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FARM CREDIT ADMINISTRATION

12 CFR Parts 620, 621, 650, 651, 652, 653, 654, and 655

RIN 3052-AC18

Disclosure to Shareholders; Accounting and Reporting Requirements; Federal Agricultural Mortgage Corporation General Provisions; Federal Agricultural Mortgage Corporation Governance; Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Federal Agricultural Mortgage Corporation Disclosure and Reporting Requirements

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA, our, or we) issues this final rule governing the Federal Agricultural Mortgage Corporation (Farmer Mac or the Corporation) in the areas of non-program investments and liquidity. The intent of the rule is to ensure that Farmer Mac continues to hold high-quality, liquid investments to maintain a sufficient liquidity reserve, invest surplus funds, and manage interest-rate risk, while maintaining non-program investments at appropriate levels considering Farmer Mac's status as a Government-sponsored enterprise.

EFFECTIVE DATE: This regulation will be effective 30 days after publication in the **Federal Register** during which time either or both Houses of Congress are in session. We will publish a notice of the effective date in the **Federal Register**.

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SUPPLEMENTARY INFORMATION:

I. Objectives

Farmer Mac's long-term liquidity is dependent on its ability to obtain funding from the securities markets. To aid in assuring market access, sources of liquid and low-risk investments are needed to provide liquidity in the short-term in the event of market disruptions or aberrations. The primary objectives of the final rule are to ensure the safety and soundness and continuity of Farmer Mac operations by:

- Establishing minimum liquidity standards that would require Farmer Mac to hold sufficient high-quality, marketable investments to provide adequate liquidity to fund maturing obligations, interest expense, and operating expenses for a minimum of 60 days;
- Specifying the type, quality, and maximum amount (or limit) of non-program investments¹ that may be held by Farmer Mac;
- Establishing diversification requirements, including portfolio limits on specific types of investments and counterparty exposure limits; and
- Requiring Farmer Mac's board of directors to approve liquidity and non-program investment management policies and implement appropriate internal controls to oversee the investment and liquidity management of the Corporation.

Another objective of this proposal is to better organize current regulatory

¹Pursuant to title VIII of the Farm Credit Act of 1971, as amended (Act), Farmer Mac issues debt in order to purchase or commit to purchase (invest in) "program" assets and obligations under the Corporation's core programs known as the Farmer Mac I Program and the Farmer Mac II Program. Under these programs, Farmer Mac purchases, or commits to purchase, "qualified loans," as that term is defined in section 8.0(9) of the Act. Generally, "qualified loans" consist of loans on agricultural real estate or portions of loans guaranteed by the United States Department of Agriculture. Under section 8.0(1) of the Act, "agricultural real estate" includes both (1) a parcel or parcels of land or a building or structure affixed to the parcel or parcels that is used for the production of one or more agricultural commodities or products and (2) single-family, moderately priced principal residential dwellings located in rural areas. In this supplementary information, we refer to loans made on this latter type of real estate as "rural housing mortgages." The rule defines investments other than those in (1) "qualified loans," or (2) securities collateralized by "qualified loans," as "non-program" investments.

sections pertaining to Farmer Mac, details of which are discussed in section V. below.

II. Background

On June 14, 2004, we published a proposed regulation for public comment.² As discussed in the proposed rule's supplementary information, we proposed these regulations because Farmer Mac has grown significantly in the past 10 years in terms of on-balance sheet assets and off-balance sheet obligations. We believe its exposure to various business risks, including liquidity risk, also has grown and could grow significantly in the future. In addition, excessive or inappropriate use of non-program investments is not consistent with the Corporation's status as a Government-sponsored enterprise (GSE). This rule seeks to enhance both safety and soundness and the program focus of the Corporation.

III. Comments

We received four comment letters on the proposed rule; two from Farmer Mac, and one each from the Farm Credit Bank of Texas (FCBT) and AgFirst Farm Credit Bank (AgFirst). In general, the comments consider the proposed rule's provisions to be inappropriately detailed, specific, and restrictive. Specific comments are discussed in the next section of this supplementary information.

IV. FCA's Summary of the Provisions of the Final Rule and Responses to Comments on the Proposed Rule

We begin by summarizing and responding to general comments on the proposed rule and then provide a section-by-section summary of provisions of the final rule. This summary includes a discussion of the comments on the proposed rule and FCA's responses to the comments.

A. General Comments

Farmer Mac and AgFirst commented that, in general, policies and procedures for investments, liquidity and the management of interest rate risk are best left to the Corporation's board of directors, with FCA oversight through the examination process. FCBT echoed this general view, adding that any regulations should be flexible enough to

² 69 FR 32905.

allow management the capability to react quickly to changing circumstances. All three commenters suggested that the level of specificity in the proposed rule could result in Farmer Mac's management being constrained to an undesirable degree under certain conditions.

In responding to these concerns we note that a primary objective of the rule is to establish a regulatory framework governing non-program investments and liquidity. This framework includes several quantitative limits on which the liquidity policies of the Corporation are to be based. We intend this regulatory framework to provide management with an enhanced level of guidance with which to structure the Corporation's internal policies on liquidity and non-program investments as well as to establish FCA standards of acceptability through quantitative limits on these measurements.

One specific requirement, the minimum liquidity reserve requirement (Farmer Mac must hold liquid investments sufficient to fund at least 60 days of maturing obligations, interest expense, and operating expenses)³ should not be viewed as a target but as the minimum acceptable level under normal financial market conditions. The Corporation must also implement internal policy targets for days-of-liquidity. We believe the 60-day minimum provides the Corporation sufficient flexibility to manage liquidity under a variety of conditions and circumstances.

We believe the provisions of the final rule achieve greater clarity of FCA guidance and expectations on internal policymaking for Farmer Mac while both avoiding an excessive level of specificity and minimizing the potential for imposing unnecessary constraints that could adversely impact Farmer Mac's operations.

In their comments, Farmer Mac and FCBT expressed a preference for a regulatory approach similar to that in place for Farm Credit System (FCS) banks' investments and liquidity. We note that the approaches are similar in areas such as investment categories, category limits, obligor limits, and discounts, because we believe certain regulatory approaches and quantitative limits on liquidity and investments are reasonably applied to a wide variety of types of financial institutions. However, there are valid reasons to adopt differing regulatory approaches in certain areas because of the differences in the types of business conducted by the regulated

institutions (e.g., Farmer Mac's large proportion of mortgage assets and off-balance sheet obligations relative to direct lenders). Other differences may exist in areas in which the approach governing FCS banks is not the only reasonable regulatory approach.

In response to the commenters' contention that FCA should exercise its oversight authority over non-program and liquidity management through its examinations rather than through regulation, we state that while examinations are an integral component of our oversight, it is inappropriate for FCA to rely solely on examinations. Regulations are another oversight tool; they enhance the examination process by establishing clearly understood requirements in advance, thus enabling the reduction of potential problems that might become examination findings absent those regulations.

B. Section 652.1—Purpose

This section provides the user with a basic understanding of the contents and purpose of this subpart. The purpose of this subpart is to ensure safety and soundness, continuity of funding, and appropriate use of non-program investments considering Farmer Mac's status as a GSE. It also highlights responsibilities of Farmer Mac's board of directors and management. No comments specific to this section were received and none of its provisions were changed in the final rule.

C. Section 652.5—Definitions

This section alphabetically lists words or phrases that are applicable to this subpart and will help the user more fully understand the subpart and our requirements. Most of the definitions are self-explanatory, but one definition will benefit from explanation.

The definition of "Government-sponsored agency" includes Government-sponsored enterprises such as Fannie Mae and the Federal Home Loan Mortgage Corporation (Freddie Mac), as well as Federal agencies, such as the Tennessee Valley Authority, that issue obligations that are not explicitly guaranteed by the Government of the United States' full faith and credit. The definition in the final rule is slightly different from that in our proposal, although the meaning is the same; we have clarified that the term includes corporations, as well as agencies or instrumentalities, that are chartered or established to serve public purposes specified by Congress, and also that it includes GSEs. This information was provided in the supplementary information to the proposed rule but

was not explicitly stated in the rule itself.

No comments specific to this section were received but several of its provisions were changed for clarity in the final rule in response to comments on other sections. Specifically, we are adding definitions for "program assets" and "program obligations" and are substituting "regulatory capital" for "total capital."

D. Section 652.10—Investment Management and Requirements

This section requires Farmer Mac to establish and follow certain fundamental practices to effectively manage risks in its investment portfolio. An effective risk management process for investments requires financial institutions to establish: (1) Policies; (2) risk limits; (3) a mechanism for identifying, measuring, and reporting risk exposures; and (4) a strong system of internal controls. Accordingly, § 652.10 requires Farmer Mac's board of directors to adopt written policies that establish risk limits and guide the decisions of investment managers. More specifically, board policies must establish objective criteria so investment managers can prudently manage credit, market, liquidity, and operational risks. Additionally, § 652.10 establishes other controls that are consistent with sound business practices, such as:

- (1) Clear delegation of responsibilities and authorities to investment managers;
- (2) Separation of duties;
- (3) Timely and effective securities valuation practices; and
- (4) Routine reports on investment performance.

Both Farmer Mac and FCBT objected to the proposed rule's pre-purchase and pre-sale securities valuation requirements for non-program investments, found in § 652.10(f). Farmer Mac commented generally that because its board has established and monitors policies and procedures governing the valuation process for securities purchased and internal controls of investment management, there is no need for FCA to adopt a regulation prescribing the details of such policies and procedures.

We agree that Farmer Mac should have flexibility in establishing its policies and procedures governing securities valuation. However, because of the potentially serious consequences of valuation errors, our regulations set forth basic requirements for Farmer Mac's policies and procedures. We believe, in general, that proposed § 652.10(f) permits sufficient flexibility for Farmer Mac. Accordingly, the final rule retains the general structure of the

³ Also referred to in this supplementary information as "days-of-liquidity."

proposed rule, although we have made some changes in response to comments on specific provisions of this section.

Section 652.10(f)(1) of the proposed regulation required Farmer Mac to evaluate a security's credit quality prior to purchase. In the supplementary information explaining this proposed provision, we stated that Farmer Mac:

may not rely exclusively on NRSRO⁴ ratings prior to purchasing investments. An independent and timely evaluation performed by Farmer Mac is needed because there may be a lag before an adverse event is reflected in the credit rating. Therefore, Farmer Mac's analysis must indicate whether the security's risk has changed subsequent to the most recent NRSRO rating.

Farmer Mac commented that the proposed regulation, as interpreted by the supplementary information, effectively required Farmer Mac to "second guess" the NRSROs and would not be practical. The FCBT made a similar comment. Farmer Mac was concerned that its practice of routinely monitoring rating watch lists and news reports for recent events that could indicate stress in individual businesses and industry sectors might not be sufficient to satisfy FCA.

We reiterate that, because of potential lags before NRSRO ratings reflect adverse events, Farmer Mac must evaluate a security's risk subsequent to its most recent rating. Section 652.10(f)(1) does not, however, require a particular method of evaluating a security's risk. Farmer Mac may use any reliable approach to monitoring this risk. As a good business practice, Farmer Mac should retain documentation of its evaluation.

Section 652.10(f)(1) of the proposed rule required Farmer Mac, among other things, to "verify the value of a security that [it] plan[s] to purchase, other than a new issue, with a source that is independent of the broker, dealer, counterparty, or other intermediary of the transaction." Farmer Mac commented that no benefit would be provided by requiring alternative price quotes because it would not necessarily afford Farmer Mac the opportunity to purchase the investment at the same or a better price.

FCA makes no change to this pre-purchase independent valuation verification requirement in the final rule. Accurate securities valuation is essential to measuring risk and monitoring compliance with Farmer Mac's objectives and risk parameters. Such valuation practices by the Corporation enable managers to better

understand the risks and cashflow characteristics of their investments.

In addition, we note that, as stated in the supplementary information to the proposed rule, independent verification of price can be as simple as obtaining a price from an industry-recognized information provider. Farmer Mac may satisfy this requirement by independently verifying the price of a security with an online market reporting service such as Bloomberg, Telerate, or Reuters. We believe the benefits of this provision exceed any added burden on Farmer Mac.

Section 652.10(f)(1) of the proposed rule also would have required Farmer Mac, before it purchases a security, to document the size and liquidity of the secondary market for the security. The supplementary information stated that we expected Farmer Mac to monitor and update this information as market conditions change. Farmer Mac commented that this requirement is vague and difficult to accomplish, would be unduly time consuming, and would lead to missed investment opportunities. The FCBT commented that the requirement is not necessary for certain types of very high quality securities commonly known to trade in active secondary markets, such as agency-issued mortgage-backed securities. The FCBT also pointed out that the regulation does not specify what form the documentation should take.

We agree that satisfying this documentation requirement could present a challenge in some instances and have removed this documentation requirement from the rule. We affirm the Agency's view that such documentation is a good business practice.

Section 652.10(c)(2) of the proposed rule required Farmer Mac to evaluate how individual instruments and the investment portfolio as a whole affect the Corporation's overall interest rate profile. We have removed this requirement in the final rule. We believe that the limitations on the investment portfolio in § 652.35 of this rule, combined with our oversight of Farmer Mac's internal procedures on interest rate risk management, warrant this removal.

Section 652.10(c)(1)(ii) of the proposed rule provided that Farmer Mac's board must approve any changes to securities firms. Farmer Mac commented that, although it may be appropriate for the board to establish criteria for the selection of securities firms, the selection or removal of firms meeting the criteria is properly a function of management, with oversight

by the board for compliance with board policy. We agree with this comment and have revised the provision to require pre-change notification to the board, or a designated subcommittee of the board, instead of board approval of the change.

We emphasize that the selection of securities firms is an important aspect of effective management of counterparty credit risk. A satisfactory approval process includes a review of each firm's financial statements and an evaluation of its ability to honor its commitments, including an inquiry into the general reputation of the securities firm. We expect Farmer Mac to review information from Federal or state securities regulators and industry self-regulatory organizations, such as the National Association of Securities Dealers, concerning any formal enforcement actions against the securities firm, its affiliates, or associated personnel.

E. Section 652.15—Interest Rate Risk Management and Requirements

Because interest rate risk management is such an important part of investment management, § 652.15 establishes certain responsibilities of Farmer Mac's board of directors and management as well as policy requirements to address the management of interest rate risk exposure. The regulations outline our minimum expectations for the management of interest rate risk exposure.

The potentially adverse effect that interest rate risk may have on net interest income and the market value of Farmer Mac's equity is of particular importance. Unless properly measured and managed, interest rate changes can have significant adverse effects on Farmer Mac's ability to generate earnings, build net worth, and maintain liquidity. We received no comments specific to this section. Other than two self-explanatory, minor clarifications, we made no changes to this provision in the final rule.

F. Section 652.20—Liquidity Reserve Management and Requirements

This section sets forth the minimum daily liquidity reserve requirement (i.e., the minimum days-of-liquidity), provides guidance on how that calculation is to be made, including specifying the discounts to be applied to various investments, and explains board responsibilities, required policies, and reporting requirements.

Section 652.20(a) provides that, within 24 months of this rule's effective date, and thereafter, Farmer Mac must hold cash, eligible non-program investments, and/or on-balance sheet

⁴ Nationally recognized statistical rating organization.

securities backed by portions of USDA guaranteed loans to maintain at all times sufficient liquidity to fund a minimum of 60 days of maturing obligations, interest expense, and estimated operating expense.

AgFirst commented that the proposed minimum days-of-liquidity requirement should be increased to 90 days from 60 days, consistent with the self-imposed policy of the FCS, which was implemented after discussions with several NRSROs.⁵ We have made no change to the required 60-day minimum. The final rule imposes a minimum below which Farmer Mac must not drop for safety and soundness purposes.⁶ Section 652.20(e) requires Farmer Mac's liquidity reserve policy to specify the minimum and target (or optimum) amounts of liquidity that the board believes are appropriate for Farmer Mac. These minimum and target amounts may need to be significantly higher than 60 days. FCA intends to monitor Farmer Mac's implementation of this provision.

Farmer Mac commented that the proposed rule's requirement, in § 652.20(a), that days-of-liquidity be calculated and documented daily was an overly burdensome time interval and recommended changing the interval to monthly. In the final rule, this time interval is revised to monthly with the added specification that the Corporation must have systems in place that provide it the ability to make this calculation daily, and must maintain liquidity greater than 60 days at all times. Prudent business practice dictates that, if circumstances warrant, Farmer Mac may need to calculate its days-of-liquidity more often than the regulation requires. Such circumstances could include management decisions relative to debt issuance, asset-liability management, and investment purchases, all of which must be made with knowledge of the institution's liquidity position. We expect Farmer Mac's liquidity management practices to be monitored by Farmer Mac's internal audit function.

FCBT commented that, rather than specifying specific discount amounts, FCA's regulations should require Farmer Mac to apply discounts that are appropriate under prevailing market practices and expectations concerning

liquidity. We believe it is appropriate for FCA to prescribe the discounts to ensure that an acceptable level of conservatism is applied to the Corporation's estimates of the liquidity of these instruments. As with other required calculations in this rule, we believe these discounts improve the clarity of the Agency's expectations on this subject to Farmer Mac and are best provided formally through rulemaking and in advance of the examination process. However, we have clarified in § 652.20(a) that discounts are to be applied to liquid asset values that have been marked to market, and in § 652.20(c)(3) and (c)(5) that discounts also apply to preferred stock investments.

Farmer Mac and FCBT commented that the discounts applied in § 652.20(c) to non-program assets for purposes of the days-of-liquidity calculation in the proposed rule are too great at 5 percent on money market instruments and floating rate debt securities and 10 percent on fixed rate debt securities. Farmer Mac supported this comment on the basis of the lower discounts applied by the Federal Reserve Discount Window (Fed) and the New York Stock Exchange (NYSE) for pledged assets. Farmer Mac's comment noted that the two examples they offer are not exactly analogous to the discounts applied in the proposed rule, but the Corporation requested consideration of these alternatives as potentially more appropriate benchmarks for discounts.

We acknowledge that the Fed discount window and NYSE discounts on margin collateral are lower but, with one exception, we have kept the discounts in this rule as proposed. The cited Fed discounts by their nature are applied to transactions with a very short-time horizon on average, typically overnight for the majority of the Fed discount window volume.⁷ While NYSE positions requiring margin accounts are, on average, likely longer term than overnight, we have no information that would suggest the typical period over which the NYSE holds such pledged assets is as long as the several-year terms of many of Farmer Mac's investments. Farmer Mac's generally longer investment terms inherently involve greater risk, as they provide more time for the liquidity of the security to change.

However, the term difference between Farmer Mac and the Fed Discount Window is not always the case, for example with Farmer Mac's use of

overnight and very short-term money market investments. In recognition of this, we have partially accommodated the comment by reducing the discount on money market instruments with maturities of 5-business days or less from 5 percent to 3 percent, in § 652.20(c)(2).

As discussed below, § 652.20(c)(7) of the rule reserves FCA's authority to modify or determine the appropriate discount for an investment if the otherwise applicable discount does not accurately reflect the investment's liquidity. FCA's Office of Secondary Market Oversight (OSMO) will consider any request Farmer Mac submits for a revised discount on particular items in its investment portfolio.

Farmer Mac commented that the proposed rule's 50-percent discount of securities backed by portions of Farmer Mac program assets (loans) guaranteed by the USDA (the Farmer Mac II portfolio or USDA-Guaranteed Portions) in § 652.20(c)(5)⁸ is excessive because: (1) The assets are backed by the full faith and credit of the U.S. Government; (2) there exists a well-developed, competitive and active secondary market for USDA-Guaranteed Portions among numerous broker/dealers and banks around the country; (3) the interest rates on a large portion of Farmer Mac's USDA-guaranteed loans reset within 1 year, thereby presenting very limited exposure to market pricing risk; and, (4) the 50-percent discount is not consistent with FCA's June 25, 2004 Informational Memorandum on Investments in Rural America, which expressly encourages FCS institutions to participate in the secondary market for USDA-Guaranteed Portions and does not suggest that such investments would be discounted.

We agree with the comment that a 50-percent discount of the Farmer Mac II portfolio is too conservative an estimate of its liquidity. It is inherently difficult to evaluate precisely the depth of the market for USDA-Guaranteed Portions because they are traded through a broker market. However, FCA believes there is reasonable evidence pointing to greater liquidity of these instruments. Accordingly, the final rule decreases the discount to 25 percent of the on-balance sheet portion of the Farmer Mac II portfolio. In other words, the calculation now includes 75 percent of on-balance sheet Farmer Mac II assets as liquid investments, as a conservative estimate of the liquidity of the Farmer Mac II portfolio.

As discussed in section G. below, we have made a corresponding change in

⁵ AgFirst also commented that FCA should try to minimize the regulatory burden this rule imposes. We note that requiring 90 rather than 60 days-of-liquidity would increase regulatory burden.

⁶ Under new § 652.30(a), if the FCA determines that an extraordinary situation exists that necessitates a temporary regulatory waiver or modification, it may, in its sole discretion, waive or modify this minimum.

⁷ The information related to the Federal Reserve is taken from the Federal Reserve Web site's description of the Discount Window.

⁸ Renumbered as § 652.20(c)(6) in the final rule.

the formula for maximum non-program investments in § 652.25(b) in order to be more consistent with our recognition of 75 percent of the on-balance sheet Farmer Mac II portfolio as a liquid investment in the days-of-liquidity calculation. It is logically consistent to conclude that if 75 percent of on-balance sheet Farmer Mac II volume is correctly viewed as a liquid investment, then the rest of that portfolio segment is by definition not liquid and is appropriately included among those program assets against which the liquidity investments are held.

As explained in greater detail in section G. below, recognition of on-balance sheet Farmer Mac II assets as liquid investments could create a disincentive for Farmer Mac to sell these assets to investors, an incentive that FCA does not intend but which is unavoidable if the Agency intends, as it does, to make that recognition. Therefore, one reason why the 25-percent discount is not even smaller is due to concerns related to any potential disincentive to sell these securities that could be created through recognition of such a high percentage of the on-balance sheet Farmer Mac II portfolio in the days-of-liquidity calculation.

We note that the referenced FCA Informational Memorandum does not expressly encourage these investments and did not factor into FCA's decision to change the percentage. The Informational Memorandum highlights these instruments as an option available to FCS institutions to make mission-related investments but does not express or imply any position on the relative liquidity of these assets.

Farmer Mac commented on proposed § 652.20(c)(6),⁹ which reserved FCA's authority to modify or determine the appropriate discount for any investment. Farmer Mac requested that it be provided 30 working days prior notice, with a longer period for those cases requiring more fundamental restructuring of the portfolio. The final rule provides Farmer Mac 20 business days to implement a discount determined by FCA unless we specify otherwise.

Commenting on the same section, FCBT noted that the provision is too general and could lead to arbitrary action on the part of FCA. The comment suggested FCA establish "market-based" criteria to guide FCA staff in making such determinations. We anticipate we would most likely exercise this provision if an adverse credit event or other adverse event caused an eligible investment to exhibit less liquidity. In

such cases, we might increase the discount associated with that investment. Information related to such an event would be expected to be generally available to the public and readily verifiable.

Accordingly, the final rule reserves FCA's authority to modify or determine the appropriate discount for any investment used to meet the minimum liquidity reserve requirement if the otherwise applicable discount does not accurately reflect the liquidity of that investment or if the investment does not fit wholly within one of the specified investment categories. In addition, it provides that in making any modification or determination, we will consider the liquidity of the investment as well as any other relevant factors. We will provide at least 20 business days notice before any modified discounts will take effect.

Farmer Mac commented that the proposed rule's requirement that any breach of the minimum days-of-liquidity requirement in § 652.20(g) be reported "immediately" to FCA was not sufficiently clear in terms of its time requirement and suggested it be revised to read "as soon as reasonably possible, but no later than 3 business days after Farmer Mac determines (or should have determined) the breach." Further, Farmer Mac suggested an additional grace period of 5 business days for the cure of any such breach if Farmer Mac is taking action to achieve compliance.

As discussed above, the final rule requires Farmer Mac to calculate its days-of-liquidity monthly, and we expect more frequent calculation if circumstances warrant it. We have revised the reporting requirement to require Farmer Mac to report a breach to FCA no later than the business day following Farmer Mac's discovery of the breach. This revision provides an objective time period for Farmer Mac to submit its report to FCA. In addition, we clarified that the regulation requires the report to be made in writing (which includes e-mail) to OSMO. In order to keep an objective standard for the reporting time frame, we did not include "should have discovered" language, as suggested by Farmer Mac. We did not include the requested grace period to cure any breach. Any cure of a breach in the minimum days-of-liquidity will be addressed as a part of the FCA's supervisory oversight of Farmer Mac. FCA adds no grace period in the final rule as any standing grace period could imply that the established minimum is less than a firm minimum. However, as affirmed in § 652.30 of the final rule, FCA would consider modifications under unusual

circumstances if requested by Farmer Mac.

FCBT commented that it is unduly burdensome to require Farmer Mac to report to FCA whenever it breaches its regulatory liquidity reserve requirements, as the proposed rule required. Since the final rule requires Farmer Mac to calculate its days-of-liquidity monthly rather than daily, and to report a breach when it is discovered rather than when it occurs, any burden the proposed rule might have caused has been significantly reduced in the final rule.

FCBT also commented that the provision in § 652.20(g) of the proposed rule that required Farmer Mac to report to FCA when it discovers noncompliance with its own board policy requirements is inappropriate and constitutes "micro-management" that is inconsistent with the role of an arms-length regulator. FCA proposed this requirement so that it may learn in advance if liquidity is decreasing to a point where it might violate our regulatory minimum. However, so long as Farmer Mac's Board is aware of breaches of the Corporation's internal policy, we have determined that OSMO is well-positioned to track breaches of the policy and management's corrective actions through the examination process. We have, therefore, removed the provision from the final rule.

G. Section 652.25—Non-Program Investment Purposes and Limitation

This section lists authorized purposes for Farmer Mac non-program investments and imposes a limitation on those investments. The rule seeks to reasonably relate investments made by Farmer Mac to its statutory purpose as set forth in section 701 of the Agricultural Credit Act of 1987¹⁰ (12 U.S.C. 2279). We recognize non-program investments provide for a blend of Farmer Mac's needs; most fundamental of these needs is to provide highly liquid assets to meet immediate funding needs associated with Farmer Mac's business in agricultural and rural housing mortgages. Farmer Mac also uses non-program investments in managing interest rate risk and providing flexibility in responding to fluctuating liquidity and economic conditions.

Section 652.25(b)(1) of the proposed rule would have limited non-program investments to the greater of \$1.5 billion or the aggregate of 30 percent of total assets and "a reasonable estimate of off-balance sheet loans covered by guarantees or commitments that Farmer

⁹Renumbered as § 652.20(c)(7) in the final rule.

¹⁰Public Law 100-233.

Mac likely will be required to purchase during the upcoming 12-month period, not to exceed 15 percent of total off-balance sheet obligations.”

Farmer Mac and FCBT commented that this formula is overly restrictive and could result in adverse effects on the Corporation. Farmer Mac also commented that the proposed policy is a departure “from the undertaking requested by FCA and given by Farmer Mac in 1999, to limit non-program investments to the greater of \$1.5 billion and 30 percent of all guarantees and commitments outstanding.” Farmer Mac further suggested that the proposed policy is inconsistent with investment limitations contained in FCA regulations governing FCS banks. Finally, Farmer Mac commented that the proposed rule’s treatment of off-balance sheet obligations both fails to respond to concerns raised by Congress and creates a disincentive for Farmer Mac to sell agricultural mortgage-backed securities. Instead of the proposal, Farmer Mac requested that FCA adopt the Corporation’s currently existing investment limit, based on its 1999 communications with FCA, of the greater of \$1.5 billion and 30 percent of the aggregate of Farmer Mac’s on-balance sheet program assets and off-balance sheet program obligations.

This rule is the first application of a regulatory maximum non-program investment level to a secondary market institution. FCA has applied caution to minimize the possibility of imposing unnecessary constraints. With this framework established, the rule’s quantitative limits can be refined in future rulemaking if necessary. Accordingly, we have modified the formula in the final rule to respond to Farmer Mac’s comments, as detailed below.

The final rule limits Farmer Mac’s non-program investments to the greater of \$1.5 billion or 35 percent of all program volume, excluding 75 percent of the on-balance sheet program assets that are guaranteed by the United States Department of Agriculture as described in section 8.9(9)(B) of the Farm Credit Act of 1971, as amended.¹¹

With this change, we have responded to Farmer Mac’s request to adopt the general approach taken in our 1999 guidance to Farmer Mac. As Farmer Mac requested, we have generally based the formula for maximum non-program investments on a percentage of both on- and off-balance program investments, with one exclusion. The formula excludes from program investments 75 percent of the Farmer Mac II portfolio

because, as discussed in the previous section of this supplementary information, that portion is recognized as a liquid investment in the minimum liquidity reserve calculation required by § 652.20(a). Thus, the rule maintains logical consistency in its recognition (in both § 652.20(a) and § 652.25(b)) of 75 percent of the on-balance sheet Farmer Mac II program assets as a source of liquidity rather than as less-liquid assets against whose funding obligations liquidity investments are held.

This exclusion would generally result in a lower maximum non-program investment limit, which was not the intent of the exclusion. Therefore, to compensate for this exclusion and to add regulatory flexibility generally to the final rule, we increased the limitation from 30 to 35 percent of the included assets. The new formula is consistent with the objective of establishing a regulatory framework that minimizes the potential of establishing unnecessary constraints on management’s ability to respond to unforeseen circumstances.

We believe the changes to this provision in the final rule should satisfy the concerns raised by Farmer Mac and the FCBT that the proposed provision was overly restrictive. Nevertheless, we respond to Farmer Mac’s specific comments on the proposed rule below.

Farmer Mac stated that the proposed rule failed to address concerns expressed at hearings of the Agriculture Committee of the U.S. House of Representatives (June 4, 2004), at which members raised questions about the adequacy of provisions for risks associated with off-balance sheet exposures. The concerns raised at this hearing were related to a General Accounting Office (GAO)¹² report stating that Farmer Mac lacked a formal contingency plan for liquidity, and particularly for the potential obligation to purchase a significant volume of off-balance sheet obligations.¹³ The GAO report did not imply any potential inadequacy of the Farmer Mac non-program investment levels.

In addition, Farmer Mac commented that the proposed rule, through its inclusion of 15 percent (at most) of off-balance sheet obligations in the maximum non-program investments formula, created a disincentive for it to sell AMBS to investors. As mentioned above in section F. with regard to

¹² This agency has been renamed the Government Accountability Office.

¹³ United States General Accounting Office, Farmer Mac: Some Progress Made, but Greater Attention to Risk Management, Mission, and Corporate Governance is Needed, GAO-04-116 (2003).

changes made to the days-of-liquidity calculation, by including all off-balance sheet program obligations in the calculation of maximum non-program investments, the final rule largely removes any disincentive to sell program assets to investors. A small disincentive arguably remains related to the recognition of 75 percent of the on-balance sheet Farmer Mac II portfolio as a liquid investment (described in section F. above). However, this disincentive is at least partially offset by a corresponding reduction in the same proportion (75 percent) of the on-balance sheet Farmer Mac II portfolio that is excluded from the maximum non-program investments calculation.

Farmer Mac also commented that the proposed rule’s maximum non-program investment formula is inconsistent with FCA’s 1993 rule governing FCS banks. We note that the provisions of this final rule, through the inclusion of off-balance sheet obligations in the calculation, are much closer to the structure established in the 1993 regulation governing FCS banks on this maximum limit.

Finally on this section, in the supplementary information to our proposed rule, we specifically sought comment on whether we should consider in this section other issues pertinent to Farmer Mac’s non-program investment needs or practices such as its “debt issuance strategy.” Farmer Mac commented that it would not be appropriate to impose regulations governing debt issuance strategies. Without agreeing or disagreeing with the comment, we note that no provision related to the strategy has been added to the final rule. Also, in response to this request for comment, FCBT said, “given our view that portfolio limits should be flexible based on an institution’s market environment, we do not believe that the regulation should fail to consider or preclude consideration of any factor that presents Farmer Mac with an actual need for liquidity, income stabilization, or diversification.” We believe the regulation adequately considers these factors through the flexibility specifically inserted in the rule, e.g., § 652.30(b) and § 652.35(e).

H. Section 652.30—Temporary Regulatory Waivers or Modifications for Extraordinary Situations

This section provides that the FCA may waive or modify restrictions on Farmer Mac’s liquidity reserve and/or may modify the amount, qualities, and types of eligible investments during times of economic stress, financial stress, or other extraordinary situations. As waivers or modifications are

¹¹ 12 U.S.C. 2279aa(9)(b).

approved, we may impose certain conditions, require plans to return to compliance, or set other limitations. The flexibility of this provision enables the agency to tailor specific remedies for particular problems or particular circumstances that might arise.

Examples of extraordinary situations include, but are not necessarily limited to: (1) Disrupted access to capital markets due to financial, economic, agricultural, or national defense crises; and (2) situations specific to Farmer Mac that necessitate modified liquidity reserves, other investments, or other measures for continued market access. No comments specific to this section were received but clarifications were added to its provisions in the final rule to note FCA's willingness in extraordinary circumstances to consider waivers of the rule's provisions related to ineligible asset quality and type.

I. Section 652.35—Eligible Non-Program Investments

This section permits Farmer Mac to invest, within limits, in an array of eligible high-quality, liquid investments while providing a regulatory framework that can readily accommodate innovations in financial products and analytical tools.

Farmer Mac may purchase and hold the eligible non-program investments listed in § 652.35(a)¹⁴ to maintain liquidity reserves, manage interest rate risk, and invest surplus short-term funds. Only investments that can be promptly converted into cash without significant loss are suitable for achieving these objectives. For this reason, the eligible investments listed in § 652.35(a) generally have short terms to maturity and high credit ratings from NRSROs. All eligible investments are either traded in active and universally recognized secondary markets or are valuable as collateral. To enhance safety and soundness, for many of the investments, we require that they not exceed certain maximum percentages of the total non-program investment portfolio. We establish these portfolio caps to limit credit risk exposures, to

promote diversification, and to curtail investments in securities that may exhibit considerable price volatility, price risk, or liquidity risks. For similar reasons, we establish obligor limits to help reduce exposure to counterparty risk.

We note that the final rule authorizes investment in shares of any investment company that is registered under section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a–8, as long as the investment company's portfolio consists solely of investments that are authorized by § 652.35. Prior to investing in a particular investment company, Farmer Mac would be required to evaluate the investment company's risk and return objectives. As part of this evaluation, Farmer Mac should determine whether the investment company's use of derivatives is consistent with FCA guidance and Farmer Mac's investment policies.

Farmer Mac must maintain appropriate documentation on each investment, including a prospectus and analysis, so its investment and selection process can be independently and objectively verified. If Farmer Mac's shares in each investment company comprise 10 percent or less of Farmer Mac's total investment portfolio, no maximum portfolio limits are triggered. However, if Farmer Mac's shares in a particular investment company comprise more than 10 percent of Farmer Mac's total investment portfolio, then the pro rata interest in an asset class of security in an investment company must be added to the same asset class of Farmer Mac's other investments to determine investment portfolio limits. For example, if Farmer Mac has 12 percent of its total investment portfolio (*i.e.*, more than 10 percent) in Diversified Investment Company Alpha (Alpha), then Farmer Mac would have to determine the composition of investments in Alpha's portfolio. The pro rata dollar amount of corporate debt securities (one example of the many asset classes) in Alpha would have to be added to Farmer Mac's corporate debt securities, and that combined amount would have to be 25 percent or less of Farmer Mac's total investment portfolio. Corporate debt securities are used here only as an example. Any asset class in Farmer Mac's portfolio with an investment portfolio limit would have to be computed the same way.

FCBT commented that FCA should reconsider its overall approach with respect to fixed percentage limits on the classes or types of investments that may be included in Farmer Mac's portfolio to allow Farmer Mac more flexibility to

respond to changing market conditions. FCBT suggests that, rather than specifying investment limits, the regulation should require Farmer Mac to establish and justify appropriate limits. Limits on classes and types of investments are a prudent managerial practice. It is not clear from the comment how changing market conditions might warrant a degree of flexibility that is not already provided for in the regulation. However, as detailed later in this section, the final rule does make an adjustment to the obligor limits from 20 to 25 percent of regulatory capital. In addition, we note that the final rule clarifies that the temporary waivers under § 652.30(b) could extend to asset quality and types, as well as amounts. In general, the regulation enhances guidance on OSMO's minimum expectations with regard to investment management policies and procedures related to concentration risk within Farmer Mac's investment portfolio.

Farmer Mac commented that the 20-percent investment category concentration limits in the proposed regulation are generally too restrictive and that a 33-percent limitation would be more appropriate. No analytical support was provided to support a 33-percent limitation rather than a 20-percent limitation. We have made a change to two categories detailed below.

Farmer Mac commented specifically that the proposed 20-percent limit on investments in corporate debt securities (§ 652.35(a)(8)) should be increased to 33 percent. The Corporation further objected to the proposed rule's requirement that corporate debt securities with maturities of less than 4 years, contending that an A rating is appropriate for such investments.¹⁵ We believe that a concentration of one-third (33 percent) of the investment portfolio is excessive, but have changed the limit for corporate debt securities to 25 percent. We believe this to be an acceptable maximum weight for this non-Government-sponsored agency-backed or government-backed investment category and to be appropriate for this rule. We have made a similar change to the investment category limit for ABS. We note that if Farmer Mac were to request a waiver under the § 652.30 to invest in ABS types that are not specifically listed in § 652.35(a)(7), and such permission were granted, it could be granted subject

¹⁴ Section 652.35(a)(1) and (a)(2) authorize investments in "obligations of the United States" and "obligations of Government-sponsored agencies," respectively. The regulation lists eligible investments for each term; read in conjunction with the definition of Government-sponsored agency, we believe the meaning of these terms is clear. FCA regulation § 615.5140 (a)(1), which lists eligible investments for Farm Credit banks and associations, uses the term "obligations of the United States" to refer to both obligations of the United States and obligations of Government-sponsored agencies. Although new § 652.35(a)(1) and (a)(2) use more precise language, the meaning is the same as § 615.5140(a)(1). Section 652.35(a) uses the more precise language only for the purpose of clarity.

¹⁵ The Corporation acknowledged that AA is appropriate for investments with maturities of between 4 and 5 years.

to reduced category limitations and other conditions.

To support its request for a minimum A rating for securities with maturities of 4 years or less, Farmer Mac cites to NRSRO data that, the Corporation contends, demonstrates that A-rated bonds represent very high asset quality, with only a slightly higher historical rate of default than AA bonds. We agree that shorter-term holdings inherently have less risk, and the final rule therefore permits investments in corporate debt securities that are rated at least A by an NRSRO as long as their maturities are 3 years or less. We did not extend the A-rating accommodation to securities with maturities of between 3 and 4 years, as Farmer Mac requested, in recognition of their higher level of risk.

Farmer Mac objects to § 652.35(d), which limits investments issued by any single entity, issue, or obligor to 20 percent of Farmer Mac's capital, with the exception of Government agency or Government-sponsored agency obligors. Farmer Mac suggests a limitation of 25 percent of capital is more appropriate. We agree with the comment and have changed the limitation to 25 percent in the final rule. For example, if Farmer Mac had \$250 million in capital, the change would permit obligor limits to rise from \$50 million to \$62.5 million.

Farmer Mac also objects to the § 652.35(d)(2) requirement that it must count securities that it holds through an investment company toward the 20-percent obligor limit unless the investment company's holdings of the securities of any one issuer do not exceed 5 percent of the investment company's total portfolio. Farmer Mac contends that this requirement is unnecessary because concentration risks are balanced by diversity in the portfolio. Farmer Mac also states that tracking portions of individual investments held within a diversified investment would be difficult and unduly time consuming.

We believe that the Corporation's net exposure to a single obligor, when the portion found in diversified investment funds is significant, is important to consider regardless of the diversification benefits of the funds. When an obligor defaults, Farmer Mac absorbs the full financial impact of its net exposure to that obligor, even if a portion of that impact is realized in a lower return from an investment fund. For that reason, we believe the benefits of prudent obligor limits exceed the additional labor cost involved in tracking total obligor exposures. Therefore, we make no change to this provision in the final rule.

Farmer Mac commented that the proposed rules' collateral restrictions on asset-backed securities (ABS) should be eliminated and that any AAA-rated ABS should be permitted. Farmer Mac did not identify additional ABS-collateralized groups in which it wishes to invest or suggest criteria for determining the suitability of new types of ABS that financial markets may create. Without more compelling evidence of the practical impact on Farmer Mac's operations, the final rule makes no change to this provision. We note that § 652.35(e) of the final rule permits Farmer Mac to purchase non-program investments not listed in § 652.35(a) with our prior approval.

Farmer Mac commented that rather than using the term "total capital," as we do in § 652.35(d)(1) of the proposed rule, we should use either the term "core capital" or the term "regulatory capital," both of which are defined in Farmer Mac's statute. We agree that using an already-defined term would provide consistent regulatory treatment. Accordingly, § 652.35(d)(1) of the final rule uses the term "regulatory capital" as defined in section 8.31(5) of the Act.¹⁶ We also make the corresponding change in the definitions section, § 652.5, replacing "total capital" with "regulatory capital."

Finally, on this section, Farmer Mac commented that investments in Farmer's Notes should be deemed an eligible non-program investment under § 652.35 if the FCA's currently pending proposed rule on Investments in Farmer's Notes becomes effective as proposed. However, as FCA did not propose such treatment of Farmer's Notes in its proposed rule on non-program investments and liquidity, we would have to propose it in another rulemaking process in order to consider this change. Therefore, the most practical process for Farmer Mac to obtain this treatment for Farmer's Notes would be to seek approval to invest in Farmer's Notes as provided for under § 652.35(e).

J. Section 652.40—Stress Tests for Mortgage Securities

Stress testing is essential when the cashflows from investments or assets of financial institutions change in response to fluctuations in market interest rates. For example, although credit risk on highly rated mortgage securities is low, mortgage securities may expose investors to significant interest rate risk. Since borrowers may prepay their mortgages, investors may not receive the expected cashflows and returns on these

securities. Prepayments on these securities are affected by the spread between market rates and the actual interest rates of mortgages in the pool, the path of interest rates, and the unpaid balances and remaining terms to maturity on the mortgage collateral. The price behavior of a mortgage security also depends on whether the security was purchased at a premium or at a discount.

To better control and manage these factors, this section requires that Farmer Mac employ appropriate analytical techniques and methodologies to measure and evaluate interest rate risk inherent in mortgage securities. More specifically, prudent risk management practices require Farmer Mac to examine the performance of each mortgage security under a wide array of possible interest rate scenarios. No comments specific to this section were received and none of its provisions were changed in the final rule.

K. Section 652.45—Divestiture of Ineligible Non-Program Investments

This section requires an ineligible non-program investment or security to be divested within 6 months, unless FCA approves, in writing, a plan that authorizes the investment or its divestiture over a longer period of time.¹⁷ Farmer Mac commented that this requirement should be revised to remove divestiture deadlines and to include a requirement that ineligible investments be tracked and reported monthly to the board's asset-liability management committee (ALCO) along with analysis and recommendations regarding strategy for remedial actions. FCA believes that 6 months is a reasonable period for Farmer Mac to divest of ineligible investments. Moreover, if over the 6-month period Farmer Mac develops analysis and a written plan that make a persuasive case for FCA to permit the retention of an ineligible investment over a period greater than 6 months, the final rule allows for such consideration.

Farmer Mac also commented that any investments it owns prior to the effective date of this rule should be deemed eligible until they mature or are sold in the normal course of business. In response, we emphasize that

¹⁷ An acceptable plan generally requires Farmer Mac to divest of the ineligible investment or security as quickly as possible without substantial financial loss. Until the ineligible investment or security is actually divested of, Farmer Mac's investment manager must report at least quarterly to Farmer Mac's board of directors and to OSMO about the status and performance of the ineligible instrument, the reason why it remains ineligible, and the investment manager's progress in divesting of the investment or security.

¹⁶ 12 U.S.C. 2279bb(5).

ineligible assets are deemed ineligible for safety and soundness reasons, and it is therefore not acceptable that such assets be held by Farmer Mac for an indefinite period of time. We make no change to this provision in the final rule, but note that the rule permits

Farmer Mac to seek FCA approval for a longer divestiture period.

V. Better Organizing Rules That Apply to Farmer Mac

In this final rule, we move some existing regulatory sections that pertain

specifically to Farmer Mac to a centralized location in our regulations so they can be more easily located and used. The following table provides details of our proposal and shows where this final rule will be located.

ORGANIZATION OF FARMER MAC RULES

New part	New part name	New subpart	New subpart name	New sections	From
650	Federal Agricultural Mortgage Corporation—General Provisions.	Receiver and Conservator.	§§ 650.1 to 650.80	Existing Part 650, Subpart C, §§ 650.50 to 650.68.
651	Federal Agricultural Mortgage Corporation—Governance.	Conflicts of Interest	§§ 651.1 to 651.4	Existing Part 650, Subpart A, §§ 650.1 to 650.4.
652	Federal Agricultural Mortgage Corporation—Funding and Fiscal Affairs.	A	Investment Management	§§ 652.1 to 652.45	New in this rule.
652	Federal Agricultural Mortgage Corporation—Funding and Fiscal Affairs.	B	Risk-Based Capital	§§ 652.50 to 652.105	Existing Part 650, Subpart B, §§ 650.20 to 650.31.
653	Reserved.				
654	Reserved.				
655	Federal Agricultural Mortgage Corporation—Disclosure and Reporting Requirements.	A	Annual Report of Condition of the Federal Agricultural Mortgage Corporation.	§ 655.1	Existing Part 620, Subpart G, § 620.40.
655	Federal Agricultural Mortgage Corporation—Disclosure and Reporting Requirements.	B	Accounting and Reporting Requirements.	§ 655.50	Existing Part 621, Subpart E, § 621.20.

VI. Regulatory Flexibility Act

Farmer Mac has assets and annual income in excess of the amounts that would qualify it as a small entity. Therefore, Farmer Mac is not a “small entity” as defined in the 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 final rule will not have a significant economic impact on a substantial number of small entities.

List of Subjects

12 CFR Part 620

Accounting, Agriculture, Banks, Banking, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 621

Accounting, Agriculture, Banks, Banking, Penalties, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 650

Agriculture, Banks, Banking, Conflicts of interest, Rural areas.

12 CFR Part 651

Agriculture, Banks, Banking, Conflicts of interest, Rural areas.

12 CFR Part 652

Agriculture, Banks, Banking, Rural areas, Investments, Capital.

12 CFR Part 655

Accounting, Agriculture, Banks, Banking, Accounting and reporting requirements, Disclosure and reporting requirements, Rural areas.

■ For the reasons stated in the preamble, we are amending parts 620, 621, and 650 of chapter VI, adding parts 651, 652, and 655 to chapter VI, and reserving parts 653 and 654 of chapter VI, title 12 of the Code of Federal Regulations to read as follows:

PART 655—FEDERAL AGRICULTURAL MORTGAGE CORPORATION DISCLOSURE AND REPORTING REQUIREMENTS

■ 1. Add the heading for a new part 655 to read as set forth above.

■ 2. Add the authority citation for new part 655 to read as follows:

Authority: Sec. 8.11 of the Farm Credit Act (12 U.S.C. 2279aa–11).

PART 620—DISCLOSURE TO SHAREHOLDERS

■ 3. The authority citation for part 620 continues to read as follows:

Authority: Secs. 5.17, 5.19, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2254, 2279aa–11); sec. 424 of Pub. L. 100–233, 101 Stat. 1568, 1656.

Subpart G—Annual Report of Condition of the Federal Agricultural Mortgage Corporation

§ 620.40 [Redesignated as § 655.1]

■ 4. Redesignate subpart G of part 620, consisting of § 620.40, as subpart A of new part 655, consisting of § 655.1.

PART 621—ACCOUNTING AND REPORTING REQUIREMENTS

■ 5. The authority citation for part 621 continues to read as follows:

Authority: Secs. 5.17, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2279aa–11).

Subpart E—Reports Relating to Securities Activities of the Federal Agricultural Mortgage Corporation

§ 621.20 [Redesignated as § 655.50]

■ 6. Redesignate subpart E of part 621, consisting of § 621.20, as subpart B of new part 655, consisting of § 655.50.

PART 651—FEDERAL AGRICULTURAL MORTGAGE CORPORATION GOVERNANCE

■ 7. Add the heading for a new part 651 to read as set forth above.

■ 8. The authority citation for new part 651 is added to read as follows:

Authority: Secs. 4.12, 5.9, 5.17, 8.11, 8.31, 8.32, 8.33, 8.34, 8.35, 8.36, 8.37, 8.41 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2252, 2279aa–11, 2279bb, 2279bb–1, 2279bb–2, 2279bb–3, 2279bb–4, 2279bb–5, 2279bb–6, 2279cc); sec. 514 of Pub. L. 102–552, 106 Stat. 4102; sec. 118 of Pub. L. 104–105, 110 Stat. 168.

■ 9. Add a new part 652 to read as follows:

PART 652—FEDERAL AGRICULTURAL MORTGAGE CORPORATION FUNDING AND FISCAL AFFAIRS

Subpart A—Investment Management

652.1 Purpose.

652.5 Definitions.

652.10 Investment management and requirements.

652.15 Interest rate risk management and requirements.

652.20 Liquidity reserve management and requirements.

652.25 Non-program investment purposes and limitation.

652.30 Temporary regulatory waivers or modifications for extraordinary situations.

652.35 Eligible non-program investments.

652.40 Stress tests for mortgage securities.

652.45 Divestiture of ineligible non-program investments.

Subpart B—Risk-Based Capital Requirements [Reserved]

Authority: Secs. 4.12, 5.9, 5.17, 8.11, 8.31, 8.32, 8.33, 8.34, 8.35, 8.36, 8.37, 8.41 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2252, 2279aa–11, 2279bb, 2279bb–1, 2279bb–2, 2279bb–3, 2279bb–4, 2279bb–5, 2279bb–6, 2279cc); sec. 514 of Pub. L. 102–552, 106 Stat. 4102; sec. 118 of Pub. L. 104–105, 110 Stat. 168.

Subpart A—Investment Management

§ 652.1 Purpose.

This subpart contains the Farm Credit Administration's (FCA) rules for governing liquidity and non-program investments held by the Federal Agricultural Mortgage Corporation (Farmer Mac). The purpose of this subpart is to ensure safety and soundness, continuity of funding, and appropriate use of non-program investments considering Farmer Mac's special status as a Government-sponsored enterprise (GSE). The subpart contains requirements for Farmer Mac's board of directors to adopt policies covering such areas as investment management, interest rate risk, and

liquidity reserves. The subpart also requires Farmer Mac to comply with various reporting requirements.

§ 652.5 Definitions.

For purposes of this subpart, the following definitions will apply:

Affiliate means any entity established under authority granted to the Corporation under section 8.3(b)(13) of the Farm Credit Act of 1971, as amended.

Asset-backed securities (ABS) means investment securities that provide for ownership of a fractional undivided interest or collateral interests in specific assets of a trust that are sold and traded in the capital markets. For the purposes of this subpart, ABS exclude mortgage securities that are defined below.

Eurodollar time deposit means a non-negotiable deposit denominated in United States dollars and issued by an overseas branch of a United States bank or by a foreign bank outside the United States.

Farmer Mac, Corporation, you, and your means the Federal Agricultural Mortgage Corporation and its affiliates.

FCA, our, or we means the Farm Credit Administration.

Final maturity means the last date on which the remaining principal amount of a security is due and payable (matures) to the registered owner. It does not mean the call date, the expected average life, the duration, or the weighted average maturity.

General obligations of a state or political subdivision means:

(1) The full faith and credit obligations of a state, the District of Columbia, the Commonwealth of Puerto Rico, a territory or possession of the United States, or a political subdivision thereof that possesses general powers of taxation, including property taxation; or

(2) An obligation that is unconditionally guaranteed by an obligor possessing general powers of taxation, including property taxation.

Government agency means an agency or instrumentality of the United States Government whose obligations are fully and explicitly guaranteed as to the timely repayment of principal and interest by the full faith and credit of the United States Government.

Government-sponsored agency means an agency, instrumentality, or corporation chartered or established to serve public purposes specified by the United States Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the United States Government, including but not limited to any Government-sponsored enterprise.

Liquid investments are assets that can be promptly converted into cash

without significant loss to the investor. A security is liquid if the spread between its bid price and ask price is narrow and a reasonable amount can be sold at those prices promptly.

Long-Term Standby Purchase

Commitment (LTSPC) is a commitment by Farmer Mac to purchase specified eligible loans on one or more undetermined future dates. In consideration for Farmer Mac's assumption of the credit risk on the specified loans underlying an LTSPC, Farmer Mac receives an annual commitment fee on the outstanding balance of those loans in monthly installments based on the outstanding balance of those loans.

Market risk means the risk to your financial condition because the value of your holdings may decline if interest rates or market prices change. Exposure to market risk is measured by assessing the effect of changing rates and prices on either the earnings or economic value of an individual instrument, a portfolio, or the entire Corporation.

Maturing obligations means maturing debt and other obligations that may be expected, such as buyouts of long-term standby purchase commitments or repurchases of agricultural mortgage securities.

Mortgage securities 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 mortgage securities, or other multiclass mortgage securities.

(3) This definition does not include agricultural mortgage-backed securities guaranteed by Farmer Mac itself.

Nationally recognized statistical rating organization (NRSRO) means a rating organization that the Securities and Exchange Commission recognizes as an NRSRO.

Non-program investments means investments other than those in:

(1) "Qualified loans" as defined in section 8.0(9) of the Farm Credit Act of 1971, as amended; or

(2) Securities collateralized by "qualified loans."

Program assets means on-balance sheet "qualified loans" as defined in section 8.0(9) of the Farm Credit Act of 1971, as amended.

Program obligations means off-balance sheet “qualified loans” as defined in section 8.0(9) of the Farm Credit Act of 1971, as amended.

Regulatory capital means your core capital plus an allowance for losses and guarantee claims, as determined in accordance with generally accepted accounting principles.

Revenue bond means an obligation of a municipal government that finances a specific project or enterprise, but it is not a full faith and credit obligation. The obligor pays a portion of the revenue generated by the project or enterprise to the bondholders.

Weighted average life (WAL) means the average time until the investor receives the principal on a security, weighted by the size of each principal payment and calculated under specified prepayment assumptions.

§ 652.10 Investment management and requirements.

(a) *Investment policies—board responsibilities.* Your board of directors must adopt written policies for managing your non-program investment activities. Your board must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. At least annually, your board, or a designated subcommittee of the board, must review these investment policies. Any changes to the policies must be adopted by the board. You must report any changes to these policies to FCA’s Office of Secondary Market Oversight within 10 business days of adoption.

(b) *Investment policies—general requirements.* Your investment policies must address the purposes and objectives of investments, risk tolerance, delegations of authority, exception parameters, securities valuation, internal controls, and reporting requirements. Furthermore, the policies must address the means for reporting, and approvals needed for, exceptions to established policies. Investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of your investments.

(c) *Investment policies—risk tolerance.* Your investment policies must establish risk limits and diversification requirements for the various classes of eligible investments and for the entire investment portfolio. These policies must ensure that you maintain prudent diversification of your investment portfolio. Risk limits must be based on the Corporation’s objectives, capital position, and risk tolerance. Your policies must identify the types and quantity of investments

that you will hold to achieve your objectives and control credit, market, liquidity, and operational risks. Your policies must establish risk limits for the following four types of risk:

(1) *Credit risk.* Your investment policies must establish:

(i) Credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations based on a single or related counterparty(ies), a geographical area, industries or obligations with similar characteristics.

(ii) Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms). You must buy and sell eligible investments with more than one securities firm. As part of your annual review of your investment policies, your board of directors, or a designated subcommittee of the board, must review the criteria for selecting securities firms. Any changes to the criteria must be approved by the board. Also, as part of your annual review, the board, or a designated subcommittee of the board, must review existing relationships with securities firms. In addition, the board, or a designated subcommittee of the board, must be notified before any changes to securities firms are made.

(iii) Collateral margin requirements on repurchase agreements. You must regularly mark the collateral to market and ensure appropriate controls are maintained over collateral held.

(2) *Market risk.* Your investment policies must set market risk limits for specific types of investments, and for the investment portfolio or for Farmer Mac generally. Your board of directors must establish market risk limits in accordance with these regulations (including, but not limited to, §§ 652.15 and 652.40) and our other policies and guidance. You must document in the Corporation’s records or minutes any analyses used in formulating your policies or amendments to the policies.

(3) *Liquidity risk.* Your investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and the Corporation’s objectives.

(4) *Operational risk.* Investment policies must address operational risks, including delegations of authority and internal controls in accordance with 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.* You 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 and supervision between personnel who execute investment transactions and personnel who approve, reevaluate, and oversee investments.

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

(f) *Securities valuations.* (1) Before you purchase a security, you must evaluate its credit quality and price sensitivity to changes in market interest rates. You must also verify the value of a security that you plan to purchase, other than a new issue, with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction. Your investment policies must fully address the extent of the prepurchase analysis that management needs to perform for various classes of instruments. For example, you should specifically describe the stress tests in § 652.40 that must be performed on various types of mortgage securities.

(2) At least monthly, you must determine the fair market value of each security in your portfolio and the fair market value of your whole investment portfolio. In doing so you must also evaluate the credit quality and price sensitivity to the change in market interest rates of each security in your portfolio and your whole investment portfolio.

(3) Before you sell a security, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(g) *Reports to the board of directors.* At least quarterly, Farmer Mac’s management must report to the Corporation’s board of directors, or a designated subcommittee of the board:

(1) On the performance and risk of each class of investments and the entire investment portfolio;

(2) All gains and losses that you incur during the quarter on individual securities that you sold before maturity and why they were liquidated;

(3) Potential risk exposure to changes in market interest rates and any other factors that may affect the value of your investment holdings;

(4) How investments affect your overall financial condition;

(5) Whether the performance of the investment portfolio effectively achieves the board’s objectives; and

(6) Any deviations from the board’s policies. These deviations must be

formally approved by the board of directors.

§ 652.15 Interest rate risk management and requirements.

(a) The board of directors of Farmer Mac must provide effective oversight (direction, controls, and supervision) to the interest rate risk management program and must be knowledgeable of the nature and level of interest rate risk taken by Farmer Mac.

(b) The management of Farmer Mac must ensure that interest rate risk is properly managed on both a long-range and a day-to-day basis.

(c) The board of directors of Farmer Mac must adopt an interest rate risk management policy that establishes appropriate interest rate risk exposure limits based on the Corporation's risk-bearing capacity and reporting requirements in accordance with paragraphs (d) and (e) of this section. At least annually, the board of directors, or a designated subcommittee of the board, must review the policy. Any changes to the policy must be approved by the board of directors. You must report any changes to the policy to FCA's Office of Secondary Market Oversight within 10 business days of adoption.

(d) The interest rate risk management policy must, at a minimum:

(1) Address the purpose and objectives of interest rate risk management;

(2) Identify and analyze the causes of interest rate risks within Farmer Mac's existing balance sheet structure;

(3) Require Farmer Mac to measure the potential impact of these risks on projected earnings and market values by conducting interest rate shock tests and simulations of multiple economic scenarios at least quarterly;

(4) Describe and implement actions needed to obtain Farmer Mac's desired risk management objectives;

(5) Document the objectives that Farmer Mac is attempting to achieve by purchasing eligible investments that are authorized by § 652.35 of this subpart;

(6) Require Farmer Mac to evaluate and document, at least quarterly, whether these investments have actually met the objectives stated under paragraph (d)(4) of this section;

(7) Identify exception parameters and post approvals needed for any exceptions to the policy's requirements;

(8) Describe delegations of authority; and

(9) Describe reporting requirements, including exceptions to policy limits.

(e) At least quarterly, Farmer Mac's management must report to the Corporation's board of directors, or a designated subcommittee of the board,

describing the nature and level of interest rate risk exposure. Any deviations from the board's policy on interest rate risk must be specifically identified in the report and approved by the board, or a designated subcommittee of the board.

§ 652.20 Liquidity reserve management and requirements.

(a) *Minimum liquidity reserve requirement.* Within 24 months of this rule becoming effective, and thereafter, Farmer Mac must hold cash, eligible non-program investments under § 652.35 of this subpart, and/or on-balance sheet securities backed by portions of Farmer Mac program assets (loans) that are guaranteed by the United States Department of Agriculture as described in section 8.0(9)(B) of the Act (in accordance with the requirements of paragraphs (b) and (c) of this section), to maintain sufficient liquidity to fund a minimum of 60 days of maturing obligations, interest expense, and operating expenses at all times. You must document your compliance with this minimum reserve requirement at least once each month as of the last day of the month using month end data. Liquid asset values must be marked to market. In addition, you must have the capability and information systems in place to be able to calculate the minimum reserve requirement on a daily basis.

(b) *Free of lien.* All investments held for the purpose of meeting the liquidity reserve requirement of this section must be free of liens or other encumbrances.

(c) *Discounts.* The amount that may be counted to meet the minimum liquidity reserve requirement is as follows:

(1) For cash and overnight investments, multiply the cash and investments by 100 percent;

(2) For money market instruments with maturities of 5 business days or less, multiply the instruments by 97 percent of market value;

(3) For money market instruments with maturities greater than 5 business days and floating rate debt and preferred stock securities, multiply the instruments and securities by 95 percent of market value;

(4) For diversified investment funds, multiply the individual securities in the funds by the discounts that would apply to the securities if held separately;

(5) For fixed rate debt and preferred stock securities, multiply the securities by 90 percent of market value;

(6) For securities backed by Farmer Mac program assets (loans) guaranteed by the United States Department of Agriculture as described in section

8.0(9)(B) of the Act, multiply the securities by 75 percent; and

(7) We reserve the authority to modify or determine the appropriate discount for any investment used to meet the minimum liquidity reserve requirement if the otherwise applicable discount does not accurately reflect the liquidity of that investment or if the investment does not fit wholly within one of the specified investment categories. In making any modification or determination, we will consider the liquidity of the investment as well as any other relevant factors. We will provide notice of at least 20 business days before any modified discounts will take effect.

(d) *Liquidity reserve policy—board responsibilities.* Farmer Mac's board of directors must adopt a liquidity reserve policy. The board must also ensure that management uses adequate internal controls to ensure compliance with the liquidity reserve policy standards, limitations, and reporting requirements established pursuant to this paragraph and to paragraphs (e), (f), and (g) of this section. At least annually, the board of directors or a designated subcommittee of the board must review and validate the liquidity policy's adequacy. The board of directors must approve any changes to the policy. You must provide a copy of the revised policy to FCA's Office of Secondary Market Oversight within 10 business days of adoption.

(e) *Liquidity reserve policy—content.* Your liquidity reserve policy must contain at a minimum the following:

(1) The purpose and objectives of liquidity reserves;

(2) A listing of specific assets, debt, and arrangements that can be used to meet liquidity objectives;

(3) Diversification requirements of your liquidity reserve portfolio;

(4) Maturity limits and credit quality standards for non-program investments used to meet the minimum liquidity reserve requirement of paragraph (a) of this section;

(5) The minimum and target (or optimum) amounts of liquidity that the board believes are appropriate for Farmer Mac;

(6) The maximum amount of non-program investments that can be held for meeting Farmer Mac's liquidity needs, as expressed as a percentage of program assets and program obligations;

(7) Exception parameters and post approvals needed;

(8) Delegations of authority; and

(9) Reporting requirements.

(f) *Liquidity reserve reporting—periodic reporting requirements.* At least quarterly, Farmer Mac's management must report to the Corporation's board

of directors or a designated subcommittee of the board describing, at a minimum, liquidity reserve compliance with the Corporation's policy and this section. Any deviations from the board's liquidity reserve policy (other than requirements specified in § 652.20(e)(5)) must be specifically identified in the report and approved by the board of directors.

(g) *Liquidity reserve reporting—special reporting requirements.* Farmer Mac's management must immediately report to its board of directors any noncompliance with board policy requirements that are specified in § 652.20(e)(5). Farmer Mac must report, in writing, to FCA's Office of Secondary Market Oversight no later than the next business day following the discovery of any breach of the minimum liquidity reserve requirement at § 652.20(a).

§ 652.25 Non-program investment purposes and limitation.

(a) Farmer Mac is authorized to hold eligible non-program investments listed under § 652.35 for the purposes of complying with the interest rate risk requirements of § 652.15, complying with the liquidity reserve requirements of § 652.20, and managing surplus short-term funds.

(b) Non-program investments cannot exceed the greater of \$1.5 billion or thirty-five (35) percent of program assets and program obligations, excluding 75 percent of the program assets that are guaranteed by the United States Department of Agriculture as described in section 8.0(9)(B) of the Farm Credit Act of 1971, as amended.

§ 652.30 Temporary regulatory waivers or modifications for extraordinary situations.

Whenever the FCA determines that an extraordinary situation exists that

necessitates a temporary regulatory waiver or modification, the FCA may, in its sole discretion:

(a) Modify or waive the minimum liquidity reserve requirement in § 652.20 of this subpart; and/or

(b) Modify the amount, qualities, and types of eligible investments that you are authorized to hold pursuant to § 652.25 of this subpart.

§ 652.35 Eligible non-program investments.

(a) You may hold only the types, quantities, and qualities of non-program investments listed in the following Non-Program Investment Eligibility Criteria Table. These investments must be denominated in United States dollars.

BILLING CODE 6705-01-P

Non-Program Investment Eligibility Criteria Table

ASSET CLASS	FINAL MATURITY LIMIT	NRSRO ISSUE OR ISSUER CREDIT RATING REQUIREMENT	OTHER REQUIREMENTS	MAXIMUM PERCENTAGE OF TOTAL NON-PROGRAM INVESTMENT PORTFOLIO
(1) Obligations of the United States <ul style="list-style-type: none"> Treasuries Other obligations (except mortgage securities) fully insured or guaranteed by the United States Government or a Government agency. 	None	NA	None	None
(2) Obligations of Government-sponsored agencies <ul style="list-style-type: none"> Government-sponsored agency securities (except mortgage securities). Other obligations (except mortgage securities) fully insured or guaranteed by Government-sponsored agencies. 	None	NA	None	None
(3) Municipal Securities				
<ul style="list-style-type: none"> General obligations 	10 years	One of the two highest.	None	None
<ul style="list-style-type: none"> Revenue bonds 	5 years for fixed rate bonds and 10 years for index/floating rate bonds	Highest	None	15%
(4) International and Multilateral Development Bank Obligations	None	None	The United States must be a voting shareholder.	None
(5) Money Market Instruments				
<ul style="list-style-type: none"> Federal funds 	1 day or continuously callable up to 100 days	One of the two highest short-term.	None	None
<ul style="list-style-type: none"> Negotiable certificates of deposit 	1 year	One of the two highest short-term.	None	None
<ul style="list-style-type: none"> Bankers acceptances 	None	One of the two highest short-term.	Issued by a depository institution.	None
<ul style="list-style-type: none"> Prime commercial paper 	270 days	Highest short-term.	None	None
<ul style="list-style-type: none"> Non-callable term Federal funds and Eurodollar time deposits. 	100 days	Highest short-term.	None	20%
<ul style="list-style-type: none"> Master notes 	270 days	Highest short-term.	None	20%
<ul style="list-style-type: none"> Repurchase agreements collateralized by eligible investments or marketable securities rated in the highest credit rating category by an NRSRO. 	100 days	NA	If counterparty defaults, you must divest non-eligible securities as required under § 652.45.	None

Note: You must also comply with requirements of paragraphs (b), (c), and (d) of this section, and § 651.40 when applicable. "NA" means not applicable.

ASSET CLASS	FINAL MATURITY LIMIT	NRSRO ISSUE OR ISSUER CREDIT RATING REQUIREMENT	OTHER REQUIREMENTS	MAXIMUM PERCENTAGE OF TOTAL NON-PROGRAM INVESTMENT PORTFOLIO
(6) Mortgage Securities				
<ul style="list-style-type: none"> • Issued or guaranteed by the United States or a Government agency. 	None	NA	Stress testing under § 652.40.	None
<ul style="list-style-type: none"> • Government-sponsored agency mortgage securities. 	None	One of the two highest.	Stress testing under § 652.40.	50%
<ul style="list-style-type: none"> • Non-Government agency or Government-sponsored agency securities that comply with 15 U.S.C. 77d(5) or 15 U.S.C. 78c(a)(41). 	None	Highest	Stress testing under § 652.40.	15% combined
<ul style="list-style-type: none"> • Commercial mortgage-backed securities. 	None	Highest	<ul style="list-style-type: none"> • Security must be backed by a minimum of 100 loans. • Loans from a single mortgagor cannot exceed 5% of the pool. • Pool must be geographically diversified pursuant to the board's policy. • Stress testing under § 652.40. 	
<p>(7) Asset-Backed Securities secured by:</p> <ul style="list-style-type: none"> • Credit card receivables • Automobile loans • Home equity loans • Wholesale automobile dealer loans • Student loans • Equipment loans • Manufactured housing loans 	None	Highest	Maximum of 5-year WAL for fixed rate or floating rate ABS at their contractual interest rate caps.	25% combined
<p>(8) Corporate Debt Securities</p>	5 years	One of the highest two for maturities greater than 3 years, and one of the highest three for maturities of three years or less.	Cannot be convertible to equity securities.	25%
<p>(9) Diversified Investment Funds</p> <p>Shares of an investment company registered under section 8 of the Investment Company Act of 1940.</p>	NA	NA	<p>The portfolio of the investment company must consist solely of eligible investments authorized by this section.</p> <p>The investment company's risk and return objectives and use of derivatives must be consistent with FCA guidance and your investment policies.</p>	None, if your shares in each investment company comprise less than 10% of your portfolio. Otherwise counts toward limit for each type of investment.

Note: You must also comply with requirements of paragraphs (b), (c), and (d) of this section, and § 651.40 when applicable. "NA" means not applicable.

(b) *Rating of foreign countries.* Whenever the obligor or issuer of an eligible investment is located outside the United States, the host country must maintain the highest sovereign rating for political and economic stability by an NRSRO.

(c) *Marketable investments.* All eligible investments, except money market instruments, must be readily marketable. An eligible investment is marketable if you can sell it promptly at a price that closely reflects its fair value in an active and universally recognized secondary market. You must evaluate and document the size and liquidity of the secondary market for the investment at time of purchase.

(d) *Obligor limits.* (1) You may not invest more than 25 percent of your regulatory capital in eligible investments issued by any single entity, issuer or obligor. This obligor limit does not apply to Government-sponsored agencies or Government agencies. You may not invest more than 100 percent of your regulatory capital in any one Government-sponsored agency. There are no obligor limits for Government agencies.

(2) *Obligor limits for your holdings in an investment company.* You must count securities that you hold through an investment company towards the obligor limits of this section unless the investment company's holdings of the security of any one issuer do not exceed 5 percent of the investment company's total portfolio.

(e) *Preferred stock and other investments approved by the FCA.* (1) You may purchase non-program investments in preferred stock issued by other Farm Credit System institutions only with our written prior approval. You may also purchase non-program investments other than those listed in the Non-Program Investment Eligibility Criteria Table at paragraph (a) of this section only with our written prior approval.

(2) Your request for our approval must explain the risk characteristics of the investment and your purpose and objectives for making the investment.

§ 652.40 Stress tests for mortgage securities.

(a) You must perform stress tests to determine how interest rate changes will affect the cashflow and price of each mortgage security that you purchase and hold, except for adjustable rate mortgage securities that reprice at intervals of 12 months or less and are tied to an index. You must also use stress tests to gauge how interest rate fluctuations on mortgage securities affect your capital and earnings. The

stress tests must be able to measure the price sensitivity of mortgage instruments over different interest rate/ yield curve scenarios and be consistent with any asset liability management and interest rate risk policies. The methodology that you use to analyze mortgage securities must be appropriate for the complexity of the instrument's structure and cashflows. Prior to purchase and each quarter thereafter, you must use the stress tests to determine that the risk in the mortgage securities is within the risk limits of your board's investment policies. The stress tests must enable you to determine at the time of purchase and each subsequent quarter that the mortgage security does not expose your capital or earnings to excessive risks.

(b) You must rely on verifiable information to support all your assumptions, including prepayment and interest rate volatility assumptions. You must document the basis for all assumptions that you use to evaluate the security and its underlying mortgages. You must also document all subsequent changes in your assumptions. If at any time after purchase, a mortgage security no longer complies with requirements in this section, Farmer Mac's management must report to the Corporation's board of directors in accordance with § 652.10(g).

§ 652.45 Divestiture of ineligible non-program investments.

(a) *Divestiture requirements—(1) Initial divestiture requirements.* Within 6 months of this rule's effective date, you must divest of all ineligible non-program investments or securities unless we approve, in writing, a plan that authorizes you to divest the instruments over a longer period of time. An acceptable plan generally would require you to divest of the ineligible investments or securities as quickly as possible without substantial financial loss.

(2) *Subsequent divestiture requirements.* Subsequent to the initial divestiture period set forth in paragraph (a)(1) of this section, you must divest of an ineligible non-program investment or security within 6 months unless we approve, in writing, a plan that authorizes you to divest the instrument over a longer period of time. An acceptable plan generally would require you to divest of the ineligible investment or security as quickly as possible without substantial financial loss.

(b) *Reporting requirements.* Until you divest of the ineligible non-program investment or security, you must report at least quarterly to your board of

directors and to FCA's Office of Secondary Market Oversight about the status and performance of the ineligible instrument, the reasons why it remains ineligible, and the manager's progress in divesting of the investment.

Subpart B—Risk-Based Capital Requirements [Reserved]

PART 650—FEDERAL AGRICULTURAL MORTGAGE CORPORATION GENERAL PROVISIONS

■ 10. The authority citation for part 650 continues to read as follows:

Authority: Secs. 4.12, 5.9, 5.17, 8.11, 8.31, 8.32, 8.33, 8.34, 8.35, 8.36, 8.37, 8.41 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2252, 2279aa-11, 2279bb, 2279bb-1, 2279bb-2, 2279bb-3, 2279bb-4, 2279bb-5, 2279bb-6, 2279cc); sec. 514 of Pub. L. 102-552, 106 Stat. 4102; sec. 118 of Pub. L. 104-105, 110 Stat. 168.

■ 11. Amend part 650 by revising the part heading to read as set forth above.

§§ 650.1 through 650.68 [Redesignated]

■ 12. Redesignate §§ 650.1 through 650.68 as follows:

Old section	New section
650.1, subpart A	651.1
650.2, subpart A	651.2
650.3, subpart A	651.3
650.4, subpart A	651.4
650.20, subpart B	652.50, subpart B
650.21, subpart B	652.55, subpart B
650.22, subpart B	652.60, subpart B
650.23, subpart B	652.65, subpart B
650.24, subpart B	652.70, subpart B
650.25, subpart B	652.75, subpart B
650.26, subpart B	652.80, subpart B
650.27, subpart B	652.85, subpart B
650.28, subpart B	652.90, subpart B
650.29, subpart B	652.95, subpart B
650.30, subpart B	652.100, subpart B
650.31, subpart B	652.105, subpart B
Appendix A to Subpart B of Part 650	Appendix A to Subpart B of Part 652
650.50, subpart C	650.1
650.51, subpart C	650.5
650.52, subpart C	650.10
650.55, subpart C	650.15
650.56, subpart C	650.20
650.57, subpart C	650.25
650.58, subpart C	650.30
650.59, subpart C	650.35
650.60, subpart C	650.40
650.61, subpart C	650.45
650.62, subpart C	650.50
650.63, subpart C	650.55
650.64, subpart C	650.60
650.65, subpart C	650.65
650.66, subpart C	650.70
650.67, subpart C	650.75
650.68, subpart C	650.80

Subpart A—General Provisions**§ 650.75 [Amended]**

■ 13. Amend newly designated § 650.75 by removing the reference “§ 620.40” and adding in its place, the reference “§ 655.1” in paragraph (c).

PART 653—[ADDED AND RESERVED]**PART 654—[ADDED AND RESERVED]**

■ 14. Add and reserve parts 653 and 654.

Dated: July 7, 2005.

Jeanette C. Brinkley,

Secretary, Farm Credit Administration Board.
[FR Doc. 05–13831 Filed 7–13–05; 8:45 am]

BILLING CODE 6705–01–P

DEPARTMENT OF TRANSPORTATION**Federal Aviation Administration****14 CFR Part 39**

[Docket No. FAA–2004–18670; Directorate Identifier 2002–NM–83–AD; Amendment 39–14187; AD 2005–14–10]

RIN 2120–AA64

Airworthiness Directives; McDonnell Douglas Model DC–10–10 and DC–10–10F Airplanes; Model DC–10–15 Airplanes; Model DC–10–30 and DC–10–30F (KC–10A and KDC–10) Airplanes; and Model DC–10–40 and DC–10–40F Airplanes

AGENCY: Federal Aviation Administration (FAA), Department of Transportation (DOT).

ACTION: Final rule.

SUMMARY: The FAA is superseding an existing airworthiness directive (AD), which applies to certain McDonnell Douglas transport category airplanes. That AD currently requires implementation of a program of structural inspections to detect and correct fatigue cracking in order to ensure the continued airworthiness of these airplanes as they approach the manufacturer’s original fatigue design life goal. This new AD requires implementation of a program of structural inspections of baseline structure to detect and correct fatigue cracking in order to ensure the continued airworthiness of these airplanes as they approach the manufacturer’s original fatigue design life goal. This AD is prompted by a significant number of these airplanes approaching or exceeding the design service goal on which the initial type certification approval was predicated. We are issuing this AD to detect and

correct fatigue cracking that could compromise the structural integrity of these airplanes.

DATES: This AD becomes effective August 18, 2005.

The incorporation by reference of Boeing Report No. L26–012, “DC–10 Supplemental Inspection Document (SID),” Volume I, Revision 6, dated February 2002; and McDonnell Douglas Report No. L26–012, “DC–10 Supplemental Inspection Document (SID),” Volume II Revision 8, dated November 2003; as listed in the AD, is approved by the Director of the Federal Register as of August 18, 2005.

On January 2, 1996, (60 FR 61649, December 1, 1995), the Director of the Federal Register approved the incorporation by reference of certain publications, as listed in the regulations.

On November 24, 1993 (58 FR 54949, October 25, 1993), the Director of the Federal Register approved the incorporation of a certain other publication, as listed in the regulations.

ADDRESSES: For service information identified in this AD, contact Boeing Commercial Airplanes, Long Beach Division, 3855 Lakewood Boulevard, Long Beach, California 90846, Attention: Data and Service Management, Dept. C1–L5A (D800–0024). You can examine this information at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call (202) 741–6030, or go to: http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

Docket: The AD docket contains the proposed AD, comments, and any final disposition. You can examine the AD docket on the Internet at <http://dms.dot.gov>, or in person at the Docket Management Facility office between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The Docket Management Facility office (Telephone (800) 647–5227) is located on the plaza level of the Nassif Building at the U.S. Department of Transportation, 400 Seventh Street SW., room PL–401, Washington, DC. This docket number is FAA–2004–18670; the directorate identifier for this docket is 2002–NM–83–AD.

FOR FURTHER INFORMATION CONTACT: Ron Atmur, Aerospace Engineer, Airframe Branch, ANM–120L, FAA, Los Angeles Aircraft Certification Office, 3960 Paramount Boulevard, Lakewood, California 90712–4137; telephone (562) 627–5224; fax (562) 627–5210.

SUPPLEMENTARY INFORMATION: The FAA proposed to amend part 39 of the

Federal Aviation Regulations (14 CFR part 39) with an AD to supersede AD 95–23–09, amendment 39–9429 (60 FR 61649, December 1, 1995). The existing AD applies to certain McDonnell Douglas transport category airplanes. The proposed AD was published in the **Federal Register** on August 3, 2004 (69 FR 46456), to require implementation of a program of structural inspections of baseline structure to detect and correct fatigue cracking in order to ensure the continued airworthiness of these airplanes as they approach the manufacturer’s original fatigue design life goal.

Comments

We provided the public the opportunity to participate in the development of this AD. We have considered the comments that have been submitted on the proposed AD.

One Commenter Has No Objection to the Proposed AD

One commenter, an operator, advises that it has no objection to the proposed AD.

Requests To Revise Compliance Times for Certain Airplanes

One commenter, an operator, requests that, for airplanes approaching $\frac{3}{4}$ of the fatigue life threshold (N_{th}), the grace period for the compliance time required by paragraph (j)(1) of the proposed AD be extended from “within 18 months of the effective date of the AD” to “within 60 months of the effective date of the AD.” The commenter states that some of the inspections would require significant efforts and cost to access the inspection area. The commenter notes that while the proposed AD would require inspection within 18 months from the effective date of the AD for airplanes approaching $\frac{3}{4}$ N_{th} , the proposed AD would not require the same inspections for airplanes just beyond $\frac{3}{4}$ N_{th} at the effective date of the AD until the airplane reached N_{th} , which is several years later in most cases. Another commenter requests that the inspections required by paragraph (j)(1) of the proposed AD be revised to “prior to N_{th} or $\Delta NDI/2$, whichever comes later.” The commenter points out that the revision would more accurately reflect the intent of the DC–10 Supplemental Inspection Document (SID) program.

We agree that the grace period specified in paragraph (j)(1) of the AD may be extended to “within 60 months after the effective date of the AD,” and have revised paragraph (j)(1) of the final rule accordingly. We consider that extension of the grace period will not