

Fact Sheet

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Fact Sheet on Investment Eligibility Proposed Rule

Today the Farm Credit Administration Board adopted a proposed rule to revise the requirements governing the eligibility of investments for Farm Credit System (System) banks and associations. The proposed rule would strengthen the safety and soundness of their investment activities.

Investment products are becoming increasingly complex, and the financial crisis that began in 2007 made clear that some investments are riskier than previously believed. The revised regulation would modernize FCA's investment eligibility criteria for System banks to more accurately reflect the complexity and risk in investments.

In addition, the proposed regulation would comply with section 939A of the Dodd–Frank Wall Street Reform and Consumer Protection Act, which the president signed into law in July 2010 to strengthen regulation of the financial industry in the wake of the financial crisis. Section 939A requires each federal agency to review all of its regulations that refer to or require the use of credit ratings; to remove the reference or requirement; and to substitute other appropriate creditworthiness standards. Since FCA's existing investment eligibility regulations use credit ratings to determine eligibility of some investments, the proposed rule would substitute other standards for determining investment eligibility.

The proposed rule also addresses investment activities of System associations. Over the past two decades, System associations have restructured and, in many cases, now hold larger and more complex agricultural loans. Currently, associations are authorized to use any eligible investment, with the approval of their funding bank, to manage surplus short-term funds and reduce interest rate risk. The existing regulation also requires each System bank to review annually the investment portfolio of every association it funds.

The proposed rule would grant associations greater flexibility regarding the risk management purposes for which they may hold investments while placing new limits on the amounts and types of investments they may hold. The proposed changes would strengthen safety and soundness at associations because investments can provide associations with an additional means to mitigate the risk associated with being a single-industry lender. At the same time, the proposed limits on the amounts and types of investments are appropriate because of the nature of the risks that associations face and because of their primary mission to extend credit to agriculture and other eligible borrowers in rural areas.

The proposed rule would make the following significant changes:

Section 615.5131 Definitions: This section of the regulation would be updated to reflect other changes in the regulation.

Section 615.5133 Investment Management: This section of the regulation would include specific diversification requirements for Farm Credit banks. In particular, it would include diversification requirements for asset class and obligors. It would also establish a separate obligor limit as a percentage of total capital. In addition, it would contain other changes designed to enhance safety and soundness in investments.

Section 615.5134 Liquidity Reserve: This section would contain technical changes to reflect changes in the definitions for “U.S. government agency” and “government-sponsored enterprise (GSE)” and to clarify that mortgage-backed securities guaranteed by U.S. government agencies and GSEs satisfy the liquidity reserve requirements only if they are fully guaranteed.

Section 615.5140 Eligible Investments for Farm Credit Banks: This section of the regulation is renamed and revised to govern investment eligibility only for System banks. The revised regulation would modernize FCA’s investment eligibility criteria for Farm Credit banks to more accurately reflect the complexity and risk in investments. The revised section would also comply with section 939A of the Dodd–Frank Act by replacing credit ratings requirements with other standards of creditworthiness.

Section 615.5142 Eligible Investments for System Associations: This section of the regulation would limit the type and amount of investments that an association may hold. It would

- limit association investments to obligations that are issued or fully guaranteed or insured as to the timely payment of principal and interest by the United States or any of its agencies,
- limit the amount of an association’s investments to no more than 10 percent of its total outstanding loans,
- require associations to maintain strong investment management practices,
- strengthen the approval and supervision authorities that funding banks have over the investment activities at their affiliated associations,
- continue to allow associations to request permission from FCA to hold other investments, and
- establish transition requirements for System associations to come into compliance with the new rule.

Section 615.5143 Management of Ineligible Investments and Reservation of Authority to Require Divestiture: This section of the regulation would clarify which requirements apply to Farm Credit banks and which apply to associations.

We also would make technical corrections to other regulations in parts 611 and 615 to ensure the accuracy of regulation citations.

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