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Handbook Mailing HM-11-4

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 614

RIN 3052-AC60

Loan Policies and Operations; Lending and Leasing Limits and Risk Management

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA, Agency, we, our) issues this final rule amending our regulations relating to lending and leasing limits (lending limits) and loan and lease concentration risk mitigation (risk mitigation) with a delayed effective date. The final rule lowers the limit on extensions of credit to a single borrower or lessee (collectively borrower) for each Farm Credit System (System) institution operating under title I or II of the Farm Credit Act of 1971, as amended (Act). This final rule also adds new regulations requiring all titles I, II, and III System institutions to adopt written policies to effectively identify, limit, measure and monitor their exposures to loan and lease (collectively loan) concentration risks. We expect this final rule will increase the safe and sound operation of System institutions by strengthening their risk mitigation practices and abilities to withstand volatile and negative changes in increasingly complex and integrated agricultural markets.

EFFECTIVE DATE: This regulation will be effective on July 1, 2012, provided either or both Houses of Congress are in session for at least 30 calendar days after publication of this regulation in the *Federal Register*. We will publish a notice of the effective date in the *Federal Register*.

FOR FURTHER INFORMATION CONTACT:

Paul K. Gibbs, Senior Accountant, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434;

or

Wendy R. Laguarda, Assistant General Counsel, Office of General Counsel, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this final rule are to:

- Strengthen the safety and soundness of System institutions;
- Ensure the establishment of consistent, uniform and prudent loan and lease concentration risk mitigation policies by System institutions;
- Ensure that all System lenders have robust methods to measure, limit and monitor reasonably foreseeable exposures to loan and lease concentration risks, including counterparty risks; and
- Strengthen the ability of System lenders to withstand volatile and negative changes in increasingly complex and integrated agricultural markets.

II. Background

On August 18, 2010, the FCA published a proposed rule (75 FR 50936) in the *Federal Register* to lower the lending limit on loans and leases to one borrower for all System institutions operating under title I or II of the Act from the current limit of 25 percent to a limit of no more than 15 percent of an institution's lending limit base. We further proposed that each title I, II and III System institution's board of directors adopt and ensure implementation of a written policy that would effectively measure, limit and monitor exposures to loan concentration risks.

III. Comments on the Proposed Rule and Our Responses

A. In General

The FCA received a total of six comment letters, including five from System associations and one from the System's trade association. No comment letters were received from outside of the System. In addition, FCA personnel had substantive oral communications during the comment period with the signatories of two of the comment letters regarding clarification of their written comments. These substantive discussions have been reduced to writing and placed in the public rulemaking file.

B. Specific Comments and Responses on the Proposal to Reduce the Lending Limit from 25 Percent to 15 Percent

1. Agreement with the Proposal

A few commenters agreed with the proposal to reduce the lending limit from 25 percent to 15 percent. One commenter also indicated that it does not anticipate that the lower limit will negatively affect its current lending and leasing practices.

In addition, one commenter recommended that there be consistent limits for titles I and II lenders as well as for title III lenders. This commenter explained that titles I and II lenders also provide financing for cooperatives and would be at a competitive disadvantage with CoBank, ACB (CoBank), the only title III lender in the System. While it is true that associations provide some financing directly to cooperatives, the overwhelming majority of lending to cooperatives by titles I and II lenders is made through CoBank. We fully support continuation of these risk-sharing arrangements, and believe that risk sharing among associations and their funding banks and/or CoBank will enable associations to continue to meet the credit needs of cooperatives, which choose to do business through their local association. We do not believe the 15-percent lending limit will change this business landscape, nor create a competitive disadvantage for titles I and II lenders. Further, as stated in the preamble to the proposed rule, we chose not to address the title III lending limits in this rulemaking due to the complexity of the issues and indicated that, should we decide to address title III lending limits in the future through a regulation amendment, we would do so in a separate rulemaking.

2. <u>No Need to Lower the Limit</u>

A few commenters questioned the need to lower the lending limit, stating that a lower limit was not the best solution to address unsafe lending practices. Rather than lower the limit for those institutions with a positive track record, these commenters advised the Agency to address the few problem institutions individually.

We believe that lowering the lending limit is an effective way to ensure that System institutions' lending practices do not result in unsafe concentrations of risk. Moreover, as stated in the proposed rule, the significant growth in System capital since the lending limit was last set in the early 1990s provides the System with significant lending capacity. Accordingly, the current 25-percent limit is no longer considered necessary or prudent.

Further, as stated in the proposed rule, a majority of titles I and II lenders already have internal lending limits that are more aligned with the 15-percent limit the Agency is now imposing. Therefore, those System institutions with a positive track record should not find compliance with the 15-percent limit onerous. The Agency also believes that imposing such limits by regulation rather than on individual institutions best meets due process principles of fairness, consistency, and transparency, as well as providing an opportunity to be heard through the public comment process.

One commenter also stated that there was no need to lower the lending limits because its funding bank already enforces a 20-percent hold limit. The fact that System banks are enforcing limits below the current 25-percent limit evidences their recognition that the current limit is too high and provides additional support for the new limit of 15 percent.

One commenter questioned the need to lower the lending limit since risk may be mitigated using Farm Service Agency guarantees, farm program subsidies and crop insurance. We note that loans or portions of loans that have a Government guarantee, as well as loans fully secured by obligations fully guaranteed by the United States Government, are exempt from the computation of loans to one borrower under § 614.4358 of the lending limit regulation. Hence, the fact that a System institution may mitigate risk using such guarantees has no bearing on loans subject to the lending limit.

3. <u>Impact on Competitiveness</u>

One commenter indicated that lowering the lending limit to 15 percent would put System institutions at a competitive disadvantage with National banks, which may loan up to 15 percent plus an additional 10 percent if the loan is fully secured by readily marketable collateral such as livestock, dairy cattle and warehouse receipts. Similarly, this commenter indicated that System institutions would be at a competitive disadvantage with State-chartered banks because such banks also have higher lending limits.

The FCA has carefully considered whether the 15-percent limit would put System lenders at a competitive disadvantage with National and State-chartered banks and have concluded it will not for all of the following reasons. First, an overwhelming majority of titles I and II lenders currently have in-house lending limits of 20, 15 and even 10 percent. The 15-percent limit, therefore, should not have a significant impact on the competitive position of the majority of System institutions with regard to National and State banks. We also note that these self-imposed limits have not resulted in a reduction in the System's market share of agricultural lending -— a market share that has, in fact, grown over the last decade or so.

Second, our review of lending limit regulations for State-chartered banks indicates that such limits vary widely. However, like National banks, in most case loans with higher lending limits made by State-chartered banks must be fully secured by readily marketable collateral.

The FCA also considered, but did not adopt exceptions to the rule based on the type and quantity of collateral supporting the loan. The concern over the time and difficulty of administering such exceptions outweighed any potential benefits that might result for System borrowers. Furthermore, the FCA does not wish to encourage System institutions to place undue reliance upon collateral as a basis for extending credit above the 15-percent limit.

The Agency also believes that comparisons with National and State-chartered banks are of limited value given that the System as a single-industry agricultural lender, a cooperative and a Government-Sponsored Enterprise with public mission responsibilities, operates very differently in many respects from other Federal or State- chartered lending institutions. Given the unique and public purpose role of the System, the Agency has an obligation to ensure its safety and soundness so that the System remains a dependable and adequate source of credit to American farmers and ranchers. We also believe the 15-percent lending limit appropriately addresses the Agency's concerns over the volatility of agricultural lending as well as single-credit and industry concentrations. For all the foregoing reasons, we believe the 15-percent limit will enhance the overall strength of each System institution, thus leveraging the System's ability to compete even more successfully with National and State-chartered banks for a share of the agricultural credit market.

Another commenter stated that the lower limits would delay the loan approval process since more than one lending institution would be involved in a loan, further reducing an institution's competitiveness in the marketplace. FCA acknowledges that a longer loan approval process may result from risk-sharing agreements (i.e., participations, capital/asset pools, guarantees, etc.). However, we also believe that the additional due diligence performed by the other lenders in these risk-sharing agreements will lead to better credit decisions and a stronger loan portfolio in each System institution –- benefits that will far outweigh any inconveniences resulting from such agreements. Further, the delayed effective date of this rule will give System institutions time to forge new relationships with other institutions so that procedures can be in place for approving such loans without significant delay.

4. <u>Impact on Future Earnings</u>

One commenter asserted that the lower lending limit would cause a substantial reduction in future earnings because larger loans represent its association's best quality, least risky and most profitable segment of its loan portfolio.

While large loans may be of sound quality and profitable, such loans have a greater impact on the viability of an institution should they deteriorate. It is the Agency's belief that a diversified loan portfolio that serves all eligible borrowers, both large and small, is one of the best ways to ensure an institution's stability.

Further, earning streams need not suffer, nor should any potential loans be forced out of the System solely on the basis of this final regulation. Each System institution should use the time provided by the delayed effective date of this rule to develop risk-sharing agreements so it can continue to meet the needs of the borrowers in its territory.

Another commenter indicated that the lower lending limit would reduce earnings because an association would be forced to sell off high quality loans, resulting in a lower return on assets and equity along with a restricted ability to build capital. This commenter also believed that the lower limit would reduce net income, negatively affecting an association's efficiency performance as reflected in its gross and net operating rates and efficiency ratio.

Although a System institution may temporarily forego some earnings as a result of reducing the size of a loan it holds, any opportunity cost should be offset by its reduced exposure to concentration risk. Such concentration risk is a greater threat to the safety and soundness of a System institution than a temporary loss of earnings. In addition, lower concentration risk levels require less capital to buffer risk that may exist in a loan portfolio, thereby lowering the capital requirements of a System lender.

Finally, we note that all existing loans are grandfathered under the transition provisions of this regulation. Therefore, unless the terms of a loan are changed, rendering it a "new loan" under the rule that would need to comply with the 15-percent lending limit, System institutions will not be forced to sell off high quality loans. Further, the delayed effective date should give System institutions enough time to forge the necessary lending relationships to offset any anticipated negative income and performance results.

5. Effect on Patronage Distributions and Customer Service

Two commenters stated that the lower limits would result in a loss of patronage paid to borrowers because System institutions would be forced to sell more participations to lenders not paying patronage. One of these commenters asserted that a loss of patronage payments by an association would cause its borrowers to spread rumors about the financial troubles of the association, resulting in a negative image for the System throughout the community. One of these commenters also stated that the lower limit would unnecessarily hurt farmers and ranchers.

While one of the effects of the final regulation is expected to be the greater use of risk-sharing agreements, the FCA expects that those System institutions paying patronage will find like partners or, alternatively, partners that will agree to patronage. System lenders can use these risk-sharing agreements to manage risk while still receiving financial consideration in the form of patronage or loan fees from a loan sale. These agreements should mitigate any temporary impact from reducing the size of loan held by a lender, as the lender can still receive income without bearing the risk of loss from holding a larger portion of the loan principal or commitment.

We also believe that such risk-sharing activities will encourage additional market discipline in System institutions by requiring them to price loans appropriately in order to find willing lending partners. We believe that the added due diligence, diversity and market discipline that lending partners bring to a System institution's loan and patronage practices will strengthen System institutions, ensure their long-term safety and soundness and benefit, rather than hurt, the System's farmer and rancher borrowers.

6. Effect of Lower Limits on Smaller System Institutions

A few commenters stated that, while lower limits may be appropriate for larger System associations, they would cause hardships on smaller associations. These commenters were concerned that the lower lending limit would make it even more challenging for small associations to meet the capital demands of those borrowers with large farming and ranching operations. One commenter suggested that the Agency should consider making exceptions to the 15-percent limit for small associations or allowing the System funding banks to make such exceptions in their general financing agreements with their district associations. Alternatively, this commenter suggested allowing the funding banks to authorize an association's use of a higher lending limit, not to exceed 25 percent, subject to other credit factors such as the association's size and capital base.

The Agency is sensitive to the fact that the lower limit may initially be more of a burden on smaller System associations. In response to this concern, we are issuing this regulation with a delayed effective date of approximately 1 year to give all titles I and II lenders more time to establish participation, syndication, capital pooling or other risk-sharing agreements so that they may continue to serve the needs of the borrowers in their territories.

However, we also note, as stated in the preamble to the proposed regulation, that the substantial growth in the capital bases of titles I and II System institutions since the current lending limit was first promulgated, has given all System lenders, including the smaller ones, much greater capacity to meet the needs of large borrowers. It is also true that smaller System institutions are often more at risk from large loans that cease to perform since their capacity to absorb such losses is often not as great as in larger-sized institutions.

The FCA considered the commenters' suggestions for exceptions to the lending limit for smaller associations and also considered the following alternatives to address the issue:

- Establishing the lending limit at the greater of 15 percent or a specific dollar amount for smaller System institutions, or
- Permanently grandfathering existing loans (even when the terms of the loan change) held by smaller institutions with a higher lending limit percentage or based on a specified dollar amount.

We ultimately rejected all of these alternatives for several reasons, not the least of which is our continued belief that the 15-percent lending limit is necessary for the long-term safety and soundness of all System institutions, including and especially the smaller institutions. We also believe that making exceptions for smaller associations, either through the funding banks or by regulation, would be difficult to effectively administer and monitor, and could end up weakening rather than strengthening the smaller institutions. Finally, with the delayed effective date providing time for System institutions to establish additional risk-sharing agreements, we believe that all System institutions, including the smaller ones, will be able to continue to meet the mission of servicing the credit needs of the creditworthy, eligible borrowers in their respective territories.

Finally, one commenter stated that lowering the lending limit for the smallest System associations is not necessary because such institutions pose no risk to the System as a whole.

As the safety and soundness regulator, it is the FCA's duty to ensure the safe and sound operation of every System institution. It would be irresponsible for the Agency to ignore or permit an unsafe lending limit based on the notion that the System as a whole could absorb the insolvency of a small institution. Further, it is important to consider the disruption caused by the failure of an institution to its farmer and rancher borrowers, to the consequences on the institution's employees or members of the community, or to the fact that the continued viability of even the smallest System association is vital to achieving the mission of the System.

This same commenter indicated that the lower limit would reduce the System's diversity in business models, presumably by forcing the smaller associations to merge with larger associations. A reduction in the diversity of System business models does not necessarily accompany the further consolidation of the System. We believe that the most successful business models adapt to changes in the operating environment, which serves to strengthen the System.

Given the concern over the impact of the 15-percent lending limit on smaller associations, the Agency especially encourages each funding bank to carefully evaluate the lending limits imposed by its general financing agreements (GFA). It may be appropriate to maintain the GFA limit at the 15-percent level for smaller associations if the bank and associations determine that the 15-percent level is needed to adequately serve the needs of the borrowers in their respective territories. This analysis should be completed with regard to each particular association's lending capacity, history, expertise, etc., and the resulting risk to the funding bank.

7. Transition Period

One commenter indicated that the transition rule contained in § 614.4361 should be lengthened to allow System institutions sufficient time to develop risk-sharing agreements to conform new loans to the 15-percent lending limits without a loss of business or customers. The FCA agrees with the need to provide more time to System institutions to develop such agreements which is why, as mentioned earlier, this final rule is being issued with a delayed effective date, giving institutions approximately 1 year to comply with the rule's requirements.

Therefore, we are deleting proposed § 614.4361(c), which in the proposed rule would have given titles I and II System institutions 6 months from the effective date to comply with the new limits and would have given titles I, II and III System institutions 6 months from the effective date to comply with the new policy requirements.

C. Specific Comments and Responses on the Proposed Loan and Lease Concentration Risk Mitigation Policies

1. Agreement with the Proposal

Two commenters agreed with the requirement to adopt risk mitigation policies and recognized the need for all financial institutions to adhere to such policies. However, one of these commenters added that such policies will not, in and of themselves, protect the System without corresponding efforts from associations to responsibly manage portfolio risk. The FCA agrees with these comments and encourages each title I, II and III System institution's board of directors to adopt robust internal controls, such as reporting requirements and other accountability safeguards, so that the board remains engaged in ensuring that those policy authorities delegated to management are effectively carried out.

2. Need for the Regulation

One commenter indicated that it did not believe that the FCA has to change its regulations to require associations to set prudent lending limits.

The FCA believes that a regulation requiring a written risk mitigation policy is necessary since our current regulations do not impose lending limits based on specified risks in an institution's loan portfolio and practices. The policy required by this final rule focuses on the mitigation of risks caused by undue industry concentrations, counterparty risks, ineffective credit administration, inadequate due diligence practices, or other shortcomings that could be present in a System institution's lending practices. The recent stresses experienced by System institutions caused by downturns in the poultry, ethanol, hog and dairy industries underscore the need for such policies in System institutions.

This commenter also indicated that the FCA has sufficient enforcement powers to ensure safe and sound loan portfolio risk mitigation by System institutions and also reminded the FCA of Congress' previous instruction to eliminate all regulations that "are unnecessary, unduly burdensome or costly."

The risk mitigation policy required by this rule is intended to strengthen a System institution's loan portfolio so that it can better withstand stresses experienced by a single borrower, industry sector or counterparty. The policy must set forth sound loan and lease concentration risk mitigation practices in order to *prevent* weak and unsound practices. In contrast, our enforcement authorities apply when a System institution (or other persons) engages, has engaged, or is about to engage in an unsafe or unsound practice in conducting the business of the institution. In addition, this commenter stated that the lower lending limits do not justify the need to regulate the specific content of an institution's lending policies, asserting that FCA's existing loan policy regulation at § 614.4150 already establishes the necessary regulatory framework for lending standards. In lieu of the regulations proposed by the FCA, this commenter suggests simply adding the phrase "effectively measure, limit and monitor exposures to concentration risk" to existing § 614.4150.

Section 614.4150 addresses requirements for prudent credit extension practices and underwriting standards for individual loans, but falls short of addressing concentration risks inherent in an institution's loan portfolio. Although some institutions have already established policies to address loan concentration risks, many have not. This final regulation is necessary to ensure that all System institutions adopt adequate risk mitigation policies. System institutions are free, however, to incorporate the requirements of this policy into their already existing lending policies.

For all the foregoing reasons, we believe that the establishment of a policy to mitigate loan concentration risks is necessary and will not be unduly burdensome or costly to System institutions.

3. Lack of Specificity in the Requirements for a Loan and Lease Concentration Risk Mitigation Policy

A few commenters thought that the risk mitigation policy was too vague, the risks mentioned would be too difficult to quantify, and the policy would not make the System safer, noting specifically that:

- The quantitative method(s) are not sufficiently defined and may unnecessarily limit the flexibility of System institutions seeking to facilitate credit opportunities for eligible and qualified System borrowers;
- Certain System institutions serve areas where particular agricultural industries dominate in their territories, resulting in unavoidable loan concentrations in their loan portfolios;
- Risks emanating from unique factors, such as dependence on off-farm income from a local manufacturing plant are difficult to effectively identify, measure, limit and monitor and are not susceptible to meaningful quantitative measures. Attempts to measure such risks could lead to arbitrary decisions that contradict the System's mission of making credit available to qualified farmers;
- The requirements of the policy could prevent System institutions from making loans to producers with a limited market for their farm products;
- The imposition of specific policy elements and quantitative methods is not appropriate for a regulation since each institution's territory, nature and scope of its activities and risk-bearing capacity is unique;
- The regulation provides no definition of the meaning of a "single-industry sector" so it is

unclear how broadly or narrowly this phrase should be defined;

- It is neither practical, necessary, or realistic to create a meaningful quantitative method around what may be a limitless set of risk factors; and finally,
- The policy would not enhance the underlying safety and soundness of the System.

The FCA recognizes that there is no ideal uniform approach to a loan and lease concentration risk mitigation policy. For this reason, the regulation intentionally outlines only minimally required elements. It is up to each institution, based on the unique risks in its territory and risk-bearing capacity, to identify and define concentration risks so that they can be effectively mitigated. For these reasons, the regulation gives institutions wide latitude to define terms, such as "industry sectors" according to their best business judgment and based on the familiarity with the types of agriculture in their territories.

For those commenters expressing apprehension about which risk factors to identify, we have added language to the rule clarifying that quantitative methods need be established only for <u>*significant*</u> concentration risks that are <u>*reasonably*</u> foreseeable. We leave it to the discretion of each institution, using their experience in providing agricultural credit and their best business judgment, to determine which credit concentration risks are significant – that is, which risks have the most potential to lead to serious loss.

The discretion the rule gives to System institutions is intended to ensure that institutions adequately control risk without limiting their ability to continue being a steady source of credit to all eligible and creditworthy borrowers in their respective territories. The policy should not result in System institutions having to make arbitrary credit decisions or turn away qualified borrowers. Rather, the policy requires institutions to mitigate rather than deny those loan concentrations presenting significant and reasonably foreseeable risks. Concentration risks caused, for example, by territories with producers/borrowers that have limited agricultural markets or few agricultural sectors may be mitigated through one or more of the following options, including hold limits, an increase in capital, loss-sharing agreements or other risk mitigation tools.

Consistent with the language in the preamble to the proposed regulations, we have deleted the reference to direct lender from the regulation text to make clear that the loan and lease concentration risk mitigation policy requirements also apply to title III System institutions.

4. <u>Period for Adopting the New Loan and Lease Concentration Risk Mitigation Policy</u>

One commenter encouraged the FCA to carefully consider the difficulty System institutions are likely to have in implementing the proposed changes. This commenter also indicated that the 6-month period for adopting the risk mitigation policy would not provide sufficient time for System boards of directors to properly evaluate and adopt policies to address those concentrations in their current portfolios that are not currently measured. As discussed in detail above, the final regulation is being issued with a delayed effective date, giving all System institutions approximately a 1-year period to adopt such policies.

IV. <u>Regulatory Flexibility Act</u>

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 <u>et</u> <u>seq</u>.), 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 Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 614

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

For the reasons stated in the preamble, part 614 of chapter VI, title 12 of the Code of Federal Regulations is amended as follows:

PART 614--LOAN POLICIES AND OPERATIONS

1. The authority citation for part 614 continues 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, 1.11, 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, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.18A, 4.19, 4.25, 4.26, 4.27, 4.28, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.8, 7.12, 7.13, 8.0, 8.5 of the Farm Credit Act (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2097, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2206a, 2207, 2211, 2212, 2213, 2214, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a-2, 2279b, 2279c-1, 2279f, 2279f-1, 2279aa, 2279aa-5); sec. 413 of Pub. L. 100-233, 101 Stat. 1568, 1639.

Subpart J--Lending and Leasing Limits

§ 614.4352 [Amended]

2. Section 614.4352 is amended by:

a. Removing the comma after the word "borrower" and removing the number "25" and adding in its place, the number "15" in paragraph (a);

b. Removing the comma after the word "Act" and removing "exceeds 25" and adding in its place "exceed 15" in paragraph (b)(1); and

c. Removing the comma after the word "Act" and removing "exceeds" and adding in its place "exceed" in paragraph (b)(2).

§ 614.4353 [Amended]

3. Section 614.4353 is amended by:

a. Adding the words "direct lender" after the word "No";

b. Removing the comma after the word "borrower"; and

c. Removing "exceeds 25" and adding in its place "exceed 15".

§ 614.4354 [Removed]

4. Section 614.4354 is removed.

§ 614.4356 [Amended]

5. Section 614.4356 is amended by removing the number "25" and adding in its place, the number "15".

6. Section 614.4362 is added to subpart J to read as follows:

§ 614.4362 Loan and lease concentration risk mitigation policy.

The board of directors of each title I, II, and III System institution must adopt and ensure implementation of a written policy to effectively measure, limit and monitor exposures to concentration risks resulting from the institution's lending and leasing activities.

(a) *Policy elements.*

The policy must include:

(1) A purpose and objective;

(2) Clearly defined and consistently used terms;

(3) Quantitative methods to measure and limit identified exposures to significant and reasonably foreseeable loan and lease concentration risks (as set forth in paragraph (b) of this section); and

(4) Internal controls that delineate authorities delegated to management, authorities retained by the board, and a process for addressing exceptions and reporting requirements.

(b) *Quantitative methods.*

(1) At a minimum, the quantitative methods included in the policy must measure and limit identified exposures to significant and reasonably foreseeable concentration risks emanating from:

(i) A single borrower;

(ii) A single-industry sector;

(iii) A single counterparty; or

(iv) Other lending activities unique to the institution because of its territory, the nature and scope of its activities and its risk-bearing capacity.

(2) In determining concentration limits, the policy must consider other risk factors that could identify significant and reasonably foreseeable loan and lease losses. Such risk factors could include borrower risk ratings, the institution's relationship with the borrower, the borrower's knowledge and experience, loan structure and purpose, type or location of collateral (including loss given default ratings), loans to emerging industries or industries outside of an institution's area of expertise, out-of-territory loans, counterparties, or weaknesses in due diligence practices.

Dated: May 19, 2011

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