

consistent with 1720.4(a)(4) and the statute.

Lenders could alternatively elect to directly pass through to the cooperative borrowers the lower interest rates it obtains under the Program by reducing the rate on a like amount of eligible loans consistent with 1720.4(a)(4) and the statute. Eligible loans consist of either new or existing loans made for electrification or telephone projects that are eligible for assistance under the RE Act and are made concurrently with RUS-funded loans. The Secretary has the authority to require that borrowers seek concurrent loans for up to 30 percent of their request as provided in Section 307 of the RE Act. Using current interest rates as a guideline, lenders with a mid investment grade credit rating are able to issue long-term debt at approximately 2 percent over the comparable term U.S. Treasury bond yield. Similar-term debt guaranteed by the U.S. government is estimated to trade at a yield spread of approximately 0.5 percent over Treasuries. Thus, there is a potential interest rate savings of approximately 1.5 percent for lenders under this guarantee program. However, the 30 basis point average annual fee associated with the guarantees reduces the potential savings. Subtracting out the fee, average interest rate savings of approximately 1.2 percent could still be realized by qualified lenders under the guarantee program.

The Federal government would deposit the annual guarantee fees it charges the Lender, less any portion necessary to pay the subsidy cost, into an account for grants and zero interest rate rural economic development loans under the Rural Economic Development Loan and Grant Program ("REDLG"). Assuming \$3 billion of loan guarantees were made under this program, approximately \$90 million dollars of investment capital could be infused into the REDLG over the next 15 years.¹ Past performance indicates that this amount could be leveraged to approximately \$265.5 million in total investment in rural America through further investment by private lenders and investors.² Using USDA's Economic Research Service multiplier for rural employment, an investment of this size

could be expected to generate over 6,000 jobs in rural America.³

The RUS program has been very successful over the years in effectively managing the government's risk. This has been accomplished by ensuring that borrowers meet strict financial and engineering requirements. Since the late 1930's the REA and now RUS has administered the Electric and Telecommunications programs which currently hold a cumulative outstanding balance of over \$45 billion. During that time the Electric and Telecommunications programs have experienced only ten defaults that required a write-off of debt in the amount of \$4.9 billion.

Federal government guarantee programs by their nature expose the taxpayer to financial risk. For the Program, the risks are estimated to be minimal because of the non-competitive nature of many of the businesses for which loans could be made (e.g., electric distribution cooperatives) and the requirement for guarantee recipients to pay an annual fee that offsets expected losses. Steps that will be taken to further reduce risk include stipulating minimum credit ratings without guarantees, establishing sound underwriting criteria, and requiring the participant to demonstrate industry expertise.

FIRREA Requirements

For this program the Federal Government proposes using capital adequacy standards of the banking industry as defined by the Federal Institutions Reform, Recovery and Enforcement Act (FIRREA). FIRREA provides regulatory oversight of all Savings and Loan institutions under the Office of Thrift Supervision. FIRREA contains a number of provisions relating to capital standards and consequences for failure to meet those standards.

The Capital Adequacy standards in FIRREA will be utilized by the Program. The investment grade rating required by the Program statute indicates that applicants must satisfy capital adequacy requirements necessary to meet their payment obligations. As part of the financial covenants in the final guarantee agreement between RUS and the participant, language will be included that is designed to address the capital adequacy standards of FIRREA. These may include financial indicators such as loan loss reserves, debt-to-equity ratios, and times-interest-earned ratios.

FIRREA contains specific language that addresses non-compliance with capital adequacy requirements to limit the institution's ability to grow, restrict its growth to correspond with capital, or submit plans to reach compliance. As part of the financial covenants in the Program legal documents, language will be included to address non-compliance with capital adequacy standards or credit rating downgrades to include specific remedies—such as requiring the obligor to post additional collateral until the capital adequacy standards are met or increases in the interest rates on the guaranteed bonds or notes.

Issues for Public Comment

In this proposed rulemaking RUS is soliciting information from the public on all aspects including terms, limitations and conditions of this program with the goal of attaining the greatest possible public benefits without assuming undue risks for the U.S. Treasury and taxpayers. Furthermore, RUS asks that commenters give consideration to the following questions.

1. A description of the impacts on rural America is presented in the preamble. Is this description complete or are there other concerns with regard to the potential benefits for, or costs to, rural communities, lenders making use of the program, or taxpayers?

2. The proposed rule requires collateral for securitization of a bond under this program as well as the establishment of a bankruptcy remote trust fund capitalized at 5% of the guaranteed amount outstanding. This trust fund would be viewed as a risk-sharing mechanism in light of the government's potential 100% guarantee of an applicant's obligations. The trust fund would establish additional collateral for reimbursement of any advances the government makes on its guarantee. Please comment on this risk-sharing methodology and other methods to protect the guarantor's interests through collateralization.

3. The capital adequacy standards of FIRREA will be utilized by this program. Please comment on the use of FIRREA standards as a model and the use of FIRREA-like restrictions in the event of noncompliance. Please also comment on whether the use of financial triggers is an effective mechanism for protecting the guarantor's interests.

4. The proposed rule does not impose a limitation on the proceeds of the bond or note guaranteed. One consideration for this program is to limit the amount of refinancing to 25% of the amount guaranteed. It is believed that such a

¹ Assumes 20 basis points (.20 percent) of the 30 basis point (.30 percent) guarantee fee is deposited in the REDLG account annually. .20 percent × \$3 billion = \$6 million × 15 years = \$90 million.

² Estimated using historical investment leveraged from the flow of funds into the REDLG account where every \$1 in investment into the REDLG account leveraged \$2.95 in further investment in rural America. Data provided by RBS.

³ Estimated using the USDA's Economic Research Service multiplier for rural employment, which estimates that for every \$1 million in investment, 23 jobs are created nationwide.