

New Section 615.5301(j)—Definition of Total Liabilities

We add a new § 615.5301(j) to define “total liabilities” for the purpose of calculating the net collateral ratio. This new definition limits the effect of the new accounting requirements for derivatives in SFAS 133, as promulgated by the Financial Accounting Standards Board. The net collateral ratio is a bank’s net collateral, as defined in § 615.5301(c), divided by the bank’s total liabilities. Section 615.5301(j)(1) specifies that total liabilities are valued in accordance with generally accepted accounting principles (GAAP), with the following exclusions for the effects of SFAS 133: (1) Adjustments to the carrying amount³ of any liability that is designated as being hedged; and (2) any derivative recognized as a liability that is designated as a hedging instrument.

Prior to SFAS 133, GAAP allowed many derivative instruments to be treated by System banks as off-balance sheet items. However, with the adoption of SFAS 133, System banks must now recognize all derivative instruments at their fair value as either an asset or a liability on the balance sheet. If a derivative instrument qualifies as a designated hedge,⁴ System banks may be required to adjust the carrying value of certain assets or liabilities.

As a result of SFAS 133, System banks that use derivatives may have to recognize an increase in the amount of total liabilities when calculating their net collateral ratios. These increases in total liabilities have resulted in lower net collateral ratios than what the banks would have had under the previous accounting requirements for derivative instruments.

Under SFAS 133, a System bank’s total liabilities will often increase for a derivative instrument designated as hedged. This resulting increase in the bank’s liabilities from a derivative instrument designated as a hedge has no offsetting equivalent increase in the collateral amount used in the computation of its net collateral ratio because of the way net collateral is defined in § 615.5301(c). Thus, a

derivative instrument used by a bank to hedge against interest rate risk can often result in an unintended decline in the bank’s net collateral ratio.

We believe a bank’s net collateral ratio should not be negatively affected by derivative instruments appropriately used to hedge against interest rate risk or other types of market risks. Appropriate use of derivatives as hedges protects System banks against a true economic decline in their net collateral. Accordingly, our amendment excludes the effect of SFAS 133 on the calculation of the net collateral ratio for derivative instruments that qualify as hedges under SFAS 133.

Conversely, we believe derivative instruments that are not designated to hedge specific assets or liabilities do not provide adequate protections for interest rate or other market risks. Therefore, our definition of total liabilities *includes* derivative instruments that do not qualify as designated hedges.

Section 615.5301(j)(2) also excludes from total liabilities the amount of term preferred stock that is eligible to be counted as total surplus in the numerator of a bank’s calculation of its total surplus ratio. In the absence of such exclusion, the existing rule could have required certain forms of term preferred stock to be considered liabilities. The exclusion eliminates the potential inconsistency of treating a particular balance sheet item as a liability for net collateral purposes but as capital for the total surplus ratio.

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA hereby certifies that the 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 in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not “small entities” as defined in the Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 615

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

■ For the reasons stated in the preamble, we amend part 615 of chapter VI, title 12 of the Code of Federal Regulations as follows:

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

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

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

Subpart H—Capital Adequacy

■ 2. Amend § 615.5201 as follows:

■ a. Remove the words “loan of lease” in paragraph (e) and add in their place, the words “loan or lease”; and

■ b. Add a new paragraph (l)(8).

§ 615.5201 Definitions.

(1) * * *

(8) Any other debt or equity instruments or other accounts the FCA has determined are appropriate to be considered permanent capital. The FCA may permit one or more institutions to include all or a portion of such instrument, entry, or account as permanent capital, permanently or on a temporary basis, for purposes of this part.

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Subpart I—Issuance of Equities

■ 3. Amend § 615.5250 by revising paragraph (c)(5) to read as follows:

§ 615.5250 Disclosure requirements.

(c) * * *

(5) For a class of stock, the FCA may waive any or all of the disclosure requirements of paragraph (c)(1) of this section when each investor acquires at least \$100,000 of the stock if the sophistication of the purchaser warrants, provided that subsequent transfers of the stock in amounts of less than \$100,000 must receive the prior written approval of the FCA.

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Subpart K—Surplus and Collateral Requirements

■ 4. Amend § 615.5301 as follows:

■ a. Redesignate paragraphs (i)(4) through (i)(7) as paragraphs (i)(5) through (i)(8);

■ b. Remove the reference “§ 615.5201(j)(4)(iv)” in paragraph (i)(2)

³ GAAP defines the carrying amount of a liability as the face amount of a liability increased or decreased by any applicable accrued interest payable and any applicable unamortized premium, discount, finance charges, or issue costs.

⁴ Under SFAS 133, derivative instruments designated as hedges routinely reduce an entity’s exposure to changes in the fair value of an asset or liability (*i.e.*, fair value hedge) or changes in expected future cash flows (*i.e.*, cash flow hedge) attributable to a particular risk. For Farm Credit banks, derivative instruments are routinely used to reduce their exposure to (hedge against) changes in interest rates or other types of market risks.