5500 South Quebec Street
Greenwood Village, CO 80111
Phone: 303 740-4000
Fax: 303 740-40
www.cobank.com

November 16, 2011

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

Subject: Proposed Rule – Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Investment Management – 76 FR 51290

Dear Mr. Van Meter:

CoBank appreciates the opportunity to comment on the Farm Credit Administration's (FCA) proposed rule on investment management. We generally support FCA's efforts to enhance its regulations. Overall, the proposed rule makes several improvements to current regulatory requirements. There are, however, sections that are too prescriptive and burdensome without providing improvement to current investment management practices. These sections are discussed in CoBank's and the Farm Credit System's (System) comment letter.

We endorse all aspects of the System's comment letter submitted by the Farm Credit Council. The System's comment letter reflects CoBank's perspective on the proposed rule. In addition, we are providing supplemental comments in support of the System's letter in the following paragraphs.

FCA should revise proposed section 615.5132 that excludes investments posted to meet collateral requirements for derivative transactions when calculating the 35 percent portfolio limit. The regulation should also exclude investments returned as a result of changes in counterparty exposures because of interest rate movements or other factors. FCA should recognize the variability in collateral posting. At times CoBank posts a large amount of investment securities just to have this collateral returned as rates move in the marketplace. Under the proposed rule, CoBank would need to plan for that eventuality by maintaining a cushion, effectively reducing flexibility for increasing the days of liquidity if needed. Therefore, the proposed exclusion does not fully enhance flexibility for managing the bank's liquidity position and derivative counterparty exposures. Flexibility is important for effective risk management during periods of financial market volatility and instability. In the past, CoBank has found it prudent to increase its liquidity position as a safeguard against financial market uncertainties. We ask that FCA fully exclude investments used for collateral posting purposes given it enhances flexibility for managing market and derivative risks, and liquidity and emerging regulatory requirements.[1]

We find proposed section 615.5133(c)(1)(ii) as unnecessary. The proposal would require the annual Board review of existing securities firm relationships and conclude whether or not to continue those relationships. We see no practical value in requiring this review, particularly given that the Board must review and approve the criteria for selecting securities firms. We find this proposed requirement as burdensome and unduly limiting Board discretion in carrying out its oversight responsibilities.

[1] FCA recently adopted a proposed rule revising regulatory requirements for liquidity and funding.

Proposed section 615.5133(e)(4) is overly prescriptive in requiring annual internal audit reviews of investment processes. A broadly accepted standard practice is for the audit committee and internal audit to determine the level of necessary review by conducting institution-specific, risk-based assessments. This allows internal audit to focus its review activities to effectively control risk. Prescribing annual reviews creates the potential for excessive and wasteful audit activities when an institution has minimal investment risk or highly effective investment management processes. We ask that FCA remove the annual review requirement and allow the audit committee and internal audit to function in accordance with accepted practice.

We find the continuation of the existing 50 percent investment portfolio limit for Fannie Mae and Freddie Mac mortgage backed securities (MBS) as restrictive. These securities are safe and liquid investments that also provide a positive return which is important considering the significant regulatory limits on other asset classes. We ask that FCA remove or raise the 50 percent investment portfolio limit for Fannie Mae and Freddie Mac MBS investments.[2]

The proposed definition of "senior-most" position found in section 615.5140(a)(6) appears problematic. FCA seems to indicate that senior-most means the tranche that has first claim to any cash flows in a securitization. This definition would effectively prohibit investments in high quality senior positions that have anticipated cash flows (e.g., Planned Amortization Class securities). We have successfully and safely invested in such securities for numerous years and they have been an important source of investment return. We ask that FCA define "senior-most" consistent with marketplace convention which focuses on liquidation and loss position.

It is unnecessary to reduce the non-agency MBS investment portfolio limit to 10 percent and asset-backed securities (ABS) limit to 15 percent. The current limit has not resulted in undue risk within the investment portfolio even during the worst of the recent financial crisis. In our view, maintaining the current limits is essential to the overall effective management of the investment portfolio through time. Therefore, we ask the FCA maintain the existing regulatory portfolio limits of 15 percent for non-agency MBS and 20 percent for ABS with up to 10 percent in a single ABS collateral type.

CoBank appreciates the opportunity to comment on the proposed investment management rule. We ask that FCA consider our comments as it works to develop a final rule that is free of over regulation. The System weathered the recent financial crisis relatively well under the current investment regulations, and undue tightening of the regulation is unnecessary.

Sincerely,

Robert B. Engel

Robert B. Engel
President and Chief Executive Officer

---

[2] The ultimate resolution of the Fannie Mae and Freddie Mac conservatorships may positively or negatively affect the traditional liquidity and safety of their MBS securities. Upon final resolution, we understand FCA may want to change the portfolio limits for this asset class. In the interim, however, FCA should increase the limit given these MBS securities are highly liquid and essentially free of credit risk given the government support to Freddie Mac and Fannie Mae.