

program. Farm Credit banks provide funding and liquidity to OFIs, whereas FCS direct lender associations provide these services through the Farmers' notes program. In both programs, the FCS acts as a source of funding and liquidity to agricultural creditors who need these services so they can meet the credit needs of their customers. As a result, the System fulfills its mission to finance agriculture and related activities in rural America, as Congress intended. From the FCA's perspective, agriculture benefits when System and non-System lenders cooperate to make affordable credit more available for farmers, ranchers, aquatic producers and harvesters, farm-related businesses, and rural homeowners.

#### IV. Capital Risk Weighting

We have previously interpreted our regulations as requiring funding banks to risk weight loans to OFIs at 100 percent. In contrast, existing § 615.5210(f)(2)(ii)(I) allows Farm Credit banks to risk weight loans to System associations at 20 percent. This means Farm Credit banks currently hold more capital (at a minimum) for loans to OFIs than loans to System associations, which in many cases have similar structures and financial conditions as OFIs.

The ANPRM acknowledged that many OFIs, particularly commercial banks or their affiliates might pose no greater risk to their FCS funding bank than System associations. However, unregulated non-bank OFIs could expose their System funding bank to greater risk than FCS associations and regulated OFIs. The preamble to the ANPRM explained, in detail, the risk-reducing features of FCS associations that justified a 20-percent risk weighting.<sup>17</sup>

Furthermore, as the preamble to the ANPRM observed, the risk-weighting categories in the FCA's capital regulations are patterned after the risk-weighting categories in the 1988 Basel Accord, which the other Federal bank regulatory agencies adopted and applied to all depository institutions. As a result, many, but not all, OFIs have the same risk-reducing features as FCS associations. The ANPRM asked several questions about whether and how we should amend our capital regulations to address the risk weighting of OFI loans by Farm Credit banks.

We received 38 comments on this issue during the ANPRM comment period and as part of the public meeting testimony from 28 commercial banks, two non-bank entities and OFIs, five Farm Credit banks, and two

associations. The overwhelming majority of the commenters supported the concept of differentiating the risk weighting of OFI loans based on the structure and risk-mitigating characteristics of the OFIs. Under this approach, OFIs that are Federal- or state-regulated depository institutions or their affiliates would be risk-weighted at 20 percent, while unregulated non-bank OFIs might be risk weighted at a higher percentage. One unregulated OFI opposed any change to the risk weighting of OFI loans by Farm Credit banks. Three commenters, including two FCBs, suggested that Farm Credit banks apply the same risk weight to all OFI and FCS association loans.

The FCA proposes amendments to § 615.5210 that would permit Farm Credit banks to risk weight their loans to OFIs that are Federal- or state-regulated depository institutions, or their affiliates, at 20 percent. Under this proposal, Farm Credit banks would continue to risk weight loans to OFIs that are unregulated, or exhibit a higher risk profile at either 50 or 100 percent, depending on certain factors, which are explained below. Although we received no comments about how to risk weight Farmers' notes, the proposed rule would establish similar risk weights for these investments.

The proposed rule would establish a 20-percent risk weighting for OFIs or Farmers' notes sold by entities that are either: (1) An equivalent to an OECD<sup>18</sup> bank (Federal- or state-regulated depository institution); (2) subsidiaries of OECD equivalent banks or bank holding companies and carry full guarantees from such parent entities; or (3) an institution that carries one of the three highest ratings from a nationally recognized statistical rating organization (NRSRO).<sup>19</sup>

Additional criteria for a 20-percent risk weighting is that the obligation must have full recourse or another form of credit enhancement. Under § 614.4570(a), OFIs must pledge full

recourse on all loans they fund or discount with a Farm Credit bank. Proposed § 615.5172(d) requires full recourse or another form of credit enhancement for Farmers' notes as described in the proposed rule.

Proposed § 615.5210 would establish a 50-percent risk weighting for OFIs or Farmers' notes sold by entities that: (1) Are not OECD banks but otherwise meet similar capital and operational standards; and (2) carry an investment grade or higher NRSRO rating. Again, full recourse or another appropriate credit enhancement is a condition for the 50-percent risk weighting. The proposed rule establishes a 100-percent risk weighting for all OFIs and Farmers' notes that do not qualify for the 20-percent or 50-percent risk weight categories.

Applying lower risk weightings for OFIs that are considered less risky would allow the FCBs to hold less capital to support such loans. This approach is consistent with the direction from the proposed Basel Accord revisions, which are currently under consideration. Lowering the capital requirements for OFI loans will lower the operating costs of the OFI program to Farm Credit banks, which in turn should lower the cost of funds to OFIs and ultimately reduce interest rates charged to OFI borrowers. These outcomes would advance the System's public mission to provide affordable credit on a consistent basis to agriculture and rural America. Greater flexibility for the risk weighting of OFI loans should provide the Farm Credit banks additional incentives to expand their lending to both existing and new OFIs.

#### V. 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 proposed 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

##### 12 CFR Part 614

Agriculture, Banks, banking, Foreign trade, Reporting and recordkeeping requirements, Rural areas.

<sup>17</sup> See 65 FR 21151 (April 20, 2000).

<sup>18</sup> OECD means the group of countries that are full members of the Organization for Economic Cooperation and Development, regardless of entry date, as well as countries that have concluded special lending arrangements with the International Monetary Fund's General Arrangement to Borrow, excluding any country that has rescheduled its external sovereign debt within the previous 5 years. For purposes of United States banking operations, all Federally regulated depository institutions are considered the equivalent of OECD banks.

<sup>19</sup> Nationally recognized statistical rating organization means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.