligations of U.S. Government agencies with a final remaining maturity of 3 years or less	97 percent
	<ul style="list-style-type: none">• GSE senior debt securities that mature within 60 days, excluding securities issued by the Farm Credit System	95 percent
	<ul style="list-style-type: none">• Diversified investment funds comprised exclusively of Level 1 instruments	95 percent
Level 2	<ul style="list-style-type: none">• Additional Level 1 investments	Discount for each Level 1 investment applies
	<ul style="list-style-type: none">• Obligations of U.S. Government agencies with a final remaining maturity of more than 3 years	97 percent
	<ul style="list-style-type: none">• MBS that are fully guaranteed by a U.S. Government agency	95 percent
	<ul style="list-style-type: none">• Diversified investment funds comprised exclusively of Level 1 and 2 instruments	95 percent
Level 3	<ul style="list-style-type: none">• Additional Level 1 or Level 2 investments	Discount for each Level 1 or Level 2 investment applies
	<ul style="list-style-type: none">• GSE senior debt securities with maturities exceeding 60 days, excluding senior debt securities of the Farm Credit System	93 percent for all instruments in Level 3
	<ul style="list-style-type: none">• MBS that are fully guaranteed by a GSE as to the timely repayment of principal and interest	
	<ul style="list-style-type: none">• Money market instruments maturing within 90 days	
	<ul style="list-style-type: none">• Diversified investment funds comprised exclusively of levels 1, 2, and 3 instruments	
	<ul style="list-style-type: none">• Qualifying securities backed by Farmer Mac program assets (loans) guaranteed by the United States Department of Agriculture (excluding the portion that would be necessary to	

	satisfy obligations to creditors and equity holders in Farmer Mac II LLC)	
Supplemental Liquidity	• Eligible investments under § 652.20 and those approved under § 652.23	90 percent except discounts for Level 1, 2 or 3 investments apply to such investments held as supplemental liquidity

Date: February 17, 2016

Dale L. Aultman,

Secretary,

Farm Credit Administration Board.

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 611 and 615

RIN 3052-AC84

Organization; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Investment Eligibility

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, Agency, us, our, or we) proposes to amend our regulations governing the eligibility of investments held by Farm Credit banks. We propose to strengthen these regulations by reinforcing that only high quality investments may be purchased and held. We also propose to revise these regulations to comply with section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or DFA) by removing references to and requirements relating to credit ratings and substituting other appropriate standards of creditworthiness. The FCA also proposes to revise its regulatory approach to Farm Credit System (System) association investments in order to limit the type and amount of investments that an association may hold. The proposed rule also addresses investment and risk management practices at associations and funding bank supervision of association investments.

DATES: You may send us comments by October 23, 2014.

ADDRESSES: We offer a variety of methods for you to submit comments on this proposed rule. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or on our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you

provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Paul K. Gibbs, Senior Accountant, or Timothy T. Nerdahl, Senior Financial Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4414, TTY (703) 883-4056;

or

Jennifer A. Cohn, Senior Counsel, or Richard A. Katz, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4056.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Strengthen the safety and soundness of Farm Credit banks¹¹ and associations;¹²
- Ensure that Farm Credit banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption;
- Enhance the ability of the Farm Credit banks to supply credit to agricultural and aquatic producers;
- Comply with the requirements of section 939A of the Dodd-Frank Act;
- Modernize the investment eligibility criteria for Farm Credit banks; and
- Revise the investment regulation for associations to improve their investment management practices so they are more resilient to risk.

II. Background

Congress created System institutions, including Farm Credit banks and associations, to provide permanent, stable, and reliable sources of credit and related services to American agricultural and aquatic producers.¹³ Associations obtain funds from Farm Credit banks to provide short-, intermediate-, and

¹¹ Section 619.9140 of FCA regulations defines "Farm Credit bank" to include Farm Credit Banks, agricultural credit banks, and banks for cooperatives.

¹² Section 619.9050 of FCA regulations defines the term "association" to include (individually or collectively) a Federal land bank association, a Federal land credit association, a production credit association, and an agricultural credit association.

¹³ The Federal Agricultural Mortgage Corporation (Farmer Mac), also a System institution, provides a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utility cooperative loans. Farmer Mac is not affected by this rulemaking, and the use of the term "System institution" in this preamble and proposed rule does not include Farmer Mac.

long-term credit and related services to farmers, ranchers, producers and harvesters of aquatic products, to rural residents for housing, and to farm-related businesses.¹⁴

Farm Credit banks depend on investments to provide liquidity and to fulfill other needs,¹⁵ and investments also enable associations to manage the risks they confront.¹⁶ Although Farm Credit banks obtain their funding primarily through the issuance of System-wide debt securities,¹⁷ they must have enough available funds, including investments, to continue operations and pay maturing obligations if access to the debt market becomes temporarily impeded.

FCA regulations, at subpart E of part 615, impose comprehensive requirements regarding the investments of System institutions. We have recently revised many of these requirements, particularly those guiding prudent investment management practices.¹⁸ This rulemaking proposes to revise the requirements governing the eligibility of investments for Farm Credit banks and associations, which have been largely unchanged since 1999, as well as the permissible investment amounts and purposes for associations.¹⁹ The regulations this rulemaking proposes to amend should not be viewed in isolation, but rather as part of a comprehensive set of rules guiding the System's liquidity and investment management.

Investment products are becoming increasingly complex, and the financial crisis that began in 2007 made clear that some investments are riskier and less liquid than were previously believed. In addition, in July 2010 the President signed into law the Dodd-Frank Act to strengthen regulation of the financial industry in the wake of the financial crisis. Section 939A of the DFA requires each Federal agency to review all of its regulations that refer to or require the use of credit ratings to assess the creditworthiness of an instrument; to remove the reference or requirement; and to substitute other appropriate creditworthiness standards. FCA's existing investment eligibility regulations use credit ratings as a determinant of eligibility of some investments.

We now propose to comply with the DFA by eliminating the regulations' reliance on credit ratings. The financial crisis that began in 2007 identified flaws in relying on credit ratings to determine credit risk, as many investments with similar labels and ratings exhibited substantially differing underlying risk characteristics, ultimately impacting marketability of the investments. Investment eligibility would no longer depend on external credit ratings, thus enhancing safety and soundness. We also propose other amendments to the provisions governing Farm Credit banks that would strengthen the safety and soundness of their investment activities by more accurately reflecting the risk in particular investments.

Finally, we propose amendments to § 615.5142, which governs the investment activities of associations. We recognize that many associations may need to hold investments for purposes other than managing surplus short-term funds and reducing interest rate risk, which are the only investment purposes authorized by the existing regulations. For this reason, the proposed rule would grant associations greater

¹⁴ One Farm Credit bank, known as an agricultural credit bank, also provides lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems, and it is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives.

¹⁵ Section 615.5132(a) authorizes a Farm Credit bank to hold eligible investments to comply with its liquidity requirements, to manage surplus short-term funds, and to manage interest rate risk.

¹⁶ As discussed below, proposed 615.5142 would enable associations, under specified conditions, to hold eligible investments to manage risk. Under § 611.1135(a), which we do not propose to revise, service corporations may hold investments for the purposes authorized for their organizers.

¹⁷ Farm Credit banks use the Federal Farm Credit Banks Funding Corporation (Funding Corporation) to issue and market System-wide debt securities. The Funding Corporation is owned by the Farm Credit banks.

¹⁸ 77 FR 66362, Nov. 5, 2012.

¹⁹ Currently, § 615.5140 identifies eligible investments for both Farm Credit banks and associations. Section 615.5142 governs investment purposes for associations, and the amount of association investments is not prescribed by regulation.

flexibility to hold investments for other risk management purposes. At the same time, we propose to limit the types and amount of investments that associations may hold.

We first considered revisions to our Farm Credit bank and association investment regulations in 2011.²⁰ As discussed above, we adopted many of these revisions in 2012, but we did not revise the provisions governing investment eligibility and association investments, which we are now proposing to revise. The revisions we now propose take into consideration the comments we received in response to the earlier rulemaking, as well as the approaches some of the other Federal banking regulatory agencies have taken toward compliance with the DFA credit ratings elimination requirement.²¹

III. Section-by-Section Description of the Proposed Rule

The proposed rule enhances the credit quality standards for eligible investments that Farm Credit banks may hold and revises the regulation governing association investment activities. It also contains conforming amendments to other regulations in parts 611 and 615.

A. Section 615.5131--Definitions

We propose to define asset class as a group of securities that exhibit similar characteristics and behave similarly in the marketplace. Asset classes include, but are not limited to, money market instruments, municipal securities, corporate bond securities, mortgage-backed securities (MBS), asset-backed securities (ABS) (excluding MBS), and any other asset class as determined by the FCA. We discuss this definition later in this preamble.

We propose to define a collateralized debt obligation (CDO) as a debt security collateralized by MBS, ABS, or trust-preferred securities.

One of our proposed criteria for Farm Credit bank investments with an obligor located outside of the United States is a high Country Risk Classification (CRC) (a 0 or a 1) as published by the Organization for Economic Cooperation and Development (OECD).²² We propose to define CRC, with respect to a sovereign, as the most recent consensus CRC published by the OECD as of December 31 of the prior calendar year that provides a view of the likelihood that the sovereign will service its external debt. This definition is identical to that adopted by the other Federal banking regulators in their capital rules to implement Basel III.²³ We proposed the same definition in the proposed revisions to our regulatory capital rule that the FCA Board adopted on May 8, 2014.²⁴

We propose to define a diversified investment fund as an investment company registered under section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a-8. This is consistent with our usage of the term in existing § 615.5140(a)(8).

We propose to replace the definitions for the existing terms "Government-sponsored agency" and "Government agency" with definitions for the new terms "Government-sponsored enterprise (GSE)" and "United States (U.S.) Government agency," respectively. We would define GSE as an entity established

²⁰ 76 FR 51289, Aug. 18, 2011.

²¹ Office of the Comptroller of the Currency (OCC), 77 FR 35253 and 35259, June 13, 2012; Federal Deposit Insurance Corporation (FDIC), 77 FR 43151 and 43155, July 24, 2012.

²² See proposed § 615.5140(a)(3). We explain this criterion in the preamble discussion of that proposed provision.

²³ OCC and the Federal Reserve System, Final Rule, 78 FR 62018, Oct. 11, 2013; FDIC, Interim Final Rule, 78 FR 55340, Sept. 10, 2013, substantively adopted as final at 79 FR 20754, April 14, 2014.

²⁴ The proposed capital rule has not yet been published in the Federal Register.

or chartered by the U.S. Government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. Government. We would define U.S. Government agency as an instrumentality of the U.S. Government whose obligations are fully guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. These terminology changes would have no substantive effect.²⁵

We propose to replace the defined term "mortgage securities" with "mortgage-backed securities" or "MBS." We also propose to change "mortgage securities" to "mortgage-backed securities" in the definition of ABS. These technical changes are for consistency with other FCA regulations and would have no substantive effect.

We propose to add a new definition for the term "obligor." Our existing regulations use this term, as do provisions that we propose to add or revise, but we have no definition for this term. We propose to define the term to ensure a common understanding of its meaning.

We would define obligor as an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded. This definition would include the debtor or immediate party that is obligated to pay a debt, as well as a guarantor of the debt. The definition would not include the sponsor (as we propose to define the term) of an investment, unless the sponsor has an obligation to pay the debt.

We propose to define "sponsor" as a person or entity that initiates a transaction by selling or pledging to a specially created issuing entity, such as a trust, a group of financial assets that the sponsor either has originated itself or has purchased; the sponsor may retain the obligation to repay or may transfer that obligation to the trust. An example of a sponsor would be an entity such as a commercial bank that transfers financial assets, such as loans that it has originated or purchased, to a bankruptcy remote trust known as a special purpose vehicle (SPV). In this example, the SPV services the debt and has the obligation to repay.

We propose to delete the following definitions because they will no longer be used in this subpart. We propose to delete "eurodollar time deposits," "final maturity," "general obligations," "liquid investments," "nationally recognized statistical rating organization," "revenue bond," and "weighted average life".

B. Section 615.5134--Liquidity Reserve

We propose to make technical, non-substantive revisions by adding the new terms "Government-sponsored enterprise (GSE)" and "U.S. Government agency" to our liquidity reserve regulation at § 615.5134, to conform to changes we made to those defined terms in § 615.5131. In addition, we propose changes to clarify that MBS must be fully guaranteed by a U.S. Government agency to qualify for Level 2 liquidity and fully guaranteed by a GSE to qualify for Level 3 liquidity.

C. Section 615.5140--Eligible Investments for Farm Credit Banks

Our existing investment eligibility regulation at § 615.5140 contains a detailed listing of eligible investment asset classes and types of investments within each asset class. The regulation imposes final maturity limits, investment portfolio limits, and other requirements for many of these investments. It also imposes credit rating requirements, based on

²⁵ We propose to delete the word "explicitly" from our existing definition because all obligations guaranteed or insured by the U.S. Government are backed by the full faith and credit of the United States unless the law or the obligation itself provides otherwise. For this reason, the word "explicitly" is superfluous.

NRSRO²⁶ credit ratings, for a number of the investments. The regulation currently applies to both Farm Credit banks and associations.

In revised § 615.5140, we propose to revise the investment eligibility requirements governing Farm Credit banks to strengthen their safety and soundness by more accurately reflecting the risk in particular investments based on recent experience in the marketplace.²⁷ In addition, to comply with section 939A of the DFA, we propose to replace the regulations' NRSRO credit ratings requirements with other standards of creditworthiness.

1. Paragraph (a)--Investment Eligibility Criteria

We propose the following criteria for Farm Credit banks to determine whether an investment is eligible. These criteria would replace the listing of eligible investments in our existing regulations.

a. Paragraph (a)(1)--Purpose

We propose to formalize our existing requirement that for an investment to be eligible, it must be purchased and held for an authorized purpose as set forth in § 615.5132(a). A Farm Credit bank must be able to identify the authorized purpose or purposes for which each investment is held.

b. Paragraph (a)(2)--Eligible Investments

The proposed regulation would specify the general requirements that investments must satisfy to be eligible. Limiting investments to those that satisfy these general requirements will ensure that investments are of high quality.

i. Paragraph (a)(2)(i)--Non-convertible Senior Debt Securities

Investments in senior debt securities that cannot be converted to any other type of securities would be eligible under the proposed rule. This investment category would include non-convertible U.S. Government agency senior debt securities, including U.S. Treasury securities, and senior non-convertible GSE bonds. Senior debt securities are those securities that have priority of claim over other securities issued. Senior debt securities may be secured by a specific pool of collateral or may be unsecured with priority of claims over other types of debt securities such as subordinated debt, preferred stock, or common equity. To be eligible under this criterion, a senior debt security must not be convertible into a non-senior security or an equity security.²⁸

Currently authorized investments such as municipal securities and corporate debt securities would be eligible under this criterion, as long as they are non-convertible senior debt securities. Other non-convertible senior debt securities would also be eligible under this criterion.

ii. Paragraph (a)(2)(ii)--Money Market Instruments

As under our existing rule, investments in money market instruments would be eligible under the proposed rule. The existing rule lists short-term instruments such as Federal funds, negotiable certificates of deposit, bankers acceptances, commercial paper, non-callable term Federal funds and Eurodollar time deposits, master notes, and repurchase agreements collateralized by eligible investments as money market instruments. The proposed rule's use

²⁶ Nationally Recognized Statistical Rating Organization.

²⁷ Revised § 615.5140 would apply to Farm Credit banks only. As discussed below, all association eligibility requirements would be located in revised § 615.5142.

²⁸ Since at least 1993, FCA has stated its belief that it is generally inappropriate for System institutions to maintain ownership interests in commercial enterprises by holding equity securities. See 58 FR 63034, 63049-50, Nov. 30, 1993.

of the term money market contemplates these instruments as well as other short-term instruments. For an investment to be eligible as a money market instrument, it must have a maturity of 1 year or less.

iii. **Paragraph (a)(2)(iii)--Mortgage-Backed Securities and Asset-Backed Securities Guaranteed by U.S. Government Agencies**

We propose that MBS and ABS that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency would be eligible securities because of their high credit quality. MBS and ABS that are partially guaranteed by a U.S. Government agency would not be eligible under this criterion (although they could be eligible under other criteria). Securities labeled "government guaranteed" satisfy this criterion only if they are fully guaranteed as to the timely payment of principal and interest.

iv. **Paragraph (a)(2)(iv)--Mortgage-Backed Securities and Asset-Backed Securities Guaranteed by GSEs**

Under the proposed rule, MBS and ABS that are fully and explicitly guaranteed as to the timely payment of principal and interest by GSEs would be eligible investments. Farmer Mac MBS would be excluded from eligibility under this provision because they are separately authorized and governed by § 615.5174.

Securities are eligible under this provision only if a GSE fully guarantees the timely payment of both the principal and interest due. A GSE "wrap" (guarantee) does not make a security eligible under this provision unless it is a guarantee of all principal and interest. When considering whether to purchase a security with a GSE guarantee or wrap, an institution must ensure that it is fully guaranteed. This provision carries over and clarifies the existing authorities.

v. **Paragraph (a)(2)(v)--Senior-most Positions of Mortgage-Backed Securities and Asset-Backed Securities not Guaranteed by U.S. Government Agencies or GSEs**

In our 2011 proposed rule on investment management,²⁹ we proposed that a position in a mortgage security that is not guaranteed by a Government agency or Government-sponsored agency would be eligible only if it is the senior-most position at the time of purchase. In that proposed rule, we said that we consider a position in such a mortgage security to be the senior-most position only if it currently meets both of the following criteria:

- No other remaining position in the securitization has priority in liquidation. Remaining positions that are the last to experience losses in the event of default and which share those losses pro rata meet this criterion.
- No other remaining position in the securitization has a higher priority claim to any contractual cash flows. Remaining positions that have the first priority claim to contractual cash flows (including planned amortization classes), as well as those that share on a pro rata basis a first priority claim to cash flows meet this criterion.

In their comments on the 2011 proposed rule, CoBank, ACB, the Farm Credit Bank of Texas, and The Farm Credit Council commented that the market understands the term "senior-most" to relate to liquidation preference rather than to the priority of claims to contractual cash flows prior to default. This is because investors, such as System institutions, are concerned with whether they receive a pro rata share

²⁹ 76 FR 51289, Aug. 18, 2011.

of cash flows in the event of depleted credit support or issuer/borrower default, not with whether contractual cash flows are paid first in the ordinary course of business. Institutions are able to successfully and safely invest in securities that are not the first priority with respect to contractual cash flows. These commenters, therefore, asked us to delete the second criterion from our understanding of the term "senior-most."³⁰

We agree with these comments and eliminate the second criterion. The first criterion set forth above remains.

In addition, as in the existing rule, we propose to retain the requirement that for a position in an MBS to be eligible, the MBS must satisfy the definition of "mortgage related security" in 15 U.S.C. 78c(a)(41). We propose to delete the alternative that the MBS could instead comply with 15 U.S.C. 77d(5), because that statutory provision was repealed by the Dodd-Frank Act. We note that commercial MBS are included under this proposed eligibility provision.

Private placements may be eligible under this proposed criterion (or other criteria), as long as they satisfy all of the proposed investment eligibility requirements. Private placement refers to the sale of securities to a relatively small number of sophisticated investors without registration with the Securities and Exchange Commission and, in many cases, without the disclosure of detailed financial information or a prospectus. Even private placements that may be eligible are generally not liquid. Farm Credit banks must be able to identify a permissible purpose for holding a private placement.

Our existing eligibility rules limit investments in ABS to those secured by specified assets and with specified weighted average lives. We propose to permit investments in the senior-most position of any ABS, regardless of the secured asset or the weighted average life.³¹

In sum, the proposed rule would permit Farm Credit banks to invest in the senior-most position of any MBS that satisfies the statutory definition of "mortgage related security" and the senior-most position of any ABS.

vi. **Paragraph (a)(2)(vi)--International and Multilateral Development Bank Obligations**

We retain the authority for Farm Credit banks to invest in obligations of international and multilateral development banks, as long as the United States is a voting shareholder.

vii. **Paragraph (a)(2)(vii)--Shares of a Diversified Investment Fund**

Under the proposal, shares of a diversified investment fund (DIF) would be eligible if the DIF's portfolio consists solely of securities that are eligible under these eligibility criteria or under § 615.5174.³² The investment company's risk and return objectives and use of derivatives must be consistent with the investment policies of the Farm Credit bank. This DIF eligibility is unchanged from the existing regulation. As discussed below, however, we propose more restrictive portfolio diversification limits on DIF investments than those that currently exist.

c. **Paragraph (a)(3)--Obligors' Capacity to Meet Financial Commitment**

³⁰ Farmer Mac made similar comments in response to the 2011 proposed rule governing Farmer Mac investment management. 76 FR 91798, Nov. 18, 2011.

³¹ Both existing and proposed § 615.5133(c) require the investment policies of each institution to establish risk limits for different types of investments based on all relevant factors, including the institution's objectives, capital position, earnings, and quality and reliability of risk management systems.

³² Section 615.5174 authorizes Farm Credit banks to purchase and hold MBS that are issued or guaranteed as to both principal and interest by Farmer Mac.

Existing § 615.5140 imposes credit rating requirements, based on NRSRO credit ratings, to determine the eligibility of investments in a number of asset classes, including municipal securities, certain money market instruments, non-agency mortgage-backed securities, asset-backed securities, and corporate debt securities.³³

Section 939A of the DFA requires each Federal agency to revise all of its regulations that refer to or require reliance on credit ratings to assess creditworthiness of an instrument to remove the reference or requirement and to substitute other appropriate creditworthiness standards.

We propose to comply with this requirement in a manner consistent with the approach of some of the Federal banking regulatory agencies. The OCC, for example, previously required national banks to determine whether a security was "investment grade" in order to determine whether purchasing the security was permissible. Under the previous definition of "investment grade," a security could be characterized as "investment grade" if it was rated in the top four "investment grade" NRSRO ratings.

In its revised regulations to comply with the DFA requirement, the OCC retained the term "investment grade" but eliminated the rating standard. Instead, it defined the term to mean "the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure."

The OCC stated that it did not intend for the elimination of references to credit ratings to change substantively the standards national banks must follow when deciding whether a security is investment grade. Its new rule permits a national bank to consider credit ratings as part of its "investment grade" determination and due diligence, but the credit rating must be supplemented by the bank's own analysis. And the new rule does not require a national bank to use NRSRO credit ratings to make the "investment grade" determination.³⁴

The OCC previously permitted national banks to invest in securities that were rated in one of the top four ratings. The OCC intends that its new definition -- the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure -- is substantively unchanged from its previous standards.

Except for investments in a few asset classes such as U.S. Government agency and GSE obligations, as discussed above, FCA's existing regulations require that in order to be eligible, investments must meet the highest or the second highest NRSRO rating, depending on the asset class. We want to retain high creditworthiness standards for Farm Credit bank investments. Accordingly, we propose to require that for an investment to be eligible for Farm Credit banks, at least one obligor (whether debtor or guarantor) must have very strong capacity to meet its financial commitment for the expected life of the investment. Obligor that exhibit very strong capacity to meet financial commitments generally have very low probability of default. This standard would apply to all investments, including those that are currently not subject to a credit rating requirement.

Like the OCC's regulations, our proposal permits but does not require Farm Credit banks to consider credit ratings. If a Farm Credit bank does consider credit ratings, it must still conduct its own due diligence to determine

³³ Existing § 615.5140 imposes no credit rating requirements on investments in obligations of U.S. Government agencies, GSEs, and international and multilateral development banks, and in DIFs and certain money market instruments.

³⁴ 77 FR 35253, June 13, 2012 (OCC rule); 77 FR 35259, June 13, 2012 (OCC guidance). See also 77 FR 43151, July 24, 2012 (FDIC rule); 77 FR 43155, July 24, 2012 (FDIC guidance).

whether an investment satisfies this standard. An investment does not automatically satisfy this standard by virtue of its credit rating.

We propose an additional standard for investments if a Farm Credit bank is relying upon the capacity of a non-U.S. obligor to meet the "very strong capacity" standard.

Unless such an investment is fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency, the sovereign host country of the obligor whose capacity is being relied upon must have the highest Country Risk Classification (CRC) (a 0 or a 1) as published by the OECD or must be an OECD member that is unrated. If the Farm Credit bank is not relying upon the capacity of a non-U.S. obligor to satisfy the "very strong capacity" standard, then the proposal establishes no requirements regarding that obligor's sovereign host country.

The OECD's CRCs are an assessment of a country's credit risk, used to set interest rate charges for transactions covered by the OECD arrangement on export credits. The OECD uses a scale of 0 to 7 with 0 being the lowest possible risk and 7 being the highest possible risk. Furthermore, the OECD no longer assigns CRCs to certain high income countries that are members of the OECD and that have previously received a CRC of 0.³⁵ OECD member countries that are no longer assigned a CRC exhibit a similar degree of country risk as that of a jurisdiction with a CRC of 0.

In their capital rules to implement Basel III, the Federal banking regulators adopted provisions basing risk weights for sovereign exposures on OECD CRCs (and on OECD membership, for countries without a CRC).³⁶ Like these other regulators, we believe that use of CRCs in this manner is permissible under section 939A of the Dodd-Frank Act and that section 939A was not intended to apply to assessments of creditworthiness of organizations such as the OECD. As discussed in those rules, section 939A was targeted at addressing the role, and the conflicts of interest, of commercial credit rating agencies that provide government-sanctioned credit ratings to their fee-paying clients. The OECD is not a commercial entity that produces credit assessments for fee-paying clients, nor does it provide the sort of evaluative and analytical services as credit rating agencies. Additionally, we propose to use CRCs only for this limited purpose.

d. Paragraph (a)(4)--Credit and Other Risk in the Investment

In addition to imposing standards on obligors, we also propose to require that for an investment to be eligible, it must itself exhibit low credit risk and other risk characteristics consistent with the purposes for which it is held. The other risks that institutions must consider include, but are not limited to, those listed in § 615.5133(c).

We believe that all investments held by Farm Credit banks must have low credit risk. We do not propose to require that other risks in the investment be low in all cases. Instead, the risk characteristics in the investment must be consistent with the purposes for which the investment is held. Accordingly, Farm Credit banks must understand the purpose for which they purchase and hold an investment.

For instance, if an investment is held for the purpose of liquidity, it would have to be marketable or liquid³⁷ and would generally have to have low price volatility. On the other hand, an investment that is high quality but has

³⁵ See <http://www.oecd.org/tad/xcred/cat0.htm>.

³⁶ OCC and the Federal Reserve System, Final Rule, 78 FR 62018, Oct. 11, 2013; FDIC, Interim Final Rule, 78 FR 55340, Sept. 10, 2013, substantively adopted as final at 79 FR 20754, April 14, 2014.

³⁷ Under § 615.5134(d), investments used to satisfy the liquidity reserve requirement must be "marketable," as defined by that provision. Under § 615.5134(e), investments held in the liquidity buffer must be "liquid," as explained in that provision.

high price volatility and questionable marketability or liquidity would not be appropriate for a liquidity investment, but it might be used effectively to manage interest rate risk, which is a permissible purpose for Farm Credit banks under § 615.5132(a). Farm Credit banks must also consider whether other risks are consistent with the purpose for which an investment is held.

e. **Paragraph (a)(5)--Denomination**

As in our existing rule, the denomination of all investments must be in U.S. dollars. We propose no change from our existing rule.

2. **Paragraph (b)--Investments That Do Not Satisfy Requirements**

We propose technical revisions to the regulatory provision authorizing institutions to hold other investments with FCA's prior approval. We intend no substantive change with these revisions.

3. **Paragraph (c)--Ineligible Investments**

We propose to prohibit Farm Credit banks from purchasing CDOs, as that term is defined in § 615.5131. Based on the experience of CDO investors during the recent financial crisis, we believe investments in CDOs pose unacceptable risk to System institutions.

4. **Paragraph (d)--Reservation of Authority**

We propose to make explicit our authority, on a case-by-case basis, to determine that a particular investment imposes inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria. The proposal also provides that FCA will notify a Farm Credit bank as to the proper treatment of any such investment.

5. **Application of Investment Eligibility Criteria to Existing Farm Credit Bank Investments**

As discussed below, the FCA is contemplating that Farm Credit banks would have to comply with the rule's requirements pertaining to their own investments 6 months after the effective date of the rule. New Farm Credit bank investments made after that compliance date would be subject to the investment eligibility criteria in § 615.5140(a).

Existing Farm Credit bank investments (investments made before the compliance date) that were not eligible under the investment eligibility criteria that were in effect at the time of purchase (or that the FCA did not approve) would continue to be subject to the requirements of § 615.5143(a), which governs the treatment of investments that are ineligible when purchased.

Existing Farm Credit bank investments (investments made before the compliance date) that were eligible under the investment eligibility criteria that were in effect at the time of purchase but that are ineligible under the revised § 615.5140(a) investment eligibility criteria would be treated as follows, unless the FCA specified different treatment. If an investment is not eligible because it does not satisfy the criteria in revised § 615.5140(a)(2) -- that is, it is a type of investment that was eligible under the previous criteria but is not eligible under the revised criteria -- the Farm Credit bank may continue to hold the investment with no restriction. If an investment is not eligible because it does not satisfy the criteria in revised § 615.5140(a)(1), (a)(3), or (a)(4) -- which pertain to permissible investment purposes and to credit quality -- the Farm Credit bank may continue to hold the investment subject to §

615.5143(b), which governs the treatment of investments that were eligible to purchase but that no longer satisfy the eligibility criteria.

We remind the Farm Credit banks that under § 615.5143(c), the FCA would retain the authority to require divestiture of any investment at any time for failure to comply with § 615.5132(a) or for safety and soundness reasons.

D. Section 615.5133--Investment Management

1. Overview

Existing § 615.5133 applies to all System institutions – Farm Credit banks, associations, and service corporations. Most of proposed revised § 615.5133 would also apply to all System institutions. However, as discussed in greater detail below, proposed § 615.5133(f) and (g), which govern portfolio diversification requirements and obligor limits, would apply only to Farm Credit banks. Additionally, we propose to modify § 615.5133(c), which addresses risk tolerance in investment policies, so it clearly distinguishes how liquidity is managed at Farm Credit banks from its treatment at associations. The investment management provisions of proposed § 615.5133 would apply to service corporations to the extent they are appropriate to the size, complexity, and risks of their investments.

2. Appropriate Use of Off-Balance Sheet Derivatives

Off-balance sheet derivatives can be appropriate and useful for the purposes of hedging and risk management. While our regulations do not prohibit a System bank from using off-balance sheet derivatives to build an investment portfolio, use of these derivatives must be consistent with an authorized investment purpose and not be for speculative purposes. We note that such derivatives generally do not provide a significant source of liquidity.

3. Paragraph (a)--Responsibilities of Board of Directors and Paragraph (b)--Investment Policies – General Requirements

The FCA proposes no changes to § 615.5133(a), which governs the responsibilities of the boards of directors of System institutions. We propose only minor stylistic and non-substantive changes to § 615.5133(b), which identifies the general requirements that System institutions must address in their investment policies.

4. Paragraph (c)--Investment Policies - Risk Tolerance

We propose several technical modifications to § 615.5133(c) that would enhance its clarity and provide better guidance to System institutions about compliance with it. For example, we propose a technical change to paragraph (c) to clarify that while operational risk must be addressed in investment policies, the policies do not need to establish quantitative risk limits for operational risk. Quantitative risk limits would continue to be required for the other identified risks – credit, market, and liquidity.

We propose to split the requirements regarding credit quality standards and concentration risk in existing paragraph (c)(1)(i) into two paragraphs. We propose to incorporate the existing general requirements regarding risk diversification standards and counterparty (obligor) risk limits into more specific requirements contained in proposed paragraphs (f) and (g). We propose these revisions in order to clarify our requirements in this area and ensure that institutions are considering risk appropriately.

Proposed paragraph (c)(1)(i) would address credit quality standards. It would require that an institution's investment policies establish credit quality standards for single or related obligors, sponsors, secured and unsecured exposures, and asset classes or obligations with similar characteristics. We propose to add sponsors to the existing requirements because, even though sponsors have no obligation to pay the debt (unless they are also obligors), we are concerned that a sponsor of low credit quality could present risk in a transaction that it initiates. We propose to add secured and unsecured investments to the existing requirements because we believe institutions should consider the differing levels of risk that these investments present.

Proposed paragraph (c)(1)(ii) would address concentration risk. It would require that an institution's investment policies establish concentration limits for single or related obligors, sponsors, geographical areas, industries, unsecured exposures, and asset classes or obligations with similar characteristics. We propose to add sponsors to the existing requirements because we believe undue concentration in a sponsor could present excessive risk. We propose to add unsecured investments to the existing requirements because institutions should carefully consider the amount of unsecured investments they are prepared to hold. Concentration limits should be commensurate with the types and complexity of investments that an institution holds.

We propose to revise § 615.5133(c)(1)(iv), which addresses collateral margin requirements on repurchase agreements. Currently, this provision requires System institutions to regularly mark collateral to market and to ensure that they maintain appropriate control over collateral that they hold. We propose to modify § 615.5133(c)(1)(iv) to clarify that this provision would apply only to System institutions that engage in repurchase agreements.

We propose to revise § 615.5133(c), which governs investment policies pertaining to liquidity, into two separate paragraphs. We propose this revision to take into account the differences in how liquidity is managed at Farm Credit banks from its treatment at associations.

Generally, Farm Credit banks hold liquidity reserves and manage liquidity risks for themselves, their affiliated associations, and certain service corporations. In contrast, System associations are not exposed to the same liquidity risks and they do not manage liquidity in the same way as their funding banks because their only substantial liability is their debt obligation to their funding bank.

Existing § 615.5133(c)(3) requires investment policies of all System institutions to describe the liquidity characteristics of eligible investments that the institutions will hold to meet their liquidity needs and other institutional objectives. Under proposed § 615.5133(c)(3)(i), Farm Credit banks would remain subject to this existing requirement. This requirement is appropriate because of the liquidity needs and liquidity risk of Farm Credit banks.

Under proposed § 615.5133(c)(3)(ii), the investment policies of System associations would have to describe the liquid characteristics of their investments. Although System associations do not have the same liquidity needs and liquidity risk as Farm Credit banks do, if they invest their funds in investments authorized by § 615.5142 they must be aware of the liquid characteristics of the assets that they purchase and hold. Proposed conforming changes throughout § 615.5133(c) would require System institutions to consider and address how investment decisions affect their liquidity risk, if and when applicable.

Except for other minor stylistic and technical changes, we propose no other changes to paragraph (c).

5. Paragraph (d)--Delegation of Authority and Paragraph (e)--Internal Controls

We propose no changes to paragraphs (d) and (e).

6. Paragraph (f)--Farm Credit Bank Portfolio Diversification

We propose to add a new paragraph (f) to govern investment portfolio diversification. This paragraph would apply only to Farm Credit banks.

a. Paragraph (f)(1)--Well Diversified Portfolio

Portfolio diversification is a key concept in ensuring the safety and soundness of investors such as Farm Credit banks. We propose requirements to ensure, at a minimum, that the investment portfolios of these institutions do not pose significant risk of loss due to excessive concentrations among asset classes, maturities, industries, geographic areas, and obligors. We also propose exemptions for certain investments from these portfolio diversification requirements. These exemptions would apply where the level of risk from concentration is low.

b. Paragraph (f)(2)--Exemptions

We propose that certain investments would not be subject to our diversification requirements. In this preamble, we refer to investments that are not subject to diversification requirements as "exempt" investments. We refer to all other investments as "covered" investments, because they are subject to our proposed diversification requirements.

i. Paragraph (f)(2)(i)--Investments Guaranteed by U.S. Government Agencies

Under the proposal, investments that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency would be exempt from the proposed diversification requirements. We propose this exemption because we believe these types of investments are of the highest quality. Our existing rules impose no portfolio diversification requirements on such investments.

ii. Paragraph (f)(2)(ii)--Investments Guaranteed by GSEs

Under the proposal, investments, other than MBS, that are fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE would be exempt from the proposed portfolio diversification requirements. No more than 50 percent of an institution's investment portfolio could be comprised of GSE MBS. These provisions are substantively unchanged from our existing regulations with respect to the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) MBS. Investments in Farmer Mac securities are governed by § 615.5174 and would not be subject to this limitation.

Our 2011 proposed investment management rule had also proposed to retain our 50-percent portfolio limit on Fannie Mae and Freddie Mac MBS. The Farm Credit Council, the Farm Credit Bank of Texas and CoBank, ACB commented in response to that proposal that this limit was too restrictive in light of the safe and liquid nature of these investments (especially since those GSEs were under U.S. Government conservatorship) and the positive yield that those investments provide. They asked us to eliminate portfolio limits for investments in these GSEs. The Council also expressed concern with language in our preamble suggesting that we might consider further restrictions on MBS investments in these GSEs in the future.

We believe no portfolio limits are needed for non-MBS investments in GSEs, such as general obligations. We are concerned, however, about concentration in housing-related investments, and accordingly we propose to retain the 50-percent limit on GSE MBS.³⁸ We do not contemplate further restrictions on investments in GSE MBS at this time.

c. Paragraph (f)(3)--Investment Portfolio Diversification Requirements

We are proposing investment portfolio diversification requirements for covered investments. Under the proposal, a well-diversified investment portfolio would mean that, at a minimum, covered investments are comprised of different asset classes, maturities, industries, geographic areas, and obligors.

Although we are not proposing specific maturity, industry, or geographic area requirements, the regulation would require each Farm Credit bank to diversify its investments by maturity, industry, and geographic area based on its risk profile.

Covered investments would have to satisfy specified asset class and obligor diversification requirements. These diversification requirements would be calculated based on the entire investment portfolio. This means that both exempt and covered investments would be included in the denominator. The numerator would consist only of those investments that are covered investments for the asset class and obligor diversification requirements. These diversification parameters would be based on the portfolio valued at amortized cost.

We note that these diversification requirements are regulatory maximums; each Farm Credit bank should establish diversification limits that fit its risk profile and that may be more restrictive than regulatory requirements.

Our current regulations impose no investment portfolio limits on investments in DIFs, as long as an institution's shares in each DIF comprise 10 percent or less of its investment portfolio. Otherwise, the portfolio limits for each asset class apply. As discussed below, we now propose different treatment for DIF investments.

i. Paragraph (f)(3)(i)--Asset Class Diversification

We propose to require Farm Credit banks to diversify their investment portfolios among various asset classes; no more than 15 percent of their investment portfolios could be invested in any one asset class.³⁹ As discussed above, we propose to define an asset class as a group of securities that exhibit similar characteristics and behave similarly in the marketplace.

³⁸ Under our recently finalized revisions to our liquidity rule (78 FR 23438, April 18, 2013), it is extremely unlikely that Farm Credit banks could approach 100 percent in GSE MBS.

³⁹ As discussed above, "exempt" investments would not be subject to this asset class diversification requirement, although under proposed § 615.5133(f)(2)(ii), MBS that are fully and explicitly guaranteed by GSEs could only comprise up to 50 percent of the total investment portfolio. Investments in Farmer Mac securities are governed by § 615.5174 and also would not be subject to this requirement.

For purposes of this proposed asset class diversification requirement, we consider MBS to be an asset class. We also consider ABS (excluding MBS) to be an asset class that includes instruments such as student loans and car loans. In addition, we consider money market securities to be an asset class that includes securities such as federal funds and commercial paper. Other asset classes would include municipal securities, corporate bond securities, and any other asset class as determined by the FCA. Each of these asset classes is limited to 15 percent of the investment portfolio of a Farm Credit bank, regardless of the different types of instruments that comprise the asset class.

For purposes of this proposed asset class diversification requirement, we do not consider DIFs to be an asset class, and therefore this requirement would impose no restrictions on the relative amount of DIF investments a Farm Credit bank could hold.⁴⁰ The securities within DIFs, however, would be subject to the asset class diversification requirements.

Our existing rule imposes portfolio limits of 15 percent, 20 percent, or 50 percent, depending on the asset class. In our proposed rule in 2011 for banks and associations, we proposed asset class limits for investments that were similar to but generally more restrictive than our existing regulations. To simplify the rule, we are proposing a 15-percent limit for all asset classes.

We believe that diversification of investments is a fundamental part of risk management and that a 15-percent portfolio limit for asset classes is appropriate. Because the vast majority of System investments are in exempt securities, a 15-percent limit on investments in each asset class should provide sufficient flexibility for institutions to manage their investment portfolios.

We seek comment on the reasonableness of this proposed limitation.

ii. Paragraph (f)(3)(ii)--Obligor Diversification

We propose to require Farm Credit banks to diversify their investment portfolios among various obligors; no more than 3 percent of their investment portfolios could be invested in any one obligor.⁴¹ As discussed above, we propose to define obligor as an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded. This definition would include the debtor or immediate party that is obligated to pay a debt, as well as a guarantor of the debt. Under this requirement, a Farm Credit bank must consider both the DIF itself and the entity or entities obligated to pay the underlying debt to be obligors. This requirement would ensure that an institution would not be able to use DIF investments to hold an excessively concentrated investment portfolio.

Our existing regulations contain no portfolio diversification requirements by obligor (although, as discussed below, they do limit the amount of total capital that institutions can invest in a single obligor). We

⁴⁰ We believe that the obligor diversification requirements discussed next in this preamble, along with the obligor limit in proposed paragraph (g) of this section, would provide sufficient diversification among DIFs themselves.

⁴¹ As discussed above, "exempt" investments would not be subject to this obligor diversification requirement, although under proposed § 615.5133(f)(2)(ii), MBS that are fully and explicitly guaranteed by GSEs could only comprise up to 50 percent of the total investment portfolio. Investments in Farmer Mac securities are governed by § 615.5174 and also would not be subject to this requirement.

propose this diversification requirement because we believe that concentration among obligors could lead to significant risk.

We believe that this proposal would likely not require changes in the current investment portfolios of Farm Credit banks, although it might have required changes to those portfolios in the past. We believe that this requirement would provide these institutions with sufficient flexibility to manage their investment portfolios while ensuring adequate diversification to further safety and soundness. We seek comment on the reasonableness of this proposed limitation.

7. Paragraph (g)--Farm Credit Bank Obligor Limit

We propose to limit the amount of capital that Farm Credit banks may invest in any one obligor. For Farm Credit banks, the limit would be 10 percent of total capital. This obligor limit would not apply to investments in obligations that are fully guaranteed as to the payment of principal and interest by a U.S. Government agency or fully and explicitly guaranteed as to the payment of principal and interest by a GSE. Under this requirement, a Farm Credit bank must consider both the DIF itself and the entity or entities obligated to pay the underlying debt to be obligors.

Our existing regulations allow Farm Credit banks to invest up to 20 percent of their total capital in eligible investments issued by any single institution, issuer, or obligor; this obligor limit does not apply to obligations, including mortgage securities, that are issued or guaranteed as to interest and principal by the United States, its agencies, instrumentalities, or corporations.

The lower obligor limit that we propose for Farm Credit banks would enhance safety and soundness by ensuring that if an obligor were to default, only a small portion of capital would be at risk. For simplicity, we propose to continue to base the Farm Credit bank investment amount on total capital. As discussed above, however, the FCA Board adopted proposed revisions to our regulatory capital rule on May 8, 2014, and we may revise the basis for the obligor limit to incorporate any revisions to our regulatory capital rule that are adopted in final in the future.⁴²

We note that this obligor limit would be a regulatory maximum; each Farm Credit bank should establish obligor limits that fit its overall risk profile and risk-bearing capacity, including earnings capacity, as well as the risks in individual types and classes of investments. For example, more restrictive obligor limits may be warranted on unsecured investments.

We seek comment on whether our proposed 10-percent obligor limit is appropriate. If you believe it is not appropriate, what should the regulatory maximum be, and why?

8. Paragraph (h)--Due Diligence

We propose to redesignate existing paragraph (f) as paragraph (h).

⁴² The proposed capital rule has not yet been published in the [Federal Register](#).

In paragraph (h)(1)(iii), we propose that a System institution must document its assessment of each investment at the time of purchase. While the assessment must be commensurate with the type of each investment, at a minimum the assessment must include an evaluation of the credit risk, liquidity risk as applicable, market risk, interest rate risk, and underlying collateral of the investment.

The nature and degree of due diligence and documentation that is required under this provision to assess eligibility varies based on the risks inherent in different types of securities. For example, institutions should assess securities that they believe are guaranteed by a U.S. Government agency or a GSE to ensure they satisfy our definitions and eligibility requirements for such securities. As another example, institutions do not need to assess the creditworthiness of U.S. Government agency securities, because they exhibit low sovereign default (credit) risk; however, institutions should assess and document all other potential risks associated with these securities. Securities that are not guaranteed by a U.S. Government agency generally present varying degrees of credit risk as well as other types of risk, and the assessment and level of documentation should be sufficient to support the investment decision.

All other changes that we propose to this paragraph are non-substantive.

9. Paragraph (i)--Reports to the Board of Directors

We propose to redesignate existing paragraph (g) as paragraph (i). We also propose to add the word "risk" to redesignated § 615.5133(i)(3) so it would require quarterly reports to the board or a designated board committee to address the current composition, quality, and the risk and liquidity profiles of the investment portfolio. This revision would ensure more comprehensive reporting to the board about how the current composition and quality of investments affect the risk and liquidity profile of the bank or association, which would enhance safety and soundness. We propose no other changes to this provision.

E. Section 615.5142--Association Investments

The FCA proposes to revise § 615.5142, which governs association investments. Existing § 615.5142 does not impose a portfolio limit on the total amount of investments that each association is authorized to hold. Additionally, existing § 615.5140 permits associations to hold the same types of investments as Farm Credit banks even though associations are not subject to the liquidity reserve requirement in § 615.5134, and they are not exposed to the same liquidity and market risks as their funding banks. Accordingly, the FCA proposes to revise its regulatory approach to association investments in order to limit the type and amount of investments that an association may hold.

As discussed in more detail below, the proposed rule generally would limit association investments to obligations that are issued or fully guaranteed or insured as to the timely payment of principal and interest by the United States or any of its agencies in an amount that does not exceed 10 percent of its total outstanding loans. The proposed rule also addresses: (1) Core investment and risk management practices at System associations; (2) funding bank supervision of association investments; (3) requests by associations to the FCA to hold other investments; and (4) transition requirements for System associations to come into compliance with the new rule.

Currently, § 615.5142 authorizes each association to hold eligible investments listed in § 615.5140, with the approval of its funding bank, for the purposes of reducing interest rate risk and managing surplus short-term funds. The existing regulation also requires each Farm Credit bank to review annually the investment portfolio of every association it funds.

Most System associations have increased in size and complexity over the past two decades, offering a diversity of products and services to accommodate a changing and increasingly competitive agricultural sector. The changes in agriculture have introduced new risks to the associations. For example, while the associations have adopted adequate risk management strategies to effectively adapt to this changing environment, they are concentrated in agriculture and have limited ability to manage concentration risk. The associations currently can use investments to manage surplus short-term funds and reduce interest rate risk but cannot use investments to manage concentration risk. The proposed rule strikes a balance by granting associations greater flexibility in the purposes for which they may hold investments, while placing more limits on the amounts and types of investments they may hold. Accordingly, the proposed changes would provide the associations the flexibility to use full faith and credit instruments to manage concentration risk by diversifying assets. We believe the proposed change would help improve association risk management practices and, therefore, strengthen the safety and soundness of the System.

The Farm Credit Act of 1971, as amended, (Farm Credit Act) specifically authorizes System associations to buy and sell obligations of, or insured by, the United States or any agency thereof, and make other investments as may be approved by their respective funding banks under regulations issued by the Farm Credit Administration.⁴³

1. Paragraph (a)--Investment Eligibility Criteria

The proposed rule would: (1) Revise the investment purposes for System associations; (2) limit the types of investments that associations may purchase and hold; and (3) impose a cap on the amount of such enumerated investments that each association may hold. Specifically, proposed § 615.5142(a) would authorize each System association, with the approval of its funding bank, to manage risk by purchasing and holding obligations that are issued by, or are fully guaranteed or insured as to the timely payment of principal and interest by, the United States or any of its agencies in an amount that does not exceed 10 percent of its total outstanding loans.

We are proposing to eliminate our requirements in the existing regulation, which authorize associations to hold investments for the purposes of reducing interest rate risks and managing surplus short-term funds, because we believe these requirements are: (1) Too restrictive; and (2) do not provide associations flexibility to manage their risks in today's environment.

As a result of mergers and consolidations, and the evolution of agricultural credit and financial management practices, System associations encounter various risk management environments. A few larger associations now have the capacity to manage interest rate risk separately from their funding banks. For many associations, a small portfolio of high quality investments could help diversify risks they experience as lenders that primarily lend to a single industry--agriculture.

Whereas the existing rule authorizes associations to hold investments for the purposes of reducing interest rate risks and managing surplus short-term funds, the proposed rule authorizes associations to hold investments to manage risks. We invite your comments about whether this proposed rule should identify specific purposes for

⁴³ See sections 2.2(10) and (11), and 2.12(17) and (18) of the Act. Additionally, sections 2.2(10) and 2.12(18) of the Act authorize System associations to deposit funds with any member bank of the Federal Reserve System, or with any bank insured by the Federal Deposit Insurance Corporation.

associations to purchase and hold investments. If you believe that our rule should expressly identify and require specific purposes, please state which ones and why.

Proposed § 615.5142(a) would authorize System associations to invest solely in obligations that are issued, or are fully guaranteed or insured as to the timely payment of principal and interest by the United States or of any of its agencies. Obligations issued, insured, or guaranteed by the United States are expressly mentioned in the provisions of the Act governing association investments. Obligations issued or fully guaranteed or insured as to the timely payment of principal and interest by the United States and its agencies are usually liquid and many are actively traded, although MBS issued by Federal agencies could expose investors to significant market risks.⁴⁴ These obligations pose virtually no credit risk to investors because they are backed by the full faith and credit of the United States, although they may expose investors to other risks, especially market risks. For these reasons, obligations issued or fully guaranteed or insured as to the timely payment of principal and interest by the United States and its agencies are suitable for risk management at System associations.

Proposed § 615.5142(a) limits association investments to 10 percent of total outstanding loans. This portfolio limit would ensure that loans to eligible borrowers always constitute the vast majority of System assets, which is consistent with the mission of each association. In this context, the FCA is imposing portfolio limits on investments so that loans to eligible borrowers always constitute a majority of assets at all System banks and associations. Our regulations authorize Farm Credit banks to hold significantly larger investment portfolios than System associations because the: (1) Banks maintain liquidity and manage interest rate risk for all System institutions operating in the district; and (2) associations borrow exclusively from their funding banks.

At the same time, the proposed 10-percent portfolio limit on investments should be sufficient to enable associations to develop robust strategies to manage risks, as long as association investment activities are supported by strong investment policies, management practices and procedures, and appropriate internal controls. Furthermore, the proposed 10-percent limit should help associations manage their concentration risk as single-industry lenders. The policies at some System associations with active investment programs typically establish a 15-percent portfolio limit for investments, while in practice, investments at most associations rarely equal or exceed 10 percent of total outstanding loans. For all these reasons, the FCA believes that the proposed 10-percent portfolio limit on investments strikes an appropriate balance by enabling associations to appropriately manage and diversify risks while continuing to serve their primary mission of funding agriculture and rural America.

We are proposing that the 10-percent limit be computed based upon the 30-day average daily balance of investments divided by loans. Investments would be calculated at amortized cost. Loans would be calculated as defined in § 615.5131, which provides that loans are calculated quarterly (as of the last day of March, June, September, and December) by using the average daily balance of loans during the quarter. For the purpose of this calculation, loans would include accrued interest and not include any allowance for loan loss adjustments. Compliance with the calculation would be measured on the last day of every month.

⁴⁴ Farmer Mac MBS are covered by § 615.5174, not § 615.5142. Investments in Farmer Mac MBS cannot exceed the total amount of outstanding loans of a System bank or association.

We also request your comments on whether using the average daily balance of loans during the quarter for computing the limit is adequate to limit any distortions caused by seasonality fluctuations in the amount of total loans.

2. Paragraph (b)--Risk Management Requirements

The following provisions would help to ensure that System associations comply with prudent investment management practices. Therefore, we are proposing to require that each association evaluate its investment management policies, and determine and document how its investment activities are conducted in accordance with the risk management processes and procedures identified in proposed § 615.5142(b)(1), (b)(2), and (b)(3).

3. Paragraph (b)(1)--Compliance with Investment Management Requirements

Proposed § 615.5142(b)(1) would require each association to comply with proposed § 615.5133(a), (b), (c), (d), (e), (h), and (i), which govern investment management practices at all System institutions.⁴⁵ From the FCA's perspective, these provisions of proposed § 615.5133 would ensure that System associations always follow prudent investment management practices. Additionally, compliance with these provisions of § 615.5133 would instill discipline in investment management practices at each System association, which protects its safety and soundness. Therefore, we are proposing to require that each association document its compliance with the applicable provisions of § 615.5133.

Under proposed § 615.5142(b)(1), each association's investment management processes must be appropriate for the size, risk characteristics, and complexity of the association and its investment portfolio. These risk management processes must take into account the association's unique circumstances, risk tolerances, and objectives. An association's board would not need to develop an investment policy if it elects not to hold investments authorized under § 615.5142(a).

We are particularly interested in comments on how the FCA can structure the documentation requirements so they do not impose undue regulatory burden on funding banks or associations.

4. Paragraph (b)(2)--Compliance with Interest Rate Risk Management Requirements

Proposed § 615.5142(b)(2) would require any association with significant interest rate risk exposure to comply with §§ 615.5180 and 615.5182. More specifically, § 615.5182 requires any association with interest rate risk that could lead to significant declines in net income or in the market value of capital to comply with § 615.5180, which establishes specific criteria for System banks to follow for managing interest rate risk. Under this regulatory framework, the interest rate risk management program must be commensurate with the level of interest rate risk at the association.

The fiduciary responsibilities of association boards of directors obligate them to develop appropriate investment management policies and practices to manage interest rate risk. Additionally, it is incumbent upon each association's investment managers to fully understand the risks of its investments and make independent and objective evaluations of investments prior to purchase.

⁴⁵ Proposed § 615.5142(b)(1) would not require System associations to comply with proposed § 615.5133(f) and (g) because those two provisions explicitly apply only to System banks.

Interest rate risk management is an important part of the overall financial management of investments at an association, and includes involvement by both senior management and the association's board of directors. To the extent an association has investments, its board must develop and implement an interest rate risk management program that is tailored to the association's needs and establishes a risk management process that effectively identifies, measures, monitors, and controls interest rate risk.

5. Paragraph (b)(3)--Other Relevant Factors

Proposed § 615.5142(b)(3) would require each association to consider and evaluate other relevant factors that are unique to its circumstances or to the nature of investments that could affect its risk-bearing capacity. Such factors include, but are not limited to, its management experience and capability to understand and manage complex structures and unique risks in the investments it purchases and holds. In this context, the size, risk characteristics, and complexity of the investment portfolio are other relevant factors that could affect an association's risk-bearing capacity when its unique circumstances, risk tolerance, and objectives are taken into account. Associations are authorized to purchase and hold investments only for the purpose of managing risks. Although the FCA does not expect associations to suffer losses or break even on investments, using investments primarily for speculative purposes or generating gains from trading is an impermissible activity. Likewise, the intentional mismatched funding of investments and the resulting increase in interest rate risk would typically be inappropriate unless used as an effective hedge against other risks in the balance sheet. Other factors that associations should consider and evaluate include option, premium and call risks of certain investments that they may acquire.

6. Paragraph (c)--Funding Bank Supervision of Association Investments

Sections 2.2(10) and 2.12(18) of the Farm Credit Act require each association to obtain its funding bank's approval of the association's investment activities in accordance with FCA regulations. Accordingly, proposed § 615.5142(c) addresses funding bank review, approval, and oversight of the investment activities of its affiliated associations. As required by statute, each association must request from its funding bank prior approval to buy and hold investments under this section. This proposed provision would not require that an association request approval for each and every investment. Instead, this proposed provision would provide flexibility for each association to choose whether it would prefer to request funding bank approval for each specific investment or instead request approval of a type or class of investments.

7. Paragraph (c)(1)--Funding Bank Review, and Approval or Denial of Association Investments

Proposed § 615.5142(c)(1) would require each funding bank to review and approve or deny requests by its affiliated associations to buy and hold investments. Additionally, the proposed rule would require the bank to explain in writing its reasons for approving or denying the association's request. Once an association has established a satisfactory investment management program under § 615.5142(b), which has been approved by its funding bank, the association would be permitted to buy and hold obligations that are issued, or are fully guaranteed or insured as to the timely payment of principal and interest by the United States government or any of its agencies. The intent of this proposed provision is to balance the funding needs of the associations with the funding capacity of the funding bank.

8. Paragraph (c)(2)--Bank Approval Process

As part of the approval process, the funding bank must evaluate, determine and document that the association has: (1) Adequate policies, procedures, internal controls, and accounting and reporting systems for its investments; (2) the capability and expertise to effectively manage risks in investments; and (3) complied with requirements of § 615.5142(b). Any existing System association investment management program previously reviewed and approved by the funding bank would need to be re-reviewed and re-approved if proposed § 615.5142 becomes final and effective.

The intent of this proposed provision is to balance the risk management needs of the associations with the funding and oversight role of the funding bank. A number of satisfactory methods exist for System banks to oversee association investment activities under our regulatory framework. A bank may take an active role in advising and approving an association's investment decisions and strategies. For example, banks may provide research, analytical or advisory services that help associations to manage their investment portfolios.

9. Paragraph (c)(3)--Annual Review of Investment Portfolio

Proposed § 615.5142(c)(3) also retains the existing requirement that each System bank annually review the investment portfolio of every association that it funds. As part of its annual review, the bank must evaluate whether the association's: (1) Investments mitigate and manage its risks; and (2) risk management practices continue to be adequate.

The FCA notes that the General Financing Agreement (GFA) (including any attached, referenced, or related documents) could establish covenants governing the investment activities of an affiliated association. As such, the GFA can be a useful tool for funding banks to review and monitor the investment activities of their affiliated associations.

10. Paragraph (d)--Other Investments Approved by the FCA

Proposed § 615.5142(d) would continue to allow an association to request the FCA's approval to purchase and hold other investments. We note that this provision represents no substantive change from current § 615.5140(e), which allows all System institutions to hold other investments that the FCA approves on a case-by-case basis. Consistent with current practice, the request for our approval must explain the risk characteristics of the investment and the purpose and objectives for making the investment.

These other investments approved by the FCA under proposed § 615.5142(d) would be subject to the portfolio limit on association investments under proposed § 615.5142(a) unless otherwise provided for by the FCA. Furthermore, these other investments could also be subject to specific conditions of approval and subject to other limits on a case-by-case basis.

11. Paragraph (e)(1)--Transition and Divestiture Issues for Association Investments

Under proposed § 615.5142(e)(1), an association would not be required to divest of any investments held on or before the date this rule becomes effective if they were previously authorized under former § 615.5140 or otherwise authorized by official written Agency action that allowed the association to continue to hold such investments. This transition rule would permit an association to continue to hold pre-existing investments that would no longer be authorized if proposed § 615.5142 is adopted as a final rule and becomes effective. However, after this proposed rule is effective, once such investments mature, the association would not be permitted to renew them unless they are authorized pursuant to proposed § 615.5142(a) or (d).

12. Paragraph (e)(2)--Impact on Existing Investments of Subsequent Declines in Total Outstanding Loans

Under proposed § 615.5142(e)(2), an association would not be required to divest of investments purchased on or after the date this proposed rule becomes effective if a subsequent decline in total outstanding loans causes it to exceed the 10-percent portfolio limit in § 615.5142(a).

Accordingly, once an association purchases an eligible investment, it would not be required to dispose of such investment just because of a subsequent decline in total outstanding loans. This provision would help to ensure that an association would not have to divest of a previously purchased asset when loan demand is reduced.

13. Paragraph (e)(3)--Management of Ineligible Investments and Divestiture under § 615.5143

Proposed § 615.5142(e)(3) would apply to all investments that an association acquires after the new regulation becomes effective. More specifically, all investments that an association purchases after proposed § 615.5142 becomes effective as a final rule would be subject to § 615.5143 of this part, which governs the management and divestiture of ineligible investments. As a result, an association would need to comply with § 615.5143 if any investment acquired after the effective date of this rule did not meet the investment criteria in § 615.5142(a) on or after the date of purchase, if it was not approved by the FCA pursuant to § 615.5142(d), or if it was approved by the FCA pursuant to § 615.5142(d) but later failed to satisfy the conditions of approval.

F. Section 615.5143--Management of Ineligible Investments and Reservation of Authority to Require Divestiture

We propose to revise § 615.5143 to add references to proposed § 615.5142, to reflect that associations are generally governed by the requirements of § 615.5143. In addition, we propose to tailor § 615.5143 to the investment and other authorities of Farm Credit banks as compared to associations. Specifically, we clarify that an association that purchases an ineligible investment would not be subject to the requirements relating to liquidity, collateral, and net collateral, because associations have no regulatory requirements in those areas. In addition, we propose to clarify that no investment is ineligible if it has been approved by the FCA, but an FCA-approved investment would be subject to the requirements of § 615.5143(b) if it no longer satisfied the conditions of approval.

G. Conforming Changes to Other Regulation Sections

We propose conforming changes to references in §§ 611.1153, 611.1155, 615.5174, and 615.5180.

IV. Compliance Date

We recognize that Farm Credit banks may require time to bring their policies and procedures into compliance with the new requirements in the proposed rule. Accordingly, we are contemplating that Farm Credit banks would be required to comply with the requirements governing their investments 6 months after the effective date of the rule, if it is adopted as final.⁴⁶ We invite your comments as to whether this delayed compliance timeframe is appropriate. We also invite your comments on whether a delayed compliance date would be appropriate for associations as well.

W. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

⁴⁶ Farm Credit bank compliance with requirements pertaining to their supervision of association investments would be required at the time associations are required to comply with this rule.

List of Subjects

12 CFR Part 611

Agriculture, Banks, banking, Rural areas.

12 CFR Part 615

Accounting, Agriculture, Banks, banking, Government securities, Investments, Rural areas.

For the reasons stated in the preamble, parts 611 and 615 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 611--ORGANIZATION

1. The authority citation for part 611 continues to read as follows:

Authority: Secs. 1.2, 1.3, 1.4, 1.5, 1.12, 1.13, 2.0, 2.1, 2.2, 2.10, 2.11, 2.12, 3.0, 3.1, 3.2, 3.3, 3.7, 3.8, 3.9, 3.21, 4.3A, 4.12, 4.12A, 4.15, 4.20, 4.21, 4.25, 4.26, 4.27, 4.28A, 5.9, 5.17, 5.25, 7.0-7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2002, 2011, 2012, 2013, 2020, 2021, 2071, 2072, 2073, 2091, 2092, 2093, 2121, 2122, 2123, 2124, 2128, 2129, 2130, 2142, 2154a, 2183, 2184, 2203, 2208, 2209, 2211, 2212, 2213, 2214, 2243, 2252, 2261, 2279a-2279f-1, 2279aa-5(e)); secs. 411 and 412 of Pub. L. 100-233, 101 Stat. 1568, 1638; sec. 414 of Pub. L. 100-399, 102 Stat. 989, 1004.

§ 611.1153 [Amended]

2. Section 611.1153 is amended by removing in paragraph (i)(1) the reference " § 615.5140(e)" and adding in its place, the reference "§ 615.5140(b) or § 615.5142(d)".

§ 611.1155 [Amended]

3. Section 611.1155 is amended by removing in paragraph (a)(1) the reference "§ 615.5140(e)" and adding in its place the reference "§ 615.5140(b) or § 615.5142(d)".

PART 615--FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS

4. The authority citation for part 615 is revised to read as follows:

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.7, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b-6, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-7, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a), Pub. L. 100-233, 101 Stat. 1568, 1608; sec. 939A, Pub. L. 111-203, 124 Stat. 1326, 1887 (15 U.S.C. 780-7 note).

§ 615.5131 [Amended]

5. Section 615.5131 is amended by:

a. Removing the definitions for "eurodollar time deposit", "final maturity", "general obligations", "Government agency", "Government-sponsored agency", "liquid investments", "mortgage securities", "Nationally Recognized Statistical Rating Organization (NRSRO)", "revenue bond", and "weighted average life (WAL)";

b. In the definition of "asset-backed securities (ABS)", remove the words "mortgage securities" and add in their place, the words "mortgage-backed securities;"

c. Adding in alphabetical order the new definitions for "Asset class", "Collateralized debt obligation (CDO)", "Country risk classification (CRC)", "Diversified investment fund (DIF)", "Government-sponsored enterprise (GSE)", "Mortgage-backed securities (MBS)", "Obligor", "Sponsor", and "United States (U.S.) Government agency" to read as follows:

§ 615.5131 Definitions.

* * * * *

Asset class means a group of securities that exhibit similar characteristics and behave similarly in the marketplace. Asset classes include, but are not limited to, money market instruments, municipal securities, corporate bond securities, MBS, ABS (excluding MBS), and any other asset class as determined by the FCA.

Collateralized debt obligation (CDO) means a debt security collateralized by MBS, ABS, or trust-preferred securities.

Country risk classification (CRC) with respect to a sovereign, means the most recent consensus CRC published by the Organization for Economic Cooperation and Development (OECD) as of December 31 of the prior calendar year that provides a view of the likelihood that the sovereign will service its external debt.

Diversified investment fund (DIF) means an investment company registered under section 8 of the Investment Company Act of 1940.

Government-sponsored enterprise (GSE) means an entity established or chartered by the United States Government to serve public purposes specified by the United States Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

* * * * *

Mortgage-backed securities (MBS) means securities that are either:

(1) Pass-through securities or participation certificates that represent ownership of a fractional undivided interest in a specified pool of residential (excluding home equity loans), multifamily or commercial mortgages, or

(2) A multiclass security (including collateralized mortgage obligations and real estate mortgage investment conduits) that is backed by a pool of residential, multifamily or commercial real estate mortgages, pass through MBS, or other multiclass MBS.

Obligor means an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded.

Sponsor means a person or entity that initiates a transaction by selling or pledging to a specially created issuing entity, such as a trust, a group of financial assets that the sponsor either has originated itself or has purchased.

United States (U.S.) Government agency means an instrumentality of the U.S. Government whose obligations are fully guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government.

* * * * *

6. Section 615.5133 is revised to read as follows:

§ 615.5133 Investment management.

(a) *Responsibilities of board of directors.* Your board of directors must adopt written policies for managing your investment activities. Your board must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. At least annually, the board, or a designated committee of the board, must review the sufficiency of these investment policies. Any changes to the policies must be adopted by the board and be documented.

(b) *Investment policies--general requirements.* Your board's written investment policies must address the purposes and objectives of investments; risk tolerance; delegations of authority; internal controls; due diligence; and reporting requirements. Your investment policies must fully address the extent of pre-purchase analysis that management must perform for various classes of investments. Your investment policies must also address the means for reporting, and approvals needed for, exceptions to established policies. If you are a Farm Credit bank, your investment policies must address portfolio diversification and obligor limits under paragraphs (f) and (g) of this section. Investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of your investments.

(c) *Investment policies--risk tolerance.* Your investment policies must establish risk limits for eligible investments and for the entire investment portfolio. Your investment policies must include concentration limits to ensure prudent diversification of credit, market, and, as applicable, liquidity risks in the investment portfolio. Risk limits must be based on all relevant factors, including your institutional objectives, capital position, earnings, and quality and reliability of risk management systems and must take into consideration the interest rate risk management program required by § 615.5180 or § 615.5182, as applicable. Your investment policies must identify the types and quantity of investments that you will hold to achieve your objectives and control credit risk, market risk, and liquidity risk as applicable. Each association or service corporation that holds significant investments and each Farm Credit bank must establish risk limits in its investment policies, as applicable, for the following types of risk:

(1) *Credit risk.* Investment policies must establish:

(i) *Credit quality standards.* Credit quality standards must be established for single or related obligors, sponsors, secured and unsecured exposures, and asset classes or obligations with similar characteristics.

(ii) *Concentration limits.* Concentration limits must be established for single or related obligors, sponsors, geographical areas, industries, unsecured exposures, and asset classes or obligations with similar characteristics.

(iii) Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms). You must buy and sell eligible investments with more than one securities firm. As part of your review of your investment policies required under paragraph (a) of this section, your board of directors, or a designated committee of the board, must review the criteria for selecting securities firms. Any changes to the criteria must be approved by the board.

(iv) Collateral margin requirements on repurchase agreements. To the extent you engage in repurchase agreements, you must regularly mark the collateral to market and ensure appropriate controls are maintained over collateral held.

(2) Market risk. Investment policies must set market risk limits for specific types of investments and for the investment portfolio.

(3) Liquidity.

(i) Liquidity risk at Farm Credit banks. Investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and other institutional objectives.

(ii) Liquidity at associations. Investment policies must describe the liquid characteristics of eligible investments that you will hold.

(4) Operational risk. Investment policies must address operational risks, including delegations of authority and internal controls in accordance with paragraphs (d) and (e) of this section.

(d) Delegation of authority. All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) Internal controls. You must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties between personnel who supervise or execute investment transactions and personnel who supervise or engage in all other investment-related functions.

(3) Maintain records and management information systems that are appropriate for the level and complexity of your investment activities.

(4) Implement an effective internal audit program to review, at least annually, your investment management function, controls, processes, and compliance with FCA regulations. The scope of the annual review must be appropriate for the size, risk and complexity of the investment portfolio.

(f) Farm Credit bank portfolio diversification.

(1) Well-diversified portfolio. Subject to the exemptions set forth in paragraph (f)(2) of this section, a Farm Credit bank must maintain a well-diversified investment portfolio as set forth in paragraph (f)(3) of this section.

(2) Exemptions from investment portfolio diversification requirements. The following investments are not subject to the investment portfolio diversification requirements specified in paragraph (f)(3) of this section:

(i) Investments that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency; and

(ii) Investments that are fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, except that no more than 50 percent of the investment portfolio may be comprised of GSE MBS. Investments in Farmer Mac securities are governed by § 615.5174 and are not subject to this limitation.

(3) Investment portfolio diversification requirements. A well-diversified investment portfolio means that, at a minimum, investments are comprised of different asset classes, maturities, industries, geographic areas, and obligors. These diversification requirements apply to each individual security that a Farm Credit bank holds within a DIF. To satisfy the asset class and obligor diversification requirements, a Farm Credit bank must, at a minimum, comply with the following requirements, except as exempted by paragraph (f)(2) of this section. These diversification parameters must be based on the portfolio valued at amortized cost.

(i) Asset class diversification. The investment portfolio must be diversified among various asset classes. No more than 15 percent of the investment portfolio may be invested in any one asset class. Securities within each DIF count toward the appropriate asset class.

(ii) Obligor diversification. The investment portfolio must be diversified among various obligors. No more than 3 percent of the investment portfolio may be invested in any one obligor. For a DIF, both the DIF itself and the entities obligated to pay the underlying debt are obligors.

(g) Farm Credit bank obligor limit. No more than 10 percent of a Farm Credit bank's total capital may be invested in any one obligor. This obligor limit does not apply to investments in obligations that are fully guaranteed as to the timely payment of principal and interest by U.S. Government agencies or fully and explicitly guaranteed as to the timely payment of principal and interest by GSEs. For a DIF, both the DIF itself and the entities obligated to pay the underlying debt are obligors.

(h) Due diligence.

(1) Pre-purchase analysis.

(i) Eligibility and compliance with investment policies. Before you purchase an investment, you must conduct sufficient due diligence to determine whether it is eligible under § 615.5140 or § 615.5142, as applicable, and complies with your board's investment policies. You must document your assessment and the information used in your assessment. You may hold an investment that does not comply with your investment policies only with the prior approval of your board.

(ii) Valuation. Prior to purchase, you must verify the value of the investment (unless it is a new issue) with a source that is independent of the broker, dealer, counterparty or other intermediary to the transaction.

(iii) Risk assessment. Your assessment of each investment at the time of purchase must at a minimum include an evaluation of the credit risk, liquidity risk as applicable, market risk, interest rate risk, and underlying collateral of the investment, as applicable. This assessment must be documented and commensurate with the complexity and type of the investment. You must perform stress testing on any investment that is structured or that has uncertain cash flows, including all MBS and ABS, before you purchase it. The stress test must be commensurate with the type and complexity of the investment and must enable you to determine that the investment does not expose your capital, earnings, or liquidity, if applicable, to risks that are greater than those specified in your investment policies. The stress testing must comply with the requirements in paragraph (h)(4)(ii) of this section.

(2) Ongoing value determination. At least monthly, you must determine the fair market value of each investment in your portfolio and the fair market value of your whole investment portfolio.

(3) Ongoing analysis of credit risk. You must establish and maintain processes to monitor and evaluate changes in the credit quality of each investment in your portfolio and in your whole investment portfolio on an ongoing basis.

(4) Quarterly stress testing.

(i) You must stress test your entire investment portfolio, including stress tests of all investments individually and stress tests of the portfolio as a whole, at the end of each quarter. The stress tests must enable you to determine that your investment securities, both individually and on a portfolio-wide basis, do not expose your capital, earnings, or liquidity, if applicable, to risks that exceed the risk tolerance specified in your investment

policies. If your portfolio risk exceeds your investment policy limits, you must develop a plan to comply with those limits.

(ii) Your stress tests must be defined in a board-approved policy and must include defined parameters for the types of securities you purchase. The stress tests must be comprehensive and appropriate for the risk profile of your institution. At a minimum, the stress tests must be able to measure the price sensitivity of investments over a range of possible interest rate/yield curve scenarios. The methodology that you use to analyze investment securities must be appropriate for the complexity, structure, and cash flows of the investments in your portfolio. You must rely to the maximum extent practicable on verifiable information to support all your assumptions, including prepayment and interest rate volatility assumptions, when you apply your stress tests. You must document the basis for all assumptions that you use to evaluate the security and its underlying collateral. You must also document all subsequent changes in your assumptions.

(5) Presale value verification. Before you sell an investment, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(i) Reports to the board of directors.

At least quarterly, your management must report on the following to your board of directors or a designated board committee:

- (1) Plans and strategies for achieving the board's objectives for the investment portfolio;
- (2) Whether the investment portfolio effectively achieves the board's objectives;
- (3) The current composition, quality, and the risk and liquidity profiles of the investment portfolio;
- (4) The performance of each class of investments and the entire investment portfolio, including all gains and losses realized during the quarter on individual investments that you sold before maturity and why they were liquidated;
- (5) Potential risk exposure to changes in market interest rates as identified through quarterly stress testing and any other factors that may affect the value of your investment holdings;
- (6) How investments affect your capital, earnings, and overall financial condition;
- (7) Any deviations from the board's policies (must be specifically identified);
- (8) The status and performance of each investment described in § 615.5143(a) and (b) or that does not comply with your investment policies; including the expected effect of these investments on your capital, earnings, liquidity, as applicable, and collateral position; and
- (9) The terms and status of any required divestiture plan or risk reduction plan.

7. In § 615.5134 paragraph (b) is amended by revising the table to read as follows:

§ 615.5134 Liquidity reserve.

* * * * *

(b) Liquidity reserve requirement.

* * * * *

Liquidity Level	Instruments	Discount (Multiply by)
Level 1	• Cash, including cash due from traded but not yet settled debt	100 percent
	• Overnight money market investments	
	• Obligations of U.S. Government agencies with a final remaining maturity of 3 years or less	100 percent
	• GSE senior debt securities that mature within 60 days, excluding securities issued by the Farm Credit System	97 percent
	• Diversified investment funds comprised exclusively of Level 1 instruments	95 percent
Level 2	• Additional Level 1 investments	95 percent Discount for each Level 1 investment applies.
	• Obligations of U.S. Government agencies with a final remaining maturity of more than 3 years	97 percent
	• MBS that are fully guaranteed by a U.S. Government agency as to the timely repayment of principal and interest	
	• Diversified investment funds comprised exclusively of Levels 1 and 2 instruments	95 percent
Level 3	• Additional Level 1 or Level 2 investments	95 percent Discount for each Level 1 or Level 2 investment applies.
	• GSE senior debt securities with maturities exceeding 60 days, excluding senior debt securities of the Farm Credit System	93 percent for all instruments in Level 3

- MBS that are fully guaranteed by a GSE as to the timely repayment of principal and interest
- Money market instruments maturing within 90 days
- Diversified investment funds comprised exclusively of levels 1, 2, and 3 instruments

* * * * *

8. Section 615.5140 is revised to read as follows:

§ 615.5140 Eligible investments for Farm Credit banks.

(a) *Investment eligibility criteria.* A Farm Credit bank may purchase an investment only if it satisfies the following investment eligibility criteria:

(1) The investment must be purchased and held for one or more investment purposes authorized in § 615.5132.

(2) The investment must be one of the following:

(i) A non-convertible senior debt security;

(ii) A money market instrument with a maturity of 1 year or less;

(iii) A portion of an MBS or ABS that is fully guaranteed as to the timely payment of principal and interest by a U. S. Government agency;

(iv) A portion of an MBS or ABS that is fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, except a security permitted under § 615.5174 of this part;

(v) The senior-most position of an MBS or ABS that is not fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency or fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, provided that the MBS satisfies the definition of "mortgage related security" in 15 U.S.C. 78c(a)(41);

(vi) An obligation of an international or multilateral development bank in which the U.S. is a voting member; or

(vii) Shares of a diversified investment fund, if its portfolio consists solely of securities that satisfy paragraphs (a)(2)(i), (a)(2)(ii), (a)(2)(iii), (a)(2)(iv), (a)(2)(v), or (a)(2)(vi) of this section or that are eligible under § 615.5174. The investment company's risk and return objectives and use of derivatives must be consistent with the Farm Credit bank's investment policies.

(3) At least one obligor of the investment must have very strong capacity to meet its financial commitment for the expected life of the investment. If any obligor whose capacity to meet its financial commitment is being relied upon to satisfy this requirement is located outside the U.S., either:

(i) That obligor's sovereign host country must have the highest or second-highest consensus Country Risk Classification (0 or 1) as published by the Organization for Economic Cooperation and Development (OECD) or be an OECD member that is unrated, or

(ii) The investment must be fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency.

(4) The investment must exhibit low credit risk and other risk characteristics consistent with the purpose or purposes for which it is held.

(5) The investment must be denominated in U.S. dollars.

(b) *Investments that do not satisfy requirements.* Farm Credit banks may request our approval to purchase and hold other investments that do not satisfy the requirements of this section. Farm Credit banks may purchase and hold such investments as approved. A Farm Credit bank's request for our approval must explain the risk characteristics of the investment and the purpose and objectives for making the investment.

(c) *Ineligible investments.* Notwithstanding any other provision of this section, Farm Credit banks may not purchase CDOs without approval under paragraph (b) of this section.

(d) *Reservation of authority.* FCA may, on a case-by-case basis, determine that a particular investment of a Farm Credit bank poses inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria. If so, we will notify the Farm Credit bank as to the proper treatment of the investment.

9. Section 615.5142 is revised to read as follows:

§ 615.5142 Eligible investments for System associations.

(a) Subject to the conditions, restrictions and limits set forth in this section, each Farm Credit System association, with the approval of its funding bank, may only purchase and hold investments to manage risk. Each System association that purchases investments must identify and evaluate how investments contribute to the management of its risks. Each investment purchased must be an obligation issued, or fully guaranteed or insured as to the timely payment of principal and interest, by the United States or its agencies and the total amount of investments held must not exceed 10 percent of the association's total outstanding loans. In computing the 10-percent limit for association investments, the 30-day average daily balance of investments is divided by loans. Investments are calculated at amortized cost. Loans are calculated as defined in § 615.5131. For the purpose of this calculation, loans include accrued interest and do not include any allowance for loan loss adjustments. Compliance with the calculation is measured on the last day of every month.

(b) *Risk management requirements.* Each System association that purchases investments must evaluate its investment management policies, and determine and document how its investment activities are conducted in accordance with the following risk management processes and procedures:

(1) *Investment management requirements.* Each association that purchases investments must comply with § 615.5133(a), (b), (c), (d), (e), (h) and (i) of this part. These investment management processes must be appropriate for the size, risk and complexity of the association's investment portfolio.

(2) *Interest rate risk management requirements.* If interest rate risk in investments could lead to significant declines in net income or in the market value of capital, the association must comply with §§ 615.5180 and 615.5182.

(3) *Other relevant risk management factors.* Each association that purchases investments must consider and evaluate any other relevant factors unique to the association or to the nature of the investments that could affect such association's risk-bearing capacity, including but not limited to management experience and capability to understand and manage complex structures and unique risks in investments purchased.

(c) Funding bank supervision of association investments.

(1) An association must not purchase and hold an investment without the prior approval of its funding bank. The bank must review each affiliated association's request to buy and hold investments and explain in writing the bank's reasons for approving or denying the request.

(2) In deciding whether or not to approve an association's request to buy and hold investments, the bank must evaluate, and document that the association:

(i) Has adequate policies, procedures, internal controls, and accounting and reporting systems for its investments;

(ii) Has the capability and expertise to effectively manage the risks in investments; and

(iii) Complies with paragraph (b) of this section.

(3) The bank must review annually the investment portfolio of every association that it funds. This annual review must evaluate whether the association's investments mitigate and manage risk over time, and the continued adequacy of the associations' risk management practices.

(d) Other investments approved by the FCA. An association may purchase and hold other investments that we approve. The request for our approval must explain the risk characteristics of the investment and the purpose and objectives for making the investment. These other investments are subject to the funding bank's approval and if approved by the FCA are subject to the portfolio limit on association investments in paragraph (a) of this section unless otherwise provided for by the FCA.

(e) Transition and divestiture for association investments.

(1) No association is required to divest any investments held on the date this rule becomes effective that were previously authorized under former § 615.5140 or otherwise authorized by official written FCA action that allowed the association to continue to hold such investments. Once such investments mature, the association must not renew them unless they are authorized pursuant to paragraphs (a) or (d) of this section.

(2) An association is not required to divest of investments if a decline in total outstanding loans causes it to exceed the portfolio limit in paragraph (a) of this section. However, the association must not purchase new investments unless after they are purchased, the total amount of investments held falls within the portfolio limit in paragraph (a) of this section.

(3) Section 615.5143 of this part applies to investments that an association acquires after the date that this rule becomes effective, if such investments:

(i) Do not comply with the investment criteria in paragraph (a) of this section on or after the date of purchase;

(ii) Have not been approved by the FCA pursuant to paragraph (d) of this section; or

(iii) Were approved by the FCA pursuant to paragraph (d) of this section but no longer satisfy the conditions of approval.

10. Section 615.5143 is revised to read as follows:

§ 615.5143 Management of ineligible investments and reservation of authority to require divestiture.

(a) *Investments ineligible when purchased.* Investments that do not satisfy the eligibility criteria set forth in § 615.5140(a) or the investment criteria set forth in § 615.5142(a) or that have not been approved by the FCA pursuant to § 615.5140(b) or § 615.5142(d), as applicable, at the time of purchase are ineligible. You must not purchase ineligible investments. If you determine that you have purchased an ineligible investment, you must notify us within 15 calendar days after the determination. You must divest of the investment no later than 60 calendar days after you determine that the investment is ineligible unless we approve, in writing, a plan that authorizes you to divest the investment over a longer period of time. Until you divest of the investment:

(1) If you are a Farm Credit bank, it must not be used to satisfy your liquidity requirement(s) under § 615.5134;

(2) It must continue to be included in the § 615.5132 Farm Credit bank investment portfolio limit calculation or in the § 615.5142(a) association portfolio limit, as applicable; and

(3) If you are a Farm Credit bank, it must be excluded as collateral under § 615.5050 and net collateral under § 615.5301(c).

(b) *Investments that no longer satisfy investment eligibility criteria.* If you determine that an investment (that satisfied the eligibility criteria set forth in § 615.5140(a) or the investment criteria set forth in § 615.5142(a), as applicable, when purchased) no longer satisfies the criteria, or that an investment that the FCA approved pursuant to § 615.5140(b) or § 615.5142(d), as applicable, no longer satisfies the conditions of approval, you may continue to hold the investment, subject to the following requirements:

(1) You must notify us within 15 calendar days after such determination;

(2) If you are a Farm Credit bank, you must not use the investment to satisfy your liquidity requirement(s) under § 615.5134;

(3) You must continue to include the investment in the § 615.5132 Farm Credit bank investment portfolio limit calculation or in the § 615.5142(a) association portfolio limit, as applicable;

(4) If you are a Farm Credit bank, you may continue to include the investment as collateral under § 615.5050 and net collateral under § 615.5301(c) at the lower of cost or market value; and

(5) You must develop a plan to reduce the investment's risk to you.

(c) *Reservation of authority.* FCA retains the authority to require you to divest of any investment at any time for failure to comply with § 615.5132(a) or § 615.5142 or for safety and soundness reasons. The timeframe set by FCA will consider the expected loss on the transaction (or transactions) and the effect on your financial condition and performance.

§ 615.5174 [Amended]

11. Section 615.5174 paragraph (d) is amended by removing the reference "§ 615.5133(f)(1)(iii) and § 615.5133(f)(4)" and adding in its place, "§ 615.5133(h)(1)(iii) and § 615.5133(h)(4)".

§ 615.5180 [Amended]

12. Section 615.5180 paragraph (c)(3) is amended by removing the reference "§ 615.5133(f)(4)" and adding in its place, the reference "§ 615.5133(h)(4)".

Date: July 21, 2014

Dale L. Aultman,

Secretary,

Farm Credit Administration Board.

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 22
Docket ID OCC-2016-0005
RIN 1557-AD67

FEDERAL RESERVE SYSTEM
12 CFR Part 208, Regulation H
Docket No. R-1549
RIN 7100-AE60

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 339
RIN 3064-AE50

FARM CREDIT ADMINISTRATION
12 CFR Part 614
RIN 3052-AD11

NATIONAL CREDIT UNION ADMINISTRATION
12 CFR Part 760
RIN 3133-AE64

Loans in Areas Having Special Flood Hazards – Private Flood Insurance

AGENCIES: Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Farm Credit Administration; National Credit Union Administration.

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the Farm Credit Administration (FCA), and the National Credit Union Administration (NCUA) are issuing a new proposal to amend their regulations regarding loans in areas having special flood hazards to implement the private flood insurance provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters Act). Specifically, the proposed rule would require regulated lending institutions to accept policies that meet the statutory definition of private flood insurance in the Biggert-Waters Act and permit regulated lending institutions to accept flood insurance provided by private insurers that does not meet the statutory definition of “private flood insurance” on a discretionary basis, subject to certain restrictions.

DATES: Comments must be received on or before **January 6, 2017**.

ADDRESSES:

OCC: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments through the Federal eRulemaking Portal or e-mail, if possible. Please use the title “Loans in Areas Having Special Flood Hazards – Private Flood Insurance” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- Federal eRulemaking Portal—“Regulations.gov”: Go to www.regulations.gov. Enter “Docket ID OCC-2016-0005” in the Search Box and click “Search.” Click on “Comment Now” to submit public comments.
- Click on the “Help” tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting public comments.

- E-mail: regs.comments@occ.treas.gov.
- Mail: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 400 7th Street, SW., suite 3E-218, mail stop 9W-11, Washington, DC 20219.
- Hand Delivery/Courier: 400 7th Street, SW., suite 3E-218, mail stop 9W-11, Washington, DC 20219.
- Fax: (571) 465-4326.

Instructions: You must include “OCC” as the agency name and “Docket ID OCC-2016-0005” in your comment. In general, the OCC will enter all comments received into the docket and publish them on the Regulations.gov Website without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this rulemaking action by any of the following methods:

- Viewing Comments Electronically: Go to www.regulations.gov. Enter “Docket ID OCC-2016-0005” in the Search box and click “Search.” Click on “Open Docket Folder” on the right side of the screen and then “Comments.” Comments can be filtered by clicking on “View All” and then using the filtering tools on the left side of the screen.
- Click on the “Help” tab on the Regulations.gov home page to get information on using Regulations.gov. Supporting materials may be viewed by clicking on “Open Docket Folder” and then clicking on “Supporting Documents.” The docket may be viewed after the close of the comment period in the same manner as during the comment period.
- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 400 7th Street, SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700 or, for persons who are deaf or hard of hearing, TTY, (202) 649-5597. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

Board: You may submit comments, identified by Docket No. R-1549 or RIN 7100 AE 60, by any of the following methods:

- Agency Website: <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.
- Fax: (202) 452-3819 or (202) 452-3102.
- Mail: Address to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551.

All public comments will be made available on the Board’s Website at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board’s Martin Building (20th and C Streets, NW.) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments by any of the following methods:

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **Agency Website:** <http://www.fdic.gov/regulations/laws/federal/propose.html>.
- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.
- **Hand Delivered/Courier:** The guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.
- **E-mail:** comments@FDIC.gov.

Comments submitted must include “FDIC” and “Loans in Areas Having Special Flood Hazards – Private Flood Insurance.” Comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose.html>, including any personal information provided.

FCA: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA’s Website. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comments multiple times via different methods. You may submit comments by any of the following methods:

- **E-mail:** Send us an e-mail at reg-comm@fca.gov.
- **Agency Website:** <http://www.fca.gov>. Select “Law & Regulations,” then “FCA Regulations,” then “Public Comments,” and follow the directions for “Submitting a Comment.”
- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **Mail:** Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia or on our Website at <http://www.fca.gov>. Once you are in the Website, select “Law & Regulations,” then “FCA Regulations,” then “Public Comments,” and follow the directions for “Reading Submitted Public Comments.” We will show your comments as submitted, including any supporting data provided, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

NCUA: You may submit comments, identified by RIN 3133-AE64 by any of the following methods (Please send comments by one method only):

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **Agency Website:** <http://www.ncua.gov>. Follow the instructions for submitting comments.
- **E-mail:** Address to regcomments@ncua.gov. Include [Your name] Comments on “Loans in Areas Having Special Flood Hazards – Private Flood Insurance” in the e-mail subject line.
- **Fax:** (703) 518-6319. Use the subject line described above for e-mail.
- **Mail:** Address to Gerard S. Poliquin, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.
- **Hand Delivery/Courier:** Same as mail address.

All public comments are available on the agency's Website at <http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx> as submitted, except when not possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library at 1775 Duke Street, Alexandria, VA 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT:

OCC: Rhonda L. Daniels, Compliance Specialist, Compliance Policy Division, (202) 649-5405; Margaret C. Hesse, Senior Counsel, Community and Consumer Law Division, (202) 649-6350; or Heidi M. Thomas, Special Counsel, or Melissa Lisenbee, Attorney, Legislative and Regulatory Activities Division, (202) 649-5490, or, for persons who are deaf or hard of hearing, TTY, (202) 649-5597.

Board: Lanette Meister, Senior Supervisory Consumer Financial Services Analyst (202) 452-2705; Vivian W. Wong, Senior Counsel (202) 452-3667, Division of Consumer and Community Affairs; or Daniel Ericson, Counsel (202) 452-3359, Legal Division; for users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263-4869.

FDIC: Navid Choudhury, Counsel, Consumer Compliance Unit, Legal Division, (202) 898-6526; or John Jackwood, Senior Policy Analyst, Division of Depositor and Consumer Protection, (202) 898-3991.

FCA: Paul K. Gibbs, Associate Director, Office of Regulatory Policy (703) 883-4203, TTY (703) 883-4056; or Mary Alice Donner, Senior Counsel, Office of General Counsel (703) 883-4020, TTY (703) 883-4056.

NCUA: Sarah Chung, Staff Attorney, Office of General Counsel, (703) 518-6540, or Judy Graham, Program Officer, Office of Examination and Insurance, (703) 518-6392.

SUPPLEMENTARY INFORMATION:

I. Background

A. Flood Insurance Statutes

The National Flood Insurance Act of 1968 (1968 Act)⁴⁷ and the Flood Disaster Protection Act of 1973 (FDPA),⁴⁸ as amended, (collectively referenced herein as the Federal flood insurance statutes) govern the National Flood Insurance Program (NFIP).⁴⁹ These laws make Federally subsidized flood insurance available to owners of improved real estate or mobile homes located in participating communities and require the purchase of flood insurance in connection with a loan made by a regulated lending institution⁵⁰ when the loan is secured by improved real estate or a mobile home located in special flood hazard areas (SFHA) in which flood insurance is available under the NFIP.⁵¹ The OCC, Board, FDIC, FCA, and NCUA (collectively, the Agencies) each have issued

⁴⁷ Pub. L. 90-448, 82 Stat. 572 (1968).

⁴⁸ Pub. L. 93-234, 87 Stat. 975 (1973).

⁴⁹ These statutes are codified at 42 U.S.C. 4001-4129. The Federal Emergency Management Agency (FEMA) administers the NFIP; its regulations implementing the NFIP appear at 44 CFR parts 59-77.

⁵⁰ The FDPA defines "regulated lending institution" to mean any bank, savings and loan association, credit union, farm credit bank, Federal land bank association, production credit association, or similar institution subject to the supervision of a Federal entity for lending regulation. 42 U.S.C. 4003(a)(1).

⁵¹ An SFHA is an area within a flood plain having a one percent or greater chance of flood occurrence in any given year. 44 CFR 59.1. SFHAs are delineated on maps issued by the FEMA for individual communities. 44 CFR part 65. A community establishes its eligibility to participate in the NFIP by adopting and enforcing flood plain management measures that regulate new construction and by making substantial improvements within its SFHAs to eliminate or minimize future flood damage. 44 CFR part 60.

regulations implementing these statutory requirements for the lending institutions they supervise.⁵² The Biggert-Waters Act⁵³ amended the NFIP requirements that the Agencies have authority to implement and enforce. Among other things, the Biggert-Waters Act: (1) required the Agencies to issue a rule regarding the escrow of premiums and fees for flood insurance;⁵⁴ (2) clarified the requirement to force place insurance;⁵⁵ and (3) required the Agencies to issue a rule to direct regulated lending institutions to accept “private flood insurance,” as defined by the Biggert-Waters Act, and to notify borrowers of the availability of private flood insurance.⁵⁶

B. Regulatory History

In October 2013, the Agencies jointly issued proposed rules to implement the escrow, force placement, and private flood insurance provisions of the Biggert-Waters Act (the October 2013 Proposed Rule).⁵⁷ In March 2014, the Homeowner Flood Insurance Affordability Act (HFIAA)⁵⁸ was enacted, which, among other things, amended the Biggert-Waters Act requirements regarding the escrow of flood insurance premiums and fees and created a new exemption from the mandatory flood insurance purchase requirements for certain detached structures. Accordingly, the Agencies jointly issued a new proposed rule in October 2014 to implement the new escrow and detached structure provisions.⁵⁹ In July 2015, the Agencies jointly issued final rules to implement the escrow and detached structure provisions of HFIAA and the force-placed flood insurance provisions of the Biggert-Waters Act.⁶⁰ Based on comments received in response to the October 2013 Proposed Rule, and the statutory effective date for the escrow provisions, the Agencies decided to finalize the escrow and force-placed insurance provisions and to revise and re-propose the private flood insurance provisions.

The October 2013 Proposed Rule would have required a regulated lending institution to accept all coverage meeting the statutory definition of “private flood insurance” in the Biggert-Waters Act. The Agencies requested comment on various issues related to this requirement. In particular, the Agencies sought comment on the inclusion of a safe harbor that would allow lenders to rely on the expertise of State insurance regulators to determine whether a policy meets the definition of private flood insurance and must be accepted by a lender. Additionally, the Agencies asked whether the rule should include a provision expressly permitting regulated lending institutions to accept, at their discretion, flood insurance provided by private insurers that does not meet the Biggert-Waters Act’s definition of private flood insurance (discretionary acceptance). The Agencies also solicited comment on what criteria the Agencies might require for such a policy.

The Agencies received 81 written comments on the October 2013 Proposed Rule, including 51 comments addressing some aspect of private flood insurance. These commenters addressed specific issues, such as: the regulatory definition of “private flood insurance,” the use of a regulatory safe harbor to facilitate compliance by regulated lending institutions, whether private flood insurance that does not conform to the statutory definition of the term should be accepted by regulated lending institutions, whether alternative criteria for such non-conforming private flood insurance should be developed by the Agencies, and whether regulated lending institutions should be permitted to accept certain non-traditional, non-conforming flood insurance coverage, such as Amish Aid plans.

⁵² See 12 CFR part 22 (OCC), part 208 (Board), part 339 (FDIC), part 614 (FCA), and part 760 (NCUA).

⁵³ Pub. L. 112-141, 126 Stat. 916 (2012).

⁵⁴ Section 100209 of the Biggert-Waters Act, amending section 102(d) of the FDPA (42 U.S.C. 4012a(d)).

⁵⁵ Section 100244 of the Act, amending section 102(e) of the FDPA (42 U.S.C. 4012a(e)).

⁵⁶ Section 100239 of the Biggert-Waters Act, amending section 102(b) of the FDPA (42 U.S.C. 4012a(b)) and section 1364(a)(3)(C) of the 1968 Act (42 U.S.C. 4104a(a)(3)(C)).

⁵⁷ 78 FR 65108 (Oct. 30, 2013).

⁵⁸ Pub. L. 113-89, 128 Stat. 1020 (2014).

⁵⁹ 79 FR 64518 (Oct. 30, 2014).

⁶⁰ 80 FR 43216 (July 21, 2015).

This proposal addresses the private flood insurance provisions of the Biggert-Waters Act.⁶¹ The preamble discusses comments received in response to the October 2013 Proposed Rule, as appropriate, in the section-by-section analysis, below.

II. Section-by-Section Analysis

A. Definitions.

Mutual aid society. As discussed below, the Agencies are proposing a provision that would permit regulated lending institutions to accept, at their discretion and under certain circumstances, a flood insurance policy issued by a private insurer that does not meet the definition of “private flood insurance” in the Biggert-Waters Act. This provision includes specific standards for the acceptance of flood policies issued by mutual aid societies. In connection with this provision, the Agencies are proposing to add a definition of “mutual aid society” to their rules. Under the proposed definition, to qualify as a mutual aid society, an organization would need to meet three criteria: (1) the members must share a common religious, charitable, educational, or fraternal bond; (2) the organization must cover losses caused by damage to members’ property including damage caused by flooding, pursuant to an agreement, in accordance with this common bond; and (3) the organization must have a demonstrated history of fulfilling the terms of agreements to cover losses to members’ property caused by flooding. This proposed definition would ensure that only established organizations that consist of members with similar delineated goals or purposes, that have agreed to cover damage caused by flooding, and that have adequately covered flood losses in the past could be considered a “mutual aid society.”

The Agencies request specific comment on whether the terms of this proposed definition adequately cover the types of organizations that should be considered “mutual aid societies” for purposes of the discretionary acceptance provision in this proposed rule. Specifically, the Agencies request comment on whether the proposed criteria are too broad or too narrow, and, if so, whether the final rule should include alternative, or additional, criteria.

Private flood insurance. The proposed rule would amend the Definitions section to include the definition of “private flood insurance” specified in section 100239 of the Biggert-Waters Act, which added a new section 102(b)(7) to the FDPA. The proposed rule would define “private flood insurance” consistent with the statutory definition, with some clarifying edits, to mean an insurance policy that:

1. Is issued by an insurance company that is licensed, admitted, or otherwise approved to engage in the business of insurance by the insurance regulator of the State or jurisdiction in which the property to be insured is located; or, in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, is recognized, or not disapproved, as a surplus lines insurer by the State insurance regulator of the State or jurisdiction where the property to be insured is located;

2. Provides flood insurance coverage that is at least as broad as the coverage provided under a standard flood insurance policy (SFIP), including when considering deductibles, exclusions, and conditions offered by the insurer;⁶²

3. Includes a requirement for the insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to the insured and the regulated lending institution, or a servicer acting on the institution’s behalf;

⁶¹ In connection with the issuance of this proposal, the Agencies have coordinated and consulted with the Federal Financial Institutions Examination Council (FFIEC), as required by certain provisions of the flood insurance statutes. See 42 U.S.C. 4012a(b)(1). Four of the five Agencies (OCC, Board, FDIC, and NCUA) are members of the FFIEC.

⁶² When determining whether coverage is at least as broad as coverage provided under an SFIP, regulated lenders should compare like policies (e.g., a policy covering a 1-4 family residence or a single family dwelling unit in a condominium to an SFIP dwelling policy, a policy covering all other buildings except residential condominium buildings to an SFIP general property policy, or a policy covering a residential condominium building to an SFIP Residential Condominium Building Association Policy).

4. Includes information about the availability of flood insurance coverage under the NFIP;
5. Includes a mortgage interest clause similar to the clause contained in an SFIP;
6. Includes a provision requiring an insured to file suit not later than one year after the date of a written denial for all or part of a claim under a policy; and
7. Contains cancellation provisions that are as restrictive as the provisions contained in an SFIP.

The proposed rule would define “SFIP” to mean a standard flood insurance policy issued under the NFIP in effect as of the date the private policy is provided to a regulated lending institution. The Agencies request comment on whether this is the correct time-frame for determining what version of the SFIP the regulated lending institution should use to evaluate the private policy. As discussed in more detail below, the proposed rule also contains criteria that regulated lending institutions would apply to determine whether a policy’s coverage is “at least as broad as” SFIP coverage.

The Agencies received a number of general comments in response to this definition of “private flood insurance” in the October 2013 Proposed Rule. One commenter argued that imposing a requirement on regulated lending institutions to evaluate a private flood insurance policy for compliance with the statutory definition would put such institutions in an untenable position: a failure to accept a compliant private policy would be considered a violation, while accepting a private policy that is later judged by an examiner to be non-compliant would also result in a violation with potential civil monetary penalties. Another commenter stated that private flood insurance is market-based, and that it is not realistic to require such coverage to duplicate NFIP terms.

The Agencies also received comments on the specific requirements in the definition. One commenter stated that the definition of “flood” included in some private flood insurance policies can differ from that of the NFIP, which has led to private policies being rejected by lenders and regulators. Some commenters asserted that the higher deductibles offered under many private flood insurance policies directly conflict with NFIP maximum deductibles. One of these commenters further noted that there are many instances when a higher deductible is reasonable on a policy purchased by a commercial business that has the financial capability to handle such a deductible. Another commenter noted that private flood insurance policies typically include a provision that details the maximum coverage amount, or aggregate limit, payable during the policy term. The statutory definition does not permit such maximum limits, which the commenter characterized as a major change that may not be acceptable to private insurers. One commenter also stated that the statute of limitations provision in the definition should be amended to allow for filing suit within two years after date of loss for commercial properties, not one year as in the definition.

The Agencies also received comments regarding the cancellation provision in the definition. One commenter asserted that the cancellation provision in the proposed definition is problematic because nothing in an SFIP provides a basis to cancel a policy. Another commenter recommended that the definition be amended to recognize the notice of cancellation standards for commercial properties (typically 10 or 30 days). A commenter also stated that notice of cancellation provisions should be allowed that are no more restrictive than provisions in commercial property forms. Another commenter noted that the requirement to provide 45 days written notice of cancellation or non-renewal of flood insurance coverage is problematic because very few private flood policies require this type of notice. This commenter specifically noted that lenders would be unable to accept private flood policies under this definition going forward, including those policies lenders have historically considered acceptable.

The Agencies note that the definition of “private flood insurance” included in the October 2013 Proposed Rule and in this current proposal is mandated by the Biggert-Waters Act. Therefore, the Agencies may not make substantive changes to this definition in our regulations. However, the issues raised in connection with this definition by commenters influenced the Agencies’ development and inclusion of a proposed provision that would permit institutions at their discretion to accept a private flood policy that does not meet the definition of “private flood insurance” in the Biggert-Waters Act, as discussed below.

“At least as broad as.” Many commenters on the October 2013 Proposed Rule also asserted that it would be difficult for institutions to determine whether private flood insurance coverage is “at least as broad as” the

coverage provided under the SFIP, as required by statute. In response to these comments, the Agencies have proposed to clarify the meaning of this phrase. Specifically, the proposed definition of “private flood insurance” would provide that a policy is “at least as broad as” the coverage provided under an SFIP if the policy, at a minimum: (1) defines the term “flood” to include the events defined as a “flood” in an SFIP; (2) covers both the mortgagor(s) and the mortgagee(s) as loss payees; (3) contains the coverage provisions specified in an SFIP, including those relating to building property coverage; personal property coverage, if purchased by the insured mortgagor(s); other coverages; and the increased cost of compliance; (4) for any total policy coverage amount up to the maximum available under the NFIP at the time the policy is provided to the lender, contains deductibles no higher than the specified NFIP maximum for the same type of property, and includes similar non-applicability provisions as under an SFIP; (5) provides coverage for direct physical loss caused by a flood and may exclude other causes of loss identified in an SFIP; any additional or different exclusions than those in an SFIP may only pertain to coverage that is in addition to the amount and type of coverage that could be provided by an SFIP; and (6) does not contain conditions that narrow the coverage that would be provided in an SFIP.

The Agencies believe these criteria would ensure that a private flood insurance policy provides coverage that would protect the collateral securing the mortgage loan, thereby protecting both the property owner and the regulated lending institution making the loan, to the same extent as a policy issued under the NFIP. The Agencies specifically request comment on whether these criteria facilitate a regulated lending institution’s determination of whether flood insurance coverage is “at least as broad as” the coverage provided under the SFIP.

B. Requirement to purchase flood insurance.

This section currently sets forth the general requirement that a regulated lending institution shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The coverage amount must at least equal the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the 1968 Act (mandatory purchase requirement). It further provides that flood insurance coverage under the FDPA is limited to the building or mobile home and any personal property that secures a loan and not the land itself. A “designated loan” means a loan secured by a building or mobile home that is located or to be located in an SFHA in which flood insurance is available under the 1968 Act, as amended.

As in the October 2013 Proposed Rule, the Agencies are proposing to amend this section to implement section 102(b)(1)(B) of the FDPA, as added by section 100239(a)(1) of the Biggert-Waters Act, which requires that all regulated lending institutions accept “private flood insurance,” as defined in the statute, if certain conditions are met. Specifically, the proposed rule includes a new provision that would require a regulated lending institution to accept a private flood insurance policy that meets both: (1) the statutory definition of “private flood insurance,” and (2) the mandatory purchase requirement, described above.

C. Compliance aid for mandatory acceptance.

The October 2013 Proposed Rule proposed to add to the flood insurance regulations a safe harbor that would have allowed lenders to rely on a State insurance regulator’s written determination that a particular private insurance policy satisfies the rule’s definition of “private flood insurance” and, therefore, must be accepted by the lender in satisfaction of the mandatory purchase requirement. The Agencies included this safe harbor because of concern that many regulated lending institutions, especially small institutions, would have difficulty evaluating whether a flood insurance policy meets the definition of “private flood insurance” that must be accepted, given their lack of technical insurance expertise regarding flood insurance policies.

Commenters on the October 2013 Proposed Rule expressed considerable support for the inclusion of a safe harbor, with many noting that few lenders have the capacity to determine whether policies meet the required standards. However, some commenters criticized the specific safe harbor included in the proposal and suggested alternatives.

In particular, many commenters raised concerns about the feasibility of State insurance regulators determining if private flood insurance is compliant with the Biggert-Waters Act, a Federal statute. Commenters noted there currently is no mechanism or process for a State insurance regulator to make such a determination. They further noted that even if such a mechanism is developed, States might not implement it consistently and it could lead to fifty different State standards. Many commenters also indicated that a State insurance regulator does not

directly supervise providers of surplus lines insurance and, therefore, the safe harbor would not be available for surplus lines insurers.

State insurance regulators raised many of the concerns regarding the proposed safe harbor. One State insurance regulatory agency stated that the proposed safe harbor should provide only a rebuttable presumption that the lender must accept the private flood insurance policy. Accordingly, the lender would not have to accept the policy if the lender or the lender's Federal supervisory agency determines that the policy does not meet the Federal legal standards for "private flood insurance." This commenter also noted that a State insurance regulator lacks the legal authority to certify that a private flood insurance policy complies with Federal law, but could inform the insurer if it sees something in the policy that would make it non-compliant with Federal law. The National Association of State Insurance Commissioners (NAIC) raised a similar objection. It stated that its members had raised concerns about the proposed safe harbor because it may not be possible for some State insurance regulators to determine whether a private flood insurance policy satisfies the Federal statutory definition of the term because of the particular State laws under which they operate.

Another commenter noted that, even if included in the regulation, a lender would not always benefit from the safe harbor because a State may not have made a determination regarding a particular policy. In this case, a lender would have to determine whether private flood insurance is compliant, particularly with respect to the "as broad as" requirement.

Among the numerous alternative safe harbors suggested, some commenters recommended that, instead of a State insurance regulator, the insurance company should certify that the private flood insurance policy being provided meets the statutory definition. One commenter stated that the insurance company should not only certify compliance with Federal law requirements, but also indemnify the lender if the policy should prove not to comply with Federal law and result in a loss to the lender. Another commenter recommended that an insurer's certification should provide that the private flood insurance policy's coverage is "at least as broad as" that provided under the NFIP. Commenters also suggested that the Agencies provide model certification language or a certification checklist.

The Agencies believe that it would be appropriate for the rule to include a compliance aid provision to assist consumers and regulated lending institutions in determining whether and how a flood insurance policy meets the definition of "private flood insurance" and is therefore a policy that the institution is required to accept as long as it otherwise meets the mandatory purchase requirement. Therefore, after careful consideration, and based on the comments received on the proposed "safe harbor" under the October 2013 Proposed Rule, the Agencies have included in this proposed rule a compliance aid provision, which provides that a policy is deemed to meet the definition of "private flood insurance" if the following three criteria are met: (1) the policy includes, or is accompanied by, a written summary that demonstrates how the policy meets the definition of private flood insurance by identifying the provisions of the policy that meet each criterion in the definition, and confirms that the insurer is regulated in accordance with that definition; (2) the regulated lending institution verifies in writing that the policy includes the provisions identified by the insurer in its summary and that these provisions satisfy the criteria included in the definition; and (3) the policy includes the following provision within the policy or as an endorsement to the policy: "This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation" (assurance clause).

The Agencies believe that the first criterion of this proposed compliance aid provision, an insurance company's written summary demonstrating how the policy meets the definition of private flood insurance, would assist a regulated lending institution in reviewing flood insurance policies, which are often lengthy and complicated. By identifying provisions of the policy that meet each criterion in this definition, this summary would enable the institution to conduct expeditiously the verification process described in the second criterion. To satisfy the second criterion, a regulated lending institution would be required to perform its own due diligence before accepting the policy instead of solely relying on the insurance company's claim that the policy meets the statutory and regulatory definition of "private flood insurance." The third prong, the insurance company's statement that the policy complies with the definition of "private flood insurance," could provide the policyholder and the regulated lending institution with recourse against the insurance company if the company fails to abide by the terms included in the definition of "private flood insurance."

The Agencies recognize that this provision does not relieve a regulated lending institution of the requirement to accept a policy that meets the definition of “private flood insurance” and the mandatory purchase requirement, even if the policy is not accompanied by a written summary and does not include an assurance clause. However, the Agencies believe that this provision would facilitate the ability of regulated institutions, as well as consumers, to recognize policies that a lender must accept and may encourage insurance providers to issue policies that meet these criteria.⁶³

The Agencies request comment on all aspects of this proposed compliance aid provision. In particular, commenters should address whether the provision as proposed would assist regulated lending institutions in complying with the requirement to accept insurance policies that meet the definition of “private flood insurance.” Furthermore, commenters should address whether each of the three criteria in this proposed provision is necessary and feasible. Moreover, the Agencies request comment on whether this provision may provide an incentive to insurance providers to demonstrate that their policy meets the definition of “private flood insurance” and, therefore, must be accepted by regulated lending institutions.

D. Discretionary acceptance.

In general. The Agencies are proposing to permit a regulated lending institution to exercise its discretion to accept certain types of flood insurance policies issued by a private insurer other than private flood insurance policies that an institution is required to accept. Although section 102(b)(1)(B) of the FDPA, as added by section 100239(a)(1) of the Biggert-Waters Act, requires a regulated lending institution to accept “private flood insurance” as that term is defined by statute, the Agencies note that the statute is silent about whether a regulated lending institution may accept a flood insurance policy issued by a private insurer that does not meet the statutory definition. The Agencies believe that the Congressional intent of the statute was to stimulate the private flood insurance market and, therefore, the statute should be construed to permit discretionary acceptance of flood insurance policies issued by private insurers that do not meet the statutory definition requiring mandatory acceptance.⁶⁴

Additionally, in the October 2013 Proposed Rule, the Agencies specifically requested comment on whether the Agencies should include a provision allowing lenders to exercise discretion in accepting a flood insurance policy issued by a private insurer that does not meet the statutory definition, but otherwise would provide flood coverage consistent with the FDPA, and a majority of commenters were supportive. Among other reasons, commenters suggested that permitting discretionary acceptance would promote a diverse market for flood insurance policies issued by private insurers; reduce delays in lenders’ analyses of policies; and limit the likelihood of lender confusion if NFIP requirements included in the definition of “private flood insurance” change. Moreover, as noted above, commenters stated that it would be difficult for many policies to meet the statutory definition of “private flood insurance” in the Biggert-Waters Act.

In addition to soliciting comment on whether the rule should specifically state that regulated lending institutions may accept flood insurance policies issued by private insurers that do not meet all of the statutory criteria for “private flood insurance,” the Agencies asked whether some criteria should be required for such policies. The Agencies received comments with various views on the imposition of such criteria. This proposed rule adds criteria intended to address some of the comments received.

Consequently, in addition to requiring regulated lending institutions to accept private flood insurance policies that comply with the statutory definition of “private flood insurance,” the proposed rule would expressly

⁶³ We note that this provision is not a “safe harbor” as generally understood. Because the statute mandates that regulated institutions accept any private flood insurance policy that meets the statutory definition of “private flood insurance” (provided it meets the mandatory purchase requirement), the provision would not reduce or eliminate liability if a lender failed to accept a policy that met the requirements in the statutory definition of private flood insurance. Therefore, we have not used the term “safe harbor” in this proposal.

⁶⁴ The Biggert-Waters Act’s reforms were designed to improve the NFIP’s financial integrity and stability as well as to “increase the role of private markets in the management of flood insurance risk.” H. Rep. No. 112-102, at 1 (2011); see also 158 Cong. Rec. H4622 (daily ed. June 29, 2012) (statement of Rep. Biggert).

permit a regulated lending institution to accept other types of flood insurance policies issued by private insurers, provided the following criteria are met.⁶⁵

First, under the proposed rule, the flood insurance policy issued by a private insurer would be required to be issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance by the insurance regulator of the State in which the property to be insured is located. In the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, the flood insurance issued by a private insurer would be required to be issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the State where the property to be insured is located. This criterion is included in the definition of “private flood insurance” in the Biggert-Waters Act, and the Agencies believe it is appropriate to include it as a criterion for discretionary acceptance as well. Because State insurance regulators, as the functional regulators of insurance companies, may be in the best position to evaluate the financial condition and ability of a private insurer to meet its obligations under a flood insurance policy, the Agencies believe this proposed criterion would safeguard both the consumer purchasing the policy and the regulated lending institution issuing a loan for which the insured property serves as collateral.

Second, under the proposed rule, the flood insurance policy issued by a private insurer would be required to cover both the mortgagor(s) and the mortgagee(s) as loss payees. This proposed criterion would ensure that the flood policy protects both the property owner and the regulated lending institution issuing the mortgage loan.

Third, the proposal would require that a flood insurance policy issued by a private insurer must provide for cancellation following reasonable notice to the borrower only for reasons permitted by FEMA for an SFIP on the Flood Insurance Cancellation Request/Nullification Form, in any case of non-payment, or when cancellation is mandated pursuant to State law. This proposed criterion would ensure that a policy is cancelled only for limited reasons and that the policyholder receives reasonable notification of cancellation.

Finally, the proposal would require that a flood insurance policy issued by a private insurer must either be “at least as broad” as the coverage provided under an SFIP, as defined above, or provide coverage that is “similar” to coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. In determining whether the coverage is similar to coverage provided under an SFIP, the proposal would require the regulated lending institution to: (1) compare the private policy with an SFIP to determine the differences between the private policy and an SFIP; (2) reasonably determine that the private policy provides sufficient protection of the loan secured by the property located in an SFHA; and (3) document its findings. The Agencies believe these proposed criteria would provide safeguards so that a regulated lending institution does not accept policies that do not sufficiently protect the collateral securing the loan.

The Agencies believe that the proposed discretionary acceptance provision provides regulated lending institutions with greater flexibility to accept flood insurance policies that do not contain all of the requirements included in the definition of “private flood insurance.” Specifically, under this provision, regulated lending institutions would be able to accept a flood insurance policy issued by a private insurer that: (1) does not contain a mortgage interest clause similar to the clause contained in an SFIP, provided that the policy covers the mortgagor and the mortgagee;⁶⁶ (2) does not contain information about the availability of flood insurance coverage under the NFIP; (3) provides for cancellation of the policy following “reasonable notice” to the borrower instead of requiring 45 days prior written notice for cancellation or non-renewal; (4) permits cancellation of the policy for reasons of non-payment or when State law mandates cancellation, in addition to the reasons for cancellation permitted in an SFIP; and (5) does not contain a provision requiring an insured to file suit not later than one year after the date of a

⁶⁵ The Agencies have included this provision pursuant to their authority under the FDPA to issue regulations directing lending institutions not to make, increase, extend, or renew any loan secured by property located in an SFHA unless the property is covered by “flood insurance.” See 42 U.S.C. 4012a(b).

⁶⁶ The SFIP mortgage interest clause ensures that any loss payable will be paid to any mortgagee named in the NFIP policy application and declarations page, as well as any other mortgagee or loss payee determined to exist at the time of the loss. We note that this differs from a clause covering both the mortgagor and the mortgagee, who are named in the policy.

written denial of all or part of a claim under the policy. In addition, with respect to deductibles, exclusions, and conditions, coverage under a policy accepted pursuant to the proposed discretionary acceptance provision could be “similar to” an SFIP instead of “at least as broad as” an SFIP, provided the institution documents that it has compared the differences between the policy and an SFIP and that it has reasonably determined that the private policy provides sufficient protection of the loan secured by the property to be insured.

The Agencies solicit comment as to whether these proposed criteria are appropriate for regulated lending institutions accepting flood insurance policies issued by a private insurer that do not meet the statutory definition of “private flood insurance.” In particular, the Agencies seek comment on whether the proposed criteria are compatible with industry practice, or whether the proposed criteria would exclude currently accepted policies or significantly limit the growth of the market for flood insurance policies issued by private insurers.

Separately, the Agencies request comment in three other areas related to the proposed discretionary acceptance criteria: (1) whether the phrase “sufficient protection of the loan” is adequately clear, (2) whether the proposed criteria raise any safety and soundness risks for regulated lending institutions, and (3) whether the proposed criteria raise any consumer protection issues.

Exception for mutual aid societies. The proposed rule also includes an exception for certain private flood coverage provided by mutual aid societies. This proposed exception is intended to be responsive to several commenters on the October 2013 Proposed Rule that supported adding provisions permitting regulated lending institutions to accept certain non-traditional coverage that does not satisfy the statutory definition for “private flood insurance,” such as Amish Aid plans, even though this coverage is not provided by a State-regulated insurance company. Under this proposed exception, flood protection offered by mutual aid societies that would not meet all of the above requirements for discretionary acceptance could continue to be offered, for example, to members of religious communities who do not purchase insurance from traditional insurance companies, provided certain conditions are met.

Specifically, the proposed rule would permit a regulated lending institution to accept a private policy issued by a mutual aid society in satisfaction of the mandatory flood insurance purchase requirement if: (1) the institution’s primary supervisory agency determines that such policy or types of policies meet the requirement for flood insurance for purposes of the Federal flood insurance statutes; (2) the policy meets the amount of coverage for losses and term requirements in the mandatory flood insurance purchase requirement; (3) the policy covers both the mortgagor(s) and the mortgagee(s) as loss payees; and (4) the regulated lending institution has determined that the policy provides sufficient protection of the loan secured by the property located in an SFHA.

In determining whether a policy issued by a mutual aid society provides sufficient protection of the loan under the proposed rule, the regulated lending institution would be required to: (1) verify that the policy is consistent with general safety and soundness principles, such as whether deductibles are reasonable based on the borrower’s financial condition; (2) consider the policy provider’s ability to satisfy claims, such as whether the policy provider has a demonstrated record of covering losses; and (3) document its conclusions.

Under the proposed rule, each Agency would use its discretion individually to determine whether policies offered by mutual aid societies qualify as flood insurance for purposes of the Federal flood insurance statutes. The OCC and FCA propose to conduct their own evaluations using the criteria that institutions are expected to consider under 12 CFR 22.3(c)(4) or 12 CFR 614.4930(c)(4), respectively. Based on their current practices regarding non-traditional flood insurance plans, the Board, FDIC, and NCUA expect that cases in which they approve policies issued by mutual aid societies to be rare and limited.

The OCC notes that it currently permits national banks and Federal savings associations to accept flood coverage issued by Amish mutual aid societies, such as Amish Aid plans. Amish Aid societies consist of members who share a common religious bond and, in accordance with this common bond, have a demonstrated history of fulfilling the terms of agreements (Amish Aid plans) to cover losses to members’ property caused by flooding in accordance with this common bond, either by paying to cover the cost of damaged structures or by repairing or rebuilding the structures. Amish Aid plans thereby provide sufficient protection of the loan secured by the property and protect the lender as well as the borrower. The proposed rule, therefore, would maintain the status quo by continuing to allow national banks and Federal savings associations to accept flood coverage issued by mutual aid

societies that have a demonstrated history of covering expenses caused by flood damage to members' property, and that is approved by the OCC, such as Amish Aid plans.

The Agencies request comment on the proposed requirements for discretionary acceptance of policies issued by mutual aid societies, including the proposed criteria a regulated lending institution would be required to consider in determining whether the policy provides sufficient protection for the loan.

Discretionary acceptance for nonresidential property. The mandatory flood insurance purchase requirement applies to loans secured by either residential or nonresidential properties. The Agencies understand that flood insurance policies issued by private insurers covering loans secured by nonresidential properties, such as commercial properties, may have coverage, deductibles, exclusions, and conditions that differ from NFIP policies based on the type, size, and number of nonresidential properties covered by the policy. In some instances, such policies are individually negotiated and tailored to the nonresidential property that secures a loan. The Agencies request comment on whether the proposed definition of "private flood insurance" or the proposed discretionary acceptance provision, both of which include specific requirements with respect to deductibles, exclusions, conditions, and cancellation, would prevent regulated lending institutions from accepting flood insurance policies issued by private insurers in the nonresidential lending context, even though coverage not including these requirements would be acceptable for policies covering another type of risk, such as fire or wind.

Furthermore, the Agencies request comment on whether the final rule should include criteria for the discretionary acceptance of flood insurance policies issued by private insurers for nonresidential properties that are different from the criteria applicable to flood insurance policies issued by private insurers for residential properties. For example, the Agencies could require that the policy: (1) meet the amount of coverage for losses and term requirements specified in the mandatory purchase requirement, (2) cover both the mortgagor(s) and the mortgagee(s) as loss payees, and (3) require the regulated institution to determine that the policy provides sufficient protection of the loan secured by the property, consistent with general safety and soundness principles, as is required for the acceptance of coverage provided by mutual aid societies. The Agencies request comment on whether a provision for flood insurance issued by private insurers covering nonresidential properties that includes these criteria is appropriate or whether different or additional criteria should be applied in the nonresidential context. For example, should the Agencies require the policy to be issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance by the insurance regulator of the State where the property to be insured is located, or issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the State where the property to be insured is located?

III. Regulatory Analysis

A. Regulatory Flexibility Act.

OCC: In general, the Regulatory Flexibility Act (RFA) requires that in connection with a notice of proposed rulemaking an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities.⁶⁷ Under section 605(b) of the RFA, this analysis is not required if an agency certifies that the rule would not have a significant economic impact on a substantial number of small entities and publishes its certification and a short explanatory statement in the Federal Register along with its rule.

⁶⁷ See 5 U.S.C. 601 *et seq.*

The OCC currently supervises approximately 1,032 small entities.⁶⁸ We identified 974 OCC-supervised small entities that may be impacted by the proposed rule, which is a substantial number.⁶⁹ The OCC classifies the economic impact of total costs on a bank as significant if the total costs in a single year are greater than 5 percent of total salaries and benefits, or greater than 2.5 percent of total non-interest expense. The OCC estimates that the average cost per small bank is approximately \$10,400 per year. Using this cost estimate, we believe the proposed rule will have a significant economic impact on four small banks, which is not a substantial number. Therefore, the OCC certifies that this regulation, if adopted, will not have a significant economic impact on a substantial number of small entities supervised by the OCC. Accordingly, a regulatory flexibility analysis is not required.

Board: The RFA requires an agency to publish an initial regulatory flexibility analysis with a proposed rule or certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. The Board is publishing an initial regulatory flexibility analysis and requests public comment on all aspects of its analysis. The Board will conduct a final regulatory flexibility analysis after considering the comments received during the public comment period.

1. Statement of the need for, and objectives of, the proposed rule. The Board is proposing revisions to Regulation H to implement the private flood insurance provisions of the Biggert-Waters Act. Consistent with the Biggert-Waters Act, the proposal would require regulated institutions accept any private insurance policy that meets the Biggert-Waters Act's definition of "private flood insurance" in satisfaction of the mandatory flood insurance purchase requirement. The proposed rule would also include a compliance aid that would deem a policy to meet the Biggert-Waters Act definition of "private flood insurance" if: (i) the policy includes, or is accompanied by, a written summary from the insurer that demonstrates how the policy meets the definition of private flood insurance; (ii) the lender verifies that the policy includes the provisions identified in the summary; and (iii) the policy includes language certifying that the policy meets the criteria. The Agencies are also proposing to permit lenders to accept, at their discretion, flood insurance policies issued by private insurers, and plans issued by mutual aid societies, that do not meet the definition of "private flood insurance," provided they meet certain conditions.

2. Small entities affected by the proposed rule. All State member banks that are subject to the Federal flood insurance statutes and the flood insurance provisions of Regulation H would be subject to the proposed rule. As of September 27, 2016, there were 821 State member banks. Under regulations issued by the Small Business Administration, banks and other depository institutions with total assets of \$550 million or less are considered small. Approximately 588 State member banks would be considered small entities by the Small Business Administration.⁷⁰

⁶⁸ We base our estimate of the number of small entities on the Small Business Administration's size thresholds for commercial banks and savings institutions, and trust companies, which are \$550 million and \$38.5 million, respectively. Consistent with the General Principles of Affiliation 13 CFR §121.103(a), we count the assets of affiliated financial institutions when determining if we should classify an institution we supervise as a small entity. We used December 31, 2015, to determine size because a "financial institution's assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year." See footnote 8 of the U.S. Small Business Administration's *Table of Size Standards*.

⁶⁹ To estimate the number of small banks that may be affected if the proposed rule is implemented, we determined the number of small banks that (a) self-identify by reporting mortgage servicing assets, reporting loans secured by real estate, or as originating 1-4 family residential mortgage loans on a Call Report submitted for any quarter in calendar year 2015 or during the first quarter of 2016 or (b) are identified by OCC examiners as originating residential mortgage loans or as Home Mortgage Disclosure Act filers.

⁷⁰ The Board reviewed the number of State member banks that reported mortgage servicing assets, loans secured by real estate, or originating 1-4 family residential mortgage loans on a Call Report submitted for the four quarters

The Board believes the proposal will not have a significant impact on small entities. First, the Board believes that most existing flood insurance policies issued by private insurers would not meet the definition of “private flood insurance” under the Biggert-Waters Act and that insurers would request that lenders accept the policies under the more flexible proposed discretionary acceptance provisions. The proposed provisions on discretionary acceptance, including plans issued by mutual aid societies, are at the discretion of the lender. As a result, regulated lending institutions may choose not to accept policies under those proposed provisions and would therefore have no compliance burden associated with those provisions.

Second, with respect to flood insurance policies that a private insurer would seek to have a lender accept under the proposed mandatory acceptance provisions, the Board notes that for those regulated lending institutions, including those that are considered small entities, that accept flood insurance policies issued by private insurers today, such institutions already have experience evaluating such policies with the criteria in the Biggert-Waters Act definition of “private flood insurance,” which are almost identical to the criteria referenced in guidance issued by the Agencies and that currently govern the acceptance of private policies by regulated lending institutions. Third, as discussed in the **SUPPLEMENTARY INFORMATION**, the Board believes the proposed rule would alleviate the burden on regulated lending institutions, including those that are considered small entities, of evaluating whether a flood insurance policy issued by a private insurer meets the definition of “private flood insurance” under the mandatory acceptance provisions with the addition of a proposed compliance aid that leverages the expertise of the insurer issuing the policy.

Although the proposed rule could impact a substantial number of small entities, the Board estimates that the costs to these entities will not be significant. The Board estimates that the cost for each covered small entity will be approximately \$8,096 during the first year the proposal goes into effect. This estimate includes first year compliance costs⁷¹ and ongoing costs⁷² and assumes that the usage of private flood insurance policies by borrower, as defined by the proposed rule, is distributed consistently across small entities. The actual ongoing cost estimate may be lower than stated because the estimate assumes that all of the policies for properties in High Risk Areas will cover loans held by Board-supervised institutions when some of these loans may be held by institutions supervised by other Agencies.

3. Other Federal rules. The Board has not identified any likely duplication, overlap and/or potential conflict between the proposed rule and any Federal rule.

ending on June 30, 2016, which included nearly all State member banks. Consequently, the Board is estimating that all small State member banks may be affected if the proposed rule is implemented.

⁷¹ Fixed compliance costs are estimated assuming each small entity requires one full-time employee working 20 hours at a rate of \$101 an hour. The total cost of compliance for all 821 covered entities is approximately \$1.658 million, or \$2,020 for each small entity.

⁷² Ongoing compliance costs are estimated based on available data. According to FEMA’s *Policy and Claim Statistics for Flood Insurance* there are approximately 5,083,071 flood insurance policies nationally as of June 2016. Only 3,537,059 of these policies are located in “High Risk Areas” and would therefore require flood insurance. The Board estimated the future adoption rate of private flood insurance will be approximately 10 percent of the total of flood insurance policies in any given year. Further, small entities hold approximately 10 percent of all loans secured by real estate held in portfolio by all Board-supervised banks as of June 30, 2016. The Board therefore assumed that small entities will have to review a similar share of annual private flood insurance policies. Ongoing policy review costs are estimated to be approximately \$6,076 per year for each small entity, assuming one labor hour per year, per policy, at \$101 per hour.

4. Significant alternatives to the proposed revisions. The Board solicits comment on any significant alternatives that would reduce the regulatory burden associated with this proposed rule on small entities.

FDIC: The RFA generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis describing the impact of the proposed rule on small entities.⁷³ A regulatory flexibility analysis is not required, however, if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The Small Business Administration has defined “small entities” to include banking organizations with total assets less than or equal to \$550 million.⁷⁴

The FDIC supervises 3,204 small banking entities that have originated 1-4 family residential mortgage loans or have reported holding mortgage servicing assets or loans secured by real estate and may therefore be affected by the proposed rule.⁷⁵ The FDIC estimates that the annual cost for each covered small entity will range between \$2,020 and \$4,500 per year, on average. This estimate includes compliance costs⁷⁶ and ongoing costs⁷⁷ and assumes that the usage of private flood insurance policies by borrowers, as defined by the proposed rule, is distributed consistently across small entities. The actual ongoing cost estimates are likely to be lower than stated because the estimate assumes that all of the loans for properties in High Risk Areas are held by FDIC-supervised institutions; at least some of these loans are held by OCC- and Board-supervised institutions.

The proposed rule could impact a substantial number of small entities; however, the costs to those entities are not estimated to be significant. For this reason, the FDIC certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities that it supervises.

FCA: Pursuant to section 605(b) of the RFA, the FCA hereby certifies that the final rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, Farm Credit System institutions are not “small entities” as defined in the RFA.

NCUA: The RFA requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities.⁷⁸ Under section 605(b) of the RFA, this analysis is not required if an agency certifies that the rule would not have a significant economic impact on a substantial number of small entities and publishes its certification and a short

⁷³ 5 U.S.C. §§ 601 *et seq.*

⁷⁴ 13 CFR 121.201 (as amended, effective December 2, 2014).

⁷⁵ FDIC Call Reports (four quarters ending on March 31, 2016).

⁷⁶ Fixed compliance costs are estimated assuming each small entity requires one full-time employee working 20 hours at a rate of \$101 an hour. The total cost of compliance for all 3,204 covered entities is approximately \$6.5 million, or \$2,020 for each small entity.

⁷⁷ Ongoing compliance costs are estimated based on available data. According to FEMA’s *Policy and Claim Statistics for Flood Insurance* there are approximately 5,118,254 flood insurance policies nationally as of March 2016. Only 3,568,638 of these policies are located in “High Risk Areas” and would therefore require flood insurance. The FDIC estimated the future adoption rate of private flood insurance will be between 1 percent and 10 percent of the total of flood insurance policies in any given year. Further, small entities hold approximately 22 percent of all loans secured by real estate held in portfolio by all FDIC-supervised banks as of March 31, 2016. The FDIC therefore assumed that small entities will have to review a similar share of annual private flood insurance policies. Ongoing policy review costs are estimated to be between \$250 and \$2,500 per year for each small entity, assuming one labor hour per year, per policy, at \$101 per hour.

⁷⁸ 5 U.S.C. 603(a).

explanatory statement in the Federal Register along with its rule.⁷⁹ For purposes of this analysis, NCUA considers small credit unions to be those having under \$100 million in assets.⁸⁰ As of June 30, 2016, there are 4,345 small, Federally insured credit unions, and only about 2,894 of these credit unions have real estate loans.

NCUA classifies the economic impact of total costs on a credit union as significant if the total costs in a single year are greater than 5 percent of total salaries and benefits, or greater than 2.5 percent of total non-interest expense. NCUA estimates that the average cost per small credit union is approximately \$2,020 per year. Using this cost estimate, NCUA believes the proposed rule will have a significant economic impact on 63 small credit unions, which is not a substantial number. Therefore, NCUA certifies that this proposed rule, if adopted, will not have a significant economic impact on a substantial number of small entities.

B. Unfunded Mandates Reform Act of 1995.

The OCC has analyzed the proposed rule under the factors in the Unfunded Mandates Reform Act of 1995 (UMRA).⁸¹ Under this analysis, the OCC considered whether the proposed rule includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year (adjusted annually for inflation). Under Title II of the UMRA, indirect costs, foregone revenues and opportunity costs are not included when determining if a mandate meets or exceeds UMRA's cost threshold. The UMRA does not apply to regulations that incorporate requirements specifically set forth in law.

The OCC's estimated annual UMRA cost is approximately \$36 million. Therefore, the OCC finds that the proposed rule does not trigger the UMRA cost threshold. Accordingly, the OCC has not prepared the written statement described in section 202 of the UMRA.

C. Paperwork Reduction Act of 1995.

The OCC, Board, FDIC, and NCUA (the Agencies)⁸² have determined that this proposed rule involves a collection of information pursuant to the provisions of the Paperwork Reduction Act of 1995 (the PRA) (44 U.S.C. 3501 et seq.).

In accordance with the PRA (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The collection of information that is subject to the PRA by this proposed rule is found in 12 CFR 22.3, 208.25, 339.3, and 760.3.

The Agencies may not conduct or sponsor, and an organization is not required to respond to, this information collection unless the information collection displays a currently valid OMB control number. The OMB control numbers are 1557-0326 (OCC), 7100-0280 (Board), and 3133-0143 (NCUA). The FDIC will seek a new OMB control number.

⁷⁹ 5 U.S.C. 605(b).

⁸⁰ 80 FR 57512 (September 24, 2015).

⁸¹ Pub. L. 104-4, 109 Stat. 48 (1995), codified at 2 U.S.C. 1501 *et seq.*

⁸² The FCA has determined that the proposed rule does not involve a collection of information pursuant to the PRA for System institutions because System institutions are Federally chartered instrumentalities of the United States and instrumentalities of the United States are specifically excepted from the definition of "collection of information" contained in 44 U.S.C. 3502(3).

Under §§ 22.3(c)(2), 208.25(c)(3)(ii), 339.3(c)(2), and 760.3(c)(2), a policy is deemed to meet the definition of private flood insurance if, among other things, (i) it includes a written summary demonstrating how the policy meets the definition of private flood insurance, identifying the provisions of the policy that meet each criterion in the definition and confirms that the insurer is regulated in accordance with that definition and (ii) the institution verifies in writing that the policy includes the provisions identified by the insurer in the summary provided and that these provisions satisfy the criteria included in the definition.

Under §§ 22.3(c)(3)(iv)(B)(3), 208.25(c)(3)(iii)(D)(2)(iii), 339.3(c)(3)(iv)(B)(3), and 760.3(c)(3)(iv)(B)(3), institutions have the discretion to accept a flood insurance policy issued by a private insurer that is not issued under the NFIP, does not meet the definition of private flood insurance, and does not satisfy §§ 22.3(c)(3)(iv)(A), 208.25(c)(3)(iii)(D)(1), 339.3(c)(3)(iv)(A), and 760.3(c)(iv)(A) if, among other things, the institution has documented in writing that it has compared the private policy with an SFIP to determine the differences between the private policy and an SFIP and reasonably determines that the private policy provides sufficient protection of the loan.

Under §§ 22.3(c)(4)(iv), 208.5(c)(iv)(D), 339.3(c)(4)(iv), and 760.3(c)(4)(iv), institutions may accept a private policy issued by a mutual aid society if, among other things, it has determined that the policy provides sufficient protection of the loan secured by the property located in the SFHA and documented its conclusions.

Burden Estimates

OCC:

Number of Respondents: 1,341.

Total Burden: 129,968 hours.

Board:

Number of Respondents: 846.

Total Burden: 42,050 hours.

FDIC:

Number of Respondents: 3,885.

Total Burden: 136,100 hours.

NCUA:

Number of Respondents: 4,058.

Total Burden: 95,211 hours.

These collections are available to the public at www.reginfo.gov.

Comments are invited on:

- (a) Whether the information collections are necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;
- (b) The accuracy of the Agencies' estimates of the burden of the information collections, including the validity of the methodology and assumptions used;
- (c) Ways to enhance the quality, utility, and clarity of the information to be collected;
- (d) Ways to minimize the burden of information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and
- (e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

D. Riegle Community Development and Regulatory Improvement Act of 1994.

Section 302(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA)⁸³ requires that each Federal banking agency,⁸⁴ in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, new

⁸³ 12 U.S.C. 4802(a).

⁸⁴ For purposes of RCDRIA, "Federal banking agency" means the OCC, FDIC, and Board. See 12 U.S.C. 4801.

regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally must take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form.

The Federal banking agencies note that comment on these matters has been solicited in other sections of this **SUPPLEMENTARY INFORMATION** section, and that the requirements of RCDRIA will be considered as part of the overall rulemaking process. In addition, the Federal banking agencies invite any other comments that further will inform the Federal banking agencies' consideration of RCDRIA.

List of Subjects

12 CFR Part 22

Flood insurance, Mortgages, National banks, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Flood insurance, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 339

Flood insurance, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 614

Agriculture, Banks, banking, Flood insurance, Foreign trade, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 760

Credit unions, Mortgages, Flood insurance, Reporting and Recordkeeping requirements.

Office of the Comptroller of the Currency

12 CFR CHAPTER I

Authority and Issuance

For the reasons set forth in the joint preamble and under the authority of 12 U.S.C. 93a, the OCC proposes to amend chapter I of title 12 of the Code of Federal Regulations as follows:

PART 22—LOANS IN AREAS HAVING SPECIAL FLOOD HAZARDS

1. The authority citation for part 22 continues to read as follows:

AUTHORITY: 12 U.S.C. 93a, 1462a, 1463, 1464, and 5412(b)(2)(B); 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. Section 22.2 is amended by:

a. Redesignating paragraphs (h) and (i) as paragraphs (i) and (j), paragraphs (j) and (k) as (l) and (m), and (l) and (m) as (o) and (p); and

b. Adding new paragraphs (h), (k) and (n) to read as follows:

§ 22.2 Definitions.

* * * * *

(h) Mutual aid society means an organization—

(1) Whose members share a common religious, charitable, educational, or fraternal bond;

(2) That covers losses caused by damage to members' property pursuant to an agreement, including damage caused by flooding, in accordance with this common bond; and

(3) That has a demonstrated history of fulfilling the terms of agreements to cover losses to members' property caused by flooding.

* * * * *

(k) Private flood insurance means an insurance policy that:

(1) Is issued by an insurance company that is:

(i) Licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located, by the insurance regulator of that State or jurisdiction; or

(ii) Recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the State or jurisdiction in which the property to be insured is located in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property;

(2) Provides flood insurance coverage that is at least as broad as the coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. For

purposes of this part, a policy is at least as broad as the coverage provided under an SFIP if, at a minimum, the policy:

- (i) Defines the term “flood” to include the events defined as a “flood” in an SFIP;
 - (ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;
 - (iii) Contains the coverage and provisions specified in an SFIP, including those relating to building property coverage; personal property coverage, if purchased by the insured mortgagor(s); other coverages; and the increased cost of compliance;
 - (iv) Contains deductibles no higher than the specified maximum for the same type of property, and includes similar non-applicability provisions, as under an SFIP, for any total policy coverage amount up to the maximum available under the NFIP at the time the policy is provided to the lender;
 - (v) Provides coverage for direct physical loss caused by a flood and may exclude other causes of loss identified in an SFIP. Any additional or different exclusions than those in an SFIP may pertain only to coverage that is in addition to the amount and type of coverage that could be provided by an SFIP; and
 - (vi) May not contain conditions that narrow the coverage provided in an SFIP;
- (3) Includes all of the following:
- (i) A requirement for the insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to:
 - (A) The insured; and
 - (B) The national bank or Federal savings association that made the designated loan secured by the property covered by the flood insurance, or the servicer acting on its behalf;
 - (ii) Information about the availability of flood insurance coverage under the NFIP;
 - (iii) A mortgage interest clause similar to the clause contained in an SFIP; and
 - (iv) A provision requiring an insured to file suit not later than one year after the date of a written denial of all or part of a claim under the policy; and
- (4) Contains cancellation provisions that are as restrictive as the provisions contained in an SFIP.

* * * * *

(n) SFIP means, for purposes of §§ 22.2 and 22.3, a standard flood insurance policy issued under the NFIP in effect as of the date the private policy is provided to a national bank or Federal savings association.

* * * * *

3. Section 22.3 is amended by adding paragraph (c) to read as follows:

§ 22.3 Requirement to purchase flood insurance where available.

* * * * *

(c) Private flood insurance. (1) Mandatory acceptance. A national bank or Federal savings association must accept private flood insurance, as defined in § 22.2(k), in satisfaction of the flood insurance purchase requirement, provided that the private flood insurance meets the requirement for coverage under paragraph (a) of this section.

(2) Compliance aid for mandatory acceptance. A flood insurance policy is deemed to meet the definition of private flood insurance in § 22.2(k) for purposes of paragraph (a) of this section if:

- (i) The policy includes, or is accompanied by, a written summary that demonstrates how the policy meets the definition of private flood insurance in § 22.2(k) by identifying the provisions of the policy that meet each criterion in the definition, and confirms that the insurer is regulated in accordance with that definition;
- (ii) The national bank or Federal savings association verifies in writing that the policy includes the provisions identified by the insurer in the summary provided pursuant to paragraph (c)(2)(i) of this section and that these provisions satisfy the criteria included in the definition; and
- (iii) The policy includes the following provision within the policy or as an endorsement to the policy: “This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation.”

(3) Discretionary acceptance. A national bank or Federal savings association may accept a flood insurance policy issued by a private insurer that is not issued under the NFIP and does not meet the definition of private flood insurance, as defined in § 22.2(k), in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section, only if the coverage under such flood insurance policy meets the amount and term requirements specified in paragraph (a) of this section, and the policy:

- (i) Is issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located by the insurance regulator of that State; or in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring

- nonresidential commercial property, is issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the State where the property to be insured is located;
- (ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;
 - (iii) Provides for cancellation following reasonable notice to the borrower only for reasons permitted by FEMA for an SFIP on the Flood Insurance Cancellation Request/Nullification Form, in any case of non-payment, or when cancellation is mandated pursuant to State law; and
 - (iv) Either:
 - (A) Meets the criteria set forth in paragraphs (k)(2)(i) and (iii) through (vi) of this section; or
 - (B) Provides coverage that is similar to coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer, and the national bank or Federal savings association has:
 - (1) Compared the private policy with an SFIP to determine the differences between the private policy and an SFIP;
 - (2) Reasonably determined that the private policy provides sufficient protection of the loan secured by the property located in a special flood hazard area; and
 - (3) Documented its findings under paragraphs (c)(3)(iv)(B)(1) and (2) of this section.
 - (4) Exception for mutual aid societies. Notwithstanding the requirements of paragraph (c)(3) of this section, a national bank or Federal savings association may accept a private policy issued by a mutual aid society in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section if:
 - (i) The OCC has determined that such types of policies qualify as flood insurance for purposes of this Act;
 - (ii) The policy meets the amount of coverage for losses and term requirements specified in paragraph (a) of this section;
 - (iii) The policy covers both the mortgagor(s) and the mortgagee(s) as loss payees; and
 - (iv) The national bank or Federal savings association has determined that the policy provides sufficient protection of the loan secured by the property located in a special flood hazard area. In making this determination, the national bank or Federal savings association must:
 - (A) Verify that the policy is consistent with general safety and soundness principles, such as whether deductibles are reasonable based on the borrower's financial condition;
 - (B) Consider the policy provider's ability to satisfy claims, such as whether the policy provider has a demonstrated record of covering losses; and
 - (C) Document its conclusions.

Federal Reserve System
12 CFR CHAPTER II
Authority and Issuance

For the reasons set forth in the joint preamble, the Board proposes to amend part 208 of chapter II of title 12 of the Code of Federal Regulations as set forth below:

4. The authority citation for part 208 is revised to read as follows:

AUTHORITY: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p-1, 1831r-1, 1831w, 1831x, 1835a, 1882, 2901-2907, 3105, 3310, 3331-3351, 3353, and 3905-3909; 15 U.S.C. 78b, 78l(b), 78l(i), 780-4(c)(5), 78q, 78q-1, 78w, 1681s, 1681w, 6801 and 6805; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104b, 4106, and 4128.

5. Amend § 208.25 by revising paragraphs (b)(7) through (b)(11) and adding paragraphs (b)(12) through (b)(14) and (c)(3) to read as follows:

§ 208.25 Loans in areas having special flood hazards.

* * * * *

(b) Definitions. For purposes of this section:

* * * * *

(7) Mutual aid society means an organization—

- (i) Whose members share a common religious, charitable, educational, or fraternal bond;

(ii) That covers losses caused by damage to members' property pursuant to an agreement, including damage caused by flooding, in accordance with this common bond; and
(iii) That has a demonstrated history of fulfilling the terms of agreements to cover losses to members' property caused by flooding.

(8) NFIP means the National Flood Insurance Program authorized under the Act.

(9) Private flood insurance means an insurance policy that:

(i) Is issued by an insurance company that is:

(A) Licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located, by the insurance regulator of that State or jurisdiction; or

(B) Recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the State or jurisdiction in which the property to be insured is located in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property;

(ii) Provides flood insurance coverage that is at least as broad as the coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. For purposes of this part, a policy is at least as broad as the coverage provided under an SFIP if, at a minimum, the policy:

(A) Defines the term "flood" to include the events defined as a "flood" in an SFIP;

(B) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;

(C) Contains the coverage and provisions specified in an SFIP, including those relating to building property coverage; personal property coverage, if purchased by the insured mortgagor(s); other coverages; and the increased cost of compliance;

(D) Contains deductibles no higher than the specified maximum for the same type of property, and includes similar non-applicability provisions, as under an SFIP, for any total policy coverage amount up to the maximum available under the NFIP at the time the policy is provided to the lender;

(E) Provides coverage for direct physical loss caused by a flood and may exclude other causes of loss identified in an SFIP. Any additional or different exclusions than those in an SFIP may pertain only to coverage that is in addition to the amount and type of coverage that could be provided by an SFIP; and

(F) May not contain conditions that narrow the coverage provided in an SFIP;

(iii) Includes all of the following:

(A) A requirement for the insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to:

(1) The insured; and

(2) The member bank that made the designated loan secured by the property covered by the flood insurance, or the servicer acting on its behalf;

(B) Information about the availability of flood insurance coverage under the NFIP;

(C) A mortgage interest clause similar to the clause contained in an SFIP; and

(D) A provision requiring an insured to file suit not later than one year after the date of a written denial of all or part of a claim under the policy; and

(iv) Contains cancellation provisions that are as restrictive as the provisions contained in an SFIP.

(10) Residential improved real estate means real estate upon which a home or other residential building is located or to be located.

(11) Servicer means the person responsible for:

(i) Receiving any scheduled, periodic payments from a borrower under the terms of a loan, including amounts for taxes, insurance premiums, and other charges with respect to the property securing the loan; and

(ii) Making payments of principal and interest and any other payments from the amounts received from the borrower as may be required under the terms of the loan.

(12) SFIP means, for purposes of paragraphs (b) and (c) of this section, a standard flood insurance policy issued under the NFIP in effect as of the date the private policy is provided to a member bank.

(13) Special flood hazard area means the land in the flood plain within a community having at least a one percent chance of flooding in any given year, as designated by the Administrator of FEMA.

(14) Table funding means a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds.

(c) Requirement to purchase flood insurance where available.

* * * * *

(3) Private flood insurance. (i) Mandatory acceptance. A member bank must accept private flood insurance, as defined in paragraph (b)(9) of this section, in satisfaction of the flood insurance purchase requirement, provided that the private flood insurance meets the requirement for coverage under paragraph (c)(1) of this section.

(ii) Compliance aid for mandatory acceptance. A flood insurance policy is deemed to meet the definition of private flood insurance in paragraph (b)(9) of this section for purposes of paragraph (c)(1) of this section if:

(A) The policy includes, or is accompanied by, a written summary that demonstrates how the policy meets the definition of private flood insurance in paragraph (b)(9) of this section by identifying the provisions of the policy that meet each criterion in the definition, and confirms that the insurer is regulated in accordance with that definition;

(B) The member bank verifies in writing that the policy includes the provisions identified by the insurer in the summary provided pursuant to paragraph (c)(3)(ii)(A) of this section and that these provisions satisfy the criteria included in the definition; and

(C) The policy includes the following provision within the policy or as an endorsement to the policy: “This policy meets the definition of private flood insurance contained in 42 U.S.C. § 4012a(b)(7) and the corresponding regulation.”

(iii) Discretionary acceptance. A member bank may accept a flood insurance policy issued by a private insurer that is not issued under the NFIP and does not meet the definition of private flood insurance, as defined in paragraph (b)(9) of this section, in satisfaction of the flood insurance purchase requirement under paragraph (c)(1) of this section, only if the coverage under such flood insurance policy meets the amount and term requirements specified in paragraph (c)(1) of this section, and the policy:

(A) Is issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located by the insurance regulator of that State; or in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, is issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the State where the property to be insured is located;

(B) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;

(C) Provides for cancellation following reasonable notice to the borrower only for reasons permitted by FEMA for an SFIP on the Flood Insurance Cancellation Request/Nullification Form, in any case of non-payment, or when cancellation is mandated pursuant to State law; and

(D) Either:

(1) Meets the criteria set forth in paragraphs (b)(9)(ii)(A) and (C) through (F) of this section; or

(2) Provides coverage that is similar to coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer, and the member bank has:

(i) Compared the private policy with an SFIP to determine the differences between the private policy and an SFIP;

(ii) Reasonably determined that the private policy provides sufficient protection of the loan secured by the property located in a special flood hazard area; and

(iii) Documented its findings under paragraphs (c)(3)(iii)(D)(2)(i) and (ii) of this section.

(iv) Exception for mutual aid societies. Notwithstanding the requirements of paragraph (c)(3)(iii) of this section, a member bank may accept a private policy issued by a mutual aid society in satisfaction of the flood insurance purchase requirement under paragraph (c)(1) of this section if:

(A) The Board has determined that such types of policies qualify as flood insurance for purposes of this Act.

(B) The policy meets the amount of coverage for losses and term requirements specified in paragraph (c)(1) of this section;

(C) The policy covers both the mortgagor(s) and the mortgagee(s) as loss payees; and

(D) The member bank has determined that the policy provides sufficient protection of the loan secured by the property located in a special flood hazard area. In making this determination, the member bank must:

(1) Verify that the policy is consistent with general safety and soundness principles, such as whether deductibles are reasonable based on the borrower’s financial condition;

(2) Consider the policy provider’s ability to satisfy claims, such as whether the policy provider has a demonstrated record of covering losses; and

(3) Document its conclusions.

Federal Deposit Insurance Corporation

12 CFR CHAPTER III

Authority and Issuance

For the reasons set forth in the joint preamble, the Board of Directors of the FDIC proposes to amend part 339 of chapter III of title 12 of the Code of Federal Regulations to read as follows:

6. The authority citation for part 339 continues to read as follows:

AUTHORITY: 12 U.S.C. 1462a, 1463, 1464, 1819 (Tenth), 5412(b)(2)(C) and 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

7. Section 339.2 is amended by adding the definitions of “Mutual aid society”, “Private flood insurance”, and “SFIP” in alphabetical order to read as follows:

§ 339.2 Definitions.

* * * * *

Mutual aid society means an organization—

- (1) Whose members share a common religious, charitable, educational, or fraternal bond;
- (2) That covers losses caused by damage to members’ property pursuant to an agreement, including damage caused by flooding, in accordance with this common bond; and
- (3) That has a demonstrated history of fulfilling the terms of agreements to cover losses to members’ property caused by flooding.

* * * * *

Private flood insurance means an insurance policy that:

- (1) Is issued by an insurance company that is:
 - (i) Licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located, by the insurance regulator of that State or jurisdiction; or
 - (ii) Recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the State or jurisdiction in which the property to be insured is located in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property;
- (2) Provides flood insurance coverage that is at least as broad as the coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. For purposes of this part, a policy is at least as broad as the coverage provided under an SFIP if, at a minimum, the policy:
 - (i) Defines the term “flood” to include the events defined as a “flood” in an SFIP;
 - (ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;
 - (iii) Contains the coverage and provisions specified in an SFIP, including those relating to building property coverage; personal property coverage, if purchased by the insured mortgagor(s); other coverages; and the increased cost of compliance;
 - (iv) Contains deductibles no higher than the specified maximum for the same type of property, and includes similar non-applicability provisions, as under an SFIP, for any total policy coverage amount up to the maximum available under the NFIP at the time the policy is provided to the lender;
 - (v) Provides coverage for direct physical loss caused by a flood and may exclude other causes of loss identified in an SFIP. Any additional or different exclusions than those in an SFIP may pertain only to coverage that is in addition to the amount and type of coverage that could be provided by an SFIP; and
 - (vi) May not contain conditions that narrow the coverage provided in an SFIP;
- (3) Includes all of the following:
 - (i) A requirement for the insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to:
 - (A) The insured; and
 - (B) The FDIC-supervised institution that made the designated loan secured by the property covered by the flood insurance, or the servicer acting on its behalf;
 - (ii) Information about the availability of flood insurance coverage under the NFIP;
 - (iii) A mortgage interest clause similar to the clause contained in an SFIP; and
 - (iv) A provision requiring an insured to file suit not later than one year after the date of a written denial of all or part of a claim under the policy; and
- (4) Contains cancellation provisions that are as restrictive as the provisions contained in an SFIP.

* * * * *

SFIP means, for purposes of §§ 339.2 and 339.3, a standard flood insurance policy issued under the NFIP in effect as of the date the private policy is provided to an FDIC-supervised institution.

* * * * *

8. Section 339.3 is amended by adding paragraph (c) to read as follows:

§ 339.3 Requirement to purchase flood insurance where available.

* * * * *

(c) Private flood insurance. (1) Mandatory acceptance. An FDIC-supervised institution must accept private flood insurance, as defined in § 339.2, in satisfaction of the flood insurance purchase requirement, provided that the private flood insurance meets the requirement for coverage under paragraph (a) of this section.

(2) Compliance aid for mandatory acceptance. A flood insurance policy is deemed to meet the definition of private flood insurance in § 339.2 for purposes of paragraph (a) of this section if:

(i) The policy includes, or is accompanied by, a written summary that demonstrates how the policy meets the definition of private flood insurance in § 339.2 by identifying the provisions of the policy that meet each criterion in the definition, and confirms that the insurer is regulated in accordance with that definition;

(ii) The FDIC-supervised institution verifies in writing that the policy includes the provisions identified by the insurer in the summary provided pursuant to paragraph (c)(2)(i) of this section and that these provisions satisfy the criteria included in the definition; and

(iii) The policy includes the following provision within the policy or as an endorsement to the policy: “This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation.”

(3) Discretionary acceptance. An FDIC-supervised institution may accept a flood insurance policy issued by a private insurer that is not issued under the NFIP and does not meet the definition of private flood insurance, as defined in § 339.2, in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section, only if the coverage under such flood insurance policy meets the amount and term requirements specified in paragraph (a) of this section, and the policy:

(i) Is issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located by the insurance regulator of that State; or in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, is issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the State where the property to be insured is located;

(ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;

(iii) Provides for cancellation following reasonable notice to the borrower only for reasons permitted by FEMA for an SFIP on the Flood Insurance Cancellation Request/Nullification Form, in any case of non-payment, or when cancellation is mandated pursuant to State law; and

(iv) Either:

(A) Meets the criteria of private flood insurance, as defined in § 339.2, set forth in paragraphs (2)(i) and (iii) through (vi) of this section; or

(B) Provides coverage that is similar to coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer, and the FDIC-supervised institution has:

(1) Compared the private policy with an SFIP to determine the differences between the private policy and an SFIP;

(2) Reasonably determined that the private policy provides sufficient protection of the loan secured by the property located in a special flood hazard area; and

(3) Documented its findings under paragraphs (c)(3)(iv)(B)(1) and (2) of this section.

(4) Exception for mutual aid societies. Notwithstanding the requirements of paragraph (c)(3) of this section, an FDIC-supervised institution may accept a private policy issued by a mutual aid society in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section if:

(i) The FDIC has determined that such types of policies qualify as flood insurance for purposes of this Act;

(ii) The policy meets the amount of coverage for losses and term requirements specified in paragraph (a) of this section;

(iii) The policy covers both the mortgagor(s) and the mortgagee(s) as loss payees; and

(iv) The FDIC-supervised institution has determined that the policy provides sufficient protection of the loan secured by the property located in a special flood hazard area. In making this determination, the FDIC-supervised institution must:

(A) Verify that the policy is consistent with general safety and soundness principles, such as whether deductibles are reasonable based on the borrower’s financial condition;

(B) Consider the policy provider’s ability to satisfy claims, such as whether the policy provider has a demonstrated record of covering losses; and

(C) Document its conclusions.

Authority and Issuance

For the reasons set forth in the joint preamble, the FCA proposes to amend part 614 Subpart S of chapter VI, title 12 of the Code of Federal Regulations as set forth below:

PART 614—LOANS IN AREAS HAVING SPECIAL FLOOD HAZARDS

9. The authority citation for part 614 is revised to read as follows:

AUTHORITY: 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128; secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 2.0, 2.2, 2.3, 2.4, 2.10, 2.12, 2.13, 2.15, 3.0, 3.1, 3.3, 3.7, 3.8, 3.10, 3.20, 3.28, 4.12, 4.12A, 4.13, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.19, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.7, 7.8, 7.12, 7.13, 8.0, 8.5 of Pub. L. 92-181, 85 Stat. 583 (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2096, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2199, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2207, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a-2, 2279b, 2279b-1, 2279b-2, 2279f, 2279f-1, 2279aa, 2279aa-5); sec. 413 of Pub. L. 100-233, 101 Stat. 1568, 1639.

10. Section 614.4925, is amended by adding the definitions of “mutual aid society”, “private flood insurance”, and “SFIP” in alphabetical order to read as follows:

§ 614.4925 Definitions.

* * * * *

Mutual aid society means an organization:

- (1) Whose members share a common religious, charitable, educational, or fraternal bond;
- (2) That covers losses caused by damage to members’ property pursuant to an agreement, including damage caused by flooding, in accordance with this common bond; and
- (3) That has a demonstrated history of fulfilling the terms of agreements to cover losses to members’ property caused by flooding.

* * * * *

Private flood insurance means an insurance policy that:

- (1) Is issued by an insurance company that is:
 - (i) Licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located, by the insurance regulator of that State or jurisdiction; or
 - (ii) Recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the State or jurisdiction in which the property to be insured is located in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property;
- (2) Provides flood insurance coverage that is at least as broad as the coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. For purposes of this subpart, a policy is at least as broad as the coverage provided under an SFIP if, at a minimum, the policy:
 - (i) Defines the term “flood” to include the events defined as a “flood” in an SFIP;
 - (ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;
 - (iii) Contains the coverage and provisions specified in an SFIP, including those relating to building property coverage; personal property coverage, if purchased by the insured mortgagor(s); other coverages; and the increased cost of compliance;
 - (iv) Contains deductibles no higher than the specified maximum for the same type of property, and includes similar non-applicability provisions, as under an SFIP, for any total policy coverage amount up to the maximum available under the NFIP at the time the policy is provided to the lender;
 - (v) Provides coverage for direct physical loss caused by a flood and may exclude other causes of loss identified in an SFIP. Any additional or different exclusions than those in an SFIP may pertain only to coverage that is in addition to the amount and type of coverage that could be provided by an SFIP; and
 - (vi) May not contain conditions that narrow the coverage provided in an SFIP;
- (3) Includes all of the following:
 - (i) A requirement for the insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to:
 - (A) The insured; and
 - (B) The System institution that made the designated loan secured by the property covered by the flood insurance, or the servicer acting on its behalf;
 - (ii) Information about the availability of flood insurance coverage under the NFIP;
 - (iii) A mortgage interest clause similar to the clause contained in an SFIP; and

(iv) A provision requiring an insured to file suit not later than one year after the date of a written denial of all or part of a claim under the policy; and

(4) Contains cancellation provisions that are as restrictive as the provisions contained in an SFIP.

* * * * *

SFIP means, for purposes of §§ 614.4925 and 614.4930, a standard flood insurance policy issued under the NFIP in effect as of the date the private policy is provided to a System institution.

* * * * *

11. Section 614.4930 is amended by adding paragraph (c) to read as follows:

§ 614.4930 Requirement to purchase flood insurance where available.

* * * * *

(c) Private flood insurance. (1) Mandatory acceptance. A System institution must accept private flood insurance, as defined in § 614.4925, in satisfaction of the flood insurance purchase requirement, provided that the private flood insurance meets the requirement for coverage under paragraph (a) of this section.

(2) Compliance aid for mandatory acceptance. A flood insurance policy is deemed to meet the definition of private flood insurance in § 614.4925 for purposes of paragraph (a) of this section if:

(i) The policy includes, or is accompanied by, a written summary that demonstrates how the policy meets the definition of private flood insurance in § 614.4925 by identifying the provisions of the policy that meet each criterion in the definition, and confirms that the insurer is regulated in accordance with that definition;

(ii) The System institution verifies in writing that the policy includes the provisions identified by the insurer in the summary provided pursuant to paragraph (c)(2)(i) of this section and that these provisions satisfy the criteria included in the definition; and

(iii) The policy includes the following provision within the policy or as an endorsement to the policy: “This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation.”

(3) Discretionary acceptance. —In general. A System institution may accept a flood insurance policy issued by a private insurer that is not issued under the NFIP and does not meet the definition of private flood insurance, as defined in § 614.4925, in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section, only if the coverage under such flood insurance policy meets the amount and term requirements specified in paragraph (a) of this section, and the policy:

(i) Is issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located by the insurance regulator of that State; or in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, is issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the State where the property to be insured is located;

(ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;

(iii) Provides for cancellation following reasonable notice to the borrower only for reasons permitted by FEMA for an SFIP on the Flood Insurance Cancellation Request/Nullification Form, in any case of non-payment, or when cancellation is mandated pursuant to State law; and

(iv) Either:

(A) Meets the criteria set forth in paragraphs (2)(i) and (iii) through (vi) of the definition of private flood insurance in § 614.4925; or

(B) Provides coverage that is similar to coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer, and the System institution has:

(1) Compared the private policy with an SFIP to determine the differences between the private policy and an SFIP;

(2) Reasonably determined that the private policy provides sufficient protection of the loan secured by the property located in a special flood hazard area; and

(3) Documented its findings under paragraphs (c)(3)(iv)(A)(B)(1) and (B)(2) of this section.

(4) Exception for mutual aid societies. Notwithstanding the requirements of paragraph (c)(3) of this section, a System institution may accept a private policy issued by a mutual aid society in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section if:

(i) The FCA has determined that such types of policies qualify as flood insurance for purposes of the 1968 Act;

(ii) The policy meets the amount of coverage for losses and term requirements specified in paragraph (a) of this section;

(iii) The policy covers both the mortgagor(s) and the mortgagee(s) as loss payees; and

(iv) The System institution has determined that the policy provides sufficient protection of the loan secured by the property located in a special flood hazard area. In making this determination, the System institution must:

(A) Verify that the policy is consistent with general safety and soundness principles, such as whether deductibles are reasonable based on the borrower's financial condition;

(B) Consider the policy provider's ability to satisfy claims, such as whether the policy provider has a demonstrated record of covering losses; and

(C) Document its conclusions.

National Credit Union Administration

12 CFR CHAPTER VII

Authority and Issuance

For the reasons set forth in the joint preamble, the NCUA Board proposes to amend part 760 of chapter VII of title 12 of the Code of Federal Regulations to read as follows:

PART 760—LOANS IN AREAS HAVING SPECIAL FLOOD HAZARDS

12. The authority citation for part 760 continues to read as follows:

AUTHORITY: 12 U.S.C. 1757, 1789; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

13. Section 760.2 is amended by adding the definitions of "Mutual aid society", "Private flood insurance", and "SFIP" in alphabetical order to read as follows:

§ 760.2 Definitions.

* * * * *

Mutual aid society means an organization—

(1) Whose members share a common religious, charitable, educational, or fraternal bond;

(2) That covers losses caused by damage to members' property pursuant to an agreement, including damage caused by flooding, in accordance with this common bond; and

(3) That has a demonstrated history of fulfilling the terms of agreements to cover losses to members' property caused by flooding.

* * * * *

Private flood insurance means an insurance policy that:

(1) Is issued by an insurance company that is:

(i) Licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located, by the insurance regulator of that State or jurisdiction; or

(ii) Recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the State or jurisdiction in which the property to be insured is located in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property;

(2) Provides flood insurance coverage that is at least as broad as the coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. For purposes of this part, a policy is at least as broad as the coverage provided under an SFIP if, at a minimum, the policy:

(i) Defines the term "flood" to include the events defined as a "flood" in an SFIP;

(ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;

(iii) Contains the coverage and provisions specified in an SFIP, including those relating to building property coverage; personal property coverage, if purchased by the insured mortgagor(s); other coverages; and the increased cost of compliance;

(iv) Contains deductibles no higher than the specified maximum for the same type of property, and includes similar non-applicability provisions, as under an SFIP, for any total policy coverage amount up to the maximum available under the NFIP at the time the policy is provided to the lender;

(v) Provides coverage for direct physical loss caused by a flood and may exclude other causes of loss identified in an SFIP. Any additional or different exclusions than those in an SFIP may pertain only to coverage that is in addition to the amount and type of coverage that could be provided by an SFIP; and

(vi) May not contain conditions that narrow the coverage provided in an SFIP;

(3) Includes all of the following:

(i) A requirement for the insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to:

(A) The insured; and

(B) The credit union that made the designated loan secured by the property covered by the flood insurance, or the servicer acting on its behalf;

(ii) Information about the availability of flood insurance coverage under the NFIP;

(iii) A mortgage interest clause similar to the clause contained in an SFIP; and

(iv) A provision requiring an insured to file suit not later than one year after the date of a written denial of all or part of a claim under the policy; and

(4) Contains cancellation provisions that are as restrictive as the provisions contained in an SFIP.

* * * * *

SFIP means, for purposes of §§ 760.2 and 760.3, a standard flood insurance policy issued under the NFIP in effect as of the date the private policy is provided to a credit union.

* * * * *

14. Section 760.3 is amended by adding paragraph (c) to read as follows:

§ 760.3 Requirement to purchase flood insurance where available.

* * * * *

(c) Private flood insurance. (1) Mandatory acceptance. A credit union must accept private flood insurance, as defined in § 760.2, in satisfaction of the flood insurance purchase requirement, provided that the private flood insurance meets the requirement for coverage under paragraph (a) of this section.

(2) Compliance aid for mandatory acceptance. A flood insurance policy is deemed to meet the definition of private flood insurance in § 760.2 for purposes of paragraph (a) of this section if:

(i) The policy includes, or is accompanied by, a written summary that demonstrates how the policy meets the definition of private flood insurance in § 760.2 by identifying the provisions of the policy that meet each criterion in the definition, and confirms that the insurer is regulated in accordance with that definition;

(ii) The credit union verifies in writing that the policy includes the provisions identified by the insurer in the summary provided pursuant to paragraph (c)(2)(i) of this section and that these provisions satisfy the criteria included in the definition; and

(iii) The policy includes the following provision within the policy or as an endorsement to the policy: “This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation.”

(3) Discretionary acceptance. A credit union may accept a flood insurance policy issued by a private insurer that is not issued under the NFIP and does not meet the definition of private flood insurance, as defined in § 760.2, in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section, only if the coverage under such flood insurance policy meets the amount and term requirements specified in paragraph (a) of this section, and the policy:

(i) Is issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the property to be insured is located by the insurance regulator of that State; or in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, is issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the State where the property to be insured is located;

(ii) Covers both the mortgagor(s) and the mortgagee(s) as loss payees;

(iii) Provides for cancellation following reasonable notice to the borrower only for reasons permitted by FEMA for an SFIP on the Flood Insurance Cancellation Request/Nullification Form, in any case of non-payment, or when cancellation is mandated pursuant to State law; and

(iv) Either:

(A) Meets the criteria set forth in paragraphs (2)(i) and (iii) through (vi) of the definition of private flood insurance in § 760.2; or

(B) Provides coverage that is similar to coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer, and the credit union has:

(1) Compared the private policy with an SFIP to determine the differences between the private policy and an SFIP;

(2) Reasonably determined that the private policy provides sufficient protection of the loan secured by the property located in a special flood hazard area; and

(3) Documented its findings under paragraphs (c)(3)(iv)(B)(1) and (2) of this section.

(4) Exception for mutual aid societies. Notwithstanding the requirements of paragraph (c)(3) of this section, a credit union may accept a private policy issued by a mutual aid society in satisfaction of the flood insurance purchase requirement under paragraph (a) of this section if:

(i) The National Credit Union Administration has determined that such types of policies qualify as flood insurance for purposes of this Act;

(ii) The policy meets the amount of coverage for losses and term requirements specified in paragraph (a) of this section;

(iii) The policy covers both the mortgagor(s) and the mortgagee(s) as loss payees; and

(iv) The credit union has determined that the policy provides sufficient protection of the loan secured by the property located in a special flood hazard area. In making this determination, the credit union must:

(A) Verify that the policy is consistent with general safety and soundness principles, such as whether deductibles are reasonable based on the borrower's financial condition;

(B) Consider the policy provider's ability to satisfy claims, such as whether the policy provider has a demonstrated record of covering losses; and

(C) Document its conclusions.

Dated: October 19, 2016

Thomas J. Curry
Comptroller of the Currency

By order of the Board of Governors of the Federal Reserve System, October 12, 2016.

Robert deV. Frierson
Secretary of the Board.

By order of the Board of Directors of the Federal Deposit Insurance Corporation.

Dated at Washington, DC, this 19th day of October, 2016.

Robert E. Feldman
Executive Secretary

By order of the Board of the Farm Credit Administration.

Dated at McLean, VA, this 14th day of October, 2016.

Dale L. Aultman
Secretary

By order of the Board of the National Credit Union Administration.

Dated at Alexandria, VA, this 27th day of October, 2016.

Gerard S. Poliquin
Secretary of the Board

BILLING CODES: 4810-33-P; 6210-01-P; 6714-01-P; 7535-01-P; 6705-01-P

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 612

RIN 3052-AC44

Standards of Conduct and Referral of Known or Suspected Criminal Violations; Standards of Conduct

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) proposes to amend its regulations governing standards of conduct of directors, employees, and agents of Farm Credit System (System) institutions, excluding the Federal Agricultural Mortgage Corporation. The amendments would clarify and strengthen reporting requirements and prohibitions, require institutions to establish a Code of Ethics, and enhance the role of the Standards of Conduct Official.

DATES: You may send comments on or before May 21, 2014.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Select "Public Commenters," then "Public Comments" and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Public Commenters," then "Public Comments" and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted but, for technical reasons, we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Jacqueline R. Melvin, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TDD (703) 883-4056,

or

Mary Alice Donner, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TDD (703) 883-4056.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Clarify and strengthen the regulations in part 612, subpart A, regarding standards of conduct;
- Modify definitions;
- Clarify reporting requirements and prohibitions on the purchase of System institution acquired property and lending transactions;
- Strengthen responsibility and accountability requirements for System institution Standards of Conduct Officials, boards of directors (or board), employees, and agents; and
- Require each System institution to adopt a Code of Ethics.

The FCA has not made significant changes to its standards of conduct regulations since 1994, and we have determined that it is appropriate to strengthen and modernize the rule. The proposed rule would add new provisions, clarify and augment some of the current provisions and provide additional flexibility for others. The proposed rule is organized differently from the current rule. Sections on director and employee reporting and prohibited conduct are repositioned to improve the logical flow of the rule. The proposed rule adds a new § 612.2136 on conflicts of interest, a new § 612.2165(a) on Code of Ethics, a new § 612.2165(c) on allowing exceptions to certain rules if no conflict of interest exists, and new requirements in § 612.2180 addressing standards of conduct for agents. It also adds new standards of conduct responsibilities to System institutions (proposed § 612.2160) and to the Standards of Conduct Official (proposed § 612.2170). We solicit comments on our proposed amendments.

II. Section-by-Section Analysis

A. Definitions [§ 612.2130]

The proposed rule would have some new and some modified definitions:

Code of Ethics. The proposed rule would define "Code of Ethics" as a written set of standards, rules, values, and guidance that an institution uses to ensure the ethical conduct of those who sign it, and that reflects professionalism and discourages misconduct so the best interests of the institution are advanced.

Controlled entity and entity controlled by. The proposed rule would continue to provide that a controlled entity includes an interest in an entity in which the individual, directly or indirectly or acting through or in concert with one or more persons, owns 5 percent or more of the equity of the entity; owns, controls, or has the power to vote 5 percent or more of any class of voting securities of the entity; or has the power to exercise a controlling influence over the management of the entity. The FCA is aware that in other contexts the definition of "controlled entity" or "entity controlled by" may mean having an ownership interest with a greater threshold than 5 percent; however, the purpose of this rule is to ensure that institution directors and employees are completely objective in their decision-making, and are not in any way influenced by personal interests. The FCA believes that a reasonable person could conclude that a director or employee could be influenced to act favorably toward an entity in which he or she had an economic interest of 5 percent or more. Therefore, directors and employees should report these interests and should abstain from decision-making with regard to them. So, for the purpose of this rule only, a "controlled entity" or "entity controlled by" is defined as an entity in which the director or employee has an interest of 5 percent or more, alone or in concert with others, directly or indirectly.

Employee. The proposed rule would clarify the definition of "employee" to include non-salaried employees such as hourly wage earners.

Entity. The proposed rule would add unincorporated business entities to the definition of "entity".

Family. The proposed rule would add to the current definition of "family" associations or relationships that are in the nature of a family relationship. This is intended to modernize the definition of family to include non-traditional relationships, and adoptions and other relationships where an adult who is not related to a child acts as a

parent to a child living in the home. Each System institution is encouraged to provide more explanation and discussion of the regulatory definition in its standards of conduct policies and procedures.

Material. The proposed rule would not change the definition of "material." However, each System institution must set specific parameters on what constitutes a material financial interest or transaction. The value of a material financial interest or transaction may change depending on the circumstances and, to some extent, the geographic location of the institution involved. The institution's determination of materiality would be subject to FCA examination.

The institution's policies and procedures may include de minimis values below which a financial interest is determined by the board not to be material. The de minimis amount is necessarily System institution-specific, and must be appropriate to the institution's size, location and risk tolerance. A de minimis amount is an amount or value representing an interest that is so insignificant that no reasonable person could conclude that it would influence a director or employee's ability to act impartially and in the best interests of the System institution. The institution would need to adequately support the values established in its determination of de minimis or not material, and this determination would be subject to FCA examination.

Officer. We propose to replace "secretary" with corporate secretary.

Ordinary course of business. We propose to remove "two" concerning transactions between persons and add "agents" to those for whom preferential treatment should be avoided.

Signed. We would add a definition of "signed" to have the same meaning as set forth in § 620.1 of this chapter, to provide for greater uniformity in our regulations and to clarify electronic signatures are acceptable.

Unincorporated business entities. We would add a definition of "unincorporated business entities" to have the same meaning as set forth in § 611.1151 of this chapter.

B. Director and Employee Responsibilities and Conduct--Generally [proposed § 612.2135]

The section heading would be replaced with "responsibilities and conduct" but otherwise this section is not substantively changed. The words "and guidance" are added to paragraph (b) to make clear that in addition to regulations, policy statements, instructions and procedures, directors and employees must observe guidance of the FCA, to the best of their abilities.

C. Conflicts of Interest [proposed § 612.2136]

The proposed rule would add a new § 612.2136 on conflicts of interest. This section is added to require directors, employees, and agents to take affirmative action to report conflicts of which they are aware. It is intended to compel them to take ownership of and invest in their ethical responsibilities. Paragraph (a) would specifically require directors, employees, and agents to disclose any conflicts of interests they may have in any matters, activities or transactions pending at the System institution to the Standards of Conduct Official. It would require immediate reporting of conflicts of interests and would supplement employee's and director's existing annual and periodic reporting requirements. Paragraph (b) would require recusal from any board action on, discussion of, or any other official action on or discussion of, those matters. For example, if a director or employee were to purchase farm equipment such as a combine harvester from a known borrower, the purchase should be reported and reviewed by the Standards of Conduct Official for conflicts. If the borrower has a matter or transaction pending at the institution, the director or employee would be recused from that matter. Note that if the purchase were financed it would be a lending transaction covered by §§ 612.2145 and 612.2155. Working together with other provisions of the rule, this section is intended to bolster the directors', employees', and agents' loyalty to the System institution and to reinforce personal responsibility and accountability in avoiding conflicts and acting ethically.

The requirements of disclosure and recusal in this section apply not only to directors, employees, and agents, but also those consultants, professionals or experts who are hired to give advice on a matter, transaction or activity but may not necessarily meet our definition of "agent". If the consultant, professional or expert has an interest that may compromise his or her complete impartiality in a matter, transaction or activity for which his or her

expertise is sought, paragraph (a) requires that he or she disclose that interest and paragraph (b) requires that he or she refrain from further discussion of System business with respect to that matter, transaction or activity.

System institutions must develop policies and procedures to implement this section. Such policies and procedures could include procedures for waiver of the recusal requirement if the Standards of Conduct Official determines in writing that the conflict would not interfere with the person's ability to perform impartially and in the best interest of the System institution. In the absence of such waiver procedures, recusal is required.

D. Director Reporting [current § 612.2145 is proposed § 612.2140]

We would revise § 612.2140(b)(1) to require that each director report all "material" financial interests with other directors, employees, agents or borrowers of the employing, supervised, and supervising institution. We believe this section is necessary to help directors and Standards of Conduct Officials identify and avoid potential conflicts of interests. Because the proposed rule would require directors to report only material financial interests we believe the requirement will not be unduly burdensome or intrusive.

As discussed in the section-by-section analysis above, each System institution must develop policies and procedures that provide parameters for that which constitutes a "material" financial interest, and may develop policies and procedures that set forth a certain de minimis value that would not be considered material for reporting requirements. Reporting of material financial interests is intended to assist the Standards of Conduct Official in identifying and resolving conflict situations and to help a director identify areas of prohibited conduct. A material financial interest does not necessarily mean that a conflict of interest exists or that the interest would unduly influence the director in his or her position.

Like the current rule, the proposed rule would require directors to report the name of any relative or person residing in the director's household, any business partner, or any entity controlled by the director or such persons (alone or in concert) if the director knows or has reason to know that such individual or entity transacts business with the institution or any institution supervised by the director's institution. This rule does not require a director to solicit information from these persons or entities to determine whether they had or have transactions with the institution. However, the FCA presumes that a director would know or have reason to know whether or not a relative or other persons residing in the director's household had or has transactions with the institution.

E. Directors--Prohibited Conduct [current § 612.2140 is proposed § 612.2145]

In our current rule, director prohibited conduct and the related limited exceptions are included in the same discussion. In proposed § 612.2145(a), we set forth the basic rules for prohibited conduct. In proposed § 612.2145(b), we set forth the specific limitations and exceptions to the prohibitions. We believe this change is necessary to remove any possible ambiguity from the meaning of the prohibitions. Most of these changes are straightforward, but proposed § 612.2145(a)(6) and (b)(3) regarding acquired property and proposed § 612.2145(a)(7) and (b)(4) regarding lending transactions require special discussion.

The proposed rule would clarify the circumstances under which directors may and may not purchase property that a System institution has owned or acquired by foreclosure or similar action. These proposed changes are not substantive; they are clarifications of the rule. Proposed § 612.2145(a)(6) would provide that, among other things, a director may not knowingly acquire, directly or indirectly, property that was owned or acquired by the employing, supervising or supervised institution as a result of foreclosure or similar action. Proposed § 612.2145(b)(3) would set forth an exception to the acquired property prohibition in proposed § 612.2145(a)(6). The exception would apply only if the director did not participate in the deliberations or decision to foreclose, or to take similar action, or to dispose of the property or in establishing the terms of the sale, and (1) the director acquired the property through inheritance, or (2) the System institution did not own the property or an interest in the property at any time during the 12-month period before the director's acquisition of the property, or (3) the director acquired the property through public auction with open competitive bidding and the Standards of Conduct Official determined, before the director acquired the property, that the director does not have an advantage over other bidders as a result of the director's position and that no other conflict of interest or the appearance thereof exists.

By open competitive bidding, we mean bidding that is both competitive, allowing involvement of all interested parties, and that is open and unsealed. Open competitive bidding affords all interested parties an opportunity to counter-bid. The advantage to open bidding is that it discourages unethical behavior or favoritism. A public auction can be accomplished on-line as long as there is an opportunity for all who may be interested to bid.

The proposed language does not reflect a substantive change from the intent of this original regulatory provision regarding acquired property. However, we believe that because of the scope of misunderstanding and misapplication of the original provision, the revision is necessary.

Proposed § 612.2145(a)(7) would provide that a director must not directly or indirectly borrow from, lend to, or become financially obligated with or on behalf of a director, employee, or agent of the employing, supervising or supervised institution or a borrower or loan applicant of the employing institution. This section addresses lending and borrowing relationships. It prohibits a director from entering into a lending or borrowing transaction with those who may have a financial relationship with the System institution. Lending and borrowing relationships include providing guarantees or stand-by letters of credit and similar forms of financial obligation.

The FCA recognizes that there are many situations in which a director may enter into lending transactions or business relationships that involve financing with other directors, employees, agents, borrowers or loan applicants in the ordinary course of business. Therefore, to keep the provision from being unduly restrictive, proposed § 612.2145(b)(4) would set forth an exception to the proposed § 612.2145(a)(7) prohibition. The exception would apply if: (1) The transaction is with a relative or any person residing in the director's household; or (2) the transaction is undertaken in an official capacity in connection with the institution's discounting, lending or participation relationships with OFIs and other lenders; or (3) the Standards of Conduct Official determines, as authorized under board policy and in the manner outlined in the rule, that the potential for a conflict of interest is insignificant. The Standards of Conduct Official's determination must be in writing; document that the transaction is in the ordinary course of business or is not material in value or amount; document that the director did not participate in the determination of any matter affecting the financial interests of the other party to the transaction except those matters affecting all shareholders/borrowers in a nondiscriminatory way; and most importantly, the Standards of Conduct Official's determination be made before the director enters into the transaction. The Standards of Conduct Official must renew this determination annually, as applicable. For example, if a director and a borrower contemplate an ongoing business relationship by which the director purchases grain from a borrower on credit on a regular basis, the Standards of Conduct Official would have to review this relationship for conflicts. Once reviewed, to the extent this is an ongoing relationship in the ordinary course of business, the Standards of Conduct Official would not have to review each and every transaction, but would renew on an annual basis his or her determination that the ongoing relationship remains in the ordinary course of business and does not create a conflict.

The Standards of Conduct Official cannot ratify prohibited conduct after the fact. If the transaction has been entered into without a pre-existing Standards of Conduct Official determination, then the FCA could consider the director to have violated this provision of the regulation.

As discussed, each System institution must set specific parameters on what constitutes a material financial interest or transaction and also what is in the ordinary course of business in the local environment. Whether or not to establish a de minimis threshold for review would be left to the discretion of each System institution board; however, as discussed above, if the institution does establish a de minimis value, it must do so under policies and procedures subject to FCA examination. The institution's board must not establish the de minimis value to be so high or so ambiguous as to circumvent the intent of this rule.

F. Employee Reporting [current § 612.2155 is proposed § 612.2150]

This provision would require employees to report all "material" financial interests with directors, employees, agents or borrowers of the employing, supervised, and supervising institution. This change can be found in proposed § 612.2150(b)(1) and is parallel to the change for directors in proposed § 612.2140(b)(1).

G. Employees--Prohibited Conduct [current § 612.2150 is proposed § 612.2155]

This provision has been changed from the current § 612.2150 and the revisions are parallel to the changes for director prohibited conduct, where applicable.

H. Joint Employees [proposed § 612.2157]

This section, like the current rule, prohibits an officer of a Farm Credit Bank (FCB) or agricultural credit bank (ACB) from contemporaneously working as an employee at an association in its district. Also, this provision prohibits a non-officer employee of a FCB or ACB from serving as an officer of an association in its district. The FCA recognizes that occasionally the System may benefit from having a FCB or an ACB officer serve at an association. Therefore, this provision is modified from the original to allow joint employee relationships with the written approval of the Standards of Conduct Official if the bank board of directors agrees that the interests of both System institutions outweighs the potential for conflicts of interest or conflicts related to devotion of time to official duties. The bank must provide written notice to the FCA before the joint relationship begins, and the FCA may object within 10 calendar days of receiving the bank's notice.

I. Institution Responsibilities [proposed § 612.2160]

The proposed rule would update this section to require new responsibilities and accountability of System institutions in overseeing the standards of conduct program.

Proposed § 612.2160(a)(1) would require the institution to dedicate appropriate resources to support the standards of conduct program. The Standards of Conduct Official has many duties and responsibilities, and depending on the size of the institution it may not be possible for one person to satisfactorily manage all of these responsibilities. Each System institution should dedicate personnel and resources as necessary to ensure that the standards of conduct program is carried out thoroughly and in compliance with this rule.

Proposed § 612.2160(a)(3) would require the institution to notify the FCA immediately of any known or suspected material standards of conduct violations. This notification can come directly from the board of directors, or from the Standards of Conduct Official as separately required in proposed § 612.2170(b)(7). The requirement is added here to make clear that the institution itself is accountable for notifying the FCA of known or suspected standards of conduct violations.

Proposed § 612.2160(e) would require the institution to ensure that directors and employees certify annually that they will adhere to the institution's standards of conduct policy and Code of Ethics. System institutions would be required under § 612.2160(f) to have documentation that agents (1) are subject to applicable industry or professional ethics standards, or (2) have certified to adhere to the provisions of the System institution's Code of Ethics applicable to agents. The certifications could be performed in various ways including electronic signatures.

Proposed § 612.2160(g) would require that System institutions make compliance with the standards of conduct program a component of the risk assessment process subject to periodic audit, as established by the audit committee, by a person or entity independent of the standards of conduct program. We would expect an institution to audit the standards of conduct program at least once every 3 to 4 years consistent with its risk assessment and audit planning process. The scope and depth of the audit would be determined and documented by the institution.

Proposed § 612.2160(h) would require institutions to establish an effective method of internal controls over the reporting, disclosing, and other requirements of this part, including controls for the confidentiality of information reported to and maintained by the Standards of Conduct Official. It would require institutions to establish an effective method of internal controls over the audit of the standards of conduct program.

J. Code of Ethics, Policies and Procedures [proposed § 612.2165]

Many of the provisions in proposed § 612.2165 would be the same as the provisions in current § 612.2165. However, each institution should have a strong sense of its role in the System's mission and should have a culture of corporate and personal responsibility to further that mission. Therefore, in addition to adopting internal standards of conduct policies and procedures, proposed § 612.2165(a) would require each System institution to adopt a Code of

Ethics that applies to directors and employees and that includes a provision for the ethical conduct of agents. Each institution would be required to provide a copy of its Code of Ethics to directors, employees, and agents. Directors and employees would be required to sign the institution's Code of Ethics. Agents not subject to industry or professional ethics standards would be required to certify that they will adhere to the institution's Code of Ethics provision applicable to agents.

The proposed rule sets forth minimum specific guidelines that each System institution's Code of Ethics would be required to meet. The institution's Code of Ethics must promote honest and ethical conduct including the ethical handling of actual or apparent conflicts of interest; promote integrity and compliance with laws and regulations; prohibit dishonesty, fraud or deceit and discourage any conduct or act that would adversely reflect on the reputation, integrity or competency of the System; prohibit misuse of office and provide for the prompt reporting of any person or persons who violates the institution's Code of Ethics or engages in any activity that may require further investigation under § 612.2301, subpart B of this part, to the Standards of Conduct Official.

Proposed § 612.2165(a)(3) would require each institution's board to adopt policies and procedures concerning the use of unincorporated business entities (UBE) that, at a minimum, ensure that all transactions between the UBE and System institution directors, employees, and agents are conducted at arm's length. These policies and procedures must ensure that System institution directors, employees, and agents comply with their employing institution standards of conduct policies and procedures and this rule in their interactions with the UBE. For example, System institution directors, employees, and agents cannot purchase acquired property from a UBE except in compliance with this rule and their institution's standards of conduct policies and procedures.

The FCA believes that each System institution must review and update its standards of conduct policies and procedures, as necessary, to strengthen them. The FCA expects each System institution to modernize and augment its existing standards of conduct policies and procedures to ensure the highest standards of honesty, ethics, integrity, impartiality and conduct. In doing this, each System institution should establish reasonable criteria for business relationships and transactions relevant to its business, geographic location, and customer base. The standards outlined in this rule serve as a minimum bar against which each System institution should build and develop stronger internal standards of conduct policies and procedures.

Proposed § 612.2165(b)(2) would require System institutions to outline authorities and responsibilities of the Standards of Conduct Official. Included in this requirement would be the authority and responsibility to review for compliance with this subpart all loans considered for approval by the supervisory bank under §§ 614.4460 and 614.4470, respectively. System institution loans to directors and employees and loans to FCA employees and others subject to §§ 614.4460 and 614.4470 present unique conflict of interest issues. The System institutions should ensure that credit decisions with respect to these loans are made without favoritism or special terms. These loans, which include insider loans, warrant a higher level of scrutiny for possible conflict or undue influence than non-insider loans.

Proposed § 612.2165(b)(14) would clarify the circumstances under which an institution's policies and procedures must prohibit the purchase and retirement of the institution's preferred stock. This section does not place a restriction on the issuance or retirement of borrower stock associated with a director or employee loan transaction.

Proposed § 612.2165(b)(16) would require the board in its policies and procedures to provide for annual training on standards of conduct. Training presents an opportunity to continually educate directors and employees on standards of conduct issues and the importance of ethical behavior.

Proposed § 612.2165(b)(17) would require the institution to report to the FCA exceptions authorized by the institution board under § 612.2165(c).

The FCA recognizes that some of the provisions of the rule may prohibit activity where no actual or apparent conflict of interest exists. Therefore, proposed § 612.2165(c)(1) would allow each System institution to adopt policies and procedures by which the System institution board of directors may grant a written exception to certain standards of conduct rules under this subpart. The FCA proposes that rules for which an exception may be granted on a case-by-case basis are a reporting requirement, an employee or director prohibition on disclosure of information not generally available to the public, an employee prohibition on serving as an officer of a non-System

entity in the district or of a non-System financial institution, a restriction on an employee serving jointly at a bank and association as discussed in proposed § 612.2157, and the 5-percent threshold for defining a controlled entity. For example, under proposed § 612.2165(c)(1) a board could allow an exception to the prohibition with respect to an individual director's interest in a "controlled entity" where that director indirectly owns more than 5 percent of the equity and the Standards of Conduct Official determines based on the facts and circumstances that there is no potential for conflict of interest. As another example, this provision would allow the board to approve an exception to the prohibition on an employee serving as an officer or director of a non-System entity that transacts business with the System institution in its district (proposed § 612.2155(a)(4)), if the Standards of Conduct Official determines that there is no conflict of interest.

The exceptions under proposed § 612.2165(c)(1) would have to be approved on a case-by-case basis by the institution's board, based on a recommendation of the Standards of Conduct Official. The Standards of Conduct Official's recommendation would need to be strongly supported by a written determination that the prohibition is not necessary to avoid a conflict or appearance of a conflict or to ensure impartiality, objectivity and public confidence in the System institution. The determination would have to be documented in the institution's files and renewed at least annually. The institution board would impose appropriate conditions, as the circumstances may dictate. In addition, the board would provide for periodic review of the criteria to determine whether the board continues to support the Standards of Conduct Official's recommendation. The exceptions approved would be subject to FCA examination, and to its determination of whether the prohibition of the activity is necessary to avoid a conflict or appearance of a conflict or to ensure impartiality, objectivity and public confidence in the System institution.

The FCA specifically requests comment on whether the provisions proposed are appropriate for board waiver and whether other provisions should be considered. There are some transactions so susceptible to conflicts that the FCA would not consider permitting a waiver of the rule prohibiting them. The rules prohibiting directors, employees, and agents from acquiring property could not be waived. The rules prohibiting an employee from acting as a real estate agent or broker could not be waived, and the rule prohibiting an employee from acting as an agent or broker in connection with the sale and placement of insurance could not be waived. Finally the requirement to comply with the institution's standards of conduct policies and Code of Ethics could not be waived. As previously stated, there may be other rules for which an institution board may appropriately consider granting a waiver, and the FCA specifically requests comment on the waiver provisions of this proposal and what those rules may be.

Proposed paragraph (c)(2) of this section would allow the institution board to consider a standing exception to director and employee reporting requirements under proposed §§ 612.2140 and 612.2150, respectively. As an example, policies and procedures under proposed § 612.2165(c)(2) could allow an exception to the requirement that a director report the name and nature of a business or any entity on whose board the director sits, if the entity is a nonprofit organization such as a Chamber of Commerce, or a place of worship, and the Standards of Conduct Official determines that the potential for conflict is insignificant with respect to that category of entity.

Proposed paragraph (c)(2) would also permit the board to establish policies and procedures that provide for a standing exception to the restrictions in proposed §§ 612.2145(b)(4) and 612.2155(b)(6) on lending transactions, if the potential for conflict is insignificant because the transaction is not material, or it is in the ordinary course of business. An institution may identify certain lending transactions that fall under a certain dollar value and are de minimis or immaterial. Those transactions falling below such identified amounts would not have to be reported to or reviewed by the Standards of Conduct Official. In addition, an institution may identify certain types of transactions that are in the ordinary course of business. Directors and employees could enter into those ordinary course of business transactions without the prior review of the Standards of Conduct Official. However, where the ordinary course of business transaction exceeds the de minimis or immaterial threshold set by the institution, the directors and employees must report such transactions, by including them in regular reports to the Standards of Conduct Official, and the Standards of Conduct Official must review them. Putting the exceptions of proposed § 612.2165(c)(2) together, a transaction that is in the ordinary course of business and that also is de minimis or falls below the immaterial amount would require neither director or employee reporting nor Standards of Conduct Official review.

For example, the System institution may find that certain goods and services that are offered to the public in the ordinary course of business at a fixed price, such as diesel fuel, or equipment repairs, do not raise conflict of

interest concerns, even if purchased from a System borrower with credit. Institution policies and procedures could provide that these transactions would not have to be reported or approved unless they reached a certain dollar amount or value threshold. By contrast, transactions involving price negotiation, such as purchasing a tractor or other heavy farm equipment, could raise issues of impartiality or favoritism and should be subject to more scrutiny.

In addition to transactions covered in the institution's policies and procedures under proposed § 612.2165(c)(2), proposed §§ 612.2145 and 612.2155 retain the existing flexibility for an institution's Standards of Conduct Official to review a transaction before it is entered into and make a case-by-case determination that there is no conflict. The exceptions in proposed § 612.2165(c)(2) are designed to be applied to all directors and employees and as such, must be set on a conservative basis. However, a particular lending transaction that does not fall within the institutions' § 612.2165(c)(2) exceptions may still be a transaction that the Standards of Conduct Official determines has little potential for conflict when applying the rules under §§ 612.2145 and 612.2155. Proposed § 612.2165(f) reminds each System institution that the FCA may determine that a transaction or activity constitutes a conflict of interest notwithstanding the System institution's board of director finding to the contrary. Section 612.2165(d) and (e) are included to prevent misuse of the requirements under this section to evade conflict of interest rules and situations. Finally, institution policies and procedures should provide for periodic review by the System institution board.

K. Standards of Conduct Official [proposed § 612.2170]

We would revise § 612.2170(a) to require that there must be an internal employee who also serves as the institution's Standards of Conduct Official and who would be accountable to the institution's board for all standards of conduct matters. The FCA believes that an in-house Standards of Conduct Official is in the best position to advise the board because they are in-tune with the day-to-day operations of the institution. In addition, in order to foster a culture of highest integrity and ethical conduct, it is important to have a Standards of Conduct Official who has a constant presence at, relationship with, and respect of, the employees of the institution. The proposed rule would require the institution's board of directors to provide for other employees to assist the Standards of Conduct Official as needed to ensure the effective operations of the institution's standards of conduct program.

Proposed § 612.2170(b) would enhance and clarify the responsibility and accountability of the Standards of Conduct Official. The Standards of Conduct Official must receive, actively review, and maintain the reports required by the rule. Proposed § 612.2170(b)(6) would require the Standards of Conduct Official to report to the board no less than annually on the effectiveness of the institution's standards of conduct policy and its implementation. This report should include an evaluation of the extent to which safeguards are in place to avoid conflicts of interest and standards of conduct policy violations and should present the opportunity to make improvements to the standards of conduct program.

The Standards of Conduct Official must also present any violations of the standards of conduct policy to the board for appropriate action. Section 612.2170(b)(7) would require the Standards of Conduct Official to report to the institution's board and to the FCA all suspected criminal and, in addition, any standards of conduct violations that may have an adverse impact on continued public confidence in the System or any of its institutions.

Proposed § 612.2170(c) would provide that a Farm Credit bank may provide assistance to an affiliated association's board of directors and Standards of Conduct Official in complying with this part. Proposed § 612.2170(d) would provide that an institution may use an outside counsel or consultant to assist the institution in meeting standards of conduct requirements. However, the institution's in-house Standards of Conduct Official would be responsible for overseeing the outside counsel or consultant.

Proposed § 612.2170(e) would provide that the Standards of Conduct Official must coordinate appropriate training with the institution's board on an annual basis.

L. Standards of Conduct for Agents [current § 612.2260 is proposed § 612.2180]

It is important for System institutions to hold their agents to the same high ethical standards held by their directors and employees. The proposed rule would require that institutions document that agents representing System institutions in contacts with third parties or who provide professional or consultant services such as legal,

accounting, and appraisal, are subject to industry or professional ethics standards and that the institution provide each agent a copy of the institution's standards of conduct policy and Code of Ethics. The proposed rule would further require that an agent who is not subject to industry or professional ethics standards must certify to the System institution that the agent will adhere to the provisions of the institution's Code of Ethics applicable to agents. Agents play an important role in System institutions and this rule would help achieve high ethical standards at every level throughout the System.

To avoid the appearance of conflicts in the disposition or purchase of institution-owned or institution-acquired real or personal property, we propose that agents must agree to prohibitions similar to those that apply to employees. The proposed rule would prohibit agents from acquiring any interest in real or personal property if it was owned or acquired by the employing institution or any supervised or supervising institution as a result of foreclosure or similar action at any time during the agent's employment. The prohibition would apply for as long as the property is owned or acquired by the System institution, and for 12 months after the property is transferred out of the System institution or after the agency relationship is terminated, whichever occurs first.

M. Purchase of System Obligations [current § 612.2270 is proposed § 612.2190]

We revised this section to clarify that directors and employees may not purchase any obligation of a System institution except as specifically stated.

III. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA hereby certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, Farm Credit System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 612

Agriculture, Banks, banking, Conflict of interests, Crime, Investigations, Rural areas.

For the reasons stated in the preamble, part 612 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 612--STANDARDS OF CONDUCT AND REFERRAL OF KNOWN OR SUSPECTED CRIMINAL VIOLATIONS

1. The authority citation for part 612 continues to read as follows:

Authority: Secs. 5.9, 5.17, 5.19 of the Farm Credit Act (12 U.S.C. 2243, 2252, 2254).

2. Subpart A, consisting of §§ 612.2130 through 612.2270, is revised to read as follows:

Subpart A--Standards of Conduct

Sec.	
612.2130	Definitions.
612.2135	Responsibilities and conduct.
612.2136	Conflicts of interest.
612.2140	Director reporting.
612.2145	Directors--prohibited conduct.
612.2150	Employee reporting.
612.2155	Employees--prohibited conduct.
612.2157	Joint employees.
612.2160	Institution responsibilities.

612.2165	Code of ethics, policies, and procedures.
612.2170	Standards of Conduct Official.
612.2180	Standards of Conduct for agents.
612.2190	Purchase of System obligations.
612.2260	[Reserved]
612.2270	[Reserved]

Subpart A--Standards of Conduct

§ 612.2130 Definitions.

For purposes of this part, the following terms are defined:

Agent means any person, other than a director or employee, who currently represents a System institution in contacts with third parties or who currently provides professional services to a System institution, such as legal, accounting, appraisal, and other similar services.

Code of Ethics means a written set of standards, rules, values, and guidance that is used to ensure the ethical conduct of those who sign it, and that reflects professionalism and discourages misconduct so that the best interests of the institution are advanced.

Conflicts of interest or the appearance thereof exists when a person has a financial interest in a transaction, relationship, or activity that actually affects or has the appearance of affecting the person's ability to perform official duties and responsibilities in a totally impartial manner and in the best interest of the employing institution when viewed from the perspective of a reasonable person with knowledge of the relevant facts.

Controlled entity and entity controlled by, for the purposes of this rule only, means an interest in an entity in which the individual, directly or indirectly, or acting through or in concert with one or more persons:

- (1) Owns 5 percent or more of the equity;
- (2) Owns, controls, or has the power to vote 5 percent or more of any class of voting securities; or
- (3) Has the power to exercise a controlling influence over the management of policies of such entity.

Employee means any salaried officer or part-time, full-time, temporary salaried employee or any non-salaried employee who receives a wage.

Entity means a corporation, company, association, firm, joint venture, partnership (general or limited), unincorporated business entity, society, joint stock company, trust (business or otherwise), fund or other organization or institution.

Family means an individual and spouse and anyone having the following relationship to either: parent, spouse, son, daughter, sibling, stepparent, stepson, stepdaughter, stepbrother, stepsister, half-brother, half-sister, uncle, aunt, nephew, niece, grandparent, grandson, granddaughter, and the spouses of the foregoing and anyone whose association or relationship with the director or employee is the equivalent of the foregoing.

Financial interest means an interest in an activity, transaction, property, or relationship with a person or an entity that involves receiving or providing something of monetary value or other present or deferred compensation.

Financially obligated with means having a joint legally enforceable obligation with, being financially obligated on behalf of (contingently or otherwise), having an enforceable legal obligation secured by property owned by another, or owning property that secures an enforceable legal obligation of another.

Material, when applied to a financial interest or transaction or series of transactions, means that the interest or transaction or series of transactions is of such magnitude that a reasonable person with knowledge of the relevant facts would question the ability of the person who has the interest or is party to such transaction(s) to perform the person's official duties objectively and impartially and in the best interest of the institution and its statutory purpose.

Mineral interest means any interest in minerals, oil, or gas, including, but not limited to, any right derived directly or indirectly from a mineral, oil, or gas lease, deed, or royalty conveyance.

OFI means other financing institutions that have established an access relationship with a Farm Credit bank or an agricultural credit bank under section 1.7(b)(1)(B) of the Act.

Officer means the chief executive officer, president, chief operating officer, vice president, corporate secretary, treasurer, general counsel, chief financial officer, and chief credit officer of each System institution, and any person not so designated who holds a similar position of authority.

Ordinary course of business, when applied to a transaction, means:

- (1) A transaction that is usual and customary between or among persons who are in business together; or
- (2) A transaction with a person who is in the business of offering the goods or services that are the subject of the transaction on terms that are not preferential. Preferential means that the transaction is not on the same terms

as those prevailing at the same time for comparable transactions for other persons who are not directors, employees, or agents of a System institution.

Person means individual or entity.

Relative means any member of the family as defined in this section.

Service corporation means each service corporation chartered under the Act.

Signed, has the same meaning as set forth in § 620.1 of this chapter.

Standards of Conduct Official means the official designated under § 612.2170.

Supervised institution is a term which only applies within the context of a System bank or an employee of a System bank and refers to each association supervised by that bank.

Supervising institution is a term that only applies within the context of an association or an employee of an association and refers to the bank that supervises that association.

System institution and institution mean any bank, association, or service corporation, chartered under the Act in the Farm Credit System, including the Farm Credit Banks, banks for cooperatives, agricultural credit banks, Federal land bank associations, agricultural credit associations, Federal land credit associations, production credit associations, and the Federal Farm Credit Banks Funding Corporation.

Unincorporated business entities (UBE) has the same meaning as set forth in § 611.1151 of this chapter.

§ 612.2135 Responsibilities and conduct.

(a) Directors and employees of all System institutions must maintain high standards of industry, honesty, integrity, impartiality, and conduct in order to ensure the proper performance of System business and continued public confidence in the System and each of its institutions. The avoidance of misconduct and conflicts of interest is indispensable to the maintenance of these standards.

(b) To achieve these high standards of conduct, directors and employees must observe, to the best of their abilities, the letter and intent of all applicable local, state, and Federal laws and regulations and policy statements, instructions, procedures, and guidance of the Farm Credit Administration. System institutions must exercise diligence and good judgment in carrying out their duties, obligations, and responsibilities.

§ 612.2136 Conflicts of interest.

(a) Each director, employee, and agent of a System institution, and consultants who provide expert or professional services to the System institution, must:

(1) Take measures to avoid conflicts of interest;

(2) Disclose conflicts of interest in any matters, activities or transactions pending at the System institution, or in the case of consultants, experts or professionals, disclose conflicts of interest in the matter, activity, or transaction for which they are providing services, including financial or other personal or official interests that may present a conflict of interest or the appearance thereof, to the Standards of Conduct Official; and

(b) If a person subject to paragraph (a) of this section has a conflict of interest in a matter, transaction or activity subject to official action, or before the board of directors, then the person must:

(1) Disclose to the official or the board all material non-privileged information relevant to the consideration of the matter, activity or transaction, including:

(i) The existence, nature, and extent of the person's interests; and

(ii) The facts known to the person as to the matter, activity or transaction under consideration;

(2) Refrain from participating in the official action or board discussion of the matter, activity or transaction; and

(3) Not vote on the matter or transaction.

(c) The System institution must establish policies and procedures to enforce this section which may include procedures by which the Standards of Conduct Official may waive the recusal requirement upon his or her written determination that a conflict of interest does not exist or would not interfere with the person's ability to perform impartially and in the best interest of the System institution.

§ 612.2140 Director reporting.

(a) Annually, as of the institution's fiscal year end, and at such other times as may be required to comply with paragraph (c) of this section, each director must file a written and signed statement with the Standards of Conduct Official that fully reports:

(1) The names of any immediate family members as defined in § 620.1(e) of this chapter, or affiliated organizations, as defined in § 620.1(a) of this chapter, who had transactions with the institution at any time during the year;

(2) Any matter required to be disclosed by § 620.6(f) of this chapter; and
(3) Any additional information the institution may require to make the disclosures required by part 620 of this chapter.

(b) Each director must, at such intervals as the institution's board determines is necessary to effectively enforce this regulation and the institution's standards of conduct policy and Code of Ethics adopted pursuant to § 612.2165, file a written and signed statement with the Standards of Conduct Official that contains those disclosures required by the regulations and such policy. At a minimum, these disclosures must include:

(1) All material financial interests with directors, employees, agents or borrowers of the employing, supervised, and supervising institution;

(2) The name of any relative or any person residing in the director's household, any business partner, or any entity controlled by the director or such persons (alone or in concert) if the director knows or has reason to know that such individual or entity transacts business with the institution or any institution supervised by the director's institution; and

(3) The name and the nature of the business of any entity in which the director has a material financial interest or on whose board the director sits if the director knows or has reason to know that such entity transacts business with:

(i) The director's institution or any institution supervised by the director's institution; or

(ii) A borrower of the director's institution or any institution supervised by the director's institution.

(c) Any director who becomes or plans to become involved in any relationship, transaction, or activity that may violate the institutions' Code of Ethics or is required to be reported under this section or could constitute a conflict of interest, must promptly report in writing such involvement or plan to become involved to the Standards of Conduct Official for a determination of whether the relationship, transaction, or activity is, in fact, a conflict of interest.

(d) Unless a disclosure as a director candidate under part 620 of this chapter has been made within the preceding 180 calendar days, a newly elected or appointed director must report matters required to be reported in paragraphs (a), (b), and (c) of this section to the Standards of Conduct Official within 30 calendar days after the election or appointment and thereafter must comply with the requirements of this section.

§ 612.2145 Directors--prohibited conduct.

(a) Prohibited conduct. Except as specifically provided under paragraph (b) of this section, a director of a System institution must not:

(1) Participate, directly or indirectly, in deliberations on, or the determination of, any matter affecting, directly or indirectly, the financial interest of the director, any relative of the director, any person residing in the director's household, any business partner of the director, or any entity controlled by the director or such persons (alone or in concert);

(2) Divulge or make use of any fact, information, or document not generally available to the public that is acquired by virtue of serving on the board of a System institution;

(3) Use the director's position to obtain or attempt to obtain special advantage or favoritism for the director, any relative of the director, any person residing in the director's household, any business partner of the director, any entity controlled by the director or such persons (alone or in concert), any other System institution, or any person transacting business with the institution, including borrowers and loan applicants;

(4) Use the director's position or information acquired in connection with the director's position to solicit or obtain, directly or indirectly, any gift, fee, or other present or deferred compensation or for any other personal benefit on behalf of the director, any relative of the director, any person residing in the director's household, any business partner of the director, any entity controlled by the director or such persons (alone or in concert), any other System institution, or any person transacting business with the institution, including borrowers and loan applicants;

(5) Accept or solicit, directly or indirectly, any gift, fee, or other present or deferred compensation that is offered or could reasonably be viewed as being offered to influence official action or to obtain information that the director has access to by reason of serving on the board of a System institution;

(6) Knowingly acquire, directly or indirectly, any interest in any real or personal property, including mineral interests, that was owned or acquired by the employing, supervising, or any supervised institution as a result of foreclosure or similar action;

(7) Directly or indirectly borrow from, lend to, or become financially obligated with or on behalf of, a director, employee, or agent of the employing, supervising or supervised institution or a borrower, or loan applicant of the employing institution; or

(8) Violate an institution's policies and procedures governing standards of conduct or Code of Ethics.

(b) Exceptions to prohibited conduct.

(1) A director may participate in deliberations and determinations of matters prohibited under paragraph (a)(1) of this section only if the matter is one of general applicability affecting all shareholders/borrowers in a nondiscriminatory way, as determined by the Standards of Conduct Official.

(2) A director may divulge or make use of any fact, information, or document prohibited under paragraph (a)(2) of this section, only if in the performance of the director's official duties.

(3) A director may acquire an interest in any real or personal property prohibited under paragraph (a)(6) of this section only if the director did not participate in the deliberations or decision to foreclose, or take similar action, or to dispose of the property or in establishing the terms of the sale; and

(i) The director acquired the property through inheritance; or

(ii) The System institution did not own the property or interest at any time during the 12-month period before the director's acquisition of the property; or

(iii) The director acquired the property through public auction with open competitive bidding and the Standards of Conduct Official determined in writing, before the director acquired the property, that the director does not have an advantage over other bidders as a result of the director's position and that no other conflict of interest or appearance thereof exists.

(4) A director may enter into a lending transaction prohibited under paragraph (a)(7) of this section only if:

(i) The transaction is with a relative or any person residing in the director's household;

(ii) The transaction is undertaken in an official capacity in connection with the institution's discounting, lending or participation relationships with OFIs and other lenders; or

(iii) The Standards of Conduct Official, on a case-by-case basis, determines and documents, pursuant to a board adopted policy and in the manner outlined herein, that the potential for conflict is insignificant. The Standards of Conduct Official's determination must:

(A) Be in writing;

(B) Adequately demonstrate that the transaction is in the ordinary course of business or is not material in amount or value;

(C) Adequately demonstrate that the director did not participate in the determination of any matter affecting the financial interests of the other party to the transaction except those matters affecting all shareholders/borrowers in a nondiscriminatory way;

(D) Be made before the director enters into the transaction, or at the time the director is appointed or elected; and

(E) Be renewed annually, as applicable.

§ 612.2150 Employee reporting.

(a) Annually, as of the institution's fiscal yearend, and at such other times as may be required to comply with paragraph (c) of this section, each senior officer as defined in § 619.9310 of this chapter must file a written and signed statement with the Standards of Conduct Official that fully reports:

(1) The names of any immediate family members, as defined in § 620.1(e) of this chapter, or affiliated organizations, as defined in § 620.1(a) of this chapter, who had transactions with the institution at any time during the year;

(2) Any matter required to be disclosed by § 620.6(f) of this chapter; and

(3) Any additional information the institution may require to make the disclosures required by part 620 of this chapter.

(b) Each employee must, at such intervals as the institution's board determines is necessary to effectively enforce this regulation and the institution's standards of conduct policy and Code of Ethics adopted pursuant to § 612.2165, file a written and signed statement with the Standards of Conduct Official that contains those disclosures required by the regulation and such policy. At a minimum, these disclosures must include:

(1) All material financial interests with directors, employees, agents or borrowers of the employing, supervised, and supervising institutions;

(2) The name of any relative or any person residing in the employee's household, any business partner, or any entity controlled by the employee or such persons (alone or in concert) if the employee knows or has reason to know that such individual or entity transacts business with the employing institution, or any institution supervised by the employing institution; and

(3) The name and the nature of the business of any entity in which the employee has a material financial interest or on whose board the employee sits if the employee knows or has reason to know that such entity transacts business with:

- (i) The employing institution or any institution supervised by the employing institution; or
- (ii) A borrower of the employing institution or any institution supervised by the employing institution.
- (c) Any employee who becomes or plans to become involved in any relationship, transaction, or activity that is required to be reported under this section or could constitute a conflict of interest must promptly report in writing such involvement to the Standards of Conduct Official for a determination of whether the relationship, transaction, or activity is, in fact, a conflict of interest.
- (d) A newly hired employee must report matters required to be reported in paragraphs (a), (b), and (c) of this section to the Standards of Conduct Official five (5) business days after starting employment and thereafter must comply with the requirements of this part.

§ 612.2155 Employees--prohibited conduct.

(a) Prohibited conduct. Except as specifically provided under paragraph (b) of this section, an employee of a System institution must not:

(1) Participate, directly or indirectly, in deliberations on, or the determination of, any matter affecting, directly or indirectly, the financial interest of the employee, any relative of the employee, any person residing in the employee's household, any business partner of the employee, or any entity controlled by the employee or such persons (alone or in concert);

(2) Divulge or make use of any fact, information, or document not generally available to the public that is acquired by virtue of being an employee of a System institution;

(3) Use the employee's position to obtain or attempt to obtain special advantage or favoritism for the employee, any relative of the employee, any person residing in the employee's household, any business partner of the employee, any entity controlled by the employee or such persons (alone or in concert), any other System institution, or any person transacting business with the institution, including borrowers and loan applicants;

(4) Serve as an officer or director of an entity other than a System institution that transacts business with a System institution in the district or of any commercial bank, savings and loan, or other non-System financial institution. For the purposes of this paragraph, "transacts business" does not include loans by a System institution to a family-owned entity, service on the board of directors of the Federal Agricultural Mortgage Corporation, or transactions with nonprofit entities or entities in which the System institution has an ownership interest;

(5) Use the employee's position or information acquired in connection with the employee's position to solicit or obtain, directly or indirectly, any gift, fee, or other present or deferred compensation or for any other personal benefit on behalf of the employee, any relative of the employee, any person residing in the employee's household, any business partner of the employee, any entity controlled by the employee or such persons (alone or in concert), any other System institution, or any person transacting business with the institution, including borrowers and loan applicants;

(6) Accept or solicit, directly or indirectly, any gift, fee, or other present or deferred compensation that is offered or could reasonably be viewed as being offered to influence official action or to obtain information that the employee has access to by reason of employment with a System institution;

(7) Knowingly acquire, directly or indirectly, any interest in any real or personal property, including mineral interests, that was owned or acquired by the employing, supervising, or any supervised institution as a result of foreclosure or similar action;

(8) Directly or indirectly borrow from, lend to, or become financially obligated with or on behalf of, a director, employee, or agent of the employing, supervising, or supervised institution or a borrower or loan applicant of the employing institution;

(9) Act as a real estate agent or broker;

(10) Act as an agent or broker in connection with the sale and placement of insurance; or

(11) Violate an institution's policies and procedures governing standards of conduct or Code of Ethics.

(b) Exceptions to prohibited conduct.

(1) An employee may participate in deliberations and determinations of matters prohibited under paragraph (a)(1) of this section only if the matter is one of general applicability affecting all shareholders/borrowers in a nondiscriminatory way, as determined by the Standards of Conduct Official.

(2) An employee may divulge or make use of a fact, information, or document prohibited under paragraph (a)(2) of this section only if in the performance of official duties.

(3) Notwithstanding the prohibitions in paragraph (a)(4) of this section, an employee may serve as an officer or director of an employee credit union. With the prior approval of the board of the employing institution, an employee of a Farm Credit Bank or association may serve as a director of a cooperative that borrows from an agricultural credit bank. Prior to approving an employee's request, the board must determine whether the

employee's proposed service as a director is likely to cause the employee to violate any regulations in this part or the institution's policies, e.g., the requirements relating to devotion of time to official duties.

(4) An employee may acquire an interest in real or personal property prohibited under paragraph (a)(7) of this section only if the employee did not participate in the deliberations or decision to foreclose on the property or to take action, or to dispose of the property or in establishing the terms of the sale; and

(i) The employee acquired the property through inheritance; or

(ii) The System institution did not own the property or interest at any time during the 12-month period before the employee's acquisition of the property.

(5) An employee may enter into a lending transaction prohibited under paragraph (a)(8) of this section only if:

(i) The transaction is with a relative or any person residing in the employee's household;

(ii) The transaction is undertaken in an official capacity in connection with the institution's discounting, lending, or participation relationships with OFIs and other lenders; or

(iii) The Standards of Conduct Official on a case-by-case basis, determines and documents, pursuant to a board adopted policy under § 612.2165 and in the manner outlined herein, that the potential for conflict is insignificant. The Standards of Conduct Official's determination must:

(A) Be in writing;

(B) Adequately demonstrate that the transaction is in the ordinary course of business or is not material in value or amount;

(C) Adequately demonstrate that the employee did not participate in the determination of any matter affecting the financial interests of the other party to the transaction except those matters affecting all shareholders/borrowers in a nondiscriminatory way;

(D) Be made before the transaction in question is entered into; and

(E) Be renewed annually, as applicable.

(6) Paragraph (a)(9) of this section does not apply to transactions involving the purchase or sale of real estate intended for the use of the employee, a member of the employee's family, or a person residing in the employee's household.

(7) Paragraph (a)(10) of this section does not apply to the sale or placement of insurance authorized by section 4.29 of the Act.

§ 612.2157 Joint employees.

(a) An employee of a Farm Credit bank may serve as an employee of an association in its district only if:

(1) The employee is not an officer of the Farm Credit bank and will not serve as an officer of the association; or

(2) Before such service begins, the Farm Credit bank's Standards of Conduct Official consents in writing to such service, the Farm Credit bank board of directors agrees that the interest of both System institutions outweighs the potential for conflicts of interest or conflicts related to devotion of time to official duties, the Farm Credit bank delivers written notice to the Farm Credit Administration, and the Farm Credit Administration does not object to such service within ten (10) calendar days of receiving the notice.

(b) Each institution must appropriately reflect the expense of joint employees in its financial statements.

§ 612.2160 Institution responsibilities.

Each institution must:

(a) Ensure compliance with this part by its directors, employees, and agents and at a minimum:

(1) Provide support as necessary to the Standards of Conduct program including assigning appropriate resources and staffing to the Standards of Conduct Official;

(2) Act promptly to preserve the integrity of and public confidence in the institution in any matter involving a conflict of interest or the appearance of a conflict of interest, whether or not specifically addressed by this subpart or the policies and procedures adopted pursuant to § 612.2165; and

(3) Notify the Farm Credit Administration immediately of known or suspected material standards of conduct violations as described in § 612.2170(b)(7).

(b) Take appropriate measures to ensure that all directors and employees are informed of the requirements of this regulation and policies and procedures adopted pursuant to § 612.2165.

(c) Maintain all standards of conduct policies and procedures, reports, investigations, determinations, and evidence of compliance with this part for a minimum of six (6) years.

(d) Remain informed of applicable industry approved best practices for standards of conduct.

(e) Ensure that directors and employees annually certify in writing that they will adhere to the institution's standards of conduct policy and Code of Ethics.

(f) Provide its agents a copy of the institution's standards of conduct policy and Code of Ethics;

(1) Adequately document which of its agents are subject to industry or professional ethics standards; and

(2) Require each agent that is not subject to industry or professional ethics standards to certify that he or she will adhere to the provisions of the institution's Code of Ethics applicable to agents.

(g) Ensure that compliance with the standards of conduct program is a component of the institution's risk assessment process subject to periodic audit by a person or entity independent of the program.

(h) Develop, implement and maintain an effective method of internal controls over the reporting, disclosure and other requirements of this part. The method of internal controls, at a minimum, must comply with the requirements of applicable Farm Credit Administration regulations, including § 618.8430 of this chapter and include controls for:

(1) The confidentiality of information reported to and maintained by the Standards of Conduct Official; and

(2) The audit of the standards of conduct program for compliance by a person or entity independent of the program.

§ 612.2165 Code of Ethics, policies, and procedures.

(a) Each institution's board of directors must adopt:

(1) Policies and procedures governing standards of conduct for directors, employees, and agents; and

(2) A code of Ethics that applies to directors and employees and that includes a provision for the ethical conduct of agents to ensure the avoidance of conflicts of interest in the performance of their duties. The Code of Ethics must include specific guidelines on what is acceptable and unacceptable conduct. The Code of Ethics must be signed by directors and employees. Agents must be presented with the institution's Code of Ethics, and agents not subject to industry or professional ethics standards must sign the institution's Code of Ethics provisions applicable to agents. The institution's Code of Ethics must:

(i) Promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest;

(ii) Promote integrity and compliance with applicable laws, rules and regulations governing standards of conduct;

(iii) Inform directors and employees that they will be held accountable for adhering to the institution's Code of Ethics, or in the case of agents, to industry or professional ethics standards or, in the absence thereof, to the System institution's Code of Ethics provisions applicable to agents;

(iv) Prohibit conduct involving dishonesty, fraud, or deceit and discourage the commitment of any act that reflects adversely on the reputation, integrity, or competency of the System institution or the System;

(v) Prohibit conduct involving misuse of office; and

(vi) Provide for the prompt reporting to the Standards of Conduct Official any person or persons in violation of the institution's Code of Ethics and of any activity that may require further investigation and reporting under § 612.2301;

(3) Policies and procedures related to UBEs that ensure the System institution's directors, employees, and agents and the UBE members, partners, employees and agents comply with their employing institution's standards of conduct and avoid conflicts of interest in carrying out their duties with respect to the UBE.

(b) Board policies and procedures adopted pursuant to paragraph (a) of this section must reflect due consideration of the potential adverse impact of activities permitted under the policies and procedures and must at a minimum:

(1) Establish requirements and prohibitions as are necessary to promote public confidence in the institution and the System, preserve the integrity and independence of the supervisory process, and prevent the improper use of official property, position, or information. In developing such requirements and prohibitions, the institution must address such issues as the hiring of relatives, political activity, devotion of time to duty, use of institution resources, the exchange of gifts and favors among directors and employees of the employing, supervising, and supervised institution, and the circumstances under which gifts may be accepted by directors and employees from outside sources, in light of the foregoing objectives;

(2) Outline authorities and responsibilities of the Standards of Conduct Official, including:

(i) The authority and responsibility to review for compliance with this subpart all loans before the supervisory bank's approval under §§ 614.4460 and 614.4470, respectively; and

(ii) A process to allow the Standards of Conduct Official to report matters to the board without fear of reprisal;

(3) Establish criteria for business relationships and transactions not specifically prohibited by this part between employees or directors and borrowers, loan applicants, directors, or employees of the employing, supervised, or supervising institutions, or persons transacting business with such institutions, including OFIs or other lenders having an access or participation relationship;

(4) Establish criteria under which employees may accept outside employment or compensation;

(5) Establish conditions under which employees may receive loans from System institutions;

(6) Establish conditions under which employees may acquire an interest in real or personal property that served as collateral for a loan from a System institution;

(7) Establish conditions under which employees may purchase any real or personal property of a System institution acquired by such institution for its operations. System institutions must use open competitive bidding whenever they sell surplus property above a stated value (as established by the board) to their employees;

(8) Provide for a reasonable period of time for directors and employees to terminate transactions, relationships, or activities that are subject to prohibitions that arise at the time of adoption or amendment of the policies;

(9) Require new directors and new employees involved in transactions, relationships, and activities prohibited by these regulations or internal policies to terminate such transactions within the same time period established for existing directors or employees pursuant to paragraph (b)(8) of this section, beginning with the commencement of the director's term for new directors, and commencement of official duties for new employees, or such shorter time period as the institution may establish;

(10) Establish procedures providing for a director's, employee's, or agent's recusal from official action on any matter in which the director, employee, or agent is prohibited from participating under these regulations or the institution's policies;

(11) Establish documentation requirements demonstrating compliance with standards of conduct decisions and board policy;

(12) Establish reporting requirements, consistent with this part, to enable the institution to comply with § 620.6 of this chapter, monitor conflicts of interest, and monitor recusal compliance;

(13) Establish appeal procedures available to any employee to whom any required approval has been denied;

(14) Prohibit directors and employees from purchasing or retiring any preferred stock of the institution in advance of the release of material non-public information concerning the institution to other stockholders;

(15) Establish when directors and employees may purchase and retire their preferred stock in the institution;

(16) Require annual training and other appropriate measures to ensure that all directors and employees are educated on best practices for ethical behavior and standards of conduct and perform their duties and responsibilities in an objective and impartial manner; and

(17) Require that the institution report to the Farm Credit Administration exceptions authorized by the board pursuant to paragraph (c) of this section.

(c) Board policies and procedures adopted pursuant to paragraphs (a) and (b) of this section may provide for:

(1) The board to consider a case-by-case exception to conflicts of interest requirements (§ 612.2136), director and employee reporting requirements (§§ 612.2140 and 612.2150), the 5-percent threshold on controlled entity (§ 612.2130), joint employee prohibitions (§ 612.2157), employee prohibitions on serving as an officer or director of a non-System financial institution (§ 612.2155(a)(4)), and director and employee prohibitions on sharing information (§§ 612.2145(a)(2) and 612.2155(a)(2), respectively). An exception may be authorized only upon board approval after the board considers the written recommendation of the Standards of Conduct Official. The recommendation must be adequately supported by the Standards of Conduct Official's written determination that in that particular matter or transaction application of the prohibition subject to the exception is not necessary to avoid a conflict of interest, to avoid the appearance of a conflict of interest or to ensure the confidence in the impartiality and objectivity of the director, employee, or System institution. The board must provide for periodic review of the criteria to determine whether the exception continues to be appropriate. If the board approves an exception, it may impose appropriate conditions, such as requiring a written disqualification or additional public disclosure.

(2) Exceptions to reporting requirements under §§ 612.2140 and 612.2150 and exceptions to the requirements under §§ 612.2145(b)(4) and 612.2155(b)(6) that the Standards of Conduct Official review a lending transaction before it is entered into. Broad based exceptions in policies may be authorized only if the potential for conflict of interest in that category of interests or transactions is insignificant. The potential for conflict of interest may only be considered insignificant if:

(i) The board determines, under its policies and procedures, that the type of interest or transaction is so immaterial in amount or value that no reasonable person with knowledge of all the facts could conclude that the interest or transaction would influence a director's or employee's ability to act impartially and in the best interests of the System institution. For this exception, transactions otherwise prohibited under §§ 612.2145 and 612.2155 do not require the prior approval of the Standards of Conduct Official or reporting under §§ 612.2140 and 612.2150; or

(ii) The board determines, under its policies and procedures that the types of interests or transactions covered by the exception or reporting requirement are in the ordinary course of business. For this exception, transactions otherwise prohibited under §§ 612.2145 and 612.2155 do not require the prior approval of the Standards of Conduct Official but must be reported under §§ 612.2140 and 612.2150, and must be reviewed by the Standards of Conduct Official at least annually; and

(iii) The board must consider the written recommendation of the Standards of Conduct Official in developing these policy exceptions. The recommendation must be adequately supported by the Standards of Conduct Official's written determination that the amount of value in the transaction or the particular type of interest or transaction, does not require application of the reporting requirement or prohibition subject to the exception and is not necessary to avoid a conflict of interest, to avoid the appearance of a conflict of interest or to ensure the confidence in the impartiality and objectivity of the director, employee, or System institution.

(d) An institution's directors and employees, including the Standards of Conduct Official, must not engage in any act or practice to evade the prohibitions and other requirements of this part.

(e) The Farm Credit Administration may take appropriate action against any institution, director or employee who or that has entered into any transaction for the purpose of evading the requirements of this part.

(f) Notwithstanding the exceptions that may be authorized and approved under this subpart, the Farm Credit Administration may find that a particular financial interest or transaction, relationship, or activity constitutes a conflict of interest or the appearance of a conflict of interest.

§ 612.2170 Standards of Conduct Official.

(a) Each institution's board of directors must:

(1) Designate an officer of the institution as its Standards of Conduct Official; and

(2) Authorize other employees of the institution or outside counsel or consultants to assist the Standards of Conduct Official as needed, and dedicate resources as needed, to ensure the effective operations of the institution's standards of conduct program for compliance with institution policies and the Farm Credit Administration's standards of conduct regulations.

(b) The Standards of Conduct Official must:

(1) Advise directors, director candidates, employees, and potential new employees concerning the provisions of this part;

(2) Receive, review, and maintain reports required by this part;

(3) Make such determinations as are required by this part;

(4) Maintain records of determinations as are required by this part;

(5) Make appropriate investigations, as directed by the institution's board;

(6) Report to the board no less than annually on the effectiveness of the institution's standards of conduct policy and its implementation;

(7) Report promptly to the institution's board and the Office of General Counsel, Farm Credit Administration, all cases where:

(i) A preliminary investigation indicates that a Federal criminal statute pursuant to subpart B of this part may have been violated;

(ii) An investigation results in the resignation or discharge of an employee or the resignation or potential removal of a director; or

(iii) A known or suspected criminal or standards of conduct violation by a director, employee or agent may have an adverse impact on continued public confidence in the System or any of its institutions.

(8) Investigate or cause to be investigated all cases involving:

(i) Possible violations of criminal statutes by a director, employee or agent;

(ii) Possible violations of §§ 612.2136, 612.2145 and 612.2155, and applicable policies and procedures approved under § 612.2165;

(iii) Complaints received against the directors, employees, and agents of such institution; and

(iv) Possible violations of other provisions of this part or when the activities or suspected activities of a director, employee or agent are of a sensitive nature and could affect continued public confidence in the institution or System.

(c) A Farm Credit bank may provide assistance to an affiliated association's board of directors and Standards of Conduct Official in complying with this part.

(d) A System institution may use an outside counsel or consultant to assist in complying with this part. However, the Standards of Conduct Official must oversee the outside counsel or consultant and remains accountable to the board.

(e) The Standards of Conduct Official must coordinate with the board and management in administering annual training to ensure that directors and employees remain informed of the institution's current standards of conduct policy and Code of Ethics.

§ 612.2180 Standards of conduct for agents.

(a) Agents of System institutions must maintain high standards of honesty, integrity, and impartiality in order to ensure the proper performance of System business and continued public confidence in the System and its institutions. The avoidance of misconduct and conflicts of interest is indispensable to the maintenance of these standards.

(b) System institutions must utilize safe and sound business practices in the engagement, utilization, and retention of agents. These practices must provide for the selection of qualified and reputable agents. Agents representing a System institution in contacts with third parties or who provide consultant or professional services such as legal, accounting and appraisal, must review and acknowledge receipt of the institution's Code of Ethics. Agents must certify to the System institution that the agent will adhere to the agent's professional or industry ethics standards, or to the institution's Code of Ethics provisions applicable to agents. Employing System institutions are responsible for the actions of their agents, and must take appropriate investigative and corrective action in the case of a breach of fiduciary duties by the agent or failure of the agent to carry out its duties.

(c) System institutions must exercise special diligence and control, through good business practices, to avoid or control situations that have inherent potential for sensitivity, either real or perceived. These areas include the employment of agents who are related to directors or employees of System institutions; the solicitation and acceptance of gifts, contributions, or special considerations by agents; and the use of System and borrower information obtained in the course of the agent's association with System institutions.

(d) An agent may not knowingly acquire, directly or indirectly, except through inheritance, any interest in real or personal property, including a mineral interest, that was owned by the employing institution or any supervised or supervising institution as a result of foreclosure or similar action during the agent's employment. This prohibition applies for one (1) year after the transfer of the property out of the System institution or after the termination of the agent relationship, whichever occurs first.

§ 612.2190 Purchase of System obligations.

(a) Employees and directors of System institutions must not purchase any obligation of a System institution, including any joint, consolidated, or Systemwide obligation, unless such obligation is:

(1) Part of an offering available to the general public; and

(2) Purchased through a dealer or dealer bank affiliated with a member of the selling group designated by the Federal Farm Credit Banks Funding Corporation or purchased in the secondary market.

(b) A director or employee of the Federal Farm Credit Banks Funding Corporation must not purchase or otherwise acquire, directly or indirectly, except by inheritance, any obligation of a System institution, including any joint, consolidated, or Systemwide obligation.

§§ 612.2260 and 612.2270 [Reserved]

Date: February 7, 2014

**Dale L. Aultman,
Secretary,
Farm Credit Administration Board.**

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 612

RIN 3052-AC44

Standards of Conduct and Referral of Known or Suspected Criminal Violations; Standards of Conduct

AGENCY: Farm Credit Administration.

ACTION: Proposed rule; reopening of comment period.

SUMMARY: The Farm Credit Administration (FCA, we, or our) reopens the comment period on a proposed rule that would amend its regulations governing standards of conduct of directors, employees, and agents of Farm Credit System (System) institutions, excluding the Federal Agricultural Mortgage Corporation and clarify and strengthen reporting requirements and prohibitions, require institutions to establish a Code of Ethics, and enhance the role of the Standards of Conduct Official. Reopening the comment period will afford interested parties a new opportunity to comment on the proposed regulations.

DATES: Comments on the proposed rule must be submitted on or before June 20, 2014.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Select "Public Commenters," then "Public Comments" and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Public Commenters," then "Public Comments" and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted but, for technical reasons, we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Jacqueline R. Melvin, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TDD (703) 883-4056,

or

Mary Alice Donner, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TDD (703) 883-4056.

SUPPLEMENTARY INFORMATION:

On February 20, 2014, the FCA published a proposed rule in the Federal Register seeking public comment on proposed changes to clarify and strengthen the standards of conduct regulations in part 612, subpart A. See 79 FR 9649. The FCA received numerous letters in response to the proposed rule requesting we extend the comment period. In a letter dated May 8, 2014, the Farm Credit Council (Council), on behalf of System institution banks, associations, and service organizations, requested that we extend the comment period for another 60 days to allow more time for boards of directors to study the rule and discuss their responses. Several System associations submitted separate letters supporting the Council's request for the extension of the comment period. Given that we have already given interested parties 90 days to comment on our proposed rule, we believe an additional 30 days is sufficient for submitting comments to FCA. As a result, we are reopening the comment period and granting an additional 30 days until June 20, 2014, to allow all interested parties an opportunity to comment.

Date: May 22, 2014

Dale L. Aultman,
Secretary,
Farm Credit Administration Board.