Webinar: To register for the webinar and receive call-in information, please register for Monday at *https://www1.gotomeeting.com/register/982871169* and for Tuesday at *https://www1.gotomeeting.com/register/370801721.*

FOR FURTHER INFORMATION CONTACT: Joe Hagerman, Senior Advisor, Building Technologies Office, U.S. Department of Energy (DOE), Office of Energy Efficiency and Renewable Energy, 950 L'Enfant Plaza SW., Washington, DC 20024. Phone: 202–586–4549; Email: *asrac@ee.doe.gov.*

SUPPLEMENTARY INFORMATION:

Purpose of Meeting

The purpose of the working group will be to discuss and, if possible, reach consensus on a proposed rule for the energy efficiency of manufactured homes, as authorized by section 413 of the Energy Independence and Security Act of 2007 (EISA). Tentative Agenda: (Subject to change):

- Overview of Working Group's Task
- Discussion and formation of a work plan for the MH Working Group to accomplish its objectives.

Public Participation

Members of the public are welcome to observe the business of the meeting and, if time allows, may make oral statements during the specified period for public comment. To attend the meeting and/or to make oral statements regarding any of the items on the agenda, email *asrac@ee.doe.gov.* In the email, please indicate your name, organization (if appropriate), citizenship, and contact information. Please note that foreign nationals visiting DOE Headquarters are subject to advance security screening procedures. Any foreign national wishing to participate in the meeting should advise ASRAC staff as soon as possible by emailing *asrac@ee.doe.gov* to initiate the necessary procedures, no later than Monday, July 28, 2014. Anyone attending the meeting will be required to present a government photo identification, such as a passport, driver's license, or government identification. Due to the required security screening upon entry, individuals attending should arrive early to allow for the extra time needed.

Members of the public will be heard in the order in which they request to make a statement at the public meeting. Time allotted per speaker will depend on the number of individuals who wish to speak but will not exceed five minutes. Reasonable provision will be made to include the scheduled oral statements on the agenda. The co-chairs of the Committee will make every effort to hear the views of all interested parties and to facilitate the orderly conduct of business.

Participation in the meeting is not a prerequisite for submission of written comments. ASRAC invites written comments from all interested parties during the course of the negotiations. If you would like to file a written statement with the committee, you may do so either by submitting a hard or electronic copy before or after the meeting. Electronic copy of written statements should be emailed to *asrac@ee.doe.gov.*

Minutes: All notices, public comments, public meeting transcripts, and supporting documents associated with this working group are included in Docket No. EERE–2009–BT–BC–0021.

Issued in Washington, DC on July 15, 2014.

Kathleen B. Hogan,

Deputy Assistant Secretary for Energy Efficiency, Energy Efficiency and Renewable Energy.

[FR Doc. 2014–17557 Filed 7–24–14; 8:45 am]

BILLING CODE 6450–01–P

FARM CREDIT ADMINISTRATION

12 CFR Parts 611 and 615

RIN 3052–AC84

Organization; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Investment Eligibility

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, Agency, us, our, or we) proposes to amend our regulations governing the eligibility of investments held by Farm Credit banks. We propose to strengthen these regulations by reinforcing that only high quality investments may be purchased and held. We also propose to revise these regulations to comply with section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or DFA) by removing references to and requirements relating to credit ratings and substituting other appropriate standards of creditworthiness. The FCA also proposes to revise its regulatory approach to Farm Credit System (System) association investments in order to limit the type and amount of investments that an association may hold. The proposed rule also addresses investment and risk management practices at associations and funding bank supervision of association investments.

DATES: You may send us comments by October 23, 2014.

ADDRESSES: We offer a variety of methods for you to submit comments on this proposed rule. For accuracy and efficiency reasons, commenters are encouraged to submit comments by email or through the Agency's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- *Email:* Send us an email at *reg-comm@fca.gov.*
- *FCA Web site: http://www.fca.gov.* Select ''Public Commenters,'' then ''Public Comments,'' and follow the directions for ''Submitting a Comment.''
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Mail:* Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or on our Web site at *http://www.fca.gov.* Once you are in the Web site, select ''Public Commenters,'' then ''Public Comments,'' and follow the directions for ''Reading Submitted Public Comments.'' We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove email addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Paul K. Gibbs, Senior Accountant, or Timothy T. Nerdahl, Senior Financial Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4414, TTY (703) 883–4056; or

Jennifer A. Cohn, Senior Counsel, or Richard A. Katz, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102–5090, (703) 883–4020, TTY (703) 883–4056.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Strengthen the safety and soundness of Farm Credit banks [1] and associations; [2]
- Ensure that Farm Credit banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption;
- Enhance the ability of the Farm Credit banks to supply credit to agricultural and aquatic producers;
- Comply with the requirements of section 939A of the Dodd-Frank Act;
- Modernize the investment eligibility criteria for Farm Credit banks; and
- Revise the investment regulation for associations to improve their investment management practices so they are more resilient to risk.

II. Background

Congress created System institutions, including Farm Credit banks and associations, to provide permanent, stable, and reliable sources of credit and related services to American agricultural and aquatic producers.[3] Associations obtain funds from Farm Credit banks to provide short-, intermediate-, and long-term credit and related services to farmers, ranchers, producers and harvesters of aquatic products, to rural residents for housing, and to farm-related businesses.[4]

Farm Credit banks depend on investments to provide liquidity and to fulfill other needs,[5] and investments also enable associations to manage the risks they confront.[6] Although Farm Credit banks obtain their funding primarily through the issuance of System-wide debt securities,[7] they must have enough available funds, including investments, to continue operations and pay maturing obligations if access to the debt market becomes temporarily impeded.

FCA regulations, at subpart E of part 615, impose comprehensive requirements regarding the investments of System institutions. We have recently revised many of these requirements, particularly those guiding prudent investment management practices.[8] This rulemaking proposes to revise the requirements governing the eligibility of investments for Farm Credit banks and associations, which have been largely unchanged since 1999, as well as the permissible investment amounts and purposes for associations.[9] The regulations this rulemaking proposes to amend should not be viewed in isolation, but rather as part of a comprehensive set of rules guiding the System's liquidity and investment management.

Investment products are becoming increasingly complex, and the financial crisis that began in 2007 made clear that some investments are riskier and less liquid than were previously believed. In addition, in July 2010 the President signed into law the Dodd-Frank Act to strengthen regulation of the financial industry in the wake of the financial crisis. Section 939A of the DFA requires each Federal agency to review all of its regulations that refer to or require the use of credit ratings to assess the creditworthiness of an instrument; to remove the reference or requirement; and to substitute other appropriate creditworthiness standards. FCA's existing investment eligibility regulations use credit ratings as a determinant of eligibility of some investments.

We now propose to comply with the DFA by eliminating the regulations' reliance on credit ratings. The financial crisis that began in 2007 identified flaws in relying on credit ratings to determine credit risk, as many investments with similar labels and ratings exhibited substantially differing underlying risk characteristics, ultimately impacting marketability of the investments. Investment eligibility would no longer depend on external credit ratings, thus enhancing safety and soundness. We also propose other amendments to the provisions governing Farm Credit banks that would strengthen the safety and soundness of their investment activities by more accurately reflecting the risk in particular investments.

Finally, we propose amendments to § 615.5142, which governs the investment activities of associations. We recognize that many associations may need to hold investments for purposes other than managing surplus short-term funds and reducing interest rate risk, which are the only investment purposes authorized by the existing regulations. For this reason, the proposed rule would grant associations greater flexibility to hold investments for other risk management purposes. At the same time, we propose to limit the types and amount of investments that associations may hold.

We first considered revisions to our Farm Credit bank and association investment regulations in 2011.[10] As discussed above, we adopted many of these revisions in 2012, but we did not revise the provisions governing investment eligibility and association investments, which we are now proposing to revise. The revisions we now propose take into consideration the comments we received in response to the earlier rulemaking, as well as the approaches some of the other Federal banking regulatory agencies have taken toward compliance with the DFA credit ratings elimination requirement.[11]

III. Section-by-Section Description of the Proposed Rule

The proposed rule enhances the credit quality standards for eligible investments that Farm Credit banks may hold and revises the regulation governing association investment activities. It also contains conforming amendments to other regulations in parts 611 and 615.

A. Section 615.5131—Definitions

We propose to define asset class as a group of securities that exhibit similar characteristics and behave similarly in the marketplace. Asset classes include, but are not limited to, money market

[1] Section 619.9140 of FCA regulations defines ''Farm Credit bank'' to include Farm Credit Banks, agricultural credit banks, and banks for cooperatives.

[2] Section 619.9050 of FCA regulations defines the term ''association'' to include (individually or collectively) a Federal land bank association, a Federal land credit association, a production credit association, and an agricultural credit association.

[3] The Federal Agricultural Mortgage Corporation (Farmer Mac), also a System institution, provides a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utility cooperative loans. Farmer Mac is not affected by this rulemaking, and the use of the term ''System institution'' in this preamble and proposed rule does not include Farmer Mac.

[4] One Farm Credit bank, known as an agricultural credit bank, also provides lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems, and it is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives.

[5] Section 615.5132(a) authorizes a Farm Credit bank to hold eligible investments to comply with its liquidity requirements, to manage surplus short-term funds, and to manage interest rate risk.

[6] As discussed below, proposed 615.5142 would enable associations, under specified conditions, to hold eligible investments to manage risk. Under § 611.1135(a), which we do not propose to revise, service corporations may hold investments for the purposes authorized for their organizers.

[7] Farm Credit banks use the Federal Farm Credit Banks Funding Corporation (Funding Corporation) to issue and market System-wide debt securities. The Funding Corporation is owned by the Farm Credit banks.

[8] 77 FR 66362, Nov. 5, 2012.

[9] Currently, § 615.5140 identifies eligible investments for both Farm Credit banks and associations. Section 615.5142 governs investment purposes for associations, and the amount of association investments is not prescribed by regulation.

[10] 76 FR 51289, Aug. 18, 2011.

[11] Office of the Comptroller of the Currency (OCC), 77 FR 35253 and 35259, June 13, 2012; Federal Deposit Insurance Corporation (FDIC), 77 FR 43151 and 43155, July 24, 2012.

instruments, municipal securities, corporate bond securities, mortgage-backed securities (MBS), asset-backed securities (ABS) (excluding MBS), and any other asset class as determined by the FCA. We discuss this definition later in this preamble.

We propose to define a collateralized debt obligation (CDO) as a debt security collateralized by MBS, ABS, or trust-preferred securities.

One of our proposed criteria for Farm Credit bank investments with an obligor located outside of the United States is a high Country Risk Classification (CRC) (a 0 or a 1) as published by the Organization for Economic Cooperation and Development (OECD).[12] We propose to define CRC, with respect to a sovereign, as the most recent consensus CRC published by the OECD as of December 31 of the prior calendar year that provides a view of the likelihood that the sovereign will service its external debt. This definition is identical to that adopted by the other Federal banking regulators in their capital rules to implement Basel III.[13] We proposed the same definition in the proposed revisions to our regulatory capital rule that the FCA Board adopted on May 8, 2014.[14]

We propose to define a diversified investment fund as an investment company registered under section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a–8. This is consistent with our usage of the term in existing § 615.5140(a)(8).

We propose to replace the definitions for the existing terms ''Government-sponsored agency'' and ''Government agency'' with definitions for the new terms ''Government-sponsored enterprise (GSE)'' and ''United States (U.S.) Government agency,'' respectively. We would define GSE as an entity established or chartered by the U.S. Government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. Government. We would define U.S. Government agency as an instrumentality of the U.S. Government whose obligations are fully guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. These terminology changes would have no substantive effect.[15]

We propose to replace the defined term ''mortgage securities'' with ''mortgage-backed securities'' or ''MBS.'' We also propose to change ''mortgage securities'' to ''mortgage-backed securities'' in the definition of ABS. These technical changes are for consistency with other FCA regulations and would have no substantive effect.

We propose to add a new definition for the term ''obligor.'' Our existing regulations use this term, as do provisions that we propose to add or revise, but we have no definition for this term. We propose to define the term to ensure a common understanding of its meaning.

We would define obligor as an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded. This definition would include the debtor or immediate party that is obligated to pay a debt, as well as a guarantor of the debt. The definition would not include the sponsor (as we propose to define the term) of an investment, unless the sponsor has an obligation to pay the debt.

We propose to define ''sponsor'' as a person or entity that initiates a transaction by selling or pledging to a specially created issuing entity, such as a trust, a group of financial assets that the sponsor either has originated itself or has purchased; the sponsor may retain the obligation to repay or may transfer that obligation to the trust. An example of a sponsor would be an entity such as a commercial bank that transfers financial assets, such as loans that it has originated or purchased, to a bankruptcy remote trust known as a special purpose vehicle (SPV). In this example, the SPV services the debt and has the obligation to repay.

We propose to delete the following definitions because they will no longer be used in this subpart. We propose to delete ''eurodollar time deposits,'' ''final maturity,'' ''general obligations,'' ''liquid investments,'' ''nationally recognized statistical rating organization,'' ''revenue bond,'' and ''weighted average life''.

B. Section 615.5134—Liquidity Reserve

We propose to make technical, non-substantive revisions by adding the new terms ''Government-sponsored enterprise (GSE)'' and ''U.S. Government agency'' to our liquidity reserve regulation at § 615.5134, to conform to changes we made to those defined terms in § 615.5131. In addition, we propose changes to clarify that MBS must be *fully* guaranteed by a U.S. Government agency to qualify for Level 2 liquidity and *fully* guaranteed by a GSE to qualify for Level 3 liquidity.

C. Section 615.5140—Eligible Investments for Farm Credit Banks

Our existing investment eligibility regulation at § 615.5140 contains a detailed listing of eligible investment asset classes and types of investments within each asset class. The regulation imposes final maturity limits, investment portfolio limits, and other requirements for many of these investments. It also imposes credit rating requirements, based on NRSRO[16] credit ratings, for a number of the investments. The regulation currently applies to both Farm Credit banks and associations.

In revised § 615.5140, we propose to revise the investment eligibility requirements governing Farm Credit banks to strengthen their safety and soundness by more accurately reflecting the risk in particular investments based on recent experience in the marketplace.[17] In addition, to comply with section 939A of the DFA, we propose to replace the regulations' NRSRO credit ratings requirements with other standards of creditworthiness.

1. Paragraph (a)—Investment Eligibility Criteria

We propose the following criteria for Farm Credit banks to determine whether an investment is eligible. These criteria would replace the listing of eligible investments in our existing regulations.

a. Paragraph (a)(1)—Purpose

We propose to formalize our existing requirement that for an investment to be eligible, it must be purchased and held for an authorized purpose as set forth in § 615.5132(a). A Farm Credit bank must be able to identify the authorized purpose or purposes for which each investment is held.

b. Paragraph (a)(2)—Eligible Investments

The proposed regulation would specify the general requirements that

[12] *See* proposed § 615.5140(a)(3). We explain this criterion in the preamble discussion of that proposed provision.

[13] OCC and the Federal Reserve System, Final Rule, 78 FR 62018, Oct. 11, 2013; FDIC, Interim Final Rule, 78 FR 55340, Sept. 10, 2013, substantively adopted as final at 79 FR 20754, April 14, 2014.

[14] The proposed capital rule has not yet been published in the **Federal Register**.

[15] We propose to delete the word ''explicitly'' from our existing definition because all obligations guaranteed or insured by the U.S. Government are backed by the full faith and credit of the United States unless the law or the obligation itself provides otherwise. For this reason, the word ''explicitly'' is superfluous.

[16] Nationally Recognized Statistical Rating Organization.

[17] Revised § 615.5140 would apply to Farm Credit banks only. As discussed below, all association eligibility requirements would be located in revised § 615.5142.

investments must satisfy to be eligible. Limiting investments to those that satisfy these general requirements will ensure that investments are of high quality.

i. Paragraph (a)(2)(i)—Non-convertible Senior Debt Securities

Investments in senior debt securities that cannot be converted to any other type of securities would be eligible under the proposed rule. This investment category would include non-convertible U.S. Government agency senior debt securities, including U.S. Treasury securities, and senior non-convertible GSE bonds. Senior debt securities are those securities that have priority of claim over other securities issued. Senior debt securities may be secured by a specific pool of collateral or may be unsecured with priority of claims over other types of debt securities such as subordinated debt, preferred stock, or common equity. To be eligible under this criterion, a senior debt security must not be convertible into a non-senior security or an equity security.[18]

Currently authorized investments such as municipal securities and corporate debt securities would be eligible under this criterion, as long as they are non-convertible senior debt securities. Other non-convertible senior debt securities would also be eligible under this criterion.

ii. Paragraph (a)(2)(ii)—Money Market Instruments

As under our existing rule, investments in money market instruments would be eligible under the proposed rule. The existing rule lists short-term instruments such as Federal funds, negotiable certificates of deposit, bankers acceptances, commercial paper, non-callable term Federal funds and Eurodollar time deposits, master notes, and repurchase agreements collateralized by eligible investments as money market instruments. The proposed rule's use of the term money market contemplates these instruments as well as other short-term instruments. For an investment to be eligible as a money market instrument, it must have a maturity of 1 year or less.

iii. Paragraph (a)(2)(iii)—Mortgage-Backed Securities and Asset-Backed Securities Guaranteed by U.S. Government Agencies

We propose that MBS and ABS that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency would be eligible securities because of their high credit quality. MBS and ABS that are partially guaranteed by a U.S. Government agency would not be eligible under this criterion (although they could be eligible under other criteria). Securities labeled ''government guaranteed'' satisfy this criterion only if they are fully guaranteed as to the timely payment of principal and interest.

iv. Paragraph (a)(2)(iv)—Mortgage-Backed Securities and Asset-Backed Securities Guaranteed by GSEs

Under the proposed rule, MBS and ABS that are fully and explicitly guaranteed as to the timely payment of principal and interest by GSEs would be eligible investments. Farmer Mac MBS would be excluded from eligibility under this provision because they are separately authorized and governed by § 615.5174.

Securities are eligible under this provision only if a GSE fully guarantees the timely payment of both the principal and interest due. A GSE ''wrap'' (guarantee) does not make a security eligible under this provision unless it is a guarantee of all principal and interest. When considering whether to purchase a security with a GSE guarantee or wrap, an institution must ensure that it is fully guaranteed. This provision carries over and clarifies the existing authorities.

v. Paragraph (a)(2)(v)—Senior-Most Positions of Mortgage-Backed Securities and Asset-Backed Securities Not Guaranteed by U.S. Government Agencies or GSEs

In our 2011 proposed rule on investment management,[19] we proposed that a position in a mortgage security that is not guaranteed by a Government agency or Government-sponsored agency would be eligible only if it is the senior-most position at the time of purchase. In that proposed rule, we said that we consider a position in such a mortgage security to be the senior-most position only if it currently meets both of the following criteria:

- No other remaining position in the securitization has priority in liquidation. Remaining positions that are the last to experience losses in the event of default and which share those losses pro rata meet this criterion.
- No other remaining position in the securitization has a higher priority claim to any contractual cash flows. Remaining positions that have the first priority claim to contractual cash flows (including planned amortization classes), as well as those that share on a pro rata basis a first priority claim to cash flows meet this criterion.

In their comments on the 2011 proposed rule, CoBank, ACB, the Farm Credit Bank of Texas, and The Farm Credit Council commented that the market understands the term ''senior-most'' to relate to liquidation preference rather than to the priority of claims to contractual cash flows prior to default. This is because investors, such as System institutions, are concerned with whether they receive a pro rata share of cash flows in the event of depleted credit support or issuer/borrower default, not with whether contractual cash flows are paid first in the ordinary course of business. Institutions are able to successfully and safely invest in securities that are not the first priority with respect to contractual cash flows. These commenters, therefore, asked us to delete the second criterion from our understanding of the term ''senior-most.'' [20]

We agree with these comments and eliminate the second criterion. The first criterion set forth above remains.

In addition, as in the existing rule, we propose to retain the requirement that for a position in an MBS to be eligible, the MBS must satisfy the definition of ''mortgage related security'' in 15 U.S.C. 78c(a)(41). We propose to delete the alternative that the MBS could instead comply with 15 U.S.C. 77d(5), because that statutory provision was repealed by the Dodd-Frank Act. We note that commercial MBS are included under this proposed eligibility provision.

Private placements may be eligible under this proposed criterion (or other criteria), as long as they satisfy all of the proposed investment eligibility requirements. Private placement refers to the sale of securities to a relatively small number of sophisticated investors without registration with the Securities and Exchange Commission and, in many cases, without the disclosure of detailed financial information or a prospectus. Even private placements that may be eligible are generally not liquid. Farm Credit banks must be able to identify a permissible purpose for holding a private placement.

[18] Since at least 1993, FCA has stated its belief that it is generally inappropriate for System institutions to maintain ownership interests in commercial enterprises by holding equity securities. *See* 58 FR 63034, 63049–50, Nov. 30, 1993.

[19] 76 FR 51289, Aug. 18, 2011.

[20] Farmer Mac made similar comments in response to the 2011 proposed rule governing Farmer Mac investment management. 76 FR 91798, Nov. 18, 2011.

Our existing eligibility rules limit investments in ABS to those secured by specified assets and with specified weighted average lives. We propose to permit investments in the senior-most position of any ABS, regardless of the secured asset or the weighted average life.[21]

In sum, the proposed rule would permit Farm Credit banks to invest in the senior-most position of any MBS that satisfies the statutory definition of ''mortgage related security'' and the senior-most position of any ABS.

vi. Paragraph (a)(2)(vi)—International and Multilateral Development Bank Obligations

We retain the authority for Farm Credit banks to invest in obligations of international and multilateral development banks, as long as the United States is a voting shareholder.

vii. Paragraph (a)(2)(vii)—Shares of a Diversified Investment Fund

Under the proposal, shares of a diversified investment fund (DIF) would be eligible if the DIF's portfolio consists solely of securities that are eligible under these eligibility criteria or under § 615.5174.[22] The investment company's risk and return objectives and use of derivatives must be consistent with the investment policies of the Farm Credit bank. This DIF eligibility is unchanged from the existing regulation. As discussed below, however, we propose more restrictive portfolio diversification limits on DIF investments than those that currently exist.

c. Paragraph (a)(3)—Obligors' Capacity To Meet Financial Commitment

Existing § 615.5140 imposes credit rating requirements, based on NRSRO credit ratings, to determine the eligibility of investments in a number of asset classes, including municipal securities, certain money market instruments, non-agency mortgage-backed securities, asset-backed securities, and corporate debt securities.[23]

Section 939A of the DFA requires each Federal agency to revise all of its regulations that refer to or require reliance on credit ratings to assess creditworthiness of an instrument to remove the reference or requirement and to substitute other appropriate creditworthiness standards.

We propose to comply with this requirement in a manner consistent with the approach of some of the Federal banking regulatory agencies. The OCC, for example, previously required national banks to determine whether a security was ''investment grade'' in order to determine whether purchasing the security was permissible. Under the previous definition of ''investment grade,'' a security could be characterized as ''investment grade'' if it was rated in the top four ''investment grade'' NRSRO ratings.

In its revised regulations to comply with the DFA requirement, the OCC retained the term ''investment grade'' but eliminated the rating standard. Instead, it defined the term to mean ''the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure.''

The OCC stated that it did not intend for the elimination of references to credit ratings to change substantively the standards national banks must follow when deciding whether a security is investment grade. Its new rule permits a national bank to consider credit ratings as part of its ''investment grade'' determination and due diligence, but the credit rating must be supplemented by the bank's own analysis. And the new rule does not require a national bank to use NRSRO credit ratings to make the ''investment grade'' determination.[24]

The OCC previously permitted national banks to invest in securities that were rated in one of the top four ratings. The OCC intends that its new definition—the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure—is substantively unchanged from its previous standards.

Except for investments in a few asset classes such as U.S. Government agency and GSE obligations, as discussed above, FCA's existing regulations require that in order to be eligible, investments must meet the highest or the second highest NRSRO rating, depending on the asset class. We want to retain high creditworthiness standards for Farm Credit bank investments. Accordingly, we propose to require that for an investment to be eligible for Farm Credit banks, at least one obligor (whether debtor or guarantor) must have very strong capacity to meet its financial commitment for the expected life of the investment. Obligors that exhibit very strong capacity to meet financial commitments generally have very low probability of default. This standard would apply to all investments, including those that are currently not subject to a credit rating requirement.

Like the OCC's regulations, our proposal permits but does not require Farm Credit banks to consider credit ratings. If a Farm Credit bank does consider credit ratings, it must still conduct its own due diligence to determine whether an investment satisfies this standard. An investment does not automatically satisfy this standard by virtue of its credit rating.

We propose an additional standard for investments if a Farm Credit bank is relying upon the capacity of a non-U.S. obligor to meet the ''very strong capacity'' standard. Unless such an investment is fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency, the sovereign host country of the obligor whose capacity is being relied upon must have the highest Country Risk Classification (CRC) (a 0 or a 1) as published by the OECD or must be an OECD member that is unrated. If the Farm Credit bank is not relying upon the capacity of a non-U.S. obligor to satisfy the ''very strong capacity'' standard, then the proposal establishes no requirements regarding that obligor's sovereign host country.

The OECD's CRCs are an assessment of a country's credit risk, used to set interest rate charges for transactions covered by the OECD arrangement on export credits. The OECD uses a scale of 0 to 7 with 0 being the lowest possible risk and 7 being the highest possible risk. Furthermore, the OECD no longer assigns CRCs to certain high income countries that are members of the OECD and that have previously received a CRC of 0.[25] OECD member countries that are no longer assigned a CRC exhibit a similar degree of country risk as that of a jurisdiction with a CRC of 0.

In their capital rules to implement Basel III, the Federal banking regulators adopted provisions basing risk weights for sovereign exposures on OECD CRCs (and on OECD membership, for

[21] Both existing and proposed § 615.5133(c) require the investment policies of each institution to establish risk limits for different types of investments based on all relevant factors, including the institution's objectives, capital position, earnings, and quality and reliability of risk management systems.

[22] Section 615.5174 authorizes Farm Credit banks to purchase and hold MBS that are issued or guaranteed as to both principal and interest by Farmer Mac.

[23] Existing § 615.5140 imposes no credit rating requirements on investments in obligations of U.S. Government agencies, GSEs, and international and multilateral development banks, and in DIFs and certain money market instruments.

[24] 77 FR 35253, June 13, 2012 (OCC rule); 77 FR 35259, June 13, 2012 (OCC guidance). *See also* 77 FR 43151, July 24, 2012 (FDIC rule); 77 FR 43155, July 24, 2012 (FDIC guidance).

[25] *See http://www.oecd.org/tad/xcred/cat0.htm.*

countries without a CRC).[26] Like these other regulators, we believe that use of CRCs in this manner is permissible under section 939A of the Dodd-Frank Act and that section 939A was not intended to apply to assessments of creditworthiness of organizations such as the OECD. As discussed in those rules, section 939A was targeted at addressing the role, and the conflicts of interest, of commercial credit rating agencies that provide government-sanctioned credit ratings to their fee-paying clients. The OECD is not a commercial entity that produces credit assessments for fee-paying clients, nor does it provide the sort of evaluative and analytical services as credit rating agencies. Additionally, we propose to use CRCs only for this limited purpose.

d. Paragraph (a)(4)—Credit and Other Risk in the Investment

In addition to imposing standards on obligors, we also propose to require that for an investment to be eligible, it must itself exhibit low credit risk and other risk characteristics consistent with the purposes for which it is held. The other risks that institutions must consider include, but are not limited to, those listed in § 615.5133(c).

We believe that all investments held by Farm Credit banks must have low credit risk. We do not propose to require that other risks in the investment be low in all cases. Instead, the risk characteristics in the investment must be consistent with the purposes for which the investment is held. Accordingly, Farm Credit banks must understand the purpose for which they purchase and hold an investment.

For instance, if an investment is held for the purpose of liquidity, it would have to be marketable or liquid [27] and would generally have to have low price volatility. On the other hand, an investment that is high quality but has high price volatility and questionable marketability or liquidity would not be appropriate for a liquidity investment, but it might be used effectively to manage interest rate risk, which is a permissible purpose for Farm Credit banks under § 615.5132(a). Farm Credit banks must also consider whether other risks are consistent with the purpose for which an investment is held.

e. Paragraph (a)(5)—Denomination

As in our existing rule, the denomination of all investments must be in U.S. dollars. We propose no change from our existing rule.

2. Paragraph (b)—Investments That Do Not Satisfy Requirements

We propose technical revisions to the regulatory provision authorizing institutions to hold other investments with FCA's prior approval. We intend no substantive change with these revisions.

3. Paragraph (c)—Ineligible Investments

We propose to prohibit Farm Credit banks from purchasing CDOs, as that term is defined in § 615.5131. Based on the experience of CDO investors during the recent financial crisis, we believe investments in CDOs pose unacceptable risk to System institutions.

4. Paragraph (d)—Reservation of Authority

We propose to make explicit our authority, on a case-by-case basis, to determine that a particular investment imposes inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria. The proposal also provides that FCA will notify a Farm Credit bank as to the proper treatment of any such investment.

5. Application of Investment Eligibility Criteria to Existing Farm Credit Bank Investments

As discussed below, the FCA is contemplating that Farm Credit banks would have to comply with the rule's requirements pertaining to their own investments 6 months after the effective date of the rule. New Farm Credit bank investments made after that compliance date would be subject to the investment eligibility criteria in § 615.5140(a).

Existing Farm Credit bank investments (investments made before the compliance date) that were not eligible under the investment eligibility criteria that were in effect at the time of purchase (or that the FCA did not approve) would continue to be subject to the requirements of § 615.5143(a), which governs the treatment of investments that are ineligible when purchased.

Existing Farm Credit bank investments (investments made before the compliance date) that were eligible under the investment eligibility criteria that were in effect at the time of purchase but that are ineligible under the revised § 615.5140(a) investment eligibility criteria would be treated as follows, unless the FCA specified different treatment. If an investment is not eligible because it does not satisfy the criteria in revised § 615.5140(a)(2)—that is, it is a type of investment that was eligible under the previous criteria but is not eligible under the revised criteria—the Farm Credit bank may continue to hold the investment with no restriction. If an investment is not eligible because it does not satisfy the criteria in revised § 615.5140(a)(1), (a)(3), or (a)(4)—which pertain to permissible investment purposes and to credit quality—the Farm Credit bank may continue to hold the investment subject to § 615.5143(b), which governs the treatment of investments that were eligible to purchase but that no longer satisfy the eligibility criteria.

We remind the Farm Credit banks that under § 615.5143(c), the FCA would retain the authority to require divestiture of any investment at any time for failure to comply with § 615.5132(a) or for safety and soundness reasons.

D. Section 615.5133—Investment Management

1. *Overview*

Existing § 615.5133 applies to all System institutions—Farm Credit banks, associations, and service corporations. Most of proposed revised § 615.5133 would also apply to all System institutions. However, as discussed in greater detail below, proposed § 615.5133(f) and (g), which govern portfolio diversification requirements and obligor limits, would apply only to Farm Credit banks. Additionally, we propose to modify § 615.5133(c), which addresses risk tolerance in investment policies, so it clearly distinguishes how liquidity is managed at Farm Credit banks from its treatment at associations. The investment management provisions of proposed § 615.5133 would apply to service corporations to the extent they are appropriate to the size, complexity, and risks of their investments.

2. Appropriate Use of Off-Balance Sheet Derivatives

Off-balance sheet derivatives can be appropriate and useful for the purposes of hedging and risk management. While our regulations do not prohibit a System bank from using off-balance sheet derivatives to build an investment portfolio, use of these derivatives must be consistent with an authorized investment purpose and not be for speculative purposes. We note that such

[26] OCC and the Federal Reserve System, Final Rule, 78 FR 62018, Oct. 11, 2013; FDIC, Interim Final Rule, 78 FR 55340, Sept. 10, 2013, substantively adopted as final at 79 FR 20754, April 14, 2014.

[27] Under § 615.5134(d), investments used to satisfy the liquidity reserve requirement must be ''marketable,'' as defined by that provision. Under § 615.5134(e), investments held in the liquidity buffer must be ''liquid,'' as explained in that provision.

derivatives generally do not provide a significant source of liquidity.

3. Paragraph (a)—Responsibilities of Board of Directors and Paragraph (b)—Investment Policies—General Requirements

The FCA proposes no changes to § 615.5133(a), which governs the responsibilities of the boards of directors of System institutions. We propose only minor stylistic and non-substantive changes to § 615.5133(b), which identifies the general requirements that System institutions must address in their investment policies.

4. Paragraph (c)—Investment Policies—Risk Tolerance

We propose several technical modifications to § 615.5133(c) that would enhance its clarity and provide better guidance to System institutions about compliance with it. For example, we propose a technical change to paragraph (c) to clarify that while operational risk must be addressed in investment policies, the policies do not need to establish quantitative risk limits for operational risk. Quantitative risk limits would continue to be required for the other identified risks—credit, market, and liquidity.

We propose to split the requirements regarding credit quality standards and concentration risk in existing paragraph (c)(1)(i) into two paragraphs. We propose to incorporate the existing general requirements regarding risk diversification standards and counterparty (obligor) risk limits into more specific requirements contained in proposed paragraphs (f) and (g). We propose these revisions in order to clarify our requirements in this area and ensure that institutions are considering risk appropriately.

Proposed paragraph (c)(1)(i) would address credit quality standards. It would require that an institution's investment policies establish credit quality standards for single or related obligors, sponsors, secured and unsecured exposures, and asset classes or obligations with similar characteristics. We propose to add sponsors to the existing requirements because, even though sponsors have no obligation to pay the debt (unless they are also obligors), we are concerned that a sponsor of low credit quality could present risk in a transaction that it initiates. We propose to add secured and unsecured investments to the existing requirements because we believe institutions should consider the differing levels of risk that these investments present.

Proposed paragraph (c)(1)(ii) would address concentration risk. It would require that an institution's investment policies establish concentration limits for single or related obligors, sponsors, geographical areas, industries, unsecured exposures, and asset classes or obligations with similar characteristics. We propose to add sponsors to the existing requirements because we believe undue concentration in a sponsor could present excessive risk. We propose to add unsecured investments to the existing requirements because institutions should carefully consider the amount of unsecured investments they are prepared to hold. Concentration limits should be commensurate with the types and complexity of investments that an institution holds.

We propose to revise § 615.5133(c)(1)(iv), which addresses collateral margin requirements on repurchase agreements. Currently, this provision requires System institutions to regularly mark collateral to market and to ensure that they maintain appropriate control over collateral that they hold. We propose to modify § 615.5133(c)(1)(iv) to clarify that this provision would apply only to System institutions that engage in repurchase agreements.

We propose to revise § 615.5133(c), which governs investment policies pertaining to liquidity, into two separate paragraphs. We propose this revision to take into account the differences in how liquidity is managed at Farm Credit banks from its treatment at associations.

Generally, Farm Credit banks hold liquidity reserves and manage liquidity risks for themselves, their affiliated associations, and certain service corporations. In contrast, System associations are not exposed to the same liquidity risks and they do not manage liquidity in the same way as their funding banks because their only substantial liability is their debt obligation to their funding bank.

Existing § 615.5133(c)(3) requires investment policies of all System institutions to describe the liquidity characteristics of eligible investments that the institutions will hold to meet their liquidity needs and other institutional objectives. Under proposed § 615.5133(c)(3)(i), Farm Credit banks would remain subject to this existing requirement. This requirement is appropriate because of the liquidity needs and liquidity risk of Farm Credit banks.

Under proposed § 615.5133(c)(3)(ii), the investment policies of System associations would have to describe the liquid characteristics of their investments. Although System associations do not have the same liquidity needs and liquidity risk as Farm Credit banks do, if they invest their funds in investments authorized by § 615.5142 they must be aware of the liquid characteristics of the assets that they purchase and hold. Proposed conforming changes throughout § 615.5133(c) would require System institutions to consider and address how investment decisions affect their liquidity risk, if and when applicable.

Except for other minor stylistic and technical changes, we propose no other changes to paragraph (c).

5. Paragraph (d)—Delegation of Authority and Paragraph (e)—Internal Controls

We propose no changes to paragraphs (d) and (e).

6. Paragraph (f)—Farm Credit Bank Portfolio Diversification

We propose to add a new paragraph (f) to govern investment portfolio diversification. This paragraph would apply only to Farm Credit banks.

a. Paragraph (f)(1)—Well Diversified Portfolio

Portfolio diversification is a key concept in ensuring the safety and soundness of investors such as Farm Credit banks. We propose requirements to ensure, at a minimum, that the investment portfolios of these institutions do not pose significant risk of loss due to excessive concentrations among asset classes, maturities, industries, geographic areas, and obligors. We also propose exemptions for certain investments from these portfolio diversification requirements. These exemptions would apply where the level of risk from concentration is low.

b. Paragraph (f)(2)—Exemptions

We propose that certain investments would not be subject to our diversification requirements. In this preamble, we refer to investments that are not subject to diversification requirements as ''exempt'' investments. We refer to all other investments as ''covered'' investments, because they are subject to our proposed diversification requirements.

i. Paragraph (f)(2)(i)—Investments Guaranteed by U.S. Government Agencies

Under the proposal, investments that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency would be exempt from the proposed

diversification requirements. We propose this exemption because we believe these types of investments are of the highest quality. Our existing rules impose no portfolio diversification requirements on such investments.

ii. Paragraph (f)(2)(ii)—Investments Guaranteed by GSEs

Under the proposal, investments, other than MBS, that are fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE would be exempt from the proposed portfolio diversification requirements. No more than 50 percent of an institution's investment portfolio could be comprised of GSE MBS. These provisions are substantively unchanged from our existing regulations with respect to the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) MBS. Investments in Farmer Mac securities are governed by § 615.5174 and would not be subject to this limitation.

Our 2011 proposed investment management rule had also proposed to retain our 50-percent portfolio limit on Fannie Mae and Freddie Mac MBS. The Farm Credit Council, the Farm Credit Bank of Texas and CoBank, ACB commented in response to that proposal that this limit was too restrictive in light of the safe and liquid nature of these investments (especially since those GSEs were under U.S. Government conservatorship) and the positive yield that those investments provide. They asked us to eliminate portfolio limits for investments in these GSEs. The Council also expressed concern with language in our preamble suggesting that we might consider further restrictions on MBS investments in these GSEs in the future.

We believe no portfolio limits are needed for non-MBS investments in GSEs, such as general obligations. We are concerned, however, about concentration in housing-related investments, and accordingly we propose to retain the 50-percent limit on GSE MBS.[28] We do not contemplate further restrictions on investments in GSE MBS at this time.

c. Paragraph (f)(3)—Investment Portfolio Diversification Requirements

We are proposing investment portfolio diversification requirements for covered investments. Under the proposal, a well-diversified investment portfolio would mean that, at a minimum, covered investments are comprised of different asset classes, maturities, industries, geographic areas, and obligors.

Although we are not proposing specific maturity, industry, or geographic area requirements, the regulation would require each Farm Credit bank to diversify its investments by maturity, industry, and geographic area based on its risk profile.

Covered investments would have to satisfy specified asset class and obligor diversification requirements. These diversification requirements would be calculated based on the entire investment portfolio. This means that both exempt and covered investments would be included in the denominator. The numerator would consist only of those investments that are covered investments for the asset class and obligor diversification requirements. These diversification parameters would be based on the portfolio valued at amortized cost.

We note that these diversification requirements are regulatory maximums; each Farm Credit bank should establish diversification limits that fit its risk profile and that may be more restrictive than regulatory requirements.

Our current regulations impose no investment portfolio limits on investments in DIFs, as long as an institution's shares in each DIF comprise 10 percent or less of its investment portfolio. Otherwise, the portfolio limits for each asset class apply. As discussed below, we now propose different treatment for DIF investments.

i. Paragraph (f)(3)(i)—Asset Class Diversification

We propose to require Farm Credit banks to diversify their investment portfolios among various asset classes; no more than 15 percent of their investment portfolios could be invested in any one asset class.[29] As discussed above, we propose to define an asset class as a group of securities that exhibit similar characteristics and behave similarly in the marketplace.

For purposes of this proposed asset class diversification requirement, we consider MBS to be an asset class. We also consider ABS (excluding MBS) to be an asset class that includes instruments such as student loans and car loans. In addition, we consider money market securities to be an asset class that includes securities such as federal funds and commercial paper. Other asset classes would include municipal securities, corporate bond securities, and any other asset class as determined by the FCA. Each of these asset classes is limited to 15 percent of the investment portfolio of a Farm Credit bank, regardless of the different types of instruments that comprise the asset class.

For purposes of this proposed asset class diversification requirement, we do not consider DIFs to be an asset class, and therefore this requirement would impose no restrictions on the relative amount of DIF investments a Farm Credit bank could hold.[30] The securities within DIFs, however, would be subject to the asset class diversification requirements.

Our existing rule imposes portfolio limits of 15 percent, 20 percent, or 50 percent, depending on the asset class. In our proposed rule in 2011 for banks and associations, we proposed asset class limits for investments that were similar to but generally more restrictive than our existing regulations. To simplify the rule, we are proposing a 15-percent limit for all asset classes.

We believe that diversification of investments is a fundamental part of risk management and that a 15-percent portfolio limit for asset classes is appropriate. Because the vast majority of System investments are in exempt securities, a 15-percent limit on investments in each asset class should provide sufficient flexibility for institutions to manage their investment portfolios.

We seek comment on the reasonableness of this proposed limitation.

ii. Paragraph (f)(3)(ii)—Obligor Diversification

We propose to require Farm Credit banks to diversify their investment portfolios among various obligors; no more than 3 percent of their investment portfolios could be invested in any one obligor.[31] As discussed above, we

[28] Under our recently finalized revisions to our liquidity rule (78 FR 23438, April 18, 2013), it is extremely unlikely that Farm Credit banks could approach 100 percent in GSE MBS.

[29] As discussed above, ''exempt'' investments would not be subject to this asset class diversification requirement, although under proposed § 615.5133(f)(2)(ii), MBS that are fully and explicitly guaranteed by GSEs could only comprise up to 50 percent of the total investment portfolio. Investments in Farmer Mac securities are governed by § 615.5174 and also would not be subject to this requirement.

[30] We believe that the obligor diversification requirements discussed next in this preamble, along with the obligor limit in proposed paragraph (g) of this section, would provide sufficient diversification among DIFs themselves.

[31] As discussed above, ''exempt'' investments would not be subject to this obligor diversification requirement, although under proposed § 615.5133(f)(2)(ii), MBS that are fully and explicitly guaranteed by GSEs could only comprise up to 50 percent of the total investment portfolio. Investments in Farmer Mac securities are governed by § 615.5174 and also would not be subject to this requirement.

propose to define obligor as an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded. This definition would include the debtor or immediate party that is obligated to pay a debt, as well as a guarantor of the debt. Under this requirement, a Farm Credit bank must consider both the DIF itself and the entity or entities obligated to pay the underlying debt to be obligors. This requirement would ensure that an institution would not be able to use DIF investments to hold an excessively concentrated investment portfolio.

Our existing regulations contain no portfolio diversification requirements by obligor (although, as discussed below, they do limit the amount of total capital that institutions can invest in a single obligor). We propose this diversification requirement because we believe that concentration among obligors could lead to significant risk.

We believe that this proposal would likely not require changes in the current investment portfolios of Farm Credit banks, although it might have required changes to those portfolios in the past. We believe that this requirement would provide these institutions with sufficient flexibility to manage their investment portfolios while ensuring adequate diversification to further safety and soundness. We seek comment on the reasonableness of this proposed limitation.

7. Paragraph (g)—Farm Credit Bank Obligor Limit

We propose to limit the amount of capital that Farm Credit banks may invest in any one obligor. For Farm Credit banks, the limit would be 10 percent of total capital. This obligor limit would not apply to investments in obligations that are fully guaranteed as to the payment of principal and interest by a U.S. Government agency or fully and explicitly guaranteed as to the payment of principal and interest by a GSE. Under this requirement, a Farm Credit bank must consider both the DIF itself and the entity or entities obligated to pay the underlying debt to be obligors.

Our existing regulations allow Farm Credit banks to invest up to 20 percent of their total capital in eligible investments issued by any single institution, issuer, or obligor; this obligor limit does not apply to obligations, including mortgage securities, that are issued or guaranteed as to interest and principal by the United States, its agencies, instrumentalities, or corporations.

The lower obligor limit that we propose for Farm Credit banks would enhance safety and soundness by ensuring that if an obligor were to default, only a small portion of capital would be at risk. For simplicity, we propose to continue to base the Farm Credit bank investment amount on total capital. As discussed above, however, the FCA Board adopted proposed revisions to our regulatory capital rule on May 8, 2014, and we may revise the basis for the obligor limit to incorporate any revisions to our regulatory capital rule that are adopted in final in the future.[32]

We note that this obligor limit would be a regulatory maximum; each Farm Credit bank should establish obligor limits that fit its overall risk profile and risk-bearing capacity, including earnings capacity, as well as the risks in individual types and classes of investments. For example, more restrictive obligor limits may be warranted on unsecured investments.

We seek comment on whether our proposed 10-percent obligor limit is appropriate. If you believe it is not appropriate, what should the regulatory maximum be, and why?

8. Paragraph (h)—Due Diligence

We propose to redesignate existing paragraph (f) as paragraph (h).

In paragraph (h)(1)(iii), we propose that a System institution must document its assessment of each investment at the time of purchase. While the assessment must be commensurate with the type of each investment, at a minimum the assessment must include an evaluation of the credit risk, liquidity risk as applicable, market risk, interest rate risk, and underlying collateral of the investment.

The nature and degree of due diligence and documentation that is required under this provision to assess eligibility varies based on the risks inherent in different types of securities. For example, institutions should assess securities that they believe are guaranteed by a U.S. Government agency or a GSE to ensure they satisfy our definitions and eligibility requirements for such securities. As another example, institutions do not need to assess the creditworthiness of U.S. Government agency securities, because they exhibit low sovereign default (credit) risk; however, institutions should assess and document all other potential risks associated with these securities. Securities that are not guaranteed by a U.S. Government agency generally present varying degrees of credit risk as well as other types of risk, and the assessment and level of documentation should be sufficient to support the investment decision.

All other changes that we propose to this paragraph are non-substantive.

9. Paragraph (i)—Reports to the Board of Directors

We propose to redesignate existing paragraph (g) as paragraph (i). We also propose to add the word ''risk'' to redesignated § 615.5133(i)(3) so it would require quarterly reports to the board or a designated board committee to address the current composition, quality, and the risk and liquidity profiles of the investment portfolio. This revision would ensure more comprehensive reporting to the board about how the current composition and quality of investments affect the risk and liquidity profile of the bank or association, which would enhance safety and soundness. We propose no other changes to this provision.

E. Section 615.5142—Association Investments

The FCA proposes to revise § 615.5142, which governs association investments. Existing § 615.5142 does not impose a portfolio limit on the total amount of investments that each association is authorized to hold. Additionally, existing § 615.5140 permits associations to hold the same types of investments as Farm Credit banks even though associations are not subject to the liquidity reserve requirement in § 615.5134, and they are not exposed to the same liquidity and market risks as their funding banks. Accordingly, the FCA proposes to revise its regulatory approach to association investments in order to limit the type and amount of investments that an association may hold.

As discussed in more detail below, the proposed rule generally would limit association investments to obligations that are issued or fully guaranteed or insured as to the timely payment of principal and interest by the United States or any of its agencies in an amount that does not exceed 10 percent of its total outstanding loans. The proposed rule also addresses: (1) Core investment and risk management practices at System associations; (2) funding bank supervision of association investments; (3) requests by associations to the FCA to hold other investments; and (4) transition requirements for System associations to come into compliance with the new rule.

[32] The proposed capital rule has not yet been published in the **Federal Register**.

Currently, § 615.5142 authorizes each association to hold eligible investments listed in § 615.5140, with the approval of its funding bank, for the purposes of reducing interest rate risk and managing surplus short-term funds. The existing regulation also requires each Farm Credit bank to review annually the investment portfolio of every association it funds.

Most System associations have increased in size and complexity over the past two decades, offering a diversity of products and services to accommodate a changing and increasingly competitive agricultural sector. The changes in agriculture have introduced new risks to the associations. For example, while the associations have adopted adequate risk management strategies to effectively adapt to this changing environment, they are concentrated in agriculture and have limited ability to manage concentration risk. The associations currently can use investments to manage surplus short-term funds and reduce interest rate risk but cannot use investments to manage concentration risk. The proposed rule strikes a balance by granting associations greater flexibility in the purposes for which they may hold investments, while placing more limits on the amounts and types of investments they may hold. Accordingly, the proposed changes would provide the associations the flexibility to use full faith and credit instruments to manage concentration risk by diversifying assets. We believe the proposed change would help improve association risk management practices and, therefore, strengthen the safety and soundness of the System.

The Farm Credit Act of 1971, as amended, (Farm Credit Act) specifically authorizes System associations to buy and sell obligations of, or insured by, the United States or any agency thereof, and make other investments as may be approved by their respective funding banks under regulations issued by the Farm Credit Administration.[33]

1. Paragraph (a)—Investment Eligibility Criteria

The proposed rule would: (1) Revise the investment purposes for System associations; (2) limit the types of investments that associations may purchase and hold; and (3) impose a cap on the amount of such enumerated investments that each association may hold. Specifically, proposed § 615.5142(a) would authorize each System association, with the approval of its funding bank, to manage risk by purchasing and holding obligations that are issued by, or are fully guaranteed or insured as to the timely payment of principal and interest by, the United States or any of its agencies in an amount that does not exceed 10 percent of its total outstanding loans.

We are proposing to eliminate our requirements in the existing regulation, which authorize associations to hold investments for the purposes of reducing interest rate risks and managing surplus short-term funds, because we believe these requirements are: (1) Too restrictive; and (2) do not provide associations flexibility to manage their risks in today's environment.

As a result of mergers and consolidations, and the evolution of agricultural credit and financial management practices, System associations encounter various risk management environments. A few larger associations now have the capacity to manage interest rate risk separately from their funding banks. For many associations, a small portfolio of high quality investments could help diversify risks they experience as lenders that primarily lend to a single industry—agriculture.

Whereas the existing rule authorizes associations to hold investments for the purposes of reducing interest rate risks and managing surplus short-term funds, the proposed rule authorizes associations to hold investments to manage risks. We invite your comments about whether this proposed rule should identify specific purposes for associations to purchase and hold investments. If you believe that our rule should expressly identify and require specific purposes, please state which ones and why.

Proposed § 615.5142(a) would authorize System associations to invest solely in obligations that are issued, or are fully guaranteed or insured as to the timely payment of principal and interest by the United States or of any of its agencies. Obligations issued, insured, or guaranteed by the United States are expressly mentioned in the provisions of the Act governing association investments. Obligations issued or fully guaranteed or insured as to the timely payment of principal and interest by the United States and its agencies are usually liquid and many are actively traded, although MBS issued by Federal agencies could expose investors to significant market risks.[34] These obligations pose virtually no credit risk to investors because they are backed by the full faith and credit of the United States, although they may expose investors to other risks, especially market risks. For these reasons, obligations issued or fully guaranteed or insured as to the timely payment of principal and interest by the United States and its agencies are suitable for risk management at System associations.

Proposed § 615.5142(a) limits association investments to 10 percent of total outstanding loans. This portfolio limit would ensure that loans to eligible borrowers always constitute the vast majority of System assets, which is consistent with the mission of each association. In this context, the FCA is imposing portfolio limits on investments so that loans to eligible borrowers always constitute a majority of assets at all System banks and associations. Our regulations authorize Farm Credit banks to hold significantly larger investment portfolios than System associations because the: (1) Banks maintain liquidity and manage interest rate risk for all System institutions operating in the district; and (2) associations borrow exclusively from their funding banks.

At the same time, the proposed 10-percent portfolio limit on investments should be sufficient to enable associations to develop robust strategies to manage risks, as long as association investment activities are supported by strong investment policies, management practices and procedures, and appropriate internal controls. Furthermore, the proposed 10-percent limit should help associations manage their concentration risk as single-industry lenders. The policies at some System associations with active investment programs typically establish a 15-percent portfolio limit for investments, while in practice, investments at most associations rarely equal or exceed 10 percent of total outstanding loans. For all these reasons, the FCA believes that the proposed 10-percent portfolio limit on investments strikes an appropriate balance by enabling associations to appropriately manage and diversify risks while continuing to serve their primary mission of funding agriculture and rural America.

We are proposing that the 10-percent limit be computed based upon the 30-day average daily balance of

[33] *See* sections 2.2(10) and (11), and 2.12(17) and (18) of the Act. Additionally, sections 2.2(10) and 2.12(18) of the Act authorize System associations to deposit funds with any member bank of the Federal Reserve System, or with any bank insured by the Federal Deposit Insurance Corporation.

[34] Farmer Mac MBS are covered by § 615.5174, not § 615.5142. Investments in Farmer Mac MBS cannot exceed the total amount of outstanding loans of a System bank or association.

investments divided by loans. Investments would be calculated at amortized cost. Loans would be calculated as defined in § 615.5131, which provides that loans are calculated quarterly (as of the last day of March, June, September, and December) by using the average daily balance of loans during the quarter. For the purpose of this calculation, loans would include accrued interest and not include any allowance for loan loss adjustments. Compliance with the calculation would be measured on the last day of every month.

We also request your comments on whether using the average daily balance of loans during the quarter for computing the limit is adequate to limit any distortions caused by seasonality fluctuations in the amount of total loans.

2. Paragraph (b)—Risk Management Requirements

The following provisions would help to ensure that System associations comply with prudent investment management practices. Therefore, we are proposing to require that each association evaluate its investment management policies, and determine and document how its investment activities are conducted in accordance with the risk management processes and procedures identified in proposed § 615.5142(b)(1), (b)(2), and (b)(3).

3. Paragraph (b)(1)—Compliance With Investment Management Requirements

Proposed § 615.5142(b)(1) would require each association to comply with proposed § 615.5133(a), (b), (c), (d), (e), (h), and (i), which govern investment management practices at all System institutions.[35] From the FCA's perspective, these provisions of proposed § 615.5133 would ensure that System associations always follow prudent investment management practices. Additionally, compliance with these provisions of § 615.5133 would instill discipline in investment management practices at each System association, which protects its safety and soundness. Therefore, we are proposing to require that each association document its compliance with the applicable provisions of § 615.5133.

Under proposed § 615.5142(b)(1), each association's investment management processes must be appropriate for the size, risk characteristics, and complexity of the association and its investment portfolio. These risk management processes must take into account the association's unique circumstances, risk tolerances, and objectives. An association's board would not need to develop an investment policy if it elects not to hold investments authorized under § 615.5142(a).

We are particularly interested in comments on how the FCA can structure the documentation requirements so they do not impose undue regulatory burden on funding banks or associations.

4. Paragraph (b)(2)—Compliance With Interest Rate Risk Management Requirements

Proposed § 615.5142(b)(2) would require any association with significant interest rate risk exposure to comply with §§ 615.5180 and 615.5182. More specifically, § 615.5182 requires any association with interest rate risk that could lead to significant declines in net income or in the market value of capital to comply with § 615.5180, which establishes specific criteria for System banks to follow for managing interest rate risk. Under this regulatory framework, the interest rate risk management program must be commensurate with the level of interest rate risk at the association.

The fiduciary responsibilities of association boards of directors obligate them to develop appropriate investment management policies and practices to manage interest rate risk. Additionally, it is incumbent upon each association's investment managers to fully understand the risks of its investments and make independent and objective evaluations of investments prior to purchase.

Interest rate risk management is an important part of the overall financial management of investments at an association, and includes involvement by both senior management and the association's board of directors. To the extent an association has investments, its board must develop and implement an interest rate risk management program that is tailored to the association's needs and establishes a risk management process that effectively identifies, measures, monitors, and controls interest rate risk.

5. Paragraph (b)(3)—Other Relevant Factors

Proposed § 615.5142(b)(3) would require each association to consider and evaluate other relevant factors that are unique to its circumstances or to the nature of investments that could affect its risk-bearing capacity. Such factors include, but are not limited to, its management experience and capability to understand and manage complex structures and unique risks in the investments it purchases and holds. In this context, the size, risk characteristics, and complexity of the investment portfolio are other relevant factors that could affect an association's risk-bearing capacity when its unique circumstances, risk tolerance, and objectives are taken into account. Associations are authorized to purchase and hold investments only for the purpose of managing risks. Although the FCA does not expect associations to suffer losses or break even on investments, using investments *primarily* for speculative purposes or generating gains from trading is an impermissible activity. Likewise, the intentional mismatched funding of investments and the resulting increase in interest rate risk would typically be inappropriate unless used as an effective hedge against other risks in the balance sheet. Other factors that associations should consider and evaluate include option, premium and call risks of certain investments that they may acquire.

6. Paragraph (c)—Funding Bank Supervision of Association Investments

Sections 2.2(10) and 2.12(18) of the Farm Credit Act require each association to obtain its funding bank's approval of the association's investment activities in accordance with FCA regulations. Accordingly, proposed § 615.5142(c) addresses funding bank review, approval, and oversight of the investment activities of its affiliated associations. As required by statute, each association must request from its funding bank prior approval to buy and hold investments under this section. This proposed provision would not require that an association request approval for each and every investment. Instead, this proposed provision would provide flexibility for each association to choose whether it would prefer to request funding bank approval for each specific investment or instead request approval of a type or class of investments.

7. Paragraph (c)(1)—Funding Bank Review, and Approval or Denial of Association Investments

Proposed § 615.5142(c)(1) would require each funding bank to review and approve or deny requests by its affiliated associations to buy and hold investments. Additionally, the proposed rule would require the bank to explain in writing its reasons for approving or denying the association's request. Once

[35] Proposed § 615.5142(b)(1) would not require System associations to comply with proposed § 615.5133(f) and (g) because those two provisions explicitly apply only to System banks.

an association has established a satisfactory investment management program under § 615.5142(b), which has been approved by its funding bank, the association would be permitted to buy and hold obligations that are issued, or are fully guaranteed or insured as to the timely payment of principal and interest by the United States government or any of its agencies. The intent of this proposed provision is to balance the funding needs of the associations with the funding capacity of the funding bank.

8. Paragraph (c)(2)—Bank Approval Process

As part of the approval process, the funding bank must evaluate, determine and document that the association has: (1) Adequate policies, procedures, internal controls, and accounting and reporting systems for its investments; (2) the capability and expertise to effectively manage risks in investments; and (3) complied with requirements of § 615.5142(b). Any existing System association investment management program previously reviewed and approved by the funding bank would need to be re-reviewed and re-approved if proposed § 615.5142 becomes final and effective.

The intent of this proposed provision is to balance the risk management needs of the associations with the funding and oversight role of the funding bank. A number of satisfactory methods exist for System banks to oversee association investment activities under our regulatory framework. A bank may take an active role in advising and approving an association's investment decisions and strategies. For example, banks may provide research, analytical or advisory services that help associations to manage their investment portfolios.

9. Paragraph (c)(3)—Annual Review of Investment Portfolio

Proposed § 615.5142(c)(3) also retains the existing requirement that each System bank annually review the investment portfolio of every association that it funds. As part of its annual review, the bank must evaluate whether the association's: (1) Investments mitigate and manage its risks; and (2) risk management practices continue to be adequate.

The FCA notes that the General Financing Agreement (GFA) (including any attached, referenced, or related documents) could establish covenants governing the investment activities of an affiliated association. As such, the GFA can be a useful tool for funding banks to review and monitor the investment activities of their affiliated associations.

10. Paragraph (d)—Other Investments Approved by the FCA

Proposed § 615.5142(d) would continue to allow an association to request the FCA's approval to purchase and hold other investments. We note that this provision represents no substantive change from current § 615.5140(e), which allows all System institutions to hold other investments that the FCA approves on a case-by-case basis. Consistent with current practice, the request for our approval must explain the risk characteristics of the investment and the purpose and objectives for making the investment.

These other investments approved by the FCA under proposed § 615.5142(d) would be subject to the portfolio limit on association investments under proposed § 615.5142(a) unless otherwise provided for by the FCA. Furthermore, these other investments could also be subject to specific conditions of approval and subject to other limits on a case-by-case basis.

11. Paragraph (e)(1)—Transition and Divestiture Issues for Association Investments

Under proposed § 615.5142(e)(1), an association would not be required to divest of any investments held on or before the date this rule becomes effective if they were previously authorized under former § 615.5140 or otherwise authorized by official written Agency action that allowed the association to continue to hold such investments. This transition rule would permit an association to continue to hold pre-existing investments that would no longer be authorized if proposed § 615.5142 is adopted as a final rule and becomes effective. However, after this proposed rule is effective, once such investments mature, the association would not be permitted to renew them unless they are authorized pursuant to proposed § 615.5142(a) or (d).

12. Paragraph (e)(2)—Impact on Existing Investments of Subsequent Declines in Total Outstanding Loans

Under proposed § 615.5142(e)(2), an association would not be required to divest of investments purchased on or after the date this proposed rule becomes effective if a subsequent decline in total outstanding loans causes it to exceed the 10-percent portfolio limit in § 615.5142(a).

Accordingly, once an association purchases an eligible investment, it would not be required to dispose of such investment just because of a subsequent decline in total outstanding loans. This provision would help to ensure that an association would not have to divest of a previously purchased asset when loan demand is reduced.

13. Paragraph (e)(3)—Management of Ineligible Investments and Divestiture Under § 615.5143

Proposed § 615.5142(e)(3) would apply to all investments that an association acquires after the new regulation becomes effective. More specifically, all investments that an association purchases after proposed § 615.5142 becomes effective as a final rule would be subject to § 615.5143 of this part, which governs the management and divestiture of ineligible investments. As a result, an association would need to comply with § 615.5143 if any investment acquired after the effective date of this rule did not meet the investment criteria in § 615.5142(a) on or after the date of purchase, if it was not approved by the FCA pursuant to § 615.5142(d), or if it was approved by the FCA pursuant to § 615.5142(d) but later failed to satisfy the conditions of approval.

F. Section 615.5143—Management of Ineligible Investments and Reservation of Authority To Require Divestiture

We propose to revise § 615.5143 to add references to proposed § 615.5142, to reflect that associations are generally governed by the requirements of § 615.5143. In addition, we propose to tailor § 615.5143 to the investment and other authorities of Farm Credit banks as compared to associations. Specifically, we clarify that an association that purchases an ineligible investment would not be subject to the requirements relating to liquidity, collateral, and net collateral, because associations have no regulatory requirements in those areas. In addition, we propose to clarify that no investment is ineligible if it has been approved by the FCA, but an FCA-approved investment would be subject to the requirements of § 615.5143(b) if it no longer satisfied the conditions of approval.

G. Conforming Changes to Other Regulation Sections

We propose conforming changes to references in §§ 611.1153, 611.1155, 615.5174, and 615.5180.

IV. Compliance Date

We recognize that Farm Credit banks may require time to bring their policies and procedures into compliance with the new requirements in the proposed rule. Accordingly, we are contemplating that Farm Credit banks would be

required to comply with the requirements governing their investments 6 months after the effective date of the rule, if it is adopted as final.[36] We invite your comments as to whether this delayed compliance timeframe is appropriate. We also invite your comments on whether a delayed compliance date would be appropriate for associations as well.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not ''small entities'' as defined in the Regulatory Flexibility Act.

List of Subjects

12 CFR Part 611

Agriculture, Banks, banking, Rural areas.

12 CFR Part 615

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

For the reasons stated in the preamble, parts 611 and 615 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 611—ORGANIZATION

■ 1. The authority citation for part 611 continues to read as follows:

Authority: Secs. 1.2, 1.3, 1.4, 1.5, 1.12, 1.13, 2.0, 2.1, 2.2, 2.10, 2.11, 2.12, 3.0, 3.1, 3.2, 3.3, 3.7, 3.8, 3.9, 3.21, 4.3A, 4.12, 4.12A, 4.15, 4.20, 4.21, 4.25, 4.26, 4.27, 4.28A, 5.9, 5.17, 5.25, 7.0–7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2002, 2011, 2012, 2013, 2020, 2021, 2071, 2072, 2073, 2091, 2092, 2093, 2121, 2122, 2123, 2124, 2128, 2129, 2130, 2142, 2154a, 2183, 2184, 2203, 2208, 2209, 2211, 2212, 2213, 2214, 2243, 2252, 2261, 2279a–2279f–1, 2279aa–5(e)); secs. 411 and 412 of Pub. L. 100–233, 101 Stat. 1568, 1638; sec. 414 of Pub. L. 100–399, 102 Stat. 989, 1004.

§ 611.1153 [Amended]

■ 2. Section 611.1153 is amended by removing in paragraph (i)(1) the reference ''§ 615.5140(e)'' and adding in its place, the reference ''§ 615.5140(b) or § 615.5142(d)''.

§ 611.1155 [Amended]

■ 3. Section 611.1155 is amended by removing in paragraph (a)(1) the reference ''§ 615.5140(e)'' and adding in its place the reference ''§ 615.5140(b) or § 615.5142(d)''.

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

■ 4. The authority citation for part 615 is revised to read as follows:

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.7, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b–6, 2279aa, 2279aa–3, 2279aa–4, 2279aa–6, 2279aa–7, 2279aa–8, 2279aa–10, 2279aa–12); sec. 301(a), Pub. L. 100–233, 101 Stat. 1568, 1608; sec. 939A, Pub. L. 111–203, 124 Stat. 1326, 1887 (15 U.S.C. 78o–7 note).

§ 615.5131 [Amended]

■ 5. Section 615.5131 is amended by:

■ a. Removing the definitions for ''eurodollar time deposit'', ''final maturity'', ''general obligations'', ''Government agency'', ''Government-sponsored agency'', ''liquid investments'', ''mortgage securities'', ''Nationally Recognized Statistical Rating Organization (NRSRO)'', ''revenue bond'', and ''weighted average life (WAL)'';

■ b. In the definition of ''asset-backed securities (ABS)'', remove the words ''mortgage securities'' and add in their place, the words ''mortgage-backed securities;''

■ c. Adding in alphabetical order the new definitions for ''*Asset class*'', ''*Collateralized debt obligation (CDO)*'', ''*Country risk classification (CRC)*'', ''*Diversified investment fund (DIF)*'', ''*Government-sponsored enterprise (GSE)*'', ''*Mortgage-backed securities* (MBS)'', ''*Obligor*'', ''Sponsor'', and ''*United States (U.S.) Government agency*'' to read as follows:

§ 615.5131 Definitions.

* * * * *

Asset class means a group of securities that exhibit similar characteristics and behave similarly in the marketplace. Asset classes include, but are not limited to, money market instruments, municipal securities, corporate bond securities, MBS, ABS (excluding MBS), and any other asset class as determined by the FCA.

Collateralized debt obligation (CDO) means a debt security collateralized by MBS, ABS, or trust-preferred securities.

Country risk classification (CRC) with respect to a sovereign, means the most recent consensus CRC published by the Organization for Economic Cooperation and Development (OECD) as of December 31 of the prior calendar year that provides a view of the likelihood that the sovereign will service its external debt.

Diversified investment fund (DIF) means an investment company registered under section 8 of the Investment Company Act of 1940.

Government-sponsored enterprise (GSE) means an entity established or chartered by the United States Government to serve public purposes specified by the United States Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

* * * * *

Mortgage-backed securities (MBS) 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 MBS, or other multiclass MBS.

Obligor means an issuer, guarantor, or other person or entity who has an obligation to pay a debt, including interest due, by a specified date or when payment is demanded.

Sponsor means a person or entity that initiates a transaction by selling or pledging to a specially created issuing entity, such as a trust, a group of financial assets that the sponsor either has originated itself or has purchased.

United States (U.S.) Government agency means an instrumentality of the U.S. Government whose obligations are fully guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government.

* * * * *

■ 6. Section 615.5133 is revised to read as follows:

§ 615.5133 Investment management.

(a) *Responsibilities of board of directors.* Your board of directors must adopt written policies for managing

[36] Farm Credit bank compliance with requirements pertaining to their supervision of association investments would be required at the time associations are required to comply with this rule.

your 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, the board, or a designated committee of the board, must review the sufficiency of these investment policies. Any changes to the policies must be adopted by the board and be documented.

(b) *Investment policies—general requirements.* Your board's written investment policies must address the purposes and objectives of investments; risk tolerance; delegations of authority; internal controls; due diligence; and reporting requirements. Your investment policies must fully address the extent of pre-purchase analysis that management must perform for various classes of investments. Your investment policies must also address the means for reporting, and approvals needed for, exceptions to established policies. If you are a Farm Credit bank, your investment policies must address portfolio diversification and obligor limits under paragraphs (f) and (g) of this section. 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 for eligible investments and for the entire investment portfolio. Your investment policies must include concentration limits to ensure prudent diversification of credit, market, and, as applicable, liquidity risks in the investment portfolio. Risk limits must be based on all relevant factors, including your institutional objectives, capital position, earnings, and quality and reliability of risk management systems and must take into consideration the interest rate risk management program required by § 615.5180 or § 615.5182, as applicable. Your investment policies must identify the types and quantity of investments that you will hold to achieve your objectives and control credit risk, market risk, and liquidity risk as applicable. Each association or service corporation that holds significant investments and each Farm Credit bank must establish risk limits in its investment policies, as applicable, for the following types of risk:

(1) *Credit risk.* Investment policies must establish:

(i) *Credit quality standards.* Credit quality standards must be established for single or related obligors, sponsors, secured and unsecured exposures, and asset classes or obligations with similar characteristics.

(ii) *Concentration limits.* Concentration limits must be established for single or related obligors, sponsors, geographical areas, industries, unsecured exposures, and asset classes or obligations with similar characteristics.

(iii) *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 review of your investment policies required under paragraph (a) of this section, your board of directors, or a designated committee of the board, must review the criteria for selecting securities firms. Any changes to the criteria must be approved by the board.

(iv) *Collateral margin requirements on repurchase agreements.* To the extent you engage in repurchase agreements, you must regularly mark the collateral to market and ensure appropriate controls are maintained over collateral held.

(2) *Market risk.* Investment policies must set market risk limits for specific types of investments and for the investment portfolio.

(3) *Liquidity.*

(i) *Liquidity risk at Farm Credit banks.* Investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and other institutional objectives.

(ii) *Liquidity at associations.* Investment policies must describe the liquid characteristics of eligible investments that you will hold.

(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 between personnel who supervise or execute investment transactions and personnel who supervise or engage in all other investment-related functions.

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

(4) Implement an effective internal audit program to review, at least annually, your investment management function, controls, processes, and compliance with FCA regulations. The scope of the annual review must be appropriate for the size, risk and complexity of the investment portfolio.

(f) *Farm Credit bank portfolio diversification.*

(1) *Well-diversified portfolio.* Subject to the exemptions set forth in paragraph (f)(2) of this section, a Farm Credit bank must maintain a well-diversified investment portfolio as set forth in paragraph (f)(3) of this section.

(2) *Exemptions from investment portfolio diversification requirements.* The following investments are not subject to the investment portfolio diversification requirements specified in paragraph (f)(3) of this section:

(i) Investments that are fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency; and

(ii) Investments that are fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, except that no more than 50 percent of the investment portfolio may be comprised of GSE MBS. Investments in Farmer Mac securities are governed by § 615.5174 and are not subject to this limitation.

(3) *Investment portfolio diversification requirements.* A well-diversified investment portfolio means that, at a minimum, investments are comprised of different asset classes, maturities, industries, geographic areas, and obligors. These diversification requirements apply to each individual security that a Farm Credit bank holds within a DIF. To satisfy the asset class and obligor diversification requirements, a Farm Credit bank must, at a minimum, comply with the following requirements, except as exempted by paragraph (f)(2) of this section. These diversification parameters must be based on the portfolio valued at amortized cost.

(i) *Asset class diversification.* The investment portfolio must be diversified among various asset classes. No more than 15 percent of the investment portfolio may be invested in any one asset class. Securities within each DIF count toward the appropriate asset class.

(ii) *Obligor diversification.* The investment portfolio must be diversified among various obligors. No more than 3 percent of the investment portfolio may be invested in any one obligor. For a DIF, both the DIF itself and the entities obligated to pay the underlying debt are obligors.

(g) *Farm Credit bank obligor limit.* No more than 10 percent of a Farm Credit bank's total capital may be invested in

any one obligor. This obligor limit does not apply to investments in obligations that are fully guaranteed as to the timely payment of principal and interest by U.S. Government agencies or fully and explicitly guaranteed as to the timely payment of principal and interest by GSEs. For a DIF, both the DIF itself and the entities obligated to pay the underlying debt are obligors.

(h) *Due diligence.*

(1) *Pre-purchase analysis.*

(i) *Eligibility and compliance with investment policies.* Before you purchase an investment, you must conduct sufficient due diligence to determine whether it is eligible under § 615.5140 or § 615.5142, as applicable, and complies with your board's investment policies. You must document your assessment and the information used in your assessment. You may hold an investment that does not comply with your investment policies only with the prior approval of your board.

(ii) *Valuation.* Prior to purchase, you must verify the value of the investment (unless it is a new issue) with a source that is independent of the broker, dealer, counterparty or other intermediary to the transaction.

(iii) *Risk assessment.* Your assessment of each investment at the time of purchase must at a minimum include an evaluation of the credit risk, liquidity risk as applicable, market risk, interest rate risk, and underlying collateral of the investment, as applicable. This assessment must be documented and commensurate with the complexity and type of the investment. You must perform stress testing on any investment that is structured or that has uncertain cash flows, including all MBS and ABS, before you purchase it. The stress test must be commensurate with the type and complexity of the investment and must enable you to determine that the investment does not expose your capital, earnings, or liquidity, if applicable, to risks that are greater than those specified in your investment policies. The stress testing must comply with the requirements in paragraph (h)(4)(ii) of this section.

(2) *Ongoing value determination.* At least monthly, you must determine the fair market value of each investment in your portfolio and the fair market value of your whole investment portfolio.

(3) *Ongoing analysis of credit risk.* You must establish and maintain processes to monitor and evaluate changes in the credit quality of each investment in your portfolio and in your whole investment portfolio on an ongoing basis.

(4) *Quarterly stress testing.*

(i) You must stress test your entire investment portfolio, including stress tests of all investments individually and stress tests of the portfolio as a whole, at the end of each quarter. The stress tests must enable you to determine that your investment securities, both individually and on a portfolio-wide basis, do not expose your capital, earnings, or liquidity, if applicable, to risks that exceed the risk tolerance specified in your investment policies. If your portfolio risk exceeds your investment policy limits, you must develop a plan to comply with those limits.

(ii) Your stress tests must be defined in a board-approved policy and must include defined parameters for the types of securities you purchase. The stress tests must be comprehensive and appropriate for the risk profile of your institution. At a minimum, the stress tests must be able to measure the price sensitivity of investments over a range of possible interest rate/yield curve scenarios. The methodology that you use to analyze investment securities must be appropriate for the complexity, structure, and cash flows of the investments in your portfolio. You must rely to the maximum extent practicable on verifiable information to support all your assumptions, including prepayment and interest rate volatility assumptions, when you apply your stress tests. You must document the basis for all assumptions that you use to evaluate the security and its underlying collateral. You must also document all subsequent changes in your assumptions.

(5) *Presale value verification.* Before you sell an investment, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(i) *Reports to the board of directors.*

At least quarterly, your management must report on the following to your board of directors or a designated board committee:

(1) Plans and strategies for achieving the board's objectives for the investment portfolio;

(2) Whether the investment portfolio effectively achieves the board's objectives;

(3) The current composition, quality, and the risk and liquidity profiles of the investment portfolio;

(4) The performance of each class of investments and the entire investment portfolio, including all gains and losses realized during the quarter on individual investments that you sold before maturity and why they were liquidated;

(5) Potential risk exposure to changes in market interest rates as identified through quarterly stress testing and any other factors that may affect the value of your investment holdings;

(6) How investments affect your capital, earnings, and overall financial condition;

(7) Any deviations from the board's policies (must be specifically identified);

(8) The status and performance of each investment described in § 615.5143(a) and (b) or that does not comply with your investment policies; including the expected effect of these investments on your capital, earnings, liquidity, as applicable, and collateral position; and

(9) The terms and status of any required divestiture plan or risk reduction plan.

■ 7. In § 615.5134 paragraph (b) is amended by revising the table to read as follows:

§ 615.5134 Liquidity reserve.

* * * * *

(b) *Liquidity reserve requirement.*

* * * * *

Liquidity level	Instruments	Discount (multiply by)
Level 1	• Cash, including cash due from traded but not yet settled debt	100 percent.
	• Overnight money market investments	100 percent.
	• Obligations of U.S. Government agencies with a final remaining maturity of 3 years or less.	97 percent.
	• GSE senior debt securities that mature within 60 days, excluding securities issued by the Farm Credit System.	95 percent.
	• Diversified investment funds comprised exclusively of Level 1 instruments ...	95 percent.

Liquidity level	Instruments	Discount (multiply by)
Level 2	• Additional Level 1 investments	Discount for each Level 1 investment applies.
	• Obligations of U.S. Government agencies with a final remaining maturity of more than 3 years.	97 percent.
	• MBS that are fully guaranteed by a U.S. Government agency as to the timely repayment of principal and interest.	95 percent.
	• Diversified investment funds comprised exclusively of Levels 1 and 2 instruments.	95 percent.
Level 3	• Additional Level 1 or Level 2 investments	Discount for each Level 1 or Level 2 investment applies.
	• GSE senior debt securities with maturities exceeding 60 days, excluding senior debt securities of the Farm Credit System.	93 percent for all instruments in Level 3.
	• MBS that are fully guaranteed by a GSE as to the timely repayment of principal and interest.	
	• Money market instruments maturing within 90 days.	
	• Diversified investment funds comprised exclusively of levels 1, 2, and 3 instruments.	

* * * * *

■ 8. Section 615.5140 is revised to read as follows:

§ 615.5140 Eligible investments for Farm Credit banks.

(a) *Investment eligibility criteria.* A Farm Credit bank may purchase an investment only if it satisfies the following investment eligibility criteria:

(1) The investment must be purchased and held for one or more investment purposes authorized in § 615.5132.

(2) The investment must be one of the following:

(i) A non-convertible senior debt security;

(ii) A money market instrument with a maturity of 1 year or less;

(iii) A portion of an MBS or ABS that is fully guaranteed as to the timely payment of principal and interest by a U. S. Government agency;

(iv) A portion of an MBS or ABS that is fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, except a security permitted under § 615.5174 of this part;

(v) The senior-most position of an MBS or ABS that is not fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency or fully and explicitly guaranteed as to the timely payment of principal and interest by a GSE, provided that the MBS satisfies the definition of ''mortgage related security'' in 15 U.S.C. 78c(a)(41);

(vi) An obligation of an international or multilateral development bank in which the U.S. is a voting member; or

(vii) Shares of a diversified investment fund, if its portfolio consists solely of securities that satisfy paragraphs (a)(2)(i), (a)(2)(ii), (a)(2)(iii), (a)(2)(iv), (a)(2)(v), or (a)(2)(vi) of this section or that are eligible under § 615.5174. The investment company's risk and return objectives and use of derivatives must be consistent with the Farm Credit bank's investment policies.

(3) At least one obligor of the investment must have very strong capacity to meet its financial commitment for the expected life of the investment. If any obligor whose capacity to meet its financial commitment is being relied upon to satisfy this requirement is located outside the U.S., either:

(i) That obligor's sovereign host country must have the highest or second-highest consensus Country Risk Classification (0 or 1) as published by the Organization for Economic Cooperation and Development (OECD) or be an OECD member that is unrated, or

(ii) The investment must be fully guaranteed as to the timely payment of principal and interest by a U.S. Government agency.

(4) The investment must exhibit low credit risk and other risk characteristics consistent with the purpose or purposes for which it is held.

(5) The investment must be denominated in U.S. dollars.

(b) *Investments that do not satisfy requirements.* Farm Credit banks may request our approval to purchase and hold other investments that do not satisfy the requirements of this section. Farm Credit banks may purchase and hold such investments as approved. A Farm Credit bank's request for our approval must explain the risk characteristics of the investment and the purpose and objectives for making the investment.

(c) *Ineligible investments.* Notwithstanding any other provision of this section, Farm Credit banks may not purchase CDOs without approval under paragraph (b) of this section.

(d) *Reservation of authority.* FCA may, on a case-by-case basis, determine that a particular investment of a Farm Credit bank poses inappropriate risk, notwithstanding that it satisfies the investment eligibility criteria. If so, we will notify the Farm Credit bank as to the proper treatment of the investment.

■ 9. Section 615.5142 is revised to read as follows:

§ 615.5142 Eligible investments for System associations.

(a) Subject to the conditions, restrictions and limits set forth in this section, each Farm Credit System association, with the approval of its funding bank, may only purchase and hold investments to manage risk. Each System association that purchases investments must identify and evaluate how investments contribute to the management of its risks. Each investment purchased must be an obligation issued, or fully guaranteed or insured as to the timely payment of principal and interest, by the United States or its agencies and the total amount of investments held must not exceed 10 percent of the association's total outstanding loans. In computing the 10-percent limit for association investments, the 30-day average daily balance of investments is divided by loans. Investments are calculated at amortized cost. Loans are calculated as defined in § 615.5131. For the purpose of this calculation, loans include accrued interest and do not include any allowance for loan loss adjustments. Compliance with the calculation is measured on the last day of every month.

(b) *Risk management requirements.* Each System association that purchases investments must evaluate its investment management policies, and

determine and document how its investment activities are conducted in accordance with the following risk management processes and procedures:

(1) *Investment management requirements.* Each association that purchases investments must comply with § 615.5133(a), (b), (c), (d), (e), (h) and (i) of this part. These investment management processes must be appropriate for the size, risk and complexity of the association's investment portfolio.

(2) *Interest rate risk management requirements.* If interest rate risk in investments could lead to significant declines in net income or in the market value of capital, the association must comply with §§ 615.5180 and 615.5182.

(3) *Other relevant risk management factors.* Each association that purchases investments must consider and evaluate any other relevant factors unique to the association or to the nature of the investments that could affect such association's risk-bearing capacity, including but not limited to management experience and capability to understand and manage complex structures and unique risks in investments purchased.

(c) *Funding bank supervision of association investments.*

(1) An association must not purchase and hold an investment without the prior approval of its funding bank. The bank must review each affiliated association's request to buy and hold investments and explain in writing the bank's reasons for approving or denying the request.

(2) In deciding whether or not to approve an association's request to buy and hold investments, the bank must evaluate, and document that the association:

(i) Has adequate policies, procedures, internal controls, and accounting and reporting systems for its investments;

(ii) Has the capability and expertise to effectively manage the risks in investments; and

(iii) Complies with paragraph (b) of this section.

(3) The bank must review annually the investment portfolio of every association that it funds. This annual review must evaluate whether the association's investments mitigate and manage risk over time, and the continued adequacy of the associations' risk management practices.

(d) *Other investments approved by the FCA.* An association may purchase and hold other investments that we approve. The request for our approval must explain the risk characteristics of the investment and the purpose and objectives for making the investment. These other investments are subject to the funding bank's approval and if approved by the FCA are subject to the portfolio limit on association investments in paragraph (a) of this section unless otherwise provided for by the FCA.

(e) *Transition and divestiture for association investments.*

(1) No association is required to divest any investments held on the date this rule becomes effective that were previously authorized under former § 615.5140 or otherwise authorized by official written FCA action that allowed the association to continue to hold such investments. Once such investments mature, the association must not renew them unless they are authorized pursuant to paragraphs (a) or (d) of this section.

(2) An association is not required to divest of investments if a decline in total outstanding loans causes it to exceed the portfolio limit in paragraph (a) of this section. However, the association must not purchase new investments unless after they are purchased, the total amount of investments held falls within the portfolio limit in paragraph (a) of this section.

(3) Section 615.5143 of this part applies to investments that an association acquires after the date that this rule becomes effective, if such investments:

(i) Do not comply with the investment criteria in paragraph (a) of this section on or after the date of purchase;

(ii) Have not been approved by the FCA pursuant to paragraph (d) of this section; or

(iii) Were approved by the FCA pursuant to paragraph (d) of this section but no longer satisfy the conditions of approval.

■ 10. Section 615.5143 is revised to read as follows:

§ 615.5143 Management of ineligible investments and reservation of authority to require divestiture.

(a) *Investments ineligible when purchased.* Investments that do not satisfy the eligibility criteria set forth in § 615.5140(a) or the investment criteria set forth in § 615.5142(a) or that have not been approved by the FCA pursuant to § 615.5140(b) or § 615.5142(d), as applicable, at the time of purchase are ineligible. You must not purchase ineligible investments. If you determine that you have purchased an ineligible investment, you must notify us within 15 calendar days after the determination. You must divest of the investment no later than 60 calendar days after you determine that the investment is ineligible unless we approve, in writing, a plan that authorizes you to divest the investment over a longer period of time. Until you divest of the investment:

(1) If you are a Farm Credit bank, it must not be used to satisfy your liquidity requirement(s) under § 615.5134;

(2) It must continue to be included in the § 615.5132 Farm Credit bank investment portfolio limit calculation or in the § 615.5142(a) association portfolio limit, as applicable; and

(3) If you are a Farm Credit bank, it must be excluded as collateral under § 615.5050 and net collateral under § 615.5301(c).

(b) *Investments that no longer satisfy investment eligibility criteria.* If you determine that an investment (that satisfied the eligibility criteria set forth in § 615.5140(a) or the investment criteria set forth in § 615.5142(a), as applicable, when purchased) no longer satisfies the criteria, or that an investment that the FCA approved pursuant to § 615.5140(b) or § 615.5142(d), as applicable, no longer satisfies the conditions of approval, you may continue to hold the investment, subject to the following requirements:

(1) You must notify us within 15 calendar days after such determination;

(2) If you are a Farm Credit bank, you must not use the investment to satisfy your liquidity requirement(s) under § 615.5134;

(3) You must continue to include the investment in the § 615.5132 Farm Credit bank investment portfolio limit calculation or in the § 615.5142(a) association portfolio limit, as applicable;

(4) If you are a Farm Credit bank, you may continue to include the investment as collateral under § 615.5050 and net collateral under § 615.5301(c) at the lower of cost or market value; and

(5) You must develop a plan to reduce the investment's risk to you.

(c) *Reservation of authority.* FCA retains the authority to require you to divest of any investment at any time for failure to comply with § 615.5132(a) or § 615.5142 or for safety and soundness reasons. The timeframe set by FCA will consider the expected loss on the transaction (or transactions) and the effect on your financial condition and performance.

§ 615.5174 [Amended]

■ 11. Section 615.5174 paragraph (d) is amended by removing the reference ''§ 615.5133(f)(1)(iii) and § 615.5133(f)(4)'' and adding in its place, ''§ 615.5133(h)(1)(iii) and § 615.5133(h)(4)''.

§ 615.5180 [Amended]

■ 12. Section 615.5180 paragraph (c)(3) is amended by removing the reference ''§ 615.5133(f)(4)'' and adding in its place, the reference ''§ 615.5133(h)(4)''.

Dated: July 21, 2014.

Dale L. Aultman,

Secretary, Farm Credit Administration Board.

[FR Doc. 2014–17493 Filed 7–24–14; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 25

[Docket No. FAA–2014–0383; Notice No. 25–14–05–SC]

Special Conditions: Bombardier Aerospace, Models BD–500–1A10 and BD–500–1A11 Series Airplanes; Alternate Fuel Tank Structural Lightning Protection Requirements

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed special conditions.

SUMMARY: This action proposes special conditions for the Bombardier Aerospace Models BD–500–1A10 and BD–500–1A11 series airplanes. These airplanes will have a novel or unusual design feature that will incorporate a nitrogen generation system (NGS) for all fuel tanks that actively reduce flammability exposure within the fuel tanks significantly below that required by the fuel tank flammability regulations. Among other benefits, the NGS significantly reduces the potential for fuel vapor ignition caused by lightning strikes. The applicable airworthiness regulations do not contain adequate or appropriate safety standards for this design feature. These proposed special conditions contain the additional safety standards that the Administrator considers necessary to establish a level of safety equivalent to that established by the existing airworthiness standards.

DATES: Send your comments on or before September 8, 2014.

ADDRESSES: Send comments identified by docket number FAA–2014–0383 using any of the following methods:

- *Federal eRegulations Portal:* Go to *http://www.regulations.gov/* and follow the online instructions for sending your comments electronically.
- *Mail:* Send comments to Docket Operations, M–30, U.S. Department of Transportation (DOT), 1200 New Jersey Avenue SE., Room W12–140, West Building Ground Floor, Washington, DC, 20590–0001.
- *Hand Delivery or Courier:* Take comments to Docket Operations in Room W12–140 of the West Building Ground Floor at 1200 New Jersey Avenue SE., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except federal holidays.
- *Fax:* Fax comments to Docket Operations at 202–493–2251.

Privacy: The FAA will post all comments it receives, without change, to *http://www.regulations.gov/*, including any personal information the commenter provides. Using the search function of the docket Web site, anyone can find and read the electronic form of all comments received into any FAA docket, including the name of the individual sending the comment (or signing the comment for an association, business, labor union, etc.). DOT's complete Privacy Act Statement can be found in the **Federal Register** published on April 11, 2000 (65 FR 19477–19478), as well as at *http://DocketsInfo.dot.gov/.*

Docket: Background documents or comments received may be read at *http://www.regulations.gov/* at any time. Follow the online instructions for accessing the docket or go to the Docket Operations in Room W12–140 of the West Building Ground Floor at 1200 New Jersey Avenue SE., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except federal holidays.

FOR FURTHER INFORMATION CONTACT: Margaret Langsted, FAA, Propulsion and Mechanical Systems Branch, ANM–112, Transport Airplane Directorate, Aircraft Certification Service, 1601 Lind Avenue SW., Renton, Washington, 98057–3356; telephone 425–227–2677; facsimile 425–227–1149.

SUPPLEMENTARY INFORMATION:

Comments Invited

We invite interested people to take part in this rulemaking by sending written comments, data, or views. The most helpful comments reference a specific portion of the special conditions, explain the reason for any recommended change, and include supporting data.

We will consider all comments we receive on or before the closing date for comments. We may change these special conditions based on the comments we receive.

Background

On December 10, 2009, Bombardier Aerospace applied for a type certificate for their new Models BD–500–1A10 and BD–500–1A11 series airplanes (hereafter collectively referred to as ''CSeries''). The CSeries airplanes are swept-wing monoplanes with a composite wing fuel tank structure and an aluminum alloy fuselage sized for 5-abreast seating. Passenger capacity is designated as 110 for the Model BD–500–1A10 and 125 for the Model BD–500–1A11. Maximum takeoff weight is 131,000 pounds for the Model BD–500–1A10 and 144,000 pounds for the Model BD–500–1A11.

Type Certification Basis

Under the provisions of Title 14, Code of Federal Regulations (14 CFR) 21.17, Bombardier Aerospace must show that the CSeries airplanes meet the applicable provisions of part 25 as amended by Amendments 25–1 through 25–129.

If the Administrator finds that the applicable airworthiness regulations (i.e., 14 CFR part 25) do not contain adequate or appropriate safety standards for the CSeries airplanes because of a novel or unusual design feature, special conditions are prescribed under the provisions of § 21.16.

Special conditions are initially applicable to the model for which they are issued. Should the type certificate for that model be amended later to include any other model that incorporates the same or similar novel or unusual design feature, the special conditions would also apply to the other model under § 21.101.

In addition to the applicable airworthiness regulations and special conditions, the CSeries airplanes must comply with the fuel vent and exhaust emission requirements of 14 CFR part 34 and the noise certification requirements of 14 CFR part 36, and the FAA must issue a finding of regulatory adequacy under section 611 of Public Law 92–574, the ''Noise Control Act of 1972.''

The FAA issues special conditions, as defined in 14 CFR 11.19, in accordance with § 11.38, and they become part of the type certification basis under § 21.17.

Novel or Unusual Design Features

The CSeries airplanes will incorporate the following novel or unusual design features: A fuel tank nitrogen generation system (NGS) that is intended to control fuel tank flammability for all fuel tanks. This NGS is designed to provide a level of performance that applies the more stringent standard for warm day flammability performance applicable to normally emptied tanks within the fuselage contour from § 25.981(b) and appendix M to part 25 to all fuel tanks of the CSeries airplanes. This high level of NGS performance for all fuel tanks is