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RE: Proposed Rule on Liquidity and Funding – RIN 3052–AC54

The Farm Credit Council (Council), on behalf of its membership, appreciates the opportunity to comment on the Farm Credit Administration's (FCA or Agency) Proposed Rule on liquidity and funding requirements for Farm Credit System (System) institutions.[1] FCA's stated purpose in proposing this rule is to strengthen liquidity risk management, enhance liquidity reserve asset quality, and bolster funding during adverse times.

We appreciate that FCA is pursuing this rulemaking in light of the general experience gained during the 2008 financial crisis that highlighted the importance of sound liquidity management. However, as FCA acknowledged, the System emerged from the financial crisis with its liquidity position intact, recognizing relatively modest investment losses considering the size of its portfolio and its risk-bearing capacity. We attribute much of the strong aggregate performance of the System's liquidity portfolio to effective risk management practices and the appropriateness of the current regulatory framework. For this reason, FCA should only make minor adjustments to existing regulatory requirements rather than comprehensive revisions.

We are proud that during the worst of the financial crisis the System maintained a strong liquidity position through effective management and regulatory oversight. The System's liquidity was supported by ongoing access to the debt markets particularly for the issuance of short-term securities such as Federal Farm Credit Banks discount notes (DNs). Throughout the financial crisis, the System maintained the liquidity needed to meet its obligations and fulfill its mission of being a dependable source of credit to American agriculture and rural communities.

Given the success of the System throughout the financial crisis and the effectiveness of current regulatory requirements, the proposed rule goes far beyond what is needed from a liquidity risk management perspective. In fact, FCA has applied concepts addressed in Basel III and Federal banking agencies' guidelines designed for financial institutions that struggled during the financial crisis and relied on government sources of liquidity.[2] While there are some useful revisions, the

[1] 76 FR 248 (December 27, 2011)
[2] Basel Committee on Banking Supervision, *Basel III: International framework for liquidity risk measurements, standards, and monitoring*, (December 2010) and 75 FR 54 (March 22, 2010)

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majority of the proposal appears problematic and burdensome since it applies concepts for the regulation of liquidity risk being developed in the broader environment without sufficient adjustment and sensitivity to the unique nature, structure, and success of the System.

The comments that follow were developed after soliciting input from System banks and the Treasurers' subcommittee of the Presidents' Planning Committee. Due to the significance of this subject, we anticipate that many of them will submit their own comments on various aspects of the proposed rule.

General Comments

The System understands and respects the importance of sound liquidity management and the need to maintain sufficient high-quality liquid investments to ensure it can meet its obligations during stressful periods. Therefore, we appreciate the spirit of FCA's efforts to enhance regulatory liquidity and funding requirements after considering the lessons learned during the financial crisis. The System completed a similar effort on its own accord to enhance the liquidity measurements, some of which were adopted in the Contractual Interbank Performance Agreement (CIPA). The revised CIPA resulted in a two-tiered approach to liquidity.[3] Beyond CIPA revisions, the effort resulted in the System banks voluntarily adopting an additional three-tiered liquidity standard implemented through individual policies and procedures.[4] On the surface, it appears the Level 1 and 2 liquidity reserve structure FCA is proposing is similar to the System's approach to liquidity measurement in the amended CIPA. However, FCA is actually proposing a complex four-tiered approach to the liquidity reserve.

FCA should simplify and improve the transparency of the proposed regulatory language and related table to clearly align with the four-tiered approach it is proposing. The first tier is 15 days coverage for maturing obligations from cash, cash due from traded but not yet settled debt, and level 1 instruments with maturity of 3 years or less. The second tier is coverage from 16 to 30 days of maturing obligations from any level 1 instruments and carryover funds or investments from Tier 1. The third tier is coverage from 31 to 90 days of maturing obligations from level 1 or level 2 instruments and carryover funds or investments from Tier 1 or Tier 2. The fourth and final tier is coverage beyond 90 days of maturing obligations from level 1, level 2, or any other eligible investment authorized by § 615.5140 or carryover funds and investments from Tier 1, Tier 2, or Tier 3.

While FCA can improve the transparency of its regulatory proposal, we find the four tier approach coupled with liquidity policy and contingency funding plan (CFP) proposals to be excessive, overly complex, and prescriptive, particularly when considering existing requirements for investment management and eligible investments. Moreover, there is a complex layering of regulatory requirements that results in undue regulatory burden. The System has weathered

[3] The CIPA tier 1 requirement is maintaining 15-days days of debt coverage from Treasury securities with maturities shorter than three years, cash balances held at Federal Reserve Banks, proceeds from traded-but-not-yet-settled debt and insured balances held in deposit accounts at FDIC-insured banks. The second tier is the overall days of liquidity minimum met by all other eligible investments as permitted by regulation.

[4] Under the voluntary liquidity standard, the tier 1 requirement is maintaining 15-days of debt coverage from Treasury securities with maturities shorter than three years, cash balances held at Federal Reserve Banks, proceeds from traded-but-not-yet-settled debt and balances held in deposit accounts at FDIC-insured banks. The tier 2 requirement is maintaining 16 to 45 days of debt coverage from tier 1 securities and 100 percent government guaranteed instruments, including structured securities. The third tier is the overall days of liquidity minimum met from tier 1, tier 2, and all other eligible investment as permitted by regulation.

the recent financial crisis in an effective and prudent manner. As a result, the proposed revisions go beyond what is necessary for the System and over regulates entities that did not contribute in any manner to the recent financial crisis.

Beyond requirement layering, the proposal creates redundancy between regulatory requirements for investment management and liquidity management. As a result, the System would be required to develop and coordinate two separate policies – one for investment management and one for liquidity. We find this redundancy unnecessary and potentially harmful given it detracts from an integrated risk management approach to investment and liquidity management. From a risk management and internal controls perspective, the System banks should be permitted flexibility to combine these policies into one integrated approach if they deem it appropriate. An integrated approach could permit greater operational efficiency and better risk oversight without creating the administrative burden of maintaining multiple policies to satisfy regulatory requirements. Therefore, FCA should not prescribe the specific content of the liquidity policy as it has done in the proposed rule. Rather, the approach should be flexible and general as taken by Federal banking agencies in their policy statement on funding and liquidity risk management.[5] Rather than publish prescriptive and detailed regulations, these regulators published a policy statement that provides guidance and general expectations for liquidity management. While the policy statement discussed the need for policies, it does not dictate the exact content as FCA has done with the proposed rule. We ask FCA to consider a more flexible approach as was implemented by the Federal banking agencies, meaning less detailed and broader regulatory requirements supported by appropriate policy guidance.

We appreciate FCA's recognition that the System is different than most commercial lenders. As FCA states, a fundamental difference is the System's reliance, as a Government Sponsored Enterprise (GSE), on debt issuance in the financial markets to fund lending and operating activities. While the financial crisis was unsettling in many respects, the System continued to enjoy relatively good access to the funding markets throughout the crisis, particularly at the short-end of the yield curve. In fact, the System benefited from the flight to quality during the crisis, a critical characteristic of highly-liquid investments discussed in the Basel III: International framework for liquidity risk, measurement, and monitoring.

During times of financial turmoil unrelated to agriculture, DNs have been a strong source of liquidity for the System. As a GSE, the System is able to issue DNs at favorable levels during such periods. The System's funding discipline maintains significant capital to issue DNs during stress periods.[6] It is important that FCA recognize the liquidity DNs provide the System during financial market downturns and avoid promulgating overly strict rules that cause System banks to hold excess levels of low-yielding liquidity investments that simply raise costs to customer-owners without providing a corresponding significant benefit.

Despite its relatively strong access to funding, we agree with FCA that the System does not have an assured "lender of last resort." Therefore, we encourage FCA to balance its safety and soundness perspective of heightened and costly regulatory liquidity requirements with efforts to develop assured access to emergency short-term liquidity through the Farm Credit System Insurance Corporation, Federal Financing Bank, or other source in the unlikely event of

[5] 75 FR 54 (March 22, 2010), pp. 13661 – 16662.

[6] The System reported DNs outstanding of $15 billion on February 22, 2012 compared to a DN issuance ceiling of $25 billion, which can be increased with the approval of FCA. The System's approach of not relying on short-term funding sources is consistent with the Basel Committees' principles for sound liquidity risk management and supervision dated September 2009.

complete, long-term financial market paralysis and illiquidity. We view FCA support as instrumental in obtaining access to a lender of last resort and we stand ready to work with FCA on such an effort.[7]

We applaud FCA's effort to create regulatory requirements that are similar to those of Federal banking agencies as appropriate. We also believe it is critical that the FCA not get ahead of these regulators' consideration and implementation of Basel III. We see FCA's proposed rule as significantly more onerous compared to the current requirements imposed on commercial banks and Farmer Mac. For Farmer Mac, FCA has proposed liquidity reserve requirements that would allow for the holding of investments as supplemental liquidity for the sole purpose of generating investment income. We see no business model difference to justify this different treatment. FCA should be consistent in its regulatory requirements for liquidity and investment management between Farmer Mac and the System. We are concerned about the more lenient liquidity and investment management regulatory requirements for Farmer Mac compared to the System and ask FCA to address this imbalance. Farmer Mac's past investment practices – aimed squarely at increasing net income – resulted in financial distress of sufficient size that the rest of the System had to inject $60 million in emergency capital. Yet, the FCA proposes to give Farmer Mac regulatory encouragement to repeat its mistake.

We are also concerned with FCA's preamble definition that "liquidity is the ability to convert assets into cash quickly and at a price that is close to their book value."[8] We cannot find a similar definition of liquidity used by Federal banking agencies or Basel III. The Basel Committee defines liquidity as "the ability of a bank to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses."[9] Banking regulators in the United States follow a similar definition.[10] For covered companies, those that are systemically important financial institutions, the Federal Reserve has proposed a prudential standard definition for liquidity as "a covered company's capacity to efficiently meet its expected and unexpected cash flows and collateral needs at a reasonable cost without adversely affecting the daily operations of the financial condition of the covered company."[11]

Considering the approach and concepts used by other regulators, FCA's definition is not practical within a business context. FCA's definition does not recognize liquid securities that could be used to meet obligations even if they generate a reasonable loss. For instance, a 5-year Treasury security booked at par would suffer a 10 percent loss in fair value for a 200 basis point increase in interest rates. While still being highly liquid in the marketplace, it appears such a security would not be considered liquid by FCA under the preamble definition even though the change in value was appropriately captured in liquidity measures and recorded in other comprehensive income for available for sale securities in accordance with Generally Accepted Accounting Principles (GAAP).[12] We see no reason why such a security should not qualify as a liquidity asset and, in fact, it appears that it does under the proposed investment management and liquidity and funding regulations. However, FCA's preamble definition of liquidity does not appear to include such a security. For this reason, we ask that FCA reduce

[7] System banks have empowered the Federal Farm Credit Banks Funding Corporation to borrow Fed Funds or issue DNs if needed in a crisis situation.
[8] 76 FR 69 (December 27, 2010) p. 80818.
[9] Basel Committee on Banking Supervision, Principles for Sound Liquidity Risk Management and Supervision (September 2008), p. 1.
[10] Office of the Comptroller of the Currency, *Comptroller's Handbook: Liquidity* (February 2001), p. 1.
[11] 77 FR 3 (January 5, 2011) p. 646.
[12] The majority of securities held in System banks' liquidity portfolios are comprised of securities that are designated as available for sale under GAAP.

the complexity of its proposed regulations and related guidance by implementing a workable definition of liquidity to guide its policy efforts in an appropriate, consistent, and realistic manner.

Section by Section Comments

FCA is proposing a comprehensive re-write of existing regulatory liquidity reserve requirements at § 615.5134. The proposed revisions include requirements for board responsibilities, policy content, liquidity reserves, unencumbered definition, marketable definition, composition of liquidity reserve, supplemental liquidity buffer, investment discounts, CFP, and reservation of authorities. In its entirety, the proposed revision is a significant increase of regulatory liquidity requirements, burden, and costs to System institutions. We provide the following specific comments on each regulatory section of the proposed rule.

§ 615.5134(a) Liquidity Policy

FCA is proposing that boards of directors (boards) adopt a liquidity policy that the preamble states can be incorporated into existing investment management policies or maintained as a standalone document. While we appreciate this flexibility, the proposed rule still results in the development and maintenance of two separate policies which are currently addressed in an effective manner in one investment management policy. Therefore, FCA should drop the requirement for a separate liquidity policy given it is already effectively incorporated in Farm Credit banks' investment policies. Rather than prescribing a new liquidity policy, FCA should rely on existing regulatory requirements and provide regulatory flexibility. We note that the guidance and proposed requirements issued by the Federal banking agencies take the approach of setting broad expectations for liquidity risk oversight by boards and relevant committees rather than prescribing the establishment of a liquidity policy with specific content.[13]

§ 615.5134(a)(1) Board Responsibility

The proposed rule requires the board to "affirmatively validate the sufficiency of its liquidity policies" at least annually. We are uncertain as to the meaning of "affirmatively validate" as opposed to simply "validate." The inclusion of the word "affirmatively" creates unnecessary regulatory uncertainty. It is a vague requirement that is subject to varying interpretation over time. FCA should drop the term "affirmatively." FCA has also gone beyond the approach taken by Federal banking agencies which do not impose such a requirement on their regulated institutions.

Like the Federal banking agencies, we encourage FCA to recognize the different roles of the board and senior management in the development and approval of policies, strategies, and procedures. It appears that FCA is requiring boards to develop and adopt liquidity strategies and policies rather than clearly articulate a liquidity risk tolerance that is appropriate for an institution's business strategy. Moreover, FCA does not appear to acknowledge that it is senior management's responsibility to develop strategy, policies and procedures to manage liquidity. While the board should review and approve the broad strategies and policies, it would be inconsistent with best governance practices for boards to develop these strategies and policies.

Basel III and Federal banking agencies appropriately recognize the critical difference in responsibilities between boards and senior management. Their interagency policy statement clearly states that the board "should oversee the establishment and approval of liquidity strategies, policies, and procedures" whereas FCA states in the preamble that the "board must establish appropriate strategies, policies, procedures, and limits. . ." The subtle and important difference in the language demonstrates an important variance in regulatory expectations regarding an appropriate role of the board and senior management. We ask that FCA follow an

[13] 75 FR 54 (March 22, 2010) p. 13661 and 77 FR 3 (January 5, 2012) p. 646.

approach that is consistent with best industry practices and related regulatory requirements for the roles of the board and senior management in liquidity management.

The proposed rule includes the expectation that the board is to identify an adverse scenario for establishing the "target days of liquidity" for the liquidity policy. Given FCA has already prescribed conservative liquidity requirements, the expectation that boards should identify the targeted days needed to outlast various stress events is unnecessary and burdensome. It is excessive to ask boards to identify various improbable and implausible scenarios for measuring liquidity risk and needs. Rather, it should be a task conducted by management that is reviewed by the board, which would be consistent with sound governance and best practices as applied by Federal banking agencies. This approach is broadly consistent with FCA's requirements related to stress testing.[14]

§ 615.5134(a)(2) Policy Content

The proposed section on policy content is too detailed and prescriptive. By detailing what a policy must contain, the FCA has inappropriately interfered with the discretion of the board to direct and oversee the liquidity management of its institution. FCA should generalize and simplify the proposed requirement by setting principles the board should consider when overseeing and approving liquidity policies appropriate for their institution's business operations.

The preamble of the proposed rule states a Farm Credit bank should select liquidity reserve investments by their liquidity characteristics and to match such assets closely to the bank's maturing liabilities. While we are uncertain what is meant by matching, we are concerned FCA may be implying it considers liquidity reserve investments as a source of funding, which they are not. To further illustrate this point, FCA states that "choosing investments primarily for their ability to generate revenue is fundamentally incompatible with the System's GSE status." We do not understand why FCA would want to regulate the liquidity reserve portfolio, including the supplemental reserve, at a net loss or cost to the bank's shareholders as if it were a source of funding, which is inconsistent with prudent long-run financial management. Moreover, there is nothing in the Farm Credit Act that supports the conclusion that the System's GSE status means investments must not be a source of profitability or even at a minimum cover funding costs. In fact, we note that FCA has taken the philosophical view in its proposed rule for Farmer Mac to specifically allow earnings generation to be an investment purpose, with such investments potentially included in the supplemental liquidity buffer.[15] We ask the FCA provide flexibility so that the liquidity portfolio can be managed in a manner to generate reasonable long-term returns and minimize the cost of liquidity management.

FCA should also generalize the proposed policy content given it is too prescriptive and inflexible. Overall, the seven minimum content requirements are over regulation, burdensome, and unnecessary. We will address each proposed requirement in turn.

The first proposed requirement that the policy must address the purpose and objectives of the liquidity reserve is a superfluous and self-evident matter that does not need to be regulated. The FCA states that it proposed the requirement so bank policies would distinguish the liquidity reserve from other bank operations and asset-liability management. We see no reason why a bank would confuse a liquidity reserve policy with an asset-liability management policy.

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[14] Informational Memorandum, *FCA's Stress Testing Expectations for All FCS Institutions*, dated March 4, 2010.

[15] 76 FR 223 (November 18, 2011) p. 71799.

The second proposed policy content requirement is for the board to set diversification standards for the liquidity reserve portfolio. We see this proposed requirement as redundant to the diversification requirement proposed in the investment management rule. Therefore, this proposed provision is unnecessary given it creates a complex and confusing layering of regulatory requirements in the investment area.

The third policy content requirement proposal is to establish maturity limits and credit quality standards for investments held in the liquidity reserve. We agree that liquidity policy needs to address the appropriate composition of investments that are held in the liquidity reserve. However, we see this regulatory requirement as redundant to the proposed investment management policy requirements and the significant regulatory specificity on eligible investments includible in level 1 and level 2 of the liquidity reserve. Therefore, FCA should withdraw this proposed requirement given it is effectively addressed elsewhere in the regulations.

We also appreciate FCA's preamble discussion that Nationally Recognized Statistical Rating Organizations' credit ratings may be considered when determining the credit quality of a security. FCA also asked for comment on approaches for addressing creditworthiness standards for investments. We refer FCA to our previous comments submitted as part of the investment management proposed rule and the capital advance notice of proposed rulemaking that effectively addressed this question. We believe that the creditworthiness standard should be treated in a consistent manner throughout FCA's regulatory requirements.

The fourth proposed policy content requirement is to state the liquidity risk tolerance. The "days of liquidity" target is an appropriate and logical risk tolerance measurement to include in a policy. In the preamble FCA states that it "expects each FCS bank to include a prudent amount of unfunded commitments in its calculation of the target amount of days of liquidity it will need to survive a liquidity crisis in the markets." We agree with FCA that the level of unfunded commitments included in liquidity thresholds should be determined by System institutions, including our affiliated associations, rather than by regulation. System institutions are in the best position to determine the level of unfunded commitments that are likely to be drawn under various economic scenarios.

The fifth proposed policy content requirement is the inclusion of the CFP. Read literally, the requirement seems to incorporate the entire CFP into the policy. We do not think that was FCA's intent. It would seem that the liquidity or other policy would require the development of an effective CFP consistent with regulatory requirements rather than the plan itself. We ask FCA to clarify this proposed regulatory requirement.

We have no comment on the sixth proposed policy content requirement to establish delegations of authority.

The seventh and final proposed policy content requirement pertains to reporting. While the general requirement for quarterly reporting appears prudent, it is an unworkable standard for management to immediately "report any deviation from the bank's liquidity policy, or failure to meet the board's liquidity targets." Specifically, it is unclear what FCA means by "immediately." Additionally, it is unclear what level of deviation or failure is necessary to trigger "immediate" reporting. We ask that FCA allow System institutions to define these terms as appropriate for their entities.

§ 615.5134(b) Liquidity Reserve Requirement

We support the proposed continuation of the 90-day liquidity reserve requirement, but find the regulatory text confusing with respect to the supplemental liquidity buffer. The proposed rule "emphasizes that all investments held in liquidity reserves must be marketable." However, it is unclear if the supplemental liquidity buffer must comply with the same marketable requirements as level 1 and level 2 liquidity investments. If yes, then the supplemental liquidity buffer will essentially be regulated to level 2 type investments, thereby limiting the use of other eligible investments. We ask the FCA provide flexibility so Farm Credit banks can hold any eligible investment, subject to appropriate discount, in the supplemental liquidity buffer.

The last sentence of the regulatory text appears unnecessary and inconsistent with the tiered approach to liquidity, where investments are organized from most liquid to least liquid, relatively, and applied sequentially to meet the days of liquidity standard. We ask that FCA recognize this sliding scale in the liquidity reserve requirement in either the liquidity reserve regulatory text or in regulatory text that defines marketable. The clarification is particularly important given FCA has proposed to eliminate the existing regulatory definition of marketable (see § 615.5140(c)) and the proposed new marketable definition is significantly more limiting.

The layering of investment requirements for various purposes, such as liquidity reserve, short-term cash management, and interest rate risk management, is also confusing. For example, if a Farm Credit bank determines an investment is suitable for interest rate risk management purposes, we conclude that it also can be included in the liquidity reserve, if it meets the unencumbered and marketable requirements. It is critical to recognize that investments can be held for multiple regulatory purposes under the regulations, which provides appropriate flexibility in managing liquidity reserves. Therefore, FCA should not create a structure by which an investment can only be held for one regulatory purpose.

FCA has made the investment management and liquidity management regulations for Farm Credit banks far more complex. As a result, the proposed regulation potentially increases costs beyond any benefit gained, creates opportunity for unintentional regulatory non-compliance, and provides significant room for varying interpretations.[16] We ask that FCA simplify the regulatory framework and recognize that all System investments are liquid and marketable under varying timeframes, even in stressed economic and financial market environments. Therefore, the proposed liquidity reserve requirement should be revised to include all investments that are unencumbered and available for sale at a fair value if needed to meet various obligations.

§ 615.5134(c) Unencumbered

We agree liquidity reserve investments must be free of lien and not pledged for some other purpose. However, the proposed rule would "prohibit a Farm Credit bank from using an investment in the liquidity reserve as a hedge against interest rate risk pursuant to § 615.5135 if liquidation of that particular investment would expose the bank to a material risk of loss." This prohibition by FCA seems unreasonably limiting and complex. For instance, "material risk of loss" is an ambiguous standard, given it could be defined based on the investment or resulting potential interest rate exposure. Similarly, the concept of "material risk of loss" cannot be looked at one dimensionally. In some circumstances it may be appropriate to use an investment held for hedging purposes to meet a maturing obligation to avoid an immediate and material loss. In a period of stress, an institution may be willing to sell such securities to generate liquidity. Therefore, if a security is liquid, it should be allowed to serve multiple investment purposes.

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[16] FCA's Policy Statement 59 dated July 8, 2011, on regulatory philosophy states that FCA will develop regulations based on a reasoned determination that benefits of any proposed regulation justify its cost and will focus regulatory efforts on issues that address identified risks.

We appreciate FCA may be concerned that a bank would not sell a security used as a hedge against interest rate risk since the sale would remove the hedge position. However, in practice, investments held for interest rate risk management purposes can be liquidated when needed during stressful periods in a safe and prudent manner or utilized as collateral in a secured borrowing transaction. When used as collateral, these investments can generate liquidity without loss of the hedge position. As a result, securities that are used to hedge interest rate risk are not diminished from a liquidity perspective. Moreover, FCA is inconsistent with the Federal banking agencies with respect to the treatment of investments used for hedging purposes. The Federal banking agencies only require the exclusion of investments from the liquidity reserve when they are used to hedge a "trading asset" or "group of trading assets." [17] For these reasons, we ask that FCA withdraw the proposed regulatory text prohibiting the holding of investments in the liquidity reserve that also hedge against interest rate risk. We find it to be an effective and appropriate approach for eligible investments to serve a dual purpose, particularly within the context of the supplemental liquidity buffer.

§ 615.5134(d) Marketable

The proposed rule's four criteria for an investment to be considered marketable might create an impossible and unworkably vague standard that frustrates the tiered approach to liquidity. In contrast, Basel III and the Federal banking agencies did not define the term marketable, but focused on the characteristics of high-quality liquid assets. Basel III specifically discusses eight factors that influence whether or not a market can be relied upon to raise liquidity in the context of possible stresses, thereby resulting in a principled and flexible approach to defining high-quality liquid investments. Particularly problematic is the first criterion, which states "an investment is marketable if it can be easily and immediately converted into cash with little or no loss in value." Given the lack of specificity, this criterion of marketable cannot be applied in any consistent manner and it is subject to varying interpretations over time. We ask that FCA revise the proposed regulatory text to: "Can be easily converted into cash." This revision allows liquid investments to be included in the liquidity reserve after the application of appropriate discounts. We see this approach as more logical and workable as well as being consistent with FCA safety and soundness objectives.

The preamble of the proposed rule states that criterion three "effectively excludes structured investments from the liquidity reserves at Farm Credit banks, although banks may hold such assets in their supplemental liquidity buffers if they are eligible investments under § 615.5140."[18] We ask that FCA clarify whether or not it meant to include U.S. government agency (Agency) collateralized mortgage obligations (CMOs) in this exclusion. We believe that the exclusion of such CMOs would be inconsistent with the objectives of the liquidity reserve requirement given they are considered high-quality liquid investments within the context of Basel III and Federal banking agencies proposed rules.[19]

Criterion four is the final problematic aspect of the proposed definition of marketable. This criterion states "an investment is marketable if it…is listed on a developed and recognized exchange market…" The preamble references that "listing on a public exchange enhances the transparency…," which is true for stocks. However, bonds do not trade on "public exchanges." Even Treasury bills, the most liquid of bond instruments by most criteria, are not technically traded on an exchange. We ask that FCA conform to the approach used by Basel III, which

[17] 77 FR 3 (January 5, 2012) p. 609 and 646

[18] 76 FR 248 (December 27, 2011), p. 80823.

[19] 77 FR3 (January 5, 2012), p. 646 and Basel Committee on Banking Supervision, *Basel III: International framework for liquidity risk measurements, standards, and monitoring*, (December 2010), p. 6.

recognizes multiple characteristics for determining highly-liquid investments. Moreover the Federal banking agencies have not used the terms "developed and recognized exchange markets" and "public exchange."[20] We ask that FCA also not use these terms given they are ambiguous and subject to inconsistent application. For instance, we are uncertain what FCA means when it uses the term "public exchanges" in the preamble of the proposed rule. We are also concerned that FCA's use of the term "public exchanges" may conflict with guidance established for the treatment of investments under FASB Fair Value Classification. Therefore, FCA should conform to the terms and approaches used by Basel III and Federal banking agencies when defining marketability for liquidity reserve purposes. FCA should also drop the marketable definition and focus the entire proposed § 615.5134(d) on high-quality liquid assets as was done by the Federal banking agencies and in Basel III.

§ 615.5134(e) Composition of Liquidity Reserve

The preamble of the proposed rule states "Each FCS bank must document and be able to demonstrate to FCA examiners how its liquidity reserve mitigates the liquidity risk posed by the bank's business mix, balance sheet structure, cash flows, and on-and-off balance sheet obligations." While Farm Credit banks currently document and demonstrate their liquidity requirements to FCA's examiners, it is unclear if FCA is signaling an increase in documentation needed and examination burden. Moreover, the specificity of the regulatory requirements tends to make the analysis focused first on demonstrating compliance. We ask that FCA examiners work closely with Farm Credit banks to understand the depth of what is currently done in liquidity management prior to implementing increased examination requirements.

The preamble also states that Farm Credit banks would draw first on the 15-day sub-level in the event of significant stress. [21] The statement is overly restrictive and not consistent with sound liquidity management practices. System institutions should have flexibility in liquidating any investment in the portfolio during periods of stress rather than set an expectation that the Treasury securities must be liquidated first. During stressful periods, a System bank may follow a strategy of utilizing less liquid instruments first and hold its most liquid securities in reserve in case the crisis worsens. Again, the preamble suggests a highly restrictive and prescriptive application of the liquidity reserve requirement that would in practice be harmful to the safety and soundness of the System. Therefore, we ask that in the final rule FCA change the phrase "would draw first" to "could draw first".

Next, the proposed rule gives classes of investment assets which System banks are authorized to hold in the first and second levels of liquidity reserves. Even though they are structured securities, we interpret that Government National Mortgage Association (Ginnie Mae) CMOs and pass-through mortgage backed securities would qualify as level 1 instruments given they fundamentally meet the marketability test. Similarly, we see Agency CMO's as includable as level 2 instruments.[22] We ask that FCA explicitly recognize that such investments are consistent with the proposed marketable definition, specifically the "ease and certainty of valuation" standard. While FCA suggests in the preamble that structured securities are effectively excluded by this standard, it goes on to say that Ginnie Mae mortgage-backed securities are not excluded and other structured investments may be held in the supplemental liquidity buffer. While confusing and somewhat contradictory, we believe FCA's preamble

[20] We could not find the term "public exchanges" used in Basel III reform documents.
[21] 76 FR 248 (December 27, 2011), p. 80822
[22] The Federal Reserve is less restrictive than FCA. The Federal Reserve has proposed to allow all unencumbered Agency guaranteed securities to count as highly liquid assets to satisfy a 30-day liquidity buffer requirement at systemically important financial institutions. See 77 FR 3 (January 5, 2012), pp. 646 and 648.

discussion to mean that all liquidity reserve investments must meet the regulatory definition of marketable and structured securities generally meet this definition. Therefore, we ask FCA to explicitly recognize that Ginnie Mae and Agency CMOs are includable as level 1 and level 2 liquidity investments respectively.

The proposed rule states "The FCA is contemplating whether to add a specific provision to the final regulation that would require the liquidity reserve to adequately cover unfunded commitments and other contingent obligations." It seems logical for FCA to wait until Federal banking agencies finalize Basel III guidance for the calculation of the liquidity coverage ratio and net sustainable funding ratio. Therefore, we ask that FCA address this matter through a separate advance notice of proposed rulemaking or the development of other policy guidance. We recommend that FCA meet with System banks to gather information on unfunded commitments. It would be imprudent and inappropriate to implement a regulatory requirement on liquidity reserves for unfunded commitments. As stated previously, we believe the inclusion of unfunded commitments and other contingent obligations is best left to the analysis and discretion of individual System banks given they are in a unique position to appropriately address this matter. We also conclude that a formulaic approach is not the appropriate method for calculating unfunded commitments.

§ 615.5134(f) Supplemental Liquidity Buffer

The proposed rule states "each FCS bank must be able to liquidate any qualified investment in its supplemental liquidity buffer within the timeframe established in the bank's liquidity policies at no less than 80 percent of its book value."[23] We find this 80 percent requirement to be unnecessary and inflexible, particularly for the supplemental liquidity buffer. Movements in interest rates alone could be sufficient to cause an investment's market value to drop below the 80 percent trigger. However, the investment may still be marketable at its fair value, which would already be recognized in other comprehensive income for available for sale securities. For instance, a 10 year Treasury bond could easily sustain a 25 percent drop in value due to the movement in interest rates but still be highly-liquid. Moreover, the proposed requirement is inconsistent and more restrictive than the approaches proposed by the Federal banking agencies and Basel III. It also creates regulatory burden by layering on already detailed investment eligibility and other requirements. For all these reasons, we conclude the requirement is inappropriate, unduly restrictive, and not based on sound analysis. Rather, the proposal is an arbitrary standard based on an unsubstantiated view that a 20 percent decline in value calls into question the marketability of all securities. In fact, there is clear evidence that many securities remain marketable even when their value declines significantly. FCA should eliminate this proposed revision in its entirety.

§ 615.5134(g) Discounts

We have no comment on the specific proposed discounts. However, a table which "outlines the discounts for the classes of assets that FCS banks hold in their liquidity reserves and supplemental liquidity buffers" would be a superior and cleaner approach than the wording of the proposed regulation text. We ask that FCA consider including a table in the regulation text prior to the final rule, which is consistent with the approach it used in the preamble.[24]

§ 615.5134(h) Contingency Funding Plan

While overall the proposed CFP is consistent with similar requirements imposed by the Federal banking agencies, we find the proposed regulatory text too detailed. The detail contained in the regulation would be more appropriate in a different policy context, such as a policy statement.

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[23] 76 FR 248 (December 27, 2011), p. 80828.
[24] 76 FR 248 (December 27, 2011), p. 80825.

The preamble explaining the proposed requirement is replete with numerous undefined terms including: *acute stress scenario; likely stress scenario; potential, but acute liquidity stress event; plausible scenario*. It is inherently problematic to define these terms. Rather than create a series of undefined terms, the proposal should be simplified to require that Farm Credit banks develop a CFP appropriate for their institution. We ask that FCA generalize this requirement so the implementation and development of a CFP can be flexible through time. A more generalized approach would be consistent with the approach taken by the Federal banking agencies.[25]

The preamble of the proposed rule states that "each FCS bank must realistically assess and analyze its cash inflows, cash outflows, and its access to funding at different phases of a potential, but acute liquidity stress event that continues for 30 days." It remains unclear, however, how this assessment and analysis differs from the quarterly stress test required by the investment management regulation. We ask that FCA clarify this in the final rule. We also ask that FCA lessen the requirements around these stress tests. It would be more effective for safety and soundness if managers spent their limited time on monitoring the markets rather than performing numerous stress tests of implausible and improbable events. While some level of liquidity stress testing for such events is appropriate, the proposed rule appears to impose a burdensome requirement without corresponding benefits to liquidity management, particularly given the prescribed nature of the liquidity reserve requirement.

§ 615.5134(i) Reservation of Authority

The preamble of the proposed rule states, "We also ask whether you think that there are other actions that the FCA could or should take during a significant stress event so it can act rapidly and decisively to staunch or prevent deterioration in the liquidity position of FCS banks on an individual or collective basis." We find this question confusing. It is during a stress event that the Farm Credit banks need to use liquidity reserves, as opposed to creating liquidity. Therefore, we read the question as asking about actions FCA can take prior to a significant stress event. Beyond what we have already addressed in this letter, we see no need for any further action by FCA to bolster the liquidity reserve requirement.

We strenuously object to the FCA's proposed reservation of authority provisions. As proposed, FCA is seeking authority to make material changes in regulatory requirements without following the Administrative Procedures Act (APA) and providing the public appropriate input to regulatory changes. FCA should withdraw this provision in its entirety. Currently, FCA has broad safety and soundness authorities to address liquidity risk management issues at individual System banks and Farmer Mac. In light of these authorities and the requirements of the APA, the proposed reservation of authority provision is inappropriate. We believe that FCA should revise the provision to allow it to relax the liquidity requirements in periods of financial market stress. This would be an appropriate authority reservation to allow Farm Credit banks to use liquidity during such periods without causing a regulatory violation.

Conclusion

While FCA's efforts are laudable and addresses an important topic, the proposed rule is too prescriptive and detailed. FCA should follow a principled approach to rulemaking rather than a directive approach. In that regard, FCA should substantially rework the proposed rule to eliminate prescriptive provisions, such as the liquidity policy, supplemental liquidity buffer,

[25] 77 FR 3 (January 5, 2012), p. 648 and 75 FR 54 (March 22, 2010), p. 13664.

marketable definition, and CFP. Therefore, we request that FCA revise this proposed rule in a manner consistent with the comments we have provided.

Again, we appreciate the opportunity to comment on this rulemaking. Please do not hesitate to contact us if you have any questions regarding our comments.

Sincerely,

Charles Dana

Charles Dana
Sr. V.P., General Counsel