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FARM CREDIT ADMINISTRATION

12 CFR Part 615

RIN 3052-AC14

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Capital Adequacy—ABS and MBS Investments

AGENCY: Farm Credit Administration.

ACTION: Interim final rule with request for comments.

SUMMARY: The Farm Credit Administration (FCA or agency) is issuing an interim final rule to amend our regulatory capital standards to allow Farm Credit System (FCS or System) institutions to use a lower risk weighting for highly rated investments in non-agency asset-backed securities (ABS) and mortgage-backed securities (MBS) that have reduced exposure to credit risk. We are adopting this rule so that the capital requirements for risk weighting of highly rated non-agency ABS and MBS investments will more closely reflect an institution's relative exposure to credit risk and help achieve a more consistent regulatory capital treatment with the other financial regulatory agencies. This interim rule will be effective until we take final action on planned further amendments to our capital regulations.

DATES: This regulation will become effective 30 days after publication in the **Federal Register** during which either or both houses of Congress are in session. We will publish notice of the effective date in the **Federal Register**. Please send your comments to the FCA by April 28, 2003.

ADDRESSES: Please send comments by electronic mail to "reg-comm@fca.gov" or through the Pending Regulations section of FCA's Web site, <http://www.fca.gov>. You may also send comments to Thomas G. McKenzie, Director, Regulation and Policy

Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or by fax to (703) 734-5784. You may review copies of all comments at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of our interim final rule are to:

- Ensure FCS institutions maintain capital levels commensurate with their relative exposure to credit risk by allowing them to use a lower risk weighting for highly rated non-agency¹ ABS and MBS investments that have reduced exposure to credit risk;
- Help achieve a more consistent regulatory capital treatment with the other financial regulatory agencies;²
- Allow FCS institutions' capital to be used more efficiently in serving agriculture and rural America and support of other System mission activities; and
- Reduce regulatory burden on FCS institutions.

II. Background

Section 615.5210 specifies the risk weightings that FCS institutions must use to calculate capital ratios for meeting our minimum risk-based capital standards. This regulation requires institutions to risk-weight their investments in non-agency ABS and MBS (including commercial MBS) as follows:

¹ Non-agency securities are securities not issued or guaranteed by the United States Government, a Government agency (as defined in § 615.5201(f)), or a Government-sponsored agency (as defined in § 615.5201(g)).

² We refer collectively to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision as the "other financial regulatory agencies."

Investment type	Current risk weighting (Percent)
Non-agency ABS and MBS with maturities under 1 year	50
Non-agency ABS and MBS with maturities of 1 year or more	100

Section 615.5140 permits System institutions to invest in non-agency ABS and MBS only if these securities are rated in the highest credit rating by a nationally recognized statistical rating organization (NRSRO),³ are marketable,⁴ and satisfy certain other requirements.

In November 2001, the other financial regulatory agencies adopted amendments to their regulatory capital standards that, among other changes, allow banking organizations⁵ to apply a lower risk weighting to certain transactions that have reduced exposure to credit risk (including highly rated non-agency ABS and MBS investments).⁶ These changes were implemented so that the capital requirements would more closely reflect a banking organization's relative exposure to credit risk and help achieve a consistent regulatory capital treatment among the financial regulatory agencies for transactions involving similar risk. The changes were effective for banking organization transactions settled after January 1, 2002.

In a letter dated August 26, 2002, the Farm Credit Council (Council), on behalf of the FCS banks, asked the FCA to allow FCS banks to apply a lower risk weighting for capital computation purposes to investments in non-agency ABS and MBS that satisfy our criteria for eligible investments. The Council specifically asked the FCA to allow the banks to apply a 20-percent risk weighting to these investments.

Since fiscal year 2001, the FCA Board's regulatory plan has included a rulemaking project that would address many of the changes implemented by

³ Section 615.5131 defines NRSRO as a rating organization that the Securities and Exchange Commission recognizes as an NRSRO.

⁴ Section 615.5140(c) provides that an investment is marketable if you can sell it quickly at a price that closely reflects its fair value in an active and universally recognized secondary market.

⁵ We refer collectively to commercial banks, bank holding companies, and thrifts as "banking organizations."

⁶ See 66 FR 59614, November 29, 2001.