

FARM CREDIT ADMINISTRATION**12 CFR Parts 611 and 615**

RIN 3052-AC84

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

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA, Agency, us, our, or we) adopts a final rule that amends our regulations governing investments of both Farm Credit System (FCS or System) banks and associations. The final rule strengthens eligibility criteria for investments that FCS banks purchase and hold, and implements section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or DFA) by removing references to and requirements for credit ratings and substituting other appropriate standards of creditworthiness. The final rule revises FCA's regulatory approach to investments by FCS associations by limiting the type and amount of investments that an association may hold for risk management purposes.

DATES: This regulation shall become effective on January 1, 2019.

FOR FURTHER INFORMATION CONTACT:

David J. Lewandowski, Senior Policy Analyst, Office of Regulatory Policy, (703) 883-4414, TTY (703) 883-4212, lewandowskid@fca.gov;
J.C. Floyd, Associate Director of Finance and Capital Market Team, Office of Regulatory Policy, (703) 883-4321, TTY (703) 883-4212, floydjc@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 final rule objectives are to:

- Strengthen investment practices at Farm Credit banks¹ and associations² to enhance their safety and soundness;
- Ensure that Farm Credit banks hold sufficient high-quality liquid investments for liquidity purposes;
- Enhance the ability of the Farm Credit banks and associations to supply

¹ Section 619.9140 of FCA regulations defines "Farm Credit banks" to include Farm Credit Banks, agricultural credit banks, and banks for cooperatives.

² Section 619.9050 of FCA regulations defines the term "association" to include (individually or collectively) Federal land bank associations, Federal land credit associations, production credit associations, and agricultural credit associations.

credit to agricultural and aquatic producers and their cooperatives in times of financial stress;

- Comply with section 939A of the Dodd-Frank Act;
- Modernize the investment eligibility criteria for Farm Credit banks; and
- Revise the investment regulation for associations to improve their investment management practices so they are more resilient to risk.

II. Background

Congress created the Farm Credit System, which consists of Farm Credit banks, associations, service corporations,³ and the Federal Farm Credit Banks Funding Corporation to provide permanent, stable, affordable, and reliable sources of credit and related services to American agricultural and aquatic producers.⁴ Farm Credit banks issue System-wide consolidated debt obligations in capital markets, which enable associations to fund short-, intermediate-, and long-term credit and related services to farmers, ranchers, producers and harvesters of aquatic products, rural residents for housing, and farm-related businesses.⁵

Farm Credit banks depend on investments to provide liquidity and to manage surplus short-term funds and interest rate risk. Investments also help enable associations to manage the risks they confront.⁶ Although Farm Credit banks get their funding through issuing System-wide consolidated debt securities, they must have enough available funds, cash and investments, to continue paying maturing obligations if access to the debt market becomes temporarily impeded.

FCA regulations in subpart E of part 615 impose comprehensive requirements on investment practices at all System institutions except Farmer Mac. We first proposed revisions to our

³ A service corporation cannot extend credit or provide insurance services.

⁴ The Federal Agricultural Mortgage Corporation (Farmer Mac), also a System institution, operates a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utility cooperative loans. This rulemaking does not affect Farmer Mac, and the use of the term "System institution" in this preamble and the final rule does not include Farmer Mac.

⁵ One Farm Credit bank, is an agricultural credit bank, which lends to, and provides other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural water and waste water disposal systems. It also finances U.S. agricultural exports and imports, and provides international banking services to cooperatives and other eligible borrowers.

⁶ Under § 611.1135(a), which we do not propose to revise, service corporations may hold investments for the purposes authorized for their organizers.

investment regulations in 2011.⁷ In 2012, we issued a final rule that adopted many of these proposed requirements, particularly those guiding prudent investment management practices at System banks.⁸ However, that final rule did not substantively revise the rules governing investment eligibility in § 615.5140, or association investments in § 615.5142. In 2014, we proposed amendments to §§ 615.5140 and 615.5142 to address comments from System institutions.⁹ More specifically, the proposed rule revised the eligibility criteria for System bank investments. In addition, proposed § 615.5142 would: (1) Impose a portfolio limit on association investments; (2) limit association investments to certain securities issued or guaranteed as to principal and interest by the United States Government and its Agencies; and, (3) delete the specific investment purposes of reducing interest rate risk and managing surplus short-term funds.¹⁰

A major reason that we engaged in this rulemaking is that investment products are becoming increasingly complex, and some investments are riskier and less liquid than previously believed. Section 939A of the DFA requires each Federal agency to review all its regulations that reference or require the use of credit ratings issued by a Nationally Recognized Statistical Rating Organization (NRSRO) to assess the creditworthiness of an instrument. Under this provision of the Dodd-Frank Act, Federal agencies must also remove references to NRSRO credit ratings from their regulations and substitute other appropriate creditworthiness standards in their place. As a result, FCA is removing the actual references to NRSRO credit ratings in our regulations in subpart E of part 615.

FCA received over 1250 comment letters about our 2014 proposed regulations. FCS banks and associations submitted 12 comment letters, and we received separate comment letters from a System trade association and Farmer Mac. Commercial banks, and their various trade associations, as well as their directors, officers, and employees submitted the remaining comment letters. Most of the letters from bank commenters were form letters, and several individuals associated with the same bank submitted multiple or

⁷ 76 FR 51289, August 18, 2011.

⁸ 77 FR 66362, November 5, 2012.

⁹ See 79 FR 43301, July 25, 2014.

¹⁰ Final § 615.5140 identifies eligible investments for both Farm Credit banks and associations. Former § 615.5142 governs investment purposes for associations, but it did not prescribe the amount of association investments.

duplicate copies of the same letter. System and Farmer Mac commenters sought revisions to the bank and association regulations to clarify specific provisions, or to address their concerns. The bank commenters opposed all provisions of the proposed rule, except the provisions implementing section 939A of the DFA. All the bankers asked FCA to withdraw the rule, and to refrain from revising the investment regulations for System banks and associations, unless the amendments implemented new statutory authority.

III. Final Rule

After reviewing and considering the comment letters, FCA now enacts a final rule that governs investment activities at System banks, associations, and service corporations. The final rule: (1) Implements section 939A of the DFA; (2) strengthens investment management practices at FCS institutions, other than Farmer Mac; (3) improves the quality of System bank investments and streamlines the list of eligible investments; (4) revises the investment purposes and types associations may hold; and (5) clarifies the rules of divestiture of ineligible investments, and establishes new transition rules. Additionally, we updated the definitions for investments in subpart E of part 615, and we made conforming amendments to other regulations. FCA plans to rescind two Informational Memoranda, revise a third Informational Memorandum, and updating FCA Bookletter BL-064 so that FCA guidance conforms with this final rule.

FCA notes that all regulations in part 615, subpart E, together create a regulatory investment management framework for System institutions. In this context, System institutions need to consider and follow all requirements specified in §§ 615.5132, 615.5133, 615.5134, and 615.5140, as applicable. A System institution's decision to purchase and hold investments must be driven by an internal assessment of their risk tolerances and liquidity needs, plus eligible investments held.

A. Definitions

The definitions in § 615.5131 apply to all our investment regulations in subpart E of part 615. We proposed to remove or revise several definitions in § 615.5131 that pertain to eligible investments and credit ratings. These amendments align the definitions in FCA's investment regulations with other FCA regulations, or with the definitions that other Federal agencies, such as the Board of Governors of the Federal Reserve System, the Office of the

Comptroller of the Currency, the Federal Deposit Insurance Corporation, and Securities and Exchange Commission use in their regulations.

We received a comment from a bank trade association about the proposed definition of "asset class." Under the proposal, "asset class means a group of securities that exhibit similar characteristics and behave similarly in the marketplace." As we noted in the preamble to the proposed rule, asset classes for bank investments include, but are not limited, to money market instruments, municipal securities, corporate bonds, mortgage-backed securities (MBS), asset-backed securities (ABS) (excluding MBS), and "any other asset class as determined by FCA." The commenter opposed this provision because it authorizes FCA to approve other asset class types. The commenter asserted that FCA should not approve new asset classes except through a formal rulemaking. FCA responds that it has authority under various provisions of section 5.17 of the Farm Credit Act of 1971, as amended, (Act) to approve new investments, including new asset classes. As appropriate, FCA will decide how best to approve any new asset classes based on the circumstances and characteristics of the instrument when the issue arises. Sometimes, a notice and comment rulemaking is appropriate, while at other times, FCA may decide to issue a booklet or informational memorandum, or approve such instruments under case-by-case authority. We adopt this definition as proposed.

The same bank trade association also commented on the definition of "obligor" in the proposed regulation. The commenter expressed concerns that the definition of "obligor" would permit System institutions to make loans to ineligible persons, businesses, agencies, or corporations under their investment authorities. Our investment regulations cannot confer authority on System institutions that exceed their powers under the Act. The Act separates the System's lending authorities from its investment authorities. Therefore, our investment regulations cannot authorize System institutions to make loans to ineligible borrowers disguised as investments. We adopt this definition as proposed.

We proposed to define a collateralized debt obligation (CDO) as a debt security collateralized by mortgage-backed securities (MBS) or asset-backed securities (ABS, or trust-preferred securities). Farmer Mac claimed that this definition was inconsistent with how the security markets defined CDOs. FCA agrees with the commenter. We

addressed this concern by deleting the term "collateralized debt obligation" in final § 615.5131, and adding the term "resecuritization." Section 628.2 already defines "resecuritization" to mean "a securitization which has more than one underlying exposure and in which one or more of the underlying exposures is a securitization exposure." We will further discuss in greater detail why resecritizations are ineligible investments for System banks below.

We proposed to delete the definition of "eurodollar time deposit", "final maturity", "general obligations", "Government agency", "Government-sponsored agency", "liquid investments", "mortgage securities", "Nationally Recognized Statistical Rating Organization (NRSRO)", "revenue bond", and "weighted average life (WAL)" in § 615.5131. We received no comments on these revisions. Accordingly, the final rule deletes these definitions for the reasons explained in the preamble to the proposed rule.

The proposal added definitions of "asset-backed securities (ABS)", "Country risk classification (CRC)", "Diversified investment fund (DIF)", "Government-sponsored enterprise (GSE)", "Mortgage-backed securities (MBS)", "sponsor", and "United States (U.S.) Government agency." We received no comments on these new definitions, and we incorporate them into final § 615.5131 without revision. However, we made a technical, non-substantive revision by replacing the definition of "Country risk classification (CRC)" in final § 615.5131 with a cross-reference to the identical definition in our Capital Adequacy regulations, § 628.2. The preamble to the proposed rule explains our reasoning for adopting these definitions.

B. Section 615.5132—Investments Purposes

Under the existing rule, System banks may continue to buy and hold eligible investments to fulfill liquidity requirements, manage short-term funds, and manage interest rate risk, under § 615.5132(a). A System trade association and a Farm Credit Bank interpret our regulations as requiring each System bank to designate a specific purpose under § 615.5132(a) for every investment it purchases and holds. The commenter claims that this is inconsistent with the approach that FCA proposed for System associations, and the approach that the Federal Banking Regulatory Agencies (FBRA) ¹¹

¹¹ The FBRA's are the Board of Governors of the Federal Reserve System, the Office of the

followed in their liquidity coverage ratio regulation, which recognized that securities often serve multiple purposes.¹² Accordingly, the commenter asserted that FCA should not require FCS banks to hold an investment for only one of the purposes identified in § 615.5132(a). The commenter urged FCA to grant System banks greater flexibility to decide the authorized purposes and allow them to change the designated purpose as circumstances warrant.

FCA responds to this comment even though we proposed no change to § 615.5132. We note that § 615.5132(a) does not restrict System banks to holding each investment for only one purpose. In fact, § 615.5140(a)(1)(i) states that eligible investments may be held for one or more of the investment purposes authorized in § 615.5132(a). However, the preamble to the proposed rule notes that certain investments, such as private placements, are not suitable for liquidity and, therefore, a System bank would need to document the specific purpose or reason for holding such investments. FCA finds no reason to revise either § 615.5132(a) or § 615.5140(a)(1) to address the commenters concerns.

C. Section 615.5133—Investment Management

Section 615.5133 governs investment management practices at Farm Credit banks, associations, and service corporations. System institutions hold investments for different purposes and, therefore, investment practices will vary. This regulation requires the boards of directors of System institutions to adopt an internal control framework that protects their institutions from potential losses. Under this regulation, the policies must establish risk tolerance parameters that address credit, market, liquidity and operational risks. Additionally, this regulation requires the institution to set up delegations of authority, internal controls, portfolio diversification requirements, obligor limits, due diligence requirements, and to report regularly to the board of directors.

Except for a few minor stylistic changes, we proposed no substantive changes to § 615.5133(a), (b), (d), and (e), which respectively addresses the responsibilities of the boards of directors, general requirements for investment policies, delegation of authority, and internal controls. We received no comments on these

provisions, which we now adopt as a final rule. We proposed to redesignate § 615.5133(f), which addresses due diligence, and § 615.5133(g), which address reports to the board, as § 615.5133(h) and (i), respectively. We proposed to enhance the portfolio diversification and the counterparty (*i.e.*, obligor) limits for Farm Credit banks, which were previously in § 615.5133(c)(1)(i), and establish them as free-standing provisions in redesignated § 615.5133(f) and (g), respectively. We received comments about risk tolerance requirements in § 615.5133(c), portfolio diversification in redesignated § 615.5133(f), and the obligor limits in redesignated § 615.5133(g), which we will now address.

1. Risk Tolerance

Proposed § 615.5133(c)(1)(ii) would address concentration risk. It would require that an institution's investment policies establish concentration limits for single or related obligors, sponsors, geographical areas, industries, unsecured exposures, and asset classes or obligations with similar characteristics. We proposed to add sponsors and unsecured investments to this regulatory provision because we believe undue concentration in a sponsor or unsecured investments could present excessive risk. Concentration limits should be commensurate with the types and complexity of investments that an institution holds.

We received a comment about proposed § 615.5133(c)(1)(ii) from a bank trade association. This commenter opined that FCA should establish a specific concentration limit by regulation, rather than allowing FCS institutions to set their own concentration limits. Both FCA and the FBRAs no longer prescribe concentration limits by regulation because each financial institution has its own business model and risk appetite. Financial institution regulators examine each regulated institution for robust risk management practices. The commenter has not identified any compelling reasons FCS institutions should not be subject to the same supervisory framework as banks.

2. Liquidity Risk

FCA proposed to revise § 615.5133(c)(3), which governs how System institutions manage the liquidity characteristics of investments they hold. Specifically, we proposed to separately address the different liquidity needs of System banks and associations. Proposed § 615.5133(c)(3)(i) would address liquidity in the investment

policies of Farm Credit banks, while proposed § 615.5133(c)(3)(ii) would address the liquid characteristics of investments that associations hold. We proposed this revision because of the differences in how Farm Credit banks and associations manage liquidity. Farm Credit banks hold liquidity reserves to manage funding and liquidity risks for themselves, their affiliated associations, and certain service corporations. In contrast, System associations have more limited funding and liquidity risk exposure because their only substantial liability is their debt obligation to their funding bank. We received no comments on proposed § 615.5133(c)(3), and we now adopt it as a final rule with minor stylistic changes.

3. Farm Credit Bank Portfolio Diversification

As discussed above, proposed § 615.5133(f) emphasized the importance of a well-diversified investment portfolio. This provision would require System banks to adopt policies that prevent their investment portfolios from posing significant risk of loss due to excessive concentrations in asset classes, maturities, industries, geographic areas, and obligors. The proposed rule retained the provisions of the previous regulations that imposed no concentration limits on securities issued or guaranteed by the U.S. government and its agencies, and kept a 50-percent cap on MBS securities issued or guaranteed by a Government-sponsored enterprise (GSE). In 2014, we proposed a 15-percent portfolio cap on all other eligible asset classes. Under our proposal, no Farm Credit bank could invest more than 10 percent of total capital in a single obligor, and the securities of a single obligor could not exceed 3 percent of the bank's total outstanding investments.

System commenters asked us to remove the portfolio limit on money market funds. The commenters stressed that money market funds are diversified in nature and they are an effective vehicle for liquidity risk management, and the short-term maturities make these investments self-liquidating, which provide the banks with a reliable source of liquidity during periods of market stress. We are persuaded by this logic and, therefore, we omit the portfolio limit on money market funds in final § 615.5133(f)(3)(iii).

System commenters also claimed that the limit of 3 percent in the overall investment portfolio for each obligor is unnecessary because the proposed rule reduced the regulatory obligor limit from 20 percent to 10 percent of total capital. According to the commenters,

obligor exposure limits based on capital provides sufficient protection for System banks, and the proposed, additional 3-percent obligor limit on the overall investment portfolio does not add meaningful protection from a risk management perspective. We agree with the commenters, and therefore, we have deleted this limit from the final regulation.

D. Section 615.5134—Liquidity Reserve

We proposed technical, non-substantive revisions to the terms “Government-sponsored enterprise (GSE)” and “U.S. Government agency” in our liquidity reserve regulation in § 615.5134. These changes conform to the definitions in § 615.5131. We received no comments about this change. This change is consistent with recent changes to FCA’s capital regulations as well as guidance from the FBRAs. For these reasons, we adopt the proposed provision as a final rule without change.

We proposed to clarify that MBS *fully* guaranteed by a U.S. Government agency qualify for Level 2 liquidity and MBS *fully* guaranteed by a GSE qualify for Level 3 liquidity. A System commenter requested that we treat the MBS of a GSE in conservatorship as full faith and credit obligations of the United States and, therefore, qualifying for Level 2 of the Liquidity Reserve. FCA declined this request. Our approach is consistent with FCA’s capital regulations and that of the FBRAs, which points to the uncertainty of the future government support of GSEs in conservatorship.

We made a clarifying change to the table “to omit two lines: In Level 2 “Additional Levels 1 investments”, and in Level 3 “Additional Level 1 or 2 investments” as well as the accompanying discount factors. We determined these two provisions are confusing and difficult to follow and are redundant given the preceding section of the regulation dealing with day counts.

E. Section 615.5140(a)—Eligible Investments for Farm Credit Banks

Proposed § 615.5140(a)(2) sets forth the types of eligible investments that Farm Credit banks may purchase and hold. The intent of this provision is to ensure that System banks invest only in high-quality investments. We received comments on each investment type, which we now discuss.¹³

¹³ Revised § 615.5140(a) would apply to Farm Credit banks only. As discussed below, all association eligibility requirements would be in revised § 615.5140(b).

1. Non-Convertible Senior Debt Securities

The proposed rule would continue to authorize FCS banks to invest in non-convertible senior debt securities. A bank trade association questioned whether System institutions should have authority to invest in corporate bonds. The commenter claims that corporate bonds are not as high quality as government bonds, and expose investors to greater interest rate risk. The commenter’s concern is that a corporate bond could allow System banks to become the only, or the majority, investor, which the commenter believes could enable the System to exceed the lending constraints in the Act.

FCA is not willing to ban investments in all corporate bonds, as the commenter requests. Our regulations have allowed FCS institutions to invest in high-quality corporate bonds since 1993. System institutions use these high-quality corporate bonds to build and diversify their liquidity portfolios. This regulatory provision imposes high credit quality standards, portfolio and obligor limits, and purpose restrictions on non-convertible senior debt securities. These restrictions mean that the FCS may purchase and hold only publicly traded debt securities. Under proposed § 615.5140(a)(2)(i), which is redesignated as final § 615.5140(a)(1)(ii)(A), investments in corporate debt securities fall under an institution’s investment authority and, therefore, they do not violate the lending restrictions of the Act. Accordingly, final § 615.5140(a)(1)(ii)(A) will allow FCS banks to buy and hold a non-convertible, senior debt security, which includes corporate bonds.

Under proposed § 615.5140(a)(2)(i), System banks could not invest in senior debt securities that can convert into another debt or equity security.¹⁴ FCA received no comments on non-convertible senior debt securities, and it adopts this provision as final and

¹⁴ As noted in the preamble to the proposed rule, non-convertible senior debt includes: (1) U.S. Government and U.S. Government agencies debt securities, (2) Government-sponsored enterprises debt securities, (3) municipal (debt) securities, (4) corporate debt securities, and (4) other senior debt securities. Senior debt securities may be secured by a specific pool of collateral or may be unsecured with priority of claims over junior types of debt or equity securities. To be eligible under this criterion, a senior debt security must not be convertible into a non-senior debt security or an equity security. See 79 FR 43301, 43304, July 25, 2014. Since 1993, FCA has stated it is generally inappropriate for System institutions to maintain an ownership interest in commercial enterprises by holding equity securities. See 58 FR 63059, 63049–50, November 30, 1993.

redesignate it as § 615.5140(a)(1)(ii)(A) without substantive change.

2. Money Market Instruments

As under our previous rule, investments in money market instruments would be eligible under the proposed rule. Money market instruments include short-term instruments such as (1) Federal funds, (2) negotiable certificates of deposit, (3) bankers’ acceptances, (4) commercial paper, (5) non-callable term Federal funds (6) Eurodollar time deposits, (7) master notes, and (8) repurchase agreements collateralized by eligible investments as money market instruments. A money market instrument is an eligible security if it matures in 1 year or less.

Two System commenters asked that we remove the asset class limit for money market instruments because their short-term maturities make them self-liquidating. FCA agrees with the commenters that money market instruments are liquid due to their short maturities and, therefore, no longer warrant a portfolio limit. However, the 10-percent obligor limit would still apply for these investments. Accordingly, FCA has removed the 15-percent portfolio diversification requirement for money market instruments in final § 615.5133(f)(3)(iii).

3. Mortgage-Backed Securities and Asset-Backed Securities Guaranteed by the U.S. Government and U.S. Government Agencies

Under proposed § 615.5140(a)(2)(iii), MBS and ABS that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency would remain eligible securities because of their high credit quality. As we explained in the preamble to the proposed rule, securities labeled “government guaranteed” satisfy this criterion only if they are fully guaranteed as to the timely payment of principal and interest.¹⁵ We received no comments on proposed § 615.5140(a)(2)(iii) and, therefore, we adopt this provision as final and redesignated § 615.5140(a)(1)(ii)(C) without substantive change.

4. Mortgage-Backed Securities and Asset-Backed Securities Guaranteed by GSEs

Under the proposed rule, MBS and ABS that are fully and explicitly guaranteed as to the timely payment of principal and interest by GSEs would

¹⁵ See 79 FR 43301, 43304, July 25, 2014.

remain eligible investments.¹⁶ Section 615.5174 authorize Farmer Mac AMBSs. As already noted in the liquidity reserve preamble discussion, a System commenter asked that the final rule treat securities of GSEs under conservatorship in the same fashion as though they were full faith and credit obligations of the U.S. Government. For the reasons explained earlier, we do not agree with the commenter, and we do not change this provision of the final rule.

5. Senior-most Positions of Non-Agency Mortgage-Backed Securities and Asset-Backed Securities

Previous § 615.5140(a)(5) and (6) classified non-agency mortgage-backed securities (including non-agency commercial mortgage-backed securities), and asset-backed securities as eligible investments. In 2014, FCA proposed restricting that provision by only allowing an institution to buy the senior-most position of a tranching non-agency MBS or ABS as an eligible security.¹⁷ A non-agency MBS or ABS, which is not tranching, and which payments are made on a pro-rata basis would be eligible securities under the proposed rule. Under proposed § 615.5140(a)(2)(v), an eligible MBS must satisfy the definition of “mortgage related security” in 15 U.S.C. 78c(a)(41). Non-agency commercial MBS (CMBS) that meet these requirements are eligible investments for System banks under this regulatory provision. Non-agency MBSs and CMBS must also meet the criteria in the Secondary Market Mortgage Enhancement Act of 1984 (SMMEA). We received no comments on the eligibility of the senior-most position of non-agency securities and, therefore, we adopt this provision as final and redesignate it as § 615.5140(a)(1)(i)(E).

6. Private Placement Securities

During this rulemaking, FCA used the term “private placement” securities when referring to privately placed bonds or debt securities. Private placement refers to the sale of securities to a few sophisticated investors without

¹⁶ Securities are eligible under this provision only if a GSE fully guarantees the timely payment of both the principal and interest due. A GSE “wrap” (guarantee) does not make a security eligible under this provision unless it is a guarantee of all principal and interest. When considering whether to purchase a security with a GSE guarantee or wrap, an institution must ensure that it is fully guaranteed.

¹⁷ In 2011, we originally proposed that one of the criteria for senior-most MBSs was that no other remaining position in the securitization had a higher priority claim to any contractual cashflows. 76 FR 51289, August 18, 2011. In response to System comment letters, we deleted this criterion in our 2014 proposed rule.

registration with the Securities and Exchange Commission, and often without a prospectus. As a result, a private placement security normally is not a liquid security and not held for liquidity purposes; however, they may be appropriate for risk management. A bank trade association opined that FCA should not authorize any System institution to purchase private placement securities. This comment letter, however, focused on FCA approval of private placement securities on a case-by case basis. Since private placements are not liquid, they need to be approved by FCA on a case-by-case basis under § 615.5140(e). We discuss this issue in greater detail below.

7. International and Multilateral Development Bank Obligations

Proposed § 615.5140(a)(2)(vi) retained the previous authority of Farm Credit banks to invest in obligations of international and multilateral development banks, if the United States is a voting shareholder. We received no comment on this provision and, therefore, we adopt this provision as final and redesignate it as § 615.5140(a)(1)(i)(F).

8. Shares of a Diversified Investment Fund

For many years, these regulations have authorized System banks to invest in several types of money market funds offered by investment companies registered under section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a–1 *et seq.* The proposed rule retained this original authority, although FCA updated and modified some of the terminology. Under proposed § 615.5140(a)(2)(vii), shares of a diversified investment fund (DIF) would remain an eligible investment if the DIF’s portfolio consists solely of eligible investments under any other paragraph of proposed § 615.5140(a)(2), or § 615.5174. The investment company’s risk and return objectives and use of derivatives must be consistent with the investment policies of the Farm Credit bank. FCA proposed, however, more restrictive portfolio diversification limits on DIF investments than those that now exist.

FCA received no comments about what constitutes a DIF. However, we wish to clarify that a diversified investment fund consists of any of three categories of investment funds, which are mutual funds,¹⁸ closed-end funds or unit investment trusts registered under

¹⁸ The Investment Company Act of 1940 does not define the term “mutual fund” but SEC literature uses it interchangeably with an open-end fund, which that statute defines.

the Investment Company Act of 1940. A diversified investment fund also includes exchanged-traded funds¹⁹ and money market funds.²⁰ Exchange-Traded Funds (ETFs) while considered mutual funds or unit investment trusts, differ from traditional mutual funds and unit investment trusts (UITs). An investor’s investment consists of purchased shares in these investment funds. All these investment funds meet the criteria of this regulation provision, which we redesignate as § 615.5140(a)(1)(i)(G).

A bank trade association objected to DIFs as eligible investments for FCS institutions. The commenter claimed that the proposed rule did not limit the scope of investments in DIFs, so this authority could be very broad and exceed the lending constraints of the Act. FCA disagrees and points out that both §§ 615.5134 and 615.5140 impose very stringent criteria for investments in DIFs. Furthermore, our regulations have allowed investments in DIFs for over 20 years, and the proposed rule did not expand this authority, or permit System banks to invest in DIFs for purposes that are beyond managing liquidity, short-term surplus funds, or interest rate risks. Additionally, this regulation still requires the portfolio of any eligible DIF to be comprised solely of investments authorized by §§ 615.5140 and 615.5174. System banks can only invest in DIFs by buying shares of investment companies registered under section 8 of the Investment Company Act of 1940. Contrary to the commenter’s claim, DIFs are eligible only if System banks exclusively hold the liquid, low-risk assets found in final and redesignated § 615.5140(a)(1)(ii)(G). Because DIFs are investments, they do not enable the FCS to exceed the lending constraints of the Act.

9. Obligors’ Creditworthiness Standard

Previous § 615.5140 relied on NRSRO credit ratings to determine the eligibility of investments in many asset classes, including municipal securities, certain money market instruments, non-agency mortgage-backed securities, asset-backed securities, and corporate debt securities.²¹ As noted earlier, section 939A of the DFA requires each Federal

¹⁹ Exchange-traded funds are investment funds that are legally classified as open-end funds or unit investment trusts under the Investment Company Act of 1940.

²⁰ A money market fund is a special type of mutual fund under the Investment Company Act of 1940 and 17 CFR 270.2a–7—Money market funds.

²¹ Our regulation has not imposed credit rating requirements on investments in obligations of United States. U.S. Government agencies, GSEs, and international and multilateral development banks, and in DIFs and certain money market instruments.

agency to revise all its regulations that refer to, or require reliance on credit ratings to assess creditworthiness of an instrument to remove the reference or requirement and to substitute other appropriate creditworthiness standards. FCA proposed § 615.5140(a)(3) to implement section 939A of the DFA by addressing the creditworthiness of the obligor of securities that System banks buy and hold as investments.

Our proposed rule would have required at least one obligor of the investment to have “very strong capacity” to meet its financial commitment for the expected life of the investment. If a Farm Credit bank is relying upon an obligor located outside of the United States to meet its financial commitment, the proposal required:

That obligor’s sovereign host country to have the highest or second-highest consensus Country Risk Classification (CRC) (a 0 or a 1) as published by the Organization of Economic Cooperation Development (OECD) or must be an OECD member that is unrated; or the investment must be fully guaranteed as to the timely payment of principle and interest.²²

A System trade association, an FCS association, and Farmer Mac commented that the proposed creditworthiness standard for obligors was too stringent. These commenters suggested that the final rule should require at least one obligor to have a “strong” capacity to meet its financial commitment for the expected life of the investment, rather than the “very strong” capacity referred to in the proposed rule. One of these commenters asked FCA to provide further clarification about how “very strong capacity to meet its financial commitments” is related to a “very low probability of default.” These commenters also urged FCA to adopt the FBRA’s creditworthiness standard of “investment grade.”

FCA declined the commenters’ request to relax the creditworthiness standard for obligors. FCA believes a security with “low credit risk” is one where the Farm Credit bank determines the issuer has a “very strong” capacity to meet all financial commitments under the security’s projected life even under adverse economic conditions. Securities that exhibit these characteristics are liquid and marketable. Farm Credit banks primarily hold securities for liquidity purposes and, therefore, the creditworthiness standards for these securities ensure that they are marketable and readily convertible into cash in a crisis at minimum costs.

We recognize our regulations governing margin and capital requirements for covered swap entities, and capital adequacy for all System institutions use the “investment grade” standard. However, we determine that “investment grade” is not appropriate for these investment regulations. FCA believes not all securities that meet the “investment grade” requirements would be of suitable high credit quality and marketable for liquidity purposes. Therefore, FCA declines to lower its proposed investment creditworthiness standard.

We now respond to the comment requesting clarification about the relationship between “very strong capacity to meet its financial commitments” and a “very low probability of default.” In evaluating the creditworthiness of a security, a Farm Credit bank should consider any of the following factors as well as any additional factors it deems appropriate:

- Credit spreads (*i.e.*, whether it is possible to demonstrate that a security is subject to an amount of credit risk based on the spread between the security’s yield and the yield of Treasury or other securities);
- Securities-related research (*i.e.*, whether providers of securities-related research believe the issuer of the security will be able to meet its financial commitments, generally or specifically, with respect to the securities held by the Farm Credit bank);
- Internal or external credit risk assessments;
- Default statistics (*i.e.*, whether providers of credit information relating to securities express a view that specific securities have a probability of default consistent with other securities with an amount of credit risk);
- Inclusion on an index (*i.e.*, whether a security, or issuer of the security, is included as a component of a recognized index of instruments that are subject to a specific amount of credit risk);
- Priorities and enhancements (*i.e.*, the extent to which credit enhancements, such as overcollateralization and reserve accounts cover a security)
- Price, yield, and volume (*i.e.*, whether the price and yield of a security are consistent with other securities that the institution has determined are subject to an amount of credit risk and whether the price resulted from active trading); and
- Asset class-specific factors (*e.g.*, in the case of structured finance products, the quality of the underlying assets).

10. Credit and Other Risk in the Investment

In addition to imposing creditworthiness standards on obligors, we also proposed that an eligible investment must exhibit low credit risk and other risk characteristics consistent with the purposes for which it is held, such as interest rate risk. Institutions must consider other risks but are not limited to just those listed in § 615.5133(c). FCA received a System comment that proposed § 615.5140(a)(4) limits the ability of System banks to use an investment for more than one investment purpose. We already responded to that comment above in the preamble discussion of final § 615.5132. In addition, our discussion in the preamble about the creditworthiness of the obligor explains our position of credit quality, and this provision requires no revision. Therefore, we adopt this provision as final and redesignate it as § 615.5140(a)(1)(iv).

11. Currency Denomination

Since 1993, § 615.5140(a) has required all investments at System institutions to be denominated in U.S. dollars. We proposed no change to this requirement, and we received no comments about it. Accordingly, we retain this requirement in the final rule without revision, but redesignate it as § 615.5140(a)(v).

12. Ineligible Investments

The proposed rule, § 615.5140(c), would have prohibited Farm Credit banks from purchasing collateralized debt obligations (CDOs), as originally defined in § 615.5131. As discussed in the preamble to the definitions section above, Farmer Mac objected to our definition of “CDO,” and we responded by substituting the term “resecuritization” for “CDO.”

However, the final rule would prohibit System banks from purchasing and holding resecritizations as we originally proposed. During the financial crisis of 2008–2009, many risky securitization exposures were resecritized into new complex securities where not all buyers fully understood the risks in the different tranches of these new resecritization exposures. These securities, which were sometimes known as CDO-squared, CDO-cubed, or reperformers, exposed investors to higher risk than the basic securitization structure. Basel III and the FBRA’s recognized the higher risk posed by resecritizations, and assigned a higher risk weight to them than basic

²² <http://www.oecd.org/trade/xcred/crc.htm>.

securitization exposure.²³ FCA strongly believes the complex nature of the risks within these resecuritization exposures are inappropriate investments for System banks. Therefore, we consider these resecuritization exposures to be ineligible investments for the purposes authorized in § 615.5132. FCA also believes certain pools of previously delinquent or reperforming loans that were once part of a different securitization exposure exhibit similar risks as a resecuritization exposure. The final rule prohibits System banks from purchasing resecuritizations without FCA's approval under final § 615.5140(e), except when both principal and interest are fully and explicitly guaranteed by the U.S. Government or a GSE.

13. Reservation of Authority

Proposed § 615.5140(d) would have made explicit our authority, on a case-by-case basis, to determine that an investment poses inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria. The proposal also provides that FCA would notify a Farm Credit bank as to the proper treatment of any such investment. We received no comment on this provision. We retain this provision to safeguard the safety and soundness of banks, and we redesignate it as § 615.5140(c).

F. Association Investments

FCA proposed to substantially revise § 615.5142, which governed association investments. Previously, § 615.5142 did not impose a portfolio limit on the total amount of association investments. Additionally, our former regulation permitted associations to hold the same types of investments as Farm Credit banks even though associations are not subject to the liquidity reserve requirement in § 615.5134, and they are not exposed to the same liquidity and market (interest rate) risks as their funding banks. Previously, § 615.5142 authorized each association to hold eligible investments listed in § 615.5140, with the approval of its funding bank, for the purposes of reducing interest rate risk and managing surplus short-term funds. The regulation also required each Farm Credit bank to review annually the investment portfolio of every association it funds.

The proposed rule would limit association investments to securities 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 in an amount that does not exceed 10 percent of its total outstanding loans. The proposed rule also addresses: (1) Investment and risk management practices at System associations; (2) funding bank supervision of association investments; (3) requests by associations to FCA to hold other investments; and (4) transition requirements for System associations to come into compliance with the new rule.

We proposed these changes because most System associations have increased in size and complexity over the past two decades, offering a diversity of products and services to adapt to a changing and increasingly competitive agricultural sector. The changes in agriculture have introduced new risks to the associations. For example, while the associations have adopted adequate risk management strategies to effectively adapt to this changing environment, they remain concentrated in agriculture and have limited ability to manage concentration risk. Although the previous regulation allowed the associations to use investments for managing surplus short-term funds and reducing interest rate risk, they could not use investments to manage concentration risk. For these reasons, we designed the proposed rule to strike a balance by granting associations greater flexibility in the purposes for which they may hold investments, while placing new limits on the amounts and types of investments they may hold. Under the proposed rule, associations would have the flexibility to manage concentration risks with securities that are issued or fully guaranteed or insured as to the timely payment of principal and interest by the U.S. Government or its agencies. The Act specifically authorizes System associations to buy and sell obligations of, or insured by, the United States or any agency thereof, and make other investments as may be approved by their respective funding banks under regulations issued by FCA.²⁴

Before we address the substantive comments that we have received, we notify the public that we have consolidated all the provisions governing eligible investments for all System institutions into a single regulation, § 615.5140. Accordingly, FCA has removed § 615.5142 concerning association investments, and

redesignated it as final § 615.5140(b). Proposed § 615.5142(d) would have redesignated, but not substantively changed, § 615.5140(e) concerning other association investments approved by FCA. The final rule restores case-by-case approvals for both banks and associations to § 615.5140(e). Although we received, no comments about restructuring final § 615.5140, we consolidated the two sections for greater uniformity in the rule. Addressing eligible investments in a single regulation will make it easier for both FCA examiners and System institutions to use and apply this rule.

1. Association Investment Purposes

The proposed rule would remove the requirements in the previous regulation that authorize associations to hold investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The preamble to the proposed rule explained that these requirements may be too restrictive and too inflexible for associations to effectively manage their risks in today's environment. For many associations, a limited portfolio of high-quality investments could help diversify risks they experience as lenders that primarily lend to a single-industry agriculture.

We invited comments about whether this rule should identify specific purposes for associations to purchase and hold investments, and we asked the commenters to expressly identify any specific purposes that the final regulation should retain or require, and why. Two bank trade associations stated that the final rule should identify specific risk management purposes for associations to purchase and hold investments. One commenter asked if associations are no longer required to manage surplus short-term funds and reduce interest rate risks, what is the reason for these investments?

FCA responded that System institutions face four broad types of risks: (1) Credit; (2) market (interest rate); (3) liquidity; and (4) operational. Although the previous regulation allowed associations to hold investments only for managing surplus short-term funds (liquidity), and reducing interest rate risk (market risk), the associations remain exposed to broader risk both in individual investments and in their overall portfolios. Additionally, the prior regulation permitted associations to hold the same investments as FCS banks, which exposed them to the same four risks. For this reason, § 615.5133 requires all FCS banks and association to address these four risks in their

²³ See § 628.43(b)(5)—A supervisory calibration parameter, *p*, is equal to 0.5 for securitization exposures that are not resecuritization exposures and equal to 1.5 for resecuritization exposures.

²⁴ See sections 2.2(10) and (11), and 2.12(17) and (18) of the Act. Additionally, sections 2.2(10) and 2.12(18) of the Act authorize System associations to deposit funds with any member bank of the Federal Reserve System, or with any bank insured by the Federal Deposit Insurance Corporation.

investment policies. The investment policies must be commensurate with the size and complexity of the institution's investment portfolio. As discussed in greater detail below, this final rule retains and strengthens the investment management requirements in § 615.5133. Additionally, new limits on the amount and types of investments in our proposal would counterbalance the greater flexibility in investment purposes.

As stated above, FCA seeks to grant associations greater flexibility in investment purposes, while placing more restrictions on the types and amount of investments they may hold. Contrary to claims in banker comment letters, this rule restricts, rather than expands the types of investments that associations may purchase and hold. This rule no longer authorizes associations to hold the same investments as FCS banks, such as money market instruments, corporate bonds, and certain asset-backed securities.

In contrast, a System association asked FCA to retain the investment list in the previous regulation, which it claims associations need to manage "prepayment [extension or contraction] risk, credit risk, liquidity risk and yield risk." However, FCA determines that the new regulation provides sufficient risk management tools for associations, and their need for investments is different from their funding banks. By only authorizing associations to hold securities issued or unconditionally guaranteed by the U.S. Government and its agencies, the regulation eliminates most credit risk associated with such assets, and helps mitigate risk in their overall portfolios. Securities issued or unconditionally guaranteed by the U.S. Government and its agencies still present market (interest rate), liquidity, and operational risks to associations. As discussed elsewhere in this preamble, placing a 10-percent portfolio cap on associations for the first time, and limiting the types of investments that associations may hold, result in a conservative and risk-adverse regulatory approach. The low credit risk in these investments offer the opportunity to diversify the balance sheet credit risks for those associations that choose to exercise their investment authorities.

2. Eligible Association Investments

Proposed § 615.5142(a) would authorize System associations to invest solely in obligations that the United States Government and its agencies issue, fully guarantee, or insure as to the timely payment of principal and interest. Sections 2.2(11) and 2.2(17)

expressly authorize System associations to invest in such obligations of the United States and its agencies. Such obligations are usually liquid and marketable. Although MBS issued by the U.S. Government and its agencies pose almost no credit risk to investors, they potentially expose investors to other risks, especially market (interest rate and prepayment risk). We find that these investments are suitable for managing risk at associations because they have no credit risk and they enable associations to diversify their portfolios. Additionally, all System institutions may hold Farmer Mac AMBS as eligible investments.²⁵

Bankers and their trade associations commented that this provision would allow System associations to buy ineligible loans that are guaranteed by the United States and its agencies in contravention of the Act. FCA revised this provision to address these concerns. FCA has addressed the commenters' concerns by changing the term "obligations" to "securities" in the third sentence of the final rule. If an association purchases the government-guaranteed portions of individual loans, such purchases do not meet the criteria for an investment security under the final rule.²⁶ FCA has added rule text to clarify that only securities that the U.S. Government and its agencies unconditionally guarantee are eligible investments for associations. Under the final regulation, only investments defined and booked as securities under GAAP qualify as authorized investments under the final rule.

For further clarification, FCA notes that pool assemblers purchase guaranteed portions of loans in the secondary market, and securitize these assets. In this context, not all these securitizations will be eligible investments for associations. We anticipate that System associations most likely will purchase and hold either securities guaranteed by SBA or issued by Farmer Mac.²⁷ The SBA and Farmer

²⁵ Investments in Farmer Mac AMBS are covered by § 615.5174. Investments in Farmer Mac AMBS cannot exceed the total amount of outstanding loans of a System bank or association.

²⁶ For Generally Accepted Accounting Principles' (GAAP) purposes, the association should treat the purchase of an individual loan as purchase of an interest in an assignment in a loan participation. System institutions, when purchasing the guaranteed portion of an individual loan, also must comply with the lending eligibility and loan purpose of parts 613 and 614, as if they originated the loan.

²⁷ The SBA issues a "SBA Guaranteed Pool Certificate" to those securitizations created by third-party issuers. In effect, the SBA unconditionally guarantees the security. Farmer Mac issues Farmer Mac 2 AMBSs whose underlying

Mac guarantee the timely payment of principal and interest to investors.²⁸ Under GAAP, such assets are reported as investments. System banks and associations purchase Farmer Mac 2 AMBSs under § 615.5174, not under § 615.5140. Farmer Mac 2 AMBSs and guaranteed SBA securities are eligible investments for associations under the final regulation. We have redesignated proposed § 615.5142(a) as final § 615.5140(b)(1).

3. Association Portfolio Limits

Proposed § 615.5142(a) limits association investments to 10 percent of total outstanding loans. This portfolio limit ensures that loans to eligible borrowers always comprise most of the assets of FCS associations, which is consistent with the System's mission. Our regulations authorize Farm Credit banks to hold significantly larger investment portfolios than System associations because the: (1) Banks maintain liquidity and manage interest rate risk for all but a few affiliated associations; and (2) associations borrow almost exclusively from their funding banks.

The proposed 10-percent portfolio limit on investments should be sufficient to enable associations to develop robust strategies to manage risks if association investment policies, management practices and procedures, and appropriate internal controls support those investment activities. Furthermore, the proposed 10-percent limit should help associations manage their concentration risk as single-industry lenders. FCA believes that the proposed 10-percent portfolio limit on investments strikes an appropriate balance by enabling associations to appropriately manage and diversify risks while continuing to serve their primary mission of lending to farmers and other eligible borrowers.

We received comments about the proposed portfolio limits from both System and non-System commenters. The principal concerns raised by the commenters focused on: (1) How FCA would apply the 10-percent limit; (2) which investments the portfolio limit covered, and (3) whether the 10-percent limit is prudent.

System commenters raised three primary issues about the proposed portfolio limit for association investments. Several System commenters inquired whether the 10-percent limit on investments applies to

assets consist of the guaranteed portions of USDA loans.

²⁸ SBA is a Government agency while Farmer Mac is a GSE.

both investments authorized under § 615.5142(a) and those approved by FCA on a case-by-case basis.

Additionally, some System commenters opined that the 10-percent limit was too restrictive, and that FCA should increase it to 15-percent. Others suggested that a limit based on “total outstanding loans” would be too restrictive. These commenters suggested that the final rule tie the portfolio cap to a broader array of assets including; “earning assets,” “loans plus mission-related investments plus UBEs plus RBICs plus [Farmer Mac] MBS” or “total assets.”

Bankers and their trade associations commenters opposed the proposed portfolio limit on association investments for other reasons. First, these commenters wanted FCA to base the portfolio limit on association capital levels, not total outstanding loans. One of the bank trade association commenters misinterpreted the proposed portfolio limit for associations by assuming that it established two separate 10-percent limits; one for U.S. Government-guaranteed investments, and one for “all other association investments.” This commenter requested that FCA limit eligible investments to 10 percent of capital (5 percent for guaranteed investments and 5 percent for non-guaranteed investments), which would include 1 percent of capital for “other investments” which are “for purposes that are [consistent] with the Act’s lending constraints.” Second, these commenters claim that the proposed portfolio limit was too high because investments at most associations would rarely equal or exceed 10 percent of total outstanding loans. Third, bank commenters claimed that if loan volume declines at an association, it should then liquidate investments to comply with the portfolio limit, which would expose it to losses on their required sale due to their presumed illiquidity.

We now respond to requests that we either increase or decrease the portfolio limit for investments. As stated above, System commenters claimed that a 10-percent limit was too restrictive, and they request that we increase it to 15 percent. System commenters have not convinced us that the 10-percent limit is too restrictive. FCA notes that the policies at some System associations with active investment programs establish a 15-percent portfolio limit for investments, while in practice, investments at most associations rarely equal or exceed 10 percent of total outstanding loans. In contrast, bank trade associations commenters asked us to significantly lower the proposed 10-

percent limit. However, a lower limit would not provide meaningful risk diversification, or the necessary economies of scale for associations to justify the added costs of establishing and maintaining the infrastructure and internal controls for holding and managing an investment portfolio of securities unconditionally guaranteed by the United States Government and its agencies. Reducing the portfolio limit below 10 percent could hamper associations from holding such investments, thereby denying them more diversified and better quality asset portfolios. For this reason, we decline both requests.

We now address requests from bank commenters that FCA change the denominator for the portfolio limit calculation from total outstanding loans to capital. These commenters stated that all FRBAs impose investment limits that are based on references to capital, rather than loans or other assets. Additionally, these commenters assert that a limit tied to capital would more effectively reduce the risk exposure to System associations. FCA responds that the purpose of the portfolio limit is to ensure that most association assets are loans to eligible agricultural and aquatic producers while promoting portfolio diversity. Under the final rule, associations may hold only securities that are unconditionally guaranteed by the U.S. Government and its agencies for risk management purposes, which effectively eliminates the credit risk exposure that the commenters fear. Furthermore, § 615.5182 requires associations to manage interest rate risk associated with such Government-guaranteed investments. For these reasons, a portfolio limit based on a reference to capital is unnecessary. In this context, the statutory framework for the FCS is different than that for banks. FBRA do not tie investments at banks to loans or other assets because their statutes do not limit their lending activity to a single economic sector.

As noted earlier, a bank trade association asked that the final rule limit non-guaranteed investments to 5 percent of capital, and “other investments” to 1 percent of capital. The commenter also suggested that the final rule prohibit associations from holding non-guaranteed and “other investments” for purposes that are inconsistent with the Act’s lending constraints. FCA already addressed the comment about using capital as the reference for a portfolio limit. More importantly, the final rule does not allow associations to disguise ineligible loans as investments in violation of the Act, and as explained elsewhere in this

preamble, we amended the final rule to address this specific concern.

We now respond to System commenters who asked us to change the portfolio limit from “total outstanding loans” to either “earning assets,” or “total assets.” We decline this request because “total outstanding loans” is a standard that provides associations with a sufficient level of investments to manage their risks prudently and economically. Our investment regulations use the same standard for calculating the limit for Farm Credit banks, which play a far greater role in managing liquidity and market risk for the entire System than associations. Under the circumstances, FCA finds no compelling reason for enacting a permissive standard for System associations, and a more stringent one for Farm Credit banks. Separately, FCA has consistently held that the principal statutory mission of the System is lending to agricultural and aquatic producers, and their cooperatives. A portfolio limit tied to loans ensures that agricultural credits remain the primary assets of all System banks and associations. A portfolio limit based on either “earning” or “total” assets could permit associations to hold a greater amount of assets that are unrelated to agriculture.

Several System commenters asked that the portfolio limit calculation exclude equity investments in Rural Business Investment Companies (RBICs), an Unincorporated Business Entities (UBE), or Farmer Mac Class B stock (held only by System investors) from its numerator. FCA agrees with System commenters, and the final rule excludes both debt and equity investments in these three entities from the calculation of the 10-percent limit. The amount that System institutions, either alone or together, may invest in RBICs are limited by statute.²⁹ Investments in UBEs are subject to limits in § 611.1153(h). FCA does not intend to place any limitations on either the purchase of Farmer Mac Class B equity or Farmer Mac issued Agricultural Mortgage Backed Securities (AMBS) because it would discourage System institutions from using Farmer Mac in its risk management strategies. A System bank or association may purchase Farmer Mac Class B equity under § 615.5173 and Farmer Mac AMBSs under § 615.5174.

Several System institutions suggested that the calculation for the portfolio limit revealed a potential conflict because the numerator would use a 30-

²⁹ See section 384J of the Consolidated Farm and Rural Development Act, 7 U.S.C. 2009cc-9.

day average while the denominator would use a 90-day average. These commenters requested that the final regulation set a 90-day average daily balance for both the numerator and denominator. FCA disagrees with the commenter that a 10-percent limit calculation should use a 90-day average balance for both the numerator and the denominator. FCA believes that the commenter's approach could favorably influence the association's calculation of the numerator of the 90-day average, and thus periodically exceed the 10-percent portfolio limit. After considering various alternatives, FCA decides that using a date-specific total investment amount for the numerator best achieves our objective that each association never exceeds the 10-percent portfolio limit. This approach simplifies the calculation by removing one of the two averages proposed. FCA will keep the denominator calculation at a 90-day average because FCA's capital regulations and call report instructions already require FCS institutions to calculate 90-day average daily balances for loans outstanding.

The final rule requires System associations to compute the 10-percent limit based upon a total amount for investments on a specific date in the numerator, divided by a 90-day average daily balance of loans outstanding in the denominator. This calculation values investments at amortized cost. Loans, as defined in § 615.5131, are calculated quarterly (as of the last day of March, June, September, and December) by using the average daily balance of loans during the quarter. For this calculation, loans would include accrued interest, but would not include allowances for loan loss adjustments.

FCA changes the 30-day average daily balance in proposed § 615.5142(a) to a date specific amount in final and redesignated § 615.5140(b)(3). FCA has made a conforming change to the final rule, which requires associations to compute the limit using for the numerator, the date-specific amount of investments divided by the denominator, using the amount of the 90-day average balance reported in the most recent call report. Unless otherwise directed by FCA, associations should calculate this limit quarterly.

A bank trade association asserted that if loan volume declines at an association, the association should liquidate investments to stay within the 10-percent limitation. FCA notes that proposed § 615.5142(e)(2) expressly stated that an association would not need to divest of investments that were eligible when purchased even if a decline in total outstanding loans causes

it to exceed the 10-percent portfolio limit. However, the rule would prohibit associations from purchasing additional investments until their total amount is equal to or less than the 10-percent limit. FCA retains this approach in the final rule and redesignate it as § 615.5140(b)(5). Requiring liquidation of investments when total outstanding loans decline could expose associations to unnecessary losses due to fluctuations in investment prices and associated transaction costs.³⁰ The commenter also claimed that it is unclear whether association investments authorized by the proposed rule would be liquid, and this could increase risk to an association in the event it had to liquidate eligible investments. Given that this regulation limits association investments for risk management purposes to securities that are issued, or unconditionally guaranteed or insured by the U.S. Government or its agencies, the commenter's concern lacks merit.

After reviewing all the comments, FCA has decided to retain the proposed portfolio limit of 10 percent of total outstanding loans, although the final rule contains some minor adjustments, which we explained earlier. This new regulation imposes a portfolio limit on association investments, whereas the former regulation had none. As we explained in the preamble to the proposed rule, the 10-percent limit on investments ensures that loans to agricultural producers and other eligible borrowers constitute most of association assets. In this context, the primary purpose of the portfolio limit is to ensure that System associations adhere to their statutory mission as a GSE to finance agriculture. Additionally, the 10-percent portfolio limit strikes an appropriate balance that enables associations to effectively manage and diversify risks while staying within the boundaries of the Act. Since associations may hold only investments issued, guaranteed or insured by the United States Government and its agencies, and investments approved by FCA on a case-by-case basis, a portfolio limit that does not exceed 10 percent of loans allows an appropriate economy of scale based on expected overhead costs and compliance with investment management requirements in § 615.5133.

³⁰ Although we received no similar comment about the bank investment portfolio limit, we note that the same rationale applies. A System bank would not need to divest of investments that were eligible when purchased even if a decline in total outstanding loans causes it to exceed the 35-percent portfolio limit. However, System banks could not purchase additional investments.

Both System institutions and bank commenters asked whether the 10-percent limit applied to investments that FCA approves on a case-by-case basis. FCA confirms that the final regulation will apply an aggregate limit of 10 percent to investments authorized in § 615.5140.

4. Association Risk Management Requirements

The proposed rule addressed risk management practices that associations must follow if they select, purchase, and hold investments. We designed these provisions to ensure that System associations comply with prudent investment management practices. The proposed rule would have required each association to evaluate its investment management policies, and determine and document how its investment activities adhere to prudent risk management processes and procedures. Under the proposed rule, each association must comply with proposed § 615.5133(a), (b), (c), (d), (e), (h), and (i), which govern investment management practices at all System institutions.³¹ From FCA's perspective, compliance with these provisions of § 615.5133 would instill discipline in investment management practices at each System association, which protects its safety and soundness. Additionally, each association's investment management must be appropriate for the size, risk characteristics, and complexity of the association and its investment portfolio. Investment management must consider the association's unique circumstances, risk tolerances, and objectives.

We asked for comments on whether these new requirements would impose undue regulatory burden on System associations and their funding banks. FCA received no comments about risk management practices at associations. Since these risk management practices enhance safety and soundness at System associations, we adopt the proposed regulatory requirements without substantive revision.

The rule requires each association to assess how investments that they purchase and hold impact the association's credit risk profile, and affect its risk-bearing capacity. Such factors that associations should consider and evaluate include, but are not limited to, its management experience

³¹ Proposed § 615.5142(b)(1) would not require System associations to comply with proposed § 615.5133(f) and (g) because those two provisions explicitly apply only to System banks. Proposed § 615.5142(b) has been redesignated as final § 615.5140(b)(2)(i). FCA did not redesignate § 615.5133(f) and (g).

and capability to understand and manage complex structures and unique risks in the investments it purchases and holds. Associations may purchase and hold investments in final § 615.5140(b)(1) only for managing risks. Although FCA does not expect associations to suffer losses or break-even on investments, using investments *primarily* for speculative purposes or generating gains from trading is an impermissible activity. Likewise, the intentional mismatched funding of investments and the resulting increase in interest rate risk would typically be inappropriate unless used as an effective hedge against other risks on the balance sheet. Other risks that associations should consider and evaluate include prepayment (extension and contraction) risks and interest rate cap risks and how these risks potentially impact earnings.

5. Funding Bank Supervision of Association Investments

Sections 2.2(10) and 2.12(18) of the Farm Credit Act require each association to obtain its funding bank's approval of the association's investment activities under FCA regulations. Proposed § 615.5142(c) sets forth the requirements for funding banks to review, approve, and oversee the investment activities of its affiliated associations. As required by statute, each association must request from its funding bank prior approval to buy and hold investments under this section. FCA structured the proposed rule to provide flexibility so that funding banks could approve types or classes of investments, rather than each individual investment. However, the proposed rule, would require funding banks to review and approve prospective association investments, prior to submission to FCA for case-by-case approval. The FCA Board continues to be the final authority for approving all association case-by-case investments. The proposed rule would require each bank to explain in writing its reasons for approving or denying the association's investment requests.

Once an association has established a satisfactory investment management program that its funding bank has approved, the association could purchase and hold investments that the Act and this regulation authorize. The intent of this provision is to balance the association investment activities with the funding and oversight role of the bank. As part of the approval, the funding bank must evaluate, determine and document that the association has: (1) Adequate policies, procedures, internal controls, and accounting and

reporting systems for its investments; (2) the capability and expertise to effectively manage risks in investments; and (3) complied with requirements of proposed § 615.5142(b). Any prior System association investment management program that the funding bank previously approved would need to be reviewed and re-approved once proposed § 615.5142 becomes final and effective. FCA notes that the General Financing Agreement (GFA) (including any attached, referenced, or related documents) could establish covenants governing the investment activities of an affiliated association. As such, the GFA can be a useful tool for funding banks to review and monitor the investment activities of their affiliated associations.

Finally, the proposed rule would keep the previous requirement that each System bank annually review the investment portfolio of every affiliated association.³² As part of its annual review, the bank must evaluate whether the association's: (1) Investments mitigate and manage its risks; and (2) risk management practices continue to be adequate.

FCA received comments from System institutions and commercial banks about funding bank approval of investments on a program rather than individual basis. We have already addressed this issue in a preceding section. Commercial bank trade associations claimed that FCA was abdicating its responsibilities by authorizing the funding banks to approve classes of association investments. We respond that sections 2.2(10) and 2.12(18) of the Act authorize associations to hold investments as may be approved by their funding bank under the regulations of FCA. This regulation meets this statutory requirement. Additionally, the final regulation only allows associations to invest in obligations issued, guaranteed, or insured by the U.S. Government and its agencies. As stated above, case-by-case investments must be approved by FCA. For these reasons, we adopt proposed § 615.5142(c)(1) as final and redesignate it as § 615.5140(b)(4).

6. Transition Issues From Previous to New Investment Regulations

Proposed § 615.5142(e)(1), would not require an association to divest of any investments held before the effective date of this rule provided we previously authorized the investment under former

§ 615.5140 or by official written Agency action. As we explained in the preamble to the proposed rule, this transition rule would allow an association to continue to hold previous investments that would no longer be authorized by the final rule. After this final rule is effective, institutions may not extend or renew investments past their maturity unless they are authorized by regulation or FCA approval.

Proposed § 615.5142(e)(3) would apply to all investments that an association acquires after the new regulation becomes effective. Specifically, all investments that an association purchases after proposed § 615.5142 becomes effective as a final rule would be subject to § 615.5143 of this part, which governs the managing and divesting of ineligible investments.

A bank trade association opposed this provision because it believes that FCA should not permit associations to hold investments that the final rule no longer authorizes. The commenter claimed that FCA should require immediate divestiture of these readily marketable investments. FCA responds that these investments were eligible when purchased under regulations and a pilot program that were then in effect. It is customary and accepted practice among financial institution regulators to allow institutions to retain investments until maturity, if prior regulations or agency action authorized their purchase unless a statute requires immediate divestiture or there is a compelling safety and soundness reason. As noted above, institutions cannot renew or extend such investments after they mature. Accordingly, we adopt proposed § 615.5142(e)(1) as final and redesignate it as § 615.5140(b)(5).

G. Other Investments Approved by FCA

Since 1999, our investment regulations have allowed all System institutions to purchase and hold other investments (not listed in our regulation) that FCA approves. The regulation requires that all requests for our approval must explain the risk characteristics of the investment and the institution's purpose and objectives for making the investment. We proposed no changes to this provision of our regulation, which still can be found at § 615.5140(e), and the final rule retains this authority without revision. Case-by-case approvals enable System institutions to purchase and hold other investments that are consistent with their statutory authorities and the objectives of the Act. Currently, FCA requires System institutions to submit information and analysis with each approval request that demonstrates that

³² FCA notes that the General Financing Agreement (including any attached, referenced, or related documents) can be a useful tool for funding banks to review and monitor the investment activities of their affiliated associations. See § 614.4125.

the asset is accounted for as an investment under GAAP,³³ and not a loan to an ineligible borrower.

The bankers and their trade associations opposed the case-by-case approval authority. These commenters claim that the case-by-case approval authority in the regulation goes beyond the investment provisions in the Act and Congressional intent. They further claimed that this regulatory provision enables FCA to approve “illegal” loans to ineligible borrowers and classify them as investments. Specifically, these commenters claim that the proposed rule and guidance provided by the Informational Memorandum dated September 4, 2014, would permit FCS institutions to evade lending restrictions by buying instruments that are improperly labeled as “debt securities,” “obligations,” or “bonds.” The commenters state that the proposed rule and the Information Memorandum dated September 4, 2014, does not state that “investments” explicitly exclude commercial business loans. A related complaint was that the proposed rule did not identify specific criteria that FCA would use to distinguish loans from investments and that the approval of private placements would further blur this distinction. According to the commenters, such approvals would enable System institutions to impermissibly compete with tax-paying banks. Another concern of banks and their trade associations is that the case-by-case approvals lack transparency.

FCA proposed no changes to the regulation governing case-by-case approvals of investments by System banks and associations. Accordingly, this final rule makes no changes to this existing regulatory provision. Therefore, FCA is not required to respond to the issues raised above by commercial bankers because they are not relevant to this rulemaking. However, FCA will address each of these issues to be responsive to the bankers and their trade associations, and transparent to the public.

Several provisions of the Farm Credit Act allow FCA to approve new investments at the request of System institutions. Sections 1.5(15), 2.2(10), 2.12(18), and 3.0(13)(A) expressly authorize Farm Credit banks and associations to make other investments as may be authorized under FCA regulations.³⁴ Additionally, section

5.17(a)(5) authorizes FCA to “grant approvals provided for under this Act either on a case-by-case basis or through regulations that confer approval on actions of System institutions.” Pursuant to these statutory provisions, FCA regulations have for many years permitted System institutions to request Agency approval of new investments that are not specifically covered in our regulations. This regulatory approach provides flexibility so System institutions can adapt to changing market conditions within their statutory authority. Financial markets often respond to economic and financial changes by creating new types of investments. By approving new investments under this case-by-case authority, FCA enables the System to react to evolving conditions in the marketplace.

In exercising its explicit statutory authority to approve System investments, FCA remains within the Act. The statute grants System institutions both lending and investment authorities, although it does not always establish specific criteria that distinguish loans from investments. As the Agency charged with interpreting, administering, and implementing the Act, FCA must look to caselaw, other statutes, accounting conventions, and guidance from the FBRA to properly distinguish loans from investments. FCA does not have authority to approve, nor does it approve, “illegal” loans to ineligible borrowers and classify them as investments, as the commenters allege. As stated earlier, FCA, pursuant to the Informational Memorandum of September 4, 2014, only approves obligations that qualify as investments under GAAP. Additionally, FCA will also analyze whether a proposed investment meets the necessary criteria under Federal Securities statutes, such as the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. As part of its analysis, FCA will also consider relevant Federal caselaw such as *Reves v. Ernest & Young*,³⁵ and *SEC v. W.J. Howey Co.*³⁶ Finally, FCA uses the Federal Financial Institution Examination Council’s call report instructions on investments and loans as additional guidance.

In response to bank concerns about whether private placements are investments or loans, FCA notes that the

same logic also applies to case-by-case approval of private placements. We observe that private placements are not liquid, but they are often suitable for other risk management purposes. Private placement securities may be appropriate in limited circumstances for interest rate risk management purposes. Bank commenters point out that private placements are not widely sold to public investors. FCA responds that it has authority to approve such private placement securities on a limited basis under specific conditions provided they meet the criteria of an investment. FCA intends to look at all relevant facts when it determines whether a private placement is an investment, not a loan to an ineligible borrower.

A bank trade association raised concerns that investments approved on a case-by-case basis would be subject to a favorable tax treatment, which would enable System banks and associations to earn additional income. The arguments of the bankers and their trade associations have not persuaded us that case-by-case approval of investments allows System institutions to “unfairly” compete with tax-paying banks. We note that many community banks, which submitted comments, may organize as Subchapter S corporations. The tax treatment for System institutions under the Internal Revenue Code for subchapter T³⁷ is similar to the tax treatment of small banks, with less than or equal to 100 investors, that file under subchapter S.

FCS debt usually trades close to Treasuries. We note that commercial banks may pay the same costs for funds as the System by funding or discounting their agricultural loans through two GSEs—Farmer Mac or the Federal Home Loan Banks. Also, System banks must hold large liquidity portfolios consisting of cash and high-quality investments. Although System banks may deposit cash at a Federal Reserve bank, they do not earn interest on their deposits in contrast to Federal Reserve member banks. In addition, most Treasuries are “negative carry-trades” for System institutions because they funded these investments at a debt price slightly above Treasury rates.

Commercial bankers also claimed that case-by-case approvals lack transparency. The FCA Board must decide whether to approve any investments that are not expressly authorized by regulation. All resolutions that the FCA Board votes on are public

³³ See Information Memorandum of September 4, 2014, (Appendix B, requirement 15).

³⁴ More specifically, the Act expressly allows Farm Credit banks and associations, “to buy and sell obligations of, or insured by, the United States or any agency thereof, or securities backed by the full faith and credit of any such agency, and make

other investments as may be authorized under regulations issued by the Farm Credit Administration.”

³⁵ 494 U.S. 56 (1990).

³⁶ 328 U.S. 293 (1946).

³⁷ Some System institutions may not elect to follow subchapter T in the Internal Revenue Code. Such institutions would pay taxes on retained net income.

documents, and FCA publishes summaries of Board actions on its website. Thus, the public can easily find out information about investments that FCA has approved on a case-by-case basis. Such information includes the investment type, investment amount, the System institution(s) making the investment, general obligor characteristics, and the investment location. Usually, institutions withdraw requests for approval if during the review process, FCA staff indicates that the proposed transaction does not qualify as an investment, or otherwise is not within the applicants' investment authority.

Commercial bank commenters requested that FCA publish a list of the potential investments it would approve on a case-by-case basis under the final rule. We believe that the bankers' approach would deny FCA and the System the flexibility to respond to changing market circumstances. As discussed earlier, sections 1.5(15), 2.2(11), 2.12(18), 3.1(13)(A), and 5.17(a)(5) expressly authorize System banks and associations to hold other investments that FCA approves by regulation. FCA exercises its express statutory authority in a manner that is consistent with law, and safety and soundness.

Commercial bank commenters noted that proposed § 615.5142(a) stated that associations may hold investments only for risk management purposes. They disputed that investments approved by FCA on a case-by-case purposes are for risk management. Under existing § 615.5140(e), case-by-case approvals have not been subject to the existing purpose requirements for association investments. This will continue unchanged in this final rule because FCA proposed no changes, and has made no changes to the case-by-case authority. We note, however, that the purposes for the investments and the risk characteristics of the investment are part of what FCA evaluates in its approval process.

H. Management of Ineligible Investments and Reservation of Authority To Require Divestiture

Our divestiture regulations have long required System institutions to: (1) Quickly divest of investments that were ineligible when purchased; and (2) effectively mitigate the risk associated with investments that became ineligible when their credit quality deteriorated. FCA expects that System institutions will rarely find themselves holding ineligible investments in their portfolio except potentially in times of a widespread financial crisis. Under our

regulatory framework, institutions must report investments that are ineligible when purchased immediately to FCA and divest within 60 calendar days or pursuant to a divestiture plan approved by FCA. If an eligible investment later deteriorates and poses additional risk to the institution, the focus of the institution becomes risk mitigation. FCA reserves authority to require divestiture in specific circumstances.

The proposed rule would retain most of the substantive divestiture requirements in previous § 615.5143. However, the proposed rule identified which divestiture requirements apply to banks, and which ones apply to associations. More specifically, final and redesignated § 615.5140(b)(5) addresses how the new 10-percent portfolio limit for associations pertains to these divestiture requirements.

A bank trade association commented that FCA should not allow System institutions to hold any investment that becomes ineligible. This commenter asked FCA to require System institutions to divest of such investments within 6 months. FCA finds this suggestion to be unduly inflexible. Requiring automatic divestiture within 6 months seems punitive because it may not allow FCA to consider the least costly remedy for the institution. The commenter's suggestion that the final regulation should require institutions to divest of investments that later became ineligible due to a credit downgrade does not consider that some of these investments may later experience a credit upgrade. In these cases, mandatory divestiture within 6 months may expose the System institution to unnecessary losses.

A comment from a bank trade association asked whether FCA is requiring FCS institutions to divest of investments approved under the Investment in Rural America—Pilot Programs after discontinuing those programs. The commenter also questioned why FCA would allow a System institution to continue to hold any investment approved under the pilot program after the program ended. Investments held under the Pilot Programs were designated as rural community investments that furthered the System's mission to increase the flow of funds into rural areas. In response to the commenter's question, we cite the FCA News Release NR 13–15(11–14–13) which states:

“ . . . [T]he Farm Credit Administration Board voted to conclude effective December 31, 2014, each pilot program approved after 2004 as part of the investments in Rural America program. The Board's action permits each Farm Credit System (System) institution

that is participating in a pilot program to continue to hold its investments through the maturity dates for the investments, provided the institution continues to meet all conditions.”

As stated above, the FCA Board permitted System institutions to hold these investments until maturity, and this approach mitigated potential losses to institutions that held these investments.

For these reasons, FCA adopts proposed § 615.5143 as a final regulation without substantive change. However, we made some minor stylistic changes which primarily included revising cross references to association investments which are now in final § 615.5140 instead of § 615.5142.

H. Miscellaneous

1. Appropriate Use of Derivatives

Derivatives can be appropriate and useful for hedging and risk management. While our regulations do not prohibit a System bank from using derivatives to build an investment portfolio, use of these derivatives must be consistent with an authorized investment purpose and not used for speculative purposes. We note that most cleared derivative contracts are very liquid, while many non-cleared derivative contracts are less liquid.

2. Conforming Changes to Other Regulation Sections

We received no comments about provisions in the proposed rule that made conforming changes to references in §§ 611.1153, 611.1155, 615.5174, and 615.5180. Accordingly, we will incorporate these changes into the final rule.

IV. Effective Date

We recognize that Farm Credit banks may require time to bring their policies and procedures into compliance with the new requirements of the final rule. A passage in the preamble to the proposed rule stated that we were contemplating whether the compliance date of the final rule for Farm Credit banks should be 6 months after its effective date. We invited comments as to whether this delayed compliance timeframe would be appropriate. We also asked for comments on whether a delayed compliance date would be appropriate for associations.

An FCS bank claimed that System institutions would need 12 months to make the necessary changes to come into compliance with the final rule. We believe that the changes in this rule for both banks and associations are not so extensive that System institutions need a full 12 months to come into

compliance. We also believe that a more prolonged delay would be detrimental to the safe and sound operations of System institutions. For these reasons, we believe that 6 months is sufficient time for all System institutions to bring their policies, procedures, and internal controls into compliance with the final rule. Accordingly, the final rule will become effective on January 1, 2019.

V. 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 final rule will 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 more than 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

12 CFR Part 611

Agriculture, Banks, banking, Rural areas.

12 CFR Part 615

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

For the reasons stated in the preamble, parts 611 and 615 of chapter VI, title 12 of the Code of Federal Regulations are amended as follows:

PART 611—ORGANIZATION

- 1. The authority citation for part 611 continues to read as follows:

Authority: Secs. 1.2, 1.3, 1.4, 1.5, 1.12, 1.13, 2.0, 2.1, 2.2, 2.10, 2.11, 2.12, 3.0, 3.1, 3.2, 3.3, 3.7, 3.8, 3.9, 3.21, 4.3A, 4.12, 4.12A, 4.15, 4.20, 4.21, 4.25, 4.26, 4.27, 4.28A, 5.9, 5.17, 5.25, 7.0–7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2002, 2011, 2012, 2013, 2020, 2021, 2071, 2072, 2073, 2091, 2092, 2093, 2121, 2122, 2123, 2124, 2128, 2129, 2130, 2142, 2154a, 2183, 2184, 2203, 2208, 2209, 2211, 2212, 2213, 2214, 2243, 2252, 2261, 2279a–2279f–1, 2279aa–5(e)); secs. 411 and 412 of Pub. L. 100–233, 101 Stat. 1568, 1638; sec. 414 of Pub. L. 100–399, 102 Stat. 989, 1004.

§ 611.1153 [Amended]

- 2. Section 611.1153 is amended by removing in paragraph (i)(1) the reference “§ 615.5140(e)” and adding in its place the reference “§ 615.5140(b) or § 615.5142(d)”.

§ 611.1155 [Amended]

- 3. Section 611.1155 is amended by removing in paragraph (a)(1) the

reference “§ 615.5140(e)” and adding in its place the reference “§ 615.5140(b) or § 615.5142(d)”.

PART 615—FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS

- 4. The authority citation for part 615 is revised 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 Pub. L. 92–181, 85 Stat. 583 (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. 780–7 note).

- 5. Section 615.5131 is amended by:
- a. In the definition of “Asset-backed securities (ABS)”, removing the words “mortgage securities” and adding in their place the words “mortgage-backed securities”;
 - b. Adding in alphabetical order definitions for “Asset class”, “Country risk classification (CRC)”, and “Diversified investment fund (DIF)”;
 - c. Removing the definitions for “Eurodollar time deposit”, “Final maturity”, “General obligations”, “Government agency”, and “Government-sponsored agency”;
 - d. Adding in alphabetical order a definition for “Government-sponsored enterprise (GSE)”;
 - e. Removing the definition for “Liquid investments” and “Mortgage securities”;
 - f. Adding in alphabetical order a definition for “Mortgage-backed securities (MBS)”;
 - g. Removing the definition for “Nationally Recognized Statistical Rating Organization (NRSRO)”;
 - h. Adding in alphabetical order definitions for “Obligor” and “Resecuritization”;
 - i. Removing the definition for “Revenue bond”;
 - j. Adding in alphabetical order definitions for “Sponsor” and “United States (U.S.) Government agency”;
 - k. Removing the definitions for “Weighted average life (WAL)”.
- The additions read as follows:

§ 615.5131 Definitions.

* * * * *

Asset class means a group of securities that exhibit similar characteristics and behave similarly in the marketplace. Asset classes include, but are not limited to, money market instruments, municipal securities,

corporate bond securities, MBS, ABS, and any other asset class as determined by FCA.

Country risk classification (CRC) as defined in § 628.2 of this chapter.

Diversified investment fund (DIF)

means an investment company registered under section 8 of the Investment Company Act of 1940.

Government-sponsored enterprise (GSE) means an entity established or chartered by the United States Government to serve public purposes specified by the United States Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

* * * * *

Mortgage-backed securities (MBS)

means securities that are either:

- (1) Pass-through securities or participation certificates that represent ownership of a fractional undivided interest in a specified pool of residential (excluding home equity loans), multifamily or commercial mortgages; or

- (2) A multiclass security (including collateralized mortgage obligations and real estate mortgage investment conduits) that is backed by a pool of residential, multifamily or commercial real estate mortgages, pass through MBS, or other multiclass MBSs.

Obligor means an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded.

Resecuritization as defined in § 628.2 of this chapter.

Sponsor means a person or entity that initiates a transaction by selling or pledging to a specially created issuing entity, such as a trust, a group of financial assets that the sponsor either has originated itself or has purchased.

United States (U.S.) Government agency means an instrumentality of the U.S. Government whose obligations are fully guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government.

* * * * *

- 6. Section 615.5133 is revised to read as follows:

§ 615.5133 Investment management.

(a) *Responsibilities of board of directors.* The board of directors must adopt written policies for managing the institution’s investment activities. The board must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. At

least annually, the board, or a designated committee of the board, must review the sufficiency of these investment policies.

(b) *Investment policies—general requirements.* Investment policies must address the purposes and objectives of investments; risk tolerance; delegations of authority; internal controls; due diligence; and reporting requirements. The investment policies must fully address the extent of pre-purchase analysis that management must perform for various classes of investments. The investment policies must also address the means for reporting, and approvals needed for, exceptions to established policies. A Farm Credit banks investment policy must address portfolio diversification and obligor limits under paragraphs (f) and (g) of this section. Investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of its investments.

(c) *Investment policies—risk tolerance.* Investment policies must establish risk limits for eligible investments and for the entire investment portfolio. The investment policies must include concentration limits to ensure prudent diversification of credit, market, and, as applicable, liquidity risks in the investment portfolio. Risk limits must be based on all relevant factors, including the institution's objectives, capital position, earnings, and quality and reliability of risk management systems and must take into consideration the interest rate risk management program required by § 615.5180 or § 615.5182, as applicable. Investment policies must identify the types and quantity of investments that the institution will hold to achieve its objectives and control credit risk, market risk, and liquidity risk as applicable. Each association or service corporation that holds significant investments and each Farm Credit bank must establish risk limits in its investment policies, as applicable, for the following types of risk:

(1) *Credit risk.* Investment policies must establish:

(i) *Credit quality standards.* Credit quality standards must be established for single or related obligors, sponsors, secured and unsecured exposures, and asset classes or obligations with similar characteristics.

(ii) *Concentration limits.* Concentration limits must be established for single or related obligors, sponsors, geographical areas, industries, unsecured exposures, asset classes or obligations with similar characteristics.

(iii) *Criteria for selecting brokers and dealers.* Each institution must buy and sell eligible investments with more than one securities firm. The institution must define its criteria for selecting brokers and dealers used in buying and selling investments.

(iv) *Collateral margin requirements on repurchase agreements.* To the extent the institution engages in repurchase agreements, it must regularly mark the collateral to fair market value and ensure appropriate controls are maintained over collateral held.

(2) *Market risk.* Investment policies must set market risk limits for specific types of investments and for the investment portfolio.

(3) *Liquidity risk—(i) Liquidity at Farm Credit banks.* Investment policies must describe the liquidity characteristics of eligible investments that the bank will hold to meet its liquidity needs and other institutional objectives.

(ii) *Liquidity at associations.* Investment policies must describe the liquid characteristics of eligible investments that the association will hold.

(4) *Operational risk.* Investment policies must address operational risks, including delegations of authority and internal controls under paragraphs (d) and (e) of this section.

(d) *Delegation of authority.* All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) *Internal controls.* Each institution must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties between personnel who supervise or execute investment transactions and personnel who supervise or engage in all other investment-related functions.

(3) Maintain records and management information systems that are appropriate for the level and complexity of the institution's investment activities.

(4) Implement an effective internal audit program to review, at least annually, the investment management practices including internal controls, reporting processes, and compliance with FCA regulations. This annual review's scope must be appropriate for the size, risk and complexity of the investment portfolio.

(f) *Farm Credit bank portfolio diversification—(1) Well-diversified portfolio.* Subject to the exemptions set forth in paragraph (f)(3) of this section,

each Farm Credit bank must maintain a well-diversified investment portfolio as set forth in paragraph (f)(2) of this section.

(2) *Investment portfolio diversification requirements.* A well-diversified investment portfolio means that, at a minimum, investments are comprised of different asset classes, maturities, industries, geographic areas, and obligors. These diversification requirements apply to each individual security that the Farm Credit bank holds within a DIF. In addition, except as exempted by paragraph (f)(3) of this section, no more than 15 percent of the investment portfolio may be invested in any one asset class. Securities within each DIF count toward the appropriate asset class. Measurement of this diversification requirement must be based on the portfolio valued at amortized cost.

(3) *Exemptions from investment portfolio diversification requirements.* The following investments are not subject to the 15-percent investment portfolio diversification requirement specified in paragraph (f)(2) of this section:

(i) Investments that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency;

(ii) Investments that are fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, except that no more than 50 percent of the investment portfolio may be comprised of GSE MBS. Investments in Farmer Mac securities are governed by § 615.5174 and are not subject to this limitation; and

(iii) Money market instruments identified in § 615.5131.

(g) *Farm Credit bank obligor limit.* No more than 10 percent of a Farm Credit bank's total capital (Tier 1 and Tier 2) as defined by § 628.2 of this chapter may be invested in any one obligor. This obligor limit does not apply to investments in obligations that are fully guaranteed as to the timely payment of principal and interest by U.S. Government agencies or fully and explicitly guaranteed as to the timely payment of principal and interest by GSEs. For a DIF, both the DIF itself and the entities obligated to pay the underlying debt are obligors.

(h) *Due diligence—(1) Pre-purchase analysis—(i) Eligibility and compliance with investment policies.* Before purchasing an investment, the institution must conduct sufficient due diligence to determine whether the investment is eligible under § 615.5140 and complies with its board's investment policies. The institution

must document its assessment and retain any supporting information used in that assessment. The institution may hold an investment that does not comply with its investment policies only with the prior approval of its board.

(ii) *Valuation.* Prior to purchase, the institution must verify the fair market value of the investment (unless it is a new issue) with a source that is independent of the broker, dealer, counterparty or other intermediary to the transaction.

(iii) *Risk assessment.* At purchase, the institution must at a minimum include an evaluation of the credit risk (including country risk when applicable), liquidity risk, market risk, interest rate risk, and underlying collateral of the investment, as applicable. This assessment must be commensurate with the complexity and type of the investment. The institution must also perform stress testing on any structured investment that has uncertain cash flows, including all MBS and ABS, before purchase. The stress test must be commensurate with the type and complexity of the investment and must enable the institution to determine that the investment does not expose its capital, earnings, or liquidity if applicable, to risks that are greater than those specified in its investment policies. The stress testing must comply with the requirements in paragraph (h)(4)(ii) of this section. The institution must document and retain its risk assessment and stress tests conducted on investments purchased.

(2) *Ongoing value determination.* At least monthly, the institution must determine the fair market value of each investment in its portfolio and the fair market value of its whole investment portfolio.

(3) *Ongoing analysis of credit risk.* The institution must establish and maintain processes to monitor and evaluate changes in the credit quality of

each investment in its portfolio and in its whole investment portfolio on an ongoing basis.

(4) *Quarterly stress testing.* (i) The institution must stress test its entire investment portfolio, including stress tests of each investment individually and the whole portfolio, at the end of each quarter. The stress tests must enable the institution to determine that its investment securities, both individually and on a portfolio-wide basis, do not expose its capital, earnings, or liquidity if applicable, to risks that exceed the risk tolerance specified in its investment policies. If the institution's portfolio risk exceeds its investment policy limits, the institution must develop a plan to comply with those limits.

(ii) The institution's stress tests must be defined in a board-approved policy and must include defined parameters for the security types purchased. The stress tests must be comprehensive and appropriate for the institution's risk profile. At a minimum, the stress tests must be able to measure the price sensitivity of investments over a range of possible interest rates and yield curve scenarios. The stress test methodology must be appropriate for the complexity, structure, and cash flows of the investments in the institution's portfolio. The institution must rely to the maximum extent practicable on verifiable information to support all its stress test assumptions, including prepayment and interest rate volatility assumptions. The institution must document the basis for all assumptions used to evaluate the security and its underlying collateral. The institution must also document all subsequent changes in its assumptions.

(5) *Presale value verification.* Before the institution sells an investment, it must verify its fair market value with an independent source not connected with the sale transaction.

(i) *Reports to the board of directors.* At least quarterly, the institution's management must report on the following to its board of directors or a designated board committee:

(1) Plans and strategies for achieving the board's objectives for the investment portfolio;

(2) Whether the investment portfolio effectively achieves the board's objectives;

(3) The current composition, quality, and the risk and liquidity profiles of the investment portfolio;

(4) The performance of each class of investments and the entire investment portfolio, including all gains and losses realized during the quarter on individual investments that the institution sold before maturity and why they were liquidated;

(5) Potential risk exposure to changes in market interest rates as identified through quarterly stress testing and any other factors that may affect the value of its investment holdings;

(6) How investments affect its capital, earnings, and overall financial condition;

(7) Any deviations from the board's policies (must be specifically identified);

(8) The status and performance of each investment described in § 615.5143(a) and (b) or that does not comply with the institution's investment policies; including the expected effect of these investments on its capital, earnings, liquidity, as applicable, and collateral position; and

(9) The terms and status of any required divestiture plan or risk reduction plan.

■ 7. In § 615.5134, paragraph (b) is amended by revising the table to read as follows:

§ 615.5134 Liquidity reserve.

* * * * *
(b) * * *

Liquidity level	Instruments	Discount (multiply by)
Level 1	• Cash, including cash due from traded but not yet settled debt.	100 percent
	• Overnight money market investment	100 percent
	• Obligations of U.S. Government agencies with a final remaining maturity of 3 years or less.	97 percent
	• GSE senior debt securities that mature within 60 days, excluding securities issued by the Farm Credit System.	95 percent
	• Diversified investment funds comprised exclusively of Level 1 instruments.	95 percent
Level 2	• Obligations of U.S. Government agencies with a final remaining maturity of more than 3 years.	97 percent
	• MBS that are fully guaranteed by a U.S. Government agency as to the timely repayment of principal and interest.	95 percent
	• Diversified investment funds comprised exclusively of Levels 1 and 2 instruments.	95 percent

Liquidity level		Instruments	Discount (multiply by)
Level 3	<ul style="list-style-type: none"> • GSE senior debt securities with maturities exceeding 60 days, excluding senior debt securities of the Farm Credit System. • MBS that are fully guaranteed by a GSE as to the timely repayment of principal and interest. • Money market instruments maturing within 90 days • Diversified investment funds comprised exclusively of levels 1, 2, and 3 instruments. 	93 percent for all Level 3 instruments

* * * * *

■ 8. Section 615.5140 is revised to read as follows:

§ 615.5140 Eligible investments.

(a) *Farm Credit banks*—(1) *Investment eligibility criteria.* A Farm Credit bank may purchase an investment only if it satisfies the following investment eligibility criteria:

(i) The investment must be purchased and held for one or more investment purposes authorized in § 615.5132.

(ii) The investment must be one of the following:

(A) A non-convertible senior debt security;

(B) A money market instrument with a maturity of 1 year or less;

(C) A portion of an MBS or ABS that is fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency;

(D) A portion of an MBS or ABS that is fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE;

(E) The senior-most position of an MBS or ABS that a U.S. Government agency does not fully guarantee as to the timely payment of principal and interest or a GSE does not fully and explicitly guarantee as to the timely payment of principal and interest, provided that the MBS satisfies the definition of “mortgage related security” in 15 U.S.C. 78c(a)(41);

(F) An obligation of an international or multilateral development bank in which the U.S. is a voting member; or

(G) Shares of a diversified investment fund registered under the Investment Company Act of 1940, if its portfolio consists solely of securities that satisfy paragraph (a)(1)(ii)(A), (B), (C), (D), (E), or (F) of this section, or are eligible under § 615.5174. The investment company’s risk and return objectives and use of derivatives must be consistent with the Farm Credit bank’s investment policies.

(iii) At least one obligor of the investment must have very strong capacity to meet its financial commitment for the expected life of the investment. If any obligor whose capacity to meet its financial

commitment is being relied upon to satisfy this requirement is located outside the U.S., either:

(A) That obligor’s sovereign host country must have the highest or second-highest consensus Country Risk Classification (0 or 1) as published by the Organization for Economic Cooperation and Development (OECD) or be an OECD member that is unrated; or

(B) The investment must be fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency.

(iv) The investment must exhibit low credit risk and other risk characteristics consistent with the purpose or purposes for which it is held.

(v) The investment must be denominated in U.S. dollars.

(2) *Resecuritizations.* Notwithstanding any other provision of this section, System banks may *not* purchase securitizations (except when both principal and interest are fully and explicitly guaranteed by the U.S. Government or a GSE) without approval under paragraph (e) of this section.

(b) *Farm Credit associations*—(1) *Risk management investments.* Each Farm Credit System association, with the approval of its funding bank, may purchase and hold investments to manage risks. Each association must identify and evaluate how the investments that it purchases contributes to management of its risks. Only securities that are issued by, or are unconditionally guaranteed or insured as to the timely payment of principal and interest by, the United States Government or its agencies are investments that associations may acquire for risk management purposes under this paragraph (b).

(2) *Secondary market Government-guaranteed loans.* 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 investments under this paragraph (b).

(3) *Risk management requirements.* Each association that purchases investments for risk management 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:

(i) Complies with § 615.5133(a), (b), (c), (d), and (e). These investment management processes must be appropriate for the size, risk and complexity of the association’s investment portfolio.

(ii) Complies with § 615.5182 for investments that exhibit interest rate risk that could lead to significant declines in net income or in the market value of capital.

(iii) Assesses how these investments impact the association’s overall credit risk profile and how these investment purchases aid in diversifying, hedging, or mitigating overall credit risk.

(iv) Considers and evaluates any other relevant factors unique to the association or to the nature of the investments that could affect the association’s overall risk-bearing capacity, including but not limited to management experience and capability to understand and manage unique risks in investments purchased.

(4) *Association investment portfolio limit.* The total amount of investments purchased and held under this section must not exceed 10 percent of the association’s total outstanding loans. In computing this limit:

(i) Include in the numerator the daily (point-in-time) balance of all investments purchased and held under this section. Unless otherwise directed by FCA, associations must use the investment balance on the last business day of the quarter when calculating the numerator of the portfolio limit under this paragraph. For this calculation, value investments at amortized cost and accrued interest.

(ii) Include in the denominator the 90-day average daily balance of total outstanding loans as defined in § 615.5132. For this calculation, value loans at amortized cost and include accrued interest. The denominator does not include any allowance for loan loss adjustments.

(iii) Exclude from the numerator the following:

(A) Equity investments in unincorporated business entities authorized in § 611.1150 of this chapter;

(B) Equity investments in Rural Business Investment Companies organized under 7 U.S.C. 2009cc *et seq.*;

(C) Equity investments in Class B Farmer Mac stock authorized in § 615.5173; and

(D) Farmer Mac agricultural mortgage-backed securities under § 615.5174.

(5) *Funding bank supervision of association investments.* (i) The association must not purchase and hold investments without the funding bank's prior approval. The bank must review the association's prior approval requests and explain in writing its reasons for approving or denying the request. The prior approval is required before the association engages in investment activities and with any significant change(s) in investment strategy.

(ii) In deciding whether to approve an association's request to purchase and hold investments, the bank must evaluate and document that the association:

(A) Has adequate policies, procedures, and controls, in place for its investment accounting and reporting;

(B) Has capable staff with the necessary expertise to manage the risks in investments; and

(C) Complies with paragraph (b)(3) of this section.

(iii) The bank must review annually the investment portfolio of every association that it funds. This annual review must evaluate whether the association's investments manage risks over time, and the continued adequacy of the associations' risk management practices.

(6) *Transition for association investments.* (i) An association is not required to divest of any investment held on January 1, 2019 that was authorized under § 615.5140 as contained in 12 CFR part 615 revised as of January 1, 2018 or otherwise by official written FCA action that allowed the association to continue to hold such investment. Once such investment matures, the association must not renew it unless the investment is authorized pursuant to this section.

(ii) No association is required to divest of investments if a decline in total outstanding loans causes it to exceed the portfolio limit in paragraph (b)(3) of this section. However, the

institution must not purchase new investments unless, after they are purchased, the total amount of investments held falls within the portfolio limit.

(c) *Reservation of authority.* FCA may, on a case-by-case basis, determine that a particular investment you are holding poses inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria. If so, we will notify you as to the proper treatment of the investment.

(d) [Reserved]

(e) *Other investments approved by FCA.* You may purchase and hold investments that we approve. Your request for our approval must explain the risk characteristics of the investment and your purpose and objectives for making the investment.

§ 615.5142 [Removed and reserved]

■ 9. Section 615.5142 is removed and reserved.

■ 10. Section 615.5143 is revised to read as follows:

§ 615.5143 Management of ineligible investments and reservation of authority to require divestiture.

(a) *Investments ineligible when purchased.* Investments that do not satisfy the eligibility criteria set forth in § 615.5140(a) or (b) or investments FCA had not approved under § 615.5140(e), as applicable, at the time of purchase are ineligible. System institutions must not purchase ineligible investments. If the institution determines that it has purchased an ineligible investment, it must notify FCA within 15 calendar days after the determination. The institution must divest of the investment no later than 60 calendar days after determining that the investment is ineligible unless FCA approves, in writing, a plan that authorizes the institution to divest the investment over a longer period. Until the institution divests of the ineligible investment:

(1) A Farm Credit bank must not use the ineligible investment to satisfy its liquidity requirement(s) under § 615.5134;

(2) The institution must include the ineligible investment in the portfolio limit calculation defined in § 615.5132 or § 615.5140(b)(3), as applicable; and

(3) A Farm Credit bank must exclude the ineligible investment as collateral under § 615.5050.

(b) *Investments that no longer satisfy investment eligibility criteria.* If the institution determines that an investment (that satisfied the eligibility criteria set forth in § 615.5140(a) or (b), as applicable, when purchased) no longer satisfies the criteria, or that an investment that FCA approved pursuant to § 615.5140(e), no longer satisfies the conditions of approval, the institution may continue to hold the investment, subject to the following requirements:

(1) The institution must notify FCA within 15 calendar days after such determination;

(2) A Farm Credit bank must not use the ineligible investment to satisfy its liquidity requirement(s) under § 615.5134;

(3) The institution must include the ineligible investment in the portfolio limit calculation defined in § 615.5132 or § 615.5140(b)(3), as applicable;

(4) A Farm Credit bank may continue to include the investment as collateral under § 615.5050 at the lower of cost or market value; and

(5) The institution must develop a plan to reduce the investment's risk to the institution.

(c) *Reservation of authority.* FCA retains the authority to require the institution to divest of any investment at any time for failure to comply with § 615.5132(a) or § 615.5140(a), (b), or (e), or for safety and soundness reasons. The timeframe set by FCA will consider the expected loss on the transaction (or transactions) and the effect on the institution's financial condition and performance.

§ 615.5174 [Amended]

■ 11. In § 615.5174, paragraph (d) is amended by removing the reference “§ 615.5133(f)(1)(iii) and § 615.5133(f)(4)” and adding in its place “§ 615.5133(h)(1)(iii) and (h)(4)”.

§ 615.5180 [Amended]

■ 12. In § 615.5180, paragraph (c)(3) is amended by removing the reference “§ 615.5133(f)(4)” and adding in its place the reference “§ 615.5133(h)(4)”.

Dated: June 5, 2018.

Dale L. Aultman,

Secretary, Farm Credit Administration Board.

[FR Doc. 2018–12366 Filed 6–11–18; 8:45 am]

BILLING CODE 6705–01–P