FCS Financial

**Central Office**

1934 East Miller Street
Jefferson City, MO 65101

573-636-7809 • Fax 573-635-4367
1-800-369-3276

www.myfcsfinancial.com

November 7, 2011

Gary K. Van Meter, Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Dear Mr. Van Meter:

Subject: Proposed Rule: 12 CFR Part 615, RIN 3052–AC50 Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Investment Management

FCS Financial would like to submit the following comments in response to the Proposed Rules as requested in the referenced Federal Register.

1. **Federal Register Statement**
   Accordingly, we propose to add paragraph (b) to § 615.5142. Paragraph (b) would require that before an association purchases an eligible investment for the purpose of managing surplus short-term funds, it must ensure that the investment's repricing and maturity characteristics match the characteristics of the surplus short-term funds to be invested.

   **Response**
   We support adding the paragraph as described but believe that there may be slight mismatches in terms of repricing dates and maturity dates that can be managed successfully within an association's asset liability policies.

2. **Federal Register Statement**
   In addition, although we do not propose this as a requirement at this time, we believe that in order for an investment to be made for the purpose of managing surplus "short-term" funds, the funds generally should be invested in instruments that are "overnight" or that have maturities of 30 days or less. We seek comment on whether we should define surplus short-term funds and if so how. Further, is our belief that surplus short-term funds should only be invested in overnight investments or in investments with maturities of 30 days or less appropriate?

   **Response**
   We do not support a narrowing of the definition of "short term" funds especially if it hinders associations from using current authorities to serve our mission to serve the agricultural and rural marketplace. Associations have used current authorities to purchase guaranteed investments creating liquidity for commercial banks to serve agriculture and rural communities, to purchase guaranteed annuities (e.g., tobacco buyout to allow farmers to more quickly transition their operations to other farming purposes) and build significant regulatory capital benefitting current and future members. Further, the association investment portfolio does represent additional liquidity as they may be sold in an active secondary market. These investment opportunities are not overnight or 30 days in length. The "short term" description may better describe Farm Credit Bank investment portfolios and perhaps such clarification may be appropriate. If "short term surplus funds must be further defined for associations, we would suggest wording such as "the unused borrowing base capacity as defined by the funding bank in the General Financing Agreement (GFA)."

If there are specific instruments FCA believes should be excluded from association use, it may be useful for regulations to provide more specific guidance. We believe associations need the ability to invest in USDA, FSA, SBA, and other fully guaranteed loans, pools and other structures. This is consistent with informational memorandum issued June 30, 2011 from Gary Van Meter, USDA Guaranteed Investments, the December 9, 2010 Bookletter 064 and an informational memorandum dated October 17, 2006 from Andrew Jacob authorizing zero percent capital risk weight of guaranteed portion of loans purchased in the secondary market.

3. **Federal Register Statement**
   Lastly, is our proposed limitation on the permissible characteristics of investments purchased for the purpose of managing surplus short-term funds appropriate for associations, or does it unreasonably restrict an association's ability to properly hold and manage investments?

   **Response**
   We believe that if surplus short-term funds" is defined improperly, associations would be unreasonably restricted from holding and managing investments. As referenced above, restrictions may be desirable as they describe Farm Credit Bank investment portfolios but we urge consideration of how associations use investments to benefit their members and the System.

Questions regarding this response may be directed to Steve Harrington, Executive Vice President, Financial Services, and CFO.

Sincerely yours,

Daryl Oldvader
President and CEO

Enclosure

**Federal Register** / Vol. 76, No. 160 / Thursday, August 18, 2011 / Proposed Rules

Excerpt from *H. Section 615.5142—Association Investments*

Section 615.5142 also permits associations to invest surplus short-term funds. We are concerned that an association could draw on its line of credit with its funding bank to obtain "surplus" short-term funds that it would invest in an investment with a longer term or repricing characteristics than the term and repricing characteristics of the funding. Funding a longer term investment with shortterm funds creates the potential for interest rate risk. Because of this potential risk, associations must carefully manage their investments of surplus short-term funds.

Accordingly, we propose to add paragraph (b) to § 615.5142. Paragraph (b) would require that before an association purchases an eligible investment for the purpose of managing surplus short-term funds, it must ensure that the investment's repricing and maturity characteristics match the characteristics of the surplus short-term funds to be invested.

In addition, although we do not propose this as a requirement at this time, we believe that in order for an investment to be made for the purpose of managing surplus "short-term" funds, the funds generally should be invested in instruments that are "overnight" or that have maturities of 30 days or less. We seek comment on whether we should define surplus short-term funds and if so how. Further, is our belief that surplus short-term funds should only be invested in overnight investments or in investments with maturities of 30 days or less appropriate? Lastly, is our proposed limitation on the permissible characteristics of investments purchased for the purpose of managing surplus short-term funds appropriate for associations, or does it unreasonably restrict an association's ability to properly hold and manage investments?

**Type: FCA Regulation**
**PART 615 - FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS**
**Subpart E - Investment Management**

**§ 615.5142 Association investments.**
An association may 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. Each bank must review annually the investment portfolio of every association that it funds.
[64 FR 28899, May 28, 1999]

**Type: FCA Regulation**
**PART 615 - FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS**
**Subpart E - Investment Management**

**§ 615.5140 Eligible investments.**
**(a)** You may hold only the following types of investments listed in the Investment Eligibility Criteria Table. These investments must be denominated in United States dollars.

**Investment Eligibility Criteria Table**

| Asset Class | Final Maturity Limit | NRSRO Credit Rating | Other Requirements | Investment Portfolio Limit |
|---|---|---|---|---|
| **(1) Obligations of the United States** Treasuries Agency securities (except mortgage securities) Other obligations fully insured or guaranteed by the United States, its agencies, instrumentalities and corporations | None | NA | None | None |

| Asset Class | Final Maturity Limit | NRSRO Credit Rating | Other Requirements | Investment Portfolio Limit |
|---|---|---|---|---|
| **(2) Municipal Securities** | | | | |
| · General obligations | 10 years | One of the highest two | None | None |
| · Revenue bonds | 5 years | Highest | At the time of purchase, you must document that the issue is actively traded in an established secondary market | 15% |
| **(3) International and Multilateral Development Bank Obligations** | None | None | The United States must be a voting shareholder | None |
| **(4) Money Market Instruments** | | | | |
| · Federal funds | 1 day or continuously callable up to 100 days | One of the two highest short-term | None | None |
| · Negotiable certificates of deposit | 1 year | | None | None |
| ·Bankers acceptances | None | | Issued by a depository institution | None |
| · Commercial paper | 270 days | Highest short-term | | None |
| · Non-callable Term Federal funds and Eurodollar time deposits | 100 days | | None | 20% |
| · Master notes | 270 days | | | 20% |
| · Repurchase agreements collateralized by eligible investments or marketable securities rated in the highest credit rating category by an NRSRO | 100 days | NA | If counterparty defaults, you must divest non-eligible securities under § 615.5143 | None |
| **(5) Mortgage Securities** | | | | |
| · Issued or guaranteed by the United States | None | NA | Stress testing under § 615.5141 | None |
| · Fannie Mae or Freddie Mac mortgage securities | None | NA | Stress testing under § 615.5141 | 50% |
| · Non-Agency securities that comply 15 U.S.C. 77d(5) or 15 U.S.C. 78c(a)(41) | None | Highest | Stress testing under § 615.5141 | 15% |

| Asset Class | Final Maturity Limit | NRSRO Credit Rating | Other Requirements | Investment Portfolio Limit |
|---|---|---|---|---|
| · Commercial mortgage-backed securities | None | Highest | Security must be backed by a minimum of 100 loans. Loans from a single mortgagor cannot exceed 5% of the pool Pool must be geographically diversified pursuant to the board's policy Stress testing under § 615.5141 | |
| **(6) Asset-Backed Securities** secured by: Credit card receivables Automobile loans Home equity loans Wholesale automobile dealer loans Student loans Equipment loans Manufactured housing loans | None | Highest | 5-year WAL for fixed rate or floating rate ABS at their contractual interest rate caps 7-year WAL for floating rate ABS that remain below their contractual interest rate cap | 20% |
| **(7) Corporate Debt Securities** | 5 years | One of the two highest | Cannot be convertible to equity securities | 20% |
| **(8) Diversified Investment Funds** Shares of an investment company registered under section 8 of the Investment Company Act of 1940 | NA | NA | The portfolio of the investment company must consist solely of eligible investments authorized by §§ 615.5140 and 615.5174. The investment company's risk and return objectives and use of derivatives must be consistent with FCA guidance and your investment policies. | None, if your shares in each investment company comprise 10% or less of your portfolio. Otherwise counts toward limit for each type of investment. |

**b)** *Rating of foreign countries*. Whenever the obligor or issuer of an eligible investment is located outside the United States, the host country must maintain the highest sovereign rating for political and economic stability by an NRSRO.

**(c)** *Marketable securities*. All eligible investments, except money market instruments, must be marketable. An eligible investment is marketable if you can sell it quickly at a price that closely reflects its fair value in an active and universally recognized secondary market.

**(d)** *Obligor limits*.

**(1)** You may not invest more than 20 percent of your 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.

**(2)** *Obligor limits for your holdings in an investment company*. You must count securities that you hold through an investment company towards the obligor limit of this section unless the investment company's holdings of the security of any one issuer do not exceed five (5) percent of the investment company's total portfolio.

**(e)** *Other investments approved by the FCA*. You may purchase and hold other investments that we approve. Your request for our approval must explain the risk characteristics of the investment and your purpose and objectives for making the investment.

[64 FR 28896, May 28, 1999]

**Type: FCA Regulation**
**PART 615 - FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS**
**Subpart E - Investment Management**

**§ 615.5141 Stress tests for mortgage securities.**
Mortgage securities are not eligible investments unless they pass a stress test. You must perform stress tests to determine how interest rate changes will affect the cashflow and price of each mortgage security that you purchase and hold, except for adjustable rate securities that reprice at intervals of 12 months or less and are tied to an index. You must also use stress tests to gauge how interest rate fluctuations on mortgage securities affect your institution's capital and earnings. You may conduct the stress tests as described in either paragraph (a) or (b) of this section.
**(a)** Mortgage securities must comply with the following three tests at the time of purchase and each following quarter:
**(1)** *Average Life Test.* The expected WAL of the instrument does not exceed 5 years.
**(2)** *Average Life Sensitivity Test.* The expected WAL does not extend for more than 2 years, assuming an immediate and sustained parallel shift in the yield curve of plus 300 basis points, nor shorten for more than 3 years, assuming an immediate and sustained parallel shift in the yield curve of minus 300 basis points.
**(3)** *Price Sensitivity Test.* The estimated change in price is not more than thirteen (13) percent due to an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.
**(4)** *Exemption.* A floating rate mortgage security is subject only to the price sensitivity test in paragraph (a)(3) of this section if at the time of purchase and each quarter thereafter it bears a rate of interest that is below its contractual cap.
**(b)** You may use an alternative stress test to evaluate the price sensitivity of your mortgage securities. An alternative stress test must be able to measure the price sensitivity of mortgage instruments over different interest rate/yield curve scenarios. The methodology that you use to analyze mortgage securities must be appropriate for the complexity of the instrument's structure and cashflows. Prior to purchase and each quarter thereafter, you must use the stress test to determine that the risk in the mortgage security is within the risk limits of your board's investment policies. The stress test must enable you to determine at the time of purchase and each subsequent quarter that the mortgage security does not expose your capital or earnings to excessive risks.
**(c)** You must rely on verifiable information to support all your assumptions, including prepayment and interest rate volatility assumptions, when you apply the stress tests in either paragraph (a) or (b) of this section. You must document the basis for all assumptions that you use to evaluate the security and its underlying mortgages. You must also document all subsequent changes in your assumptions. If at any time after purchase, a mortgage security no longer complies with requirements in this section, you must divest it in accordance with § 615.5143.

[64 FR 28899, May 28, 1999]