



[6705-01-P]

**FARM CREDIT ADMINISTRATION**

**12 CFR Part 615**

**RIN 3052-AD35**

**Organization; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Investment Eligibility**

**AGENCY:** Farm Credit Administration.

**ACTION:** Proposed rule.

**SUMMARY:** The Farm Credit Administration (FCA, Agency, us, our, or we) is proposing to amend its investment regulations to allow Farm Credit System (FCS or System) associations to purchase and hold the portion of certain loans that non-FCS lenders originate and sell in the secondary market, and that the United States Department of Agriculture (USDA) unconditionally guarantees or insures as to the timely payment of principal and interest.

**DATES:** Please send us your comments on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through FCA's website. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508

of the Rehabilitation Act of 1973, as amended, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at [reg-comm@fca.gov](mailto:reg-comm@fca.gov).
- FCA Web site: <http://www.fca.gov>. Click inside the "I want to..." field near the top of the page; select "comment on a pending regulation" from the dropdown menu; and click "Go." This takes you to an electronic public comment form.
- Federal eRulemaking Portal:  
<http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Barry F. Mardock, Acting Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia or on our Web site at <http://www.fca.gov>. Once you are on the Web site, click inside the "I want to..." field near the top of the page; select "find comments on a pending regulation" from the dropdown menu; and click "Go." This will take you to the

Comment Letters page where you can select the regulation for which you would like to read the public comments. We will show your comments as submitted, including any supporting data provided, but for technical reasons we may omit items such as logos and special characters.

Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

**FOR FURTHER INFORMATION CONTACT:**

David J. Lewandrowski, Senior Policy Analyst, Office of Regulatory Policy, (703) 883-4212, lewandrowskid@fca.gov;

or

Jeremy R. Edelstein, Associate Director of Finance and Capital Market Team, Office of Regulatory Policy, (703) 883-4497, edelsteinj@fca.gov;

or

Richard A. Katz, Senior Counsel, Office of General Counsel, (703) 883-4020, TTY (703) 883-4056, katzr@fca.gov.

**SUPPLEMENTARY INFORMATION:**

**I. Objectives**

The objectives of the proposed rule are to authorize FCS associations to buy as investments for risk management purposes, portions of certain loans that non-System lenders

originate, and the USDA fully guarantees as to principal and interest to:

- Augment the liquidity of rural credit markets;
- Reduce the capital burden on community banks and other non-System lenders who choose to sell their USDA guaranteed portions of loans, so they may extend additional credit in rural areas; and
- Enhance the ability of associations to manage risk.

## II. **Background**

In general, the authority for FCS association to buy and sell certain types of financial instruments, including the ones addressed in this proposed rule, is found in Sections 2.2(11) and 2.12(17) of the Farm Credit Act of 1971, as amended (Act). In 2014, FCA proposed amendments to the investment regulation for FCS associations.<sup>1</sup> The proposed rule would have authorized associations to purchase and hold, as investments, obligations issued or guaranteed by the United States or its agencies for risk management purposes. Under the proposed rule, no association could hold investments in an amount that exceeds 10 percent of its total outstanding loans.

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<sup>1</sup> See 79 FR 43301, July 25, 2014.

FCA received more than 1,250 comment letters on this proposal. After consideration of these comments, FCA changed the term "obligations" in the proposed rule to the more narrow term "securities" in the final rule. FCA also added § 615.5140(b)(2) to the final regulation to clarify that loans purchased in the secondary market that are unconditionally guaranteed or insured by the U.S. Government or its agencies as to principal and interest are not eligible risk management investment for FCS associations. Such loans meet the statutory definition of "obligations", but we did not include them as securities in the final rule.

Shortly after we approved and published the final rule, several FCS associations, community banks, and a broker-dealer expressed concern that final § 615.5140(b)(1) and (2) would disrupt the secondary market for the portions of loans that USDA fully and unconditionally guarantees as to both principal and interest. Representatives of the Office of the Administrator for the Rural Business Cooperative Service at USDA (USDA Administrator) contacted FCA to support these parties. More specifically, concerns were raised about the potential impact that the final rule could have on the secondary market for USDA-guaranteed portions of loans and, more broadly, on rural development.

The USDA Administrator, two community banks, and the broker-dealer warned that the withdrawal of FCS associations from this market could substantially reduce the liquidity in this market and the availability of credit in rural areas.

In response to the concerns raised by the USDA Administrator and market participants, FCA decided to review final § 615.5140(b)(1) and (2) and consider their impact on the secondary market for loans that the USDA fully and unconditionally guarantees as to principal and interest. As a result of this review, FCA is now initiating another rulemaking that would amend § 615.5140(b)(2) to exempt USDA-guaranteed loan portions from § 615.5140(b)(1), as well as a conforming change to § 615.5140(b)(3).

### **III. Secondary Market for USDA Guarantees of Loans**

USDA may guarantee up to 90 percent of certain loans that FCS banks and associations, commercial banks, and other lenders originate.<sup>2</sup> These lenders may either hold the guaranteed portion of such loans or sell them in the secondary market.<sup>3</sup> Data provided by USDA indicates that loan

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<sup>2</sup> USDA guarantees loans to borrowers under a variety of programs pursuant to its authorities, primarily subtitles A and B of the Consolidated Farm and Rural Development Act and title VI of the Rural Electrification Act of 1936.

<sup>3</sup> Lenders who originate loans that are eligible for USDA guarantees only obtain a conditional guarantee from the USDA. The guarantee is conditional on the lender complying with the origination and servicing regulatory requirements applicable to the loan, as well as other

originators retain approximately 60 percent of the USDA-guaranteed portions of such loans and sell the remaining 40 percent in the secondary market, usually at a premium.

There are risks to purchasers of these guaranteed portions of loans.<sup>4</sup> According to the Rural Development Agency at USDA, FCS associations buy approximately 40 percent of such USDA-loan guarantees in the secondary market.

#### **IV. Association Investment Authorities**

FCS associations derive their authority to make investments from sections 2.2(10) 2.2(11), 2.12(17), and 2.12(18) of the Act.<sup>5</sup> The statutory provisions that are most

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program requirements. Loan originators may sell the USDA-guaranteed portions of their loans, in the form of an assignment, to other persons, including individuals, corporate entities, and other financial institutions. See, 7 CFR 762.160, 1779.65, 3575.65, and 4279.75. Pursuant to these regulations, the seller must submit a form to the USDA that identifies the party that becomes the holder of record. *Id.* A purchaser who subsequently assigns the loan guarantee to another party must similarly comply with the same requirement. Only an assignee who is listed as the holder of record for the loan guarantee may seek payment from the USDA if the borrower defaults. The USDA provides an unconditional guarantee to a good-faith guarantee holder who purchased the guaranteed portion of the loan in the secondary market.

<sup>4</sup> The primary risks are premium risk and operational risk. The USDA-guaranteed portions of these loans typically command significant premiums in the secondary market. The payment of premiums demonstrates the high demand for USDA loan guarantees in the marketplace because buyers consider them as financially valuable assets. However, premiums are not covered by the USDA guarantee. The buyer may not always recover the full amount of the premium paid if the borrower defaults on the loan. Operational risk to purchasers center on proper transfer of the assignment of the guarantee so that it is recognized by USDA.

<sup>5</sup> Sections 2.2(10) and 2.12(18) of the Act authorize associations to invest their funds, as may be approved by their funding bank under FCA regulations. These two provisions also allow associations to deposit their funds and securities with their funding bank, a member bank of the Federal Reserve System or any bank insured by the Federal Deposit Insurance Corporation.

relevant to this rulemaking are sections 2.2(11) and 2.12(17), which authorize System associations to “buy and sell obligations of or insured by the United States or of any agency thereof or of any banks of the Farm Credit System.”

Pursuant to its authority under section 5.17(a)(9) of the Act,<sup>6</sup> FCA promulgated current § 615.5140(b), which allows FCS associations to buy and hold obligations issued or guaranteed by the United States subject to certain restrictions. More specifically, § 615.5140(b)(1) and (2) specify that the obligations that associations acquire must be securities, but not loans, while § 615.5140(b)(4) imposes a portfolio cap of 10 percent of outstanding loans on such investments. The intended purpose of these limits in the regulation is to ensure that the FCS continue to operate as cooperative lending institutions that are owned and controlled by the farmers, ranchers, aquatic producers and harvesters, and cooperatives that borrow from them. As discussed in the preamble to the final rule, FCA decided, in response to the comment letters, that placing limits on association investments is necessary so that loans to

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<sup>6</sup> Section 5.17(a)(9) of the Act authorizes FCA to “prescribe rules and regulations necessary or appropriate for carrying out this Act.” Additionally, the introductory text to sections 2.2 and 2.12 of the Act state that each association is subject to regulation by FCA.

eligible borrowers constitute most of the assets of each FCS association.

### **Explanation of the Proposed Rule**

As discussed above, certain external parties communicated concerns that the final rule may have had the unintended consequence of disrupting the secondary market for USDA-guaranteed portions of loans. As noted above, FCS institutions constitute approximately 40 percent of the buyers in this market even though System purchases of USDA-guaranteed loan portions total only about \$200 million per year. In this context, the total amount of loan guarantees purchased in the secondary market represents a minimal portion of System assets, and it does not fundamentally shift the System away from its core mandate of lending to its voting member-borrowers, who are agricultural and aquatic producers, their cooperatives, and rural utilities. However, from the perspective of the USDA and certain secondary market participants for these loan guarantees, the impact is significant. The final rule may have an unintended impact by causing 40 percent of the existing buyers to be excluded from the secondary market. More importantly, USDA loan guarantees contribute to the flow of adequate and affordable credit into rural areas, which is

related to the System's mission as a government-sponsored enterprise.

For these reasons, FCA is now proposing an amendment to § 615.5140(b)(2) that would authorize FCS associations to help manage risk by holding portions of loans that: (1) Lenders, which are not Farm Credit System institutions, originate and then sell in the secondary market; and (2) USDA fully and unconditionally guarantees or insures as to both principal and interest. These loan obligations are within the statutory authority of associations in sections 2.2(11) and 2.12(17) of the Act, and the authority to purchase these obligations will remain subject to the portfolio restrictions in § 615.5140(b)(4).

Under proposed § 615.5140(b)(2), FCS associations would purchase the USDA-guaranteed portions of loans that non-System lenders, most of whom are commercial banks, originate. The loan originators decide whether to retain or sell the guaranteed portions of these loans. Originators that sell USDA loan guarantees in the secondary market, whether directly or through brokers, negotiate the terms of sale, and thus have knowledge of the buyers' identities. As a result, the secondary market for USDA guaranteed loans brings together willing sellers and buyers and, therefore, the proposed regulation encourages cooperation between FCS

associations, community banks, larger banks, and other non-System lenders.

The scope of the proposed rule is limited to USDA loan guarantees, which is what USDA, community banks, the FCS, and a broker-dealer asked FCA to reconsider. For this reason, loans guaranteed by other United States government agencies are not in the scope of this rulemaking and, therefore, FCA is not addressing them in this proposed rule. However, FCA points out that the existing regulation allows FCS associations to purchase securities that are issued, insured, or guaranteed by the United States or its agencies, which includes securities issued by the Small Business Administration and the Government National Mortgage Association. Additionally, associations may buy securities issued by Farmer Mac pursuant to § 615.5174.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities. Each of the banks in the 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, System institutions are

not "small entities" as defined in the Regulatory Flexibility Act.

**List of Subjects in 12 CFR Part 615**

Accounting, Agriculture, Banks, banking, Government securities, Investments, Rural areas.

For the reasons stated in the preamble, part 615 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

**PART 615--FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS**

1. The authority citation for part 615 continues to read as follows:

**Authority:** Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.7, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b-6, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-7, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a), Pub. L. 100-233, 101 Stat. 1568, 1608; sec. 939A, Pub. L. 111-203, 124 Stat. 1326, 1887 (15 U.S.C. 78o-7 note).

2. Section 615.5140 is amended by revising paragraph (b) (2) and paragraph (b) (3) introductory text to read as follows:

§ 615.5140 Eligible investments.

\* \* \* \* \*

(b) \* \* \*

(2) Secondary market Government-guaranteed loans. In addition to investing in the securities described in paragraph (b) (1) of this section, each Farm Credit System association may also manage risk by holding those portions of loans that:

(i) Lenders, which are not Farm Credit System institutions, originate and then sell in the secondary market; and

(ii) The United States Department of Agriculture fully and unconditionally guarantees or insures as to both principal and interest.

(3) Risk management requirements. Each association that purchases investments pursuant to paragraphs (b) (1) and (2) of this section—must document how its investment activities contribute to managing risks as required by paragraph (b) (1) of this section. Such documentation must address and evidence that the association:

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Dated: August 14, 2019 Dale Aultman,

Secretary,  
Farm Credit Administration Board.

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