August 15, 2011

Ms. Laurie A. Rea
Director
Office of Secondary Market Oversight
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Subject: Advance Notice of Proposed Rulemaking – Farmer Mac Risk-Based Capital Stress Test – 76 FR 35138

Dear Ms. Rea:

The Farm Credit Council (Council) appreciates the opportunity to comment on the Farm Credit Administration's (FCA or Agency) Advance Notice of Proposed Rulemaking (ANPRM) regarding Federal Agricultural Mortgage Corporation's (Farmer Mac or FAMC) Risk-Based Capital Stress Test (RBCST) published in the June 16, 2011 Federal Register.

The Council, at the direction of our board, developed this comment letter to express our views on the ongoing capital standards applicable to Farmer Mac. As you know, the Farm Credit System's Presidents Planning Committee has established a Capital Workgroup consisting of financial officers from throughout the System. Our comments are based, in part, on input received from the Workgroup, as well as various Farm Credit System (FCS or System) institutions.

General Comments

While the ANPRM focuses on capital planning and eliminating the reliance on ratings from Nationally Recognized Statistical Rating Organizations (NRSRO) in the RBCST, we want to address the broader issue of Farmer Mac's capital standards. In our view, the Farm Credit Administration must address a systemic weakness in the capitalization of Farmer Mac. This weakness stems from Farmer Mac's capital standards being inconsistent with those applicable to other regulated financial institutions, including the System. As a result, Farmer Mac is consistently able to undercapitalize on- and off-balance sheet assets at a fraction of the capital that other lenders must hold. This creates the opportunity for systemic risk within the agricultural markets. Institutions seek capital arbitrage opportunities with Farmer Mac, and Farmer Mac chronically undercapitalizes risk relative to other regulated credit providers. To the extent FCA does not already possess the necessary statutory authority to allow it, as Farmer Mac's safety and soundness regulator, to set capital standards for Farmer Mac that are consistent with those applicable to other regulated financial institutions, it should immediately seek the necessary changes in the Farm Credit Act (Act) to ensure sufficient flexibility is in place. While FCA may have the authority under Section 8.11(a) of the Act, which does provide FCA authority to regulate Farmer Mac notwithstanding any other provision of the Act, we do not believe there is justification for FCA to accept more limited capital regulatory authority over Farmer Mac than over System institutions.

We believe that flexibly using existing authority or obtaining such authority would permit FCA to discontinue a statutory capitalization approach that is essentially identical to the requirements that had been in place for the housing Government Sponsored Enterprises (GSEs) – the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The lack of capital building at the housing GSEs relative to increasing on-balance sheet risk exposures was a key factor leading to their conservatorship during the recent financial crisis. With Farmer Mac apparently on a similar path of increasing on-balance sheet risk exposures given the 2008 expansion in its authorities and plans to pursue legislation for further expansion, this needs to be addressed. It is critically important that Farmer Mac be subject to strong safety and soundness regulation and oversight to ensure risks are fully identified, controlled, and capitalized. In our view, the FCA should establish Farmer Mac capital standards based on the BASEL III framework that is applicable to other regulated financial institutions.[1] Under this approach, as FCA works to remove the reliance on NRSRO ratings in the RBCST, it should also establish capital charges that reflect the creditworthiness as considered under a BASEL styled framework.

In applying this approach, the fundamental principle that FCA should employ is to ensure that like risks are capitalized in a like manner regardless of entity. The BASEL framework also provides clear qualitative and quantitative standards for evaluating and appropriately capitalizing various risks. Among the most important of which are the quality of capital requirements, which should be applicable to all regulated lenders, including those in the secondary market, that provide credit to agricultural and rural America. Otherwise, undercapitalized lenders could create significant disruptions, potentially systemic, in the rural credit markets. FCA should not base capital standards based on the assumption that Farmer Mac assets are liquid or will be securitized and sold. This has not been their operating model to date.

This response is intended to address ANPRM questions 1 through 11. In general, our response is that FCA should revise the RBCST to implement capital standards comparable to the capital requirements applicable to other regulated lenders.

Farmer Mac's Business Model

The recent financial crisis demonstrates the weakness of the hybrid GSE ownership model for Farmer Mac of publicly traded stock balanced against the need to accomplish a congressionally established mission. This model proved troublesome for Freddie Mac and Fannie Mae where incentives for board and management to focus on short term returns on investment rather than long term mission fulfillment did not end well. Farmer Mac has not been able to create an active securitization market for qualified agricultural

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[1] See Basel Committee, *Basel III: A global regulatory framework for more resilient banks and banking sy*stems (December 2010) at www.bis.org/publ/bcbs189.htm.

and rural utility loans. Farmer Mac appears to be following a strategy of retaining program business on its balance sheet in order to generate growth and returns with extraordinarily low capital requirements. FCA should review this situation closely focusing first on its responsibility as a safety and soundness regulator and noting whether appropriate incentives are in place to ensure that mission fulfillment and achieving financial strength are the areas of prime focus for Farmer Mac as opposed to managing the value of its publicly traded stock.

Capital Planning

We note the questions raised by FCA regarding the need for Farmer Mac to address diversity and inclusion in business planning. While we agree that Farmer Mac should be required to have marketing and human capital plans that address diversity and inclusion, we think the regulatory requirements should be simple and flexible. We refer FCA to our comment letter dated July 25, 2011, on its proposed rule for business planning for System institutions. As a general principle, Farmer Mac should be subject to the same regulatory and supervisory requirements for business planning that is applicable to System institutions.

Beyond diversity and inclusion in business planning, capital planning is a critical safe and sound business practice. While existing regulatory requirements for Farmer Mac capital planning exist, they should be modified to ensure that Farmer Mac builds sufficient high quality capital consistent with the capital standards applicable to regulated financial institutions. Today, Farmer Mac has about 50 percent of its capital in non-controlling preferred stock. It is notable that this would not be available to generally absorb losses given it is over collateralized by Farmer Mac II program assets. This type of preferred stock would not receive treatment as high-quality capital under any existing capital standard applicable to other regulated lenders. Moreover, Farmer Mac is required to hold only 75 cents of capital for each $100 of off-balance sheet credit risk and only $2.75 for each $100 of on-balance sheet credit risk. Under FCA regulatory requirements, Farm Credit System lenders are required to hold higher levels of capital to cushion against the same risks that Farmer Mac is undertaking today. FCS lenders are required to hold at least $7 for each $100 of credit risk. We believe it would be prudent as part of the capital planning requirements, that FCA require Farmer Mac to calculate and disclose to its shareholders the capital it would be required to hold under a fully implemented BASEL compliant capital regime. As a minimum, Farmer Mac should be required to calculate and report Tier 1 capital, Tier 1 common equity, leverage, and liquidity measures. We see enhanced disclosure as providing critical information to shareholders and investors on the risk and capital strength of Farmer Mac.

Farmer Mac's Legislative Proposal

As the agency knows Farmer Mac is considering a legislative proposal that would significantly expand the types of loans in rural America that Farmer Mac would be able to securitize, purchase or guarantee. While we believe this change would be inappropriate and that it would not address an identified need in rural credit markets, we are fundamentally concerned that the proposal would significantly increase potential risk exposures for Farmer Mac. These exposures could become significant considering

Farmer Mac's business model and existing capital requirements. In fact, we see that the current capital and supervisory framework is simply insufficient to support an expansion in Farmer Mac's authorities. For these reasons, we are opposed to their proposed legislative expansion, particularly without any corresponding change in Farmer Mac's capital standards as we have discussed in this letter.

Alternatives To Ratings From Nationally Recognized Statistical Rating Agencies
We note that FCA, at its August 11 Board meeting issued an ANPRM on this issue with respect to Farm Credit System institutions. We will be providing additional comment on this issue in response to that ANPRM.

Conclusion
Thank you for the opportunity to comment on the Farmer Mac RBCST ANPRM. We believe that the durability of agricultural and rural credit markets is founded on consistent and appropriate capital requirements for regulated providers of loans and liquidity. A cornerstone for such a requirement is capital standards that result in the equal capitalization regardless of the type of regulated entity holding such credit risk.

Please do not hesitate to contact me if you have any questions regarding this comment letter.

Respectfully,

Charles P. Dana

Charles P. Dana
Sr., Vice President, General Counsel