FARM CREDIT ADMINISTRATION

12 CFR Part 615

RIN 3052–AC54

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Liquidity and Funding

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA, we or us) adopts a final rule that amends its liquidity regulation. The purpose of the final rule is to strengthen liquidity risk management at Farm Credit System (FCS, Farm Credit, or System) banks, improve the quality of assets in their liquidity reserves, and bolster the ability of System banks to fund their obligations and continue operations during times of economic, financial, or market adversity.

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

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of the final rule are to:

- Improve the capacity of FCS banks to pay their obligations and fund their operations by maintaining adequate liquidity to withstand various market disruptions and adverse economic or financial conditions;
- Strengthen liquidity management at all FCS banks;
- Enhance the liquidity of assets that System banks hold in their liquidity reserves;
- Require FCS banks to maintain a three-tiered liquidity reserve. The first tier of the liquidity reserve must consist of a sufficient amount of cash and cash-like instruments to cover each bank's financial obligations for 15 days. The second and third tiers of the liquidity reserve must contain cash and highly liquid instruments that are sufficient to cover the bank's obligations for the next 15 and subsequent 60 days, respectively;
- Establish a supplemental liquidity buffer that a bank can draw upon during an emergency and is sufficient to cover the bank's liquidity needs beyond 90 days; and
- Strengthen each bank's Contingency Funding Plan (CFP).

II. Background

The FCS is a nationwide network of borrower-owned financial cooperatives that lend to farmers, ranchers, aquatic producers and harvesters, agricultural cooperatives, rural utilities, farm-related service businesses, and rural homeowners. Its primary purpose is to furnish ''sound, adequate, and constructive credit and closely related services'' necessary for efficient agricultural operations in the United States.[1] By law, FCS institutions are instrumentalities of the United States,[2] and Government-sponsored enterprises (GSEs).[3]

FCS banks issue Systemwide debt securities, which are the primary source of funding System loans to farmers, ranchers, cooperatives, and other eligible borrowers.[4] The System depends on continuing access to the debt markets in order to finance agriculture, rural utilities, and rural housing in both good and bad economic times. If access to the debt markets becomes impeded for any reason, Farm Credit banks must have enough readily available funds and assets that can be quickly converted into cash to continue operations and pay maturing obligations. In contrast to non-System financial institutions, the FCS does not have an assured governmental lender of last resort that it could turn to in an emergency.[5] As a result, FCS banks must rely on their liquidity reserves more heavily than other federally regulated lending institutions if market access is impeded.[6]

III. History of This Rule

We have periodically amended our liquidity rule over the past 19 years as part of our ongoing efforts to limit the adverse effect that changing economic, financial, or market conditions have on the liquidity of FCS banks.[7] On December 27, 2011, the FCA published a proposed rule in the **Federal Register** to amend its liquidity regulation at § 615.5134.[8] The FCA proposed this rule after it identified vulnerabilities that could impair the ability of FCS banks to pay their obligations, fund their assets, and continue operations whenever economic or financial turmoil impedes System access to the debt markets. The purpose of this rulemaking is to improve the System's ability to withstand market disruptions by strengthening liquidity management practices at Farm Credit banks and enhancing the liquidity of assets in their liquidity reserves. Proposed § 615.5134 would:

(1) Require FCS banks to manage their liquidity reserves primarily as an emergency source of funding;

(2) Require boards to adopt stronger and more focused policies concerning liquidity management and the contingency funding plan;

(3) Divide the 90-day liquidity reserve into tiers so each FCS bank has a sufficient amount of cash and cash-like instruments available to pay its obligations and fund its operations for the next 15 days, and maintain a pool of cash or highly liquid instruments for the subsequent 15 days and the 60 days after that;

(4) Require each FCS bank to establish and maintain a supplemental liquidity buffer that would provide a longer term, stable source of funding beyond the 90-day minimum liquidity reserve; and

(5) Specify corrective actions that the FCA could compel FCS banks to

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[1] *See* Section 1.1(a) of the Act; 12 U.S.C. 2001(a).

[2] *See* Sections 1.3(a), 2.0(a), 2.10(a), 3.0, 4.25, and 8.1(a)(1) of the Act; 12 U.S.C. 2011(a), 2071(a), 2091(a), 2121, 2211, and 2279aa–1.

[3] Pub. L. 101–73, § 1404(e)(1)(A), 103 Stat. 183, 552–53, (Aug. 9, 1989).

[4] Farm Credit banks (which are the three Farm Credit Banks and the Agricultural Credit Bank) issue and market Systemwide debt securities through the Federal Farm Credit Banks Funding Corporation (Funding Corporation). The Funding Corporation, which is established pursuant to section 4.9 of the Act, is owned by all Farm Credit banks.

[5] The Federal Reserve Banks, the Federal Home Loan Banks, and National Credit Union Administration Central Liquidity Facility serve as a source of liquidity for commercial banks, savings associations, and credit unions both in ordinary times and during emergencies.

[6] Section 1101 of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended section 13(3) of the Federal Reserve Act, 12 U.S.C. 343(3), to allow the Board of Governors of the Federal Reserve System, in consultation with the Secretary of the Treasury, to establish by regulation, policies and procedures that would govern emergency lending under a program or facility for the purpose of providing liquidity to the financial system. Under section 13(3) of the Federal Reserve Act, as amended, the Board of Governors of the Federal Reserve System must establish procedures that prohibit insolvent and failing entities from borrowing under the emergency program or facility. Pursuant to section 13(3) of the Federal Reserve Act, as amended, the Board of Governors of the Federal Reserve System, with the approval of the Secretary of the Treasury could authorize the Federal Reserve Banks to serve as an emergency source of liquidity for the FCS, but it is not obligated to do so. *See* Public Law 111–203, title XI, § 1101(a), 124 Stat. 1376, 2113 (Jul. 21, 2010).

[7] *See* 58 FR 63056 (Nov. 30, 1993); 64 FR 28896 (May 28, 1999); 70 FR 51590 (Aug. 31, 2005).

[8] *See* 76 FR 80817 (Dec. 27, 2011).

implement under a reservation of authority.

IV. Comment Letters

The four System banks and the Farm Credit Council (Council) commented on the proposed rule. All five commenters acknowledge sound liquidity management enables the FCS to fulfill its statutory mandate to fund agriculture. As the FCA noted in the preamble to the proposed rule, the commenters emphasized that all FCS banks withstood the financial crisis of 2008 with their liquidity intact. The commenters attribute this success to effective liquidity management at FCS banks and the current regulatory framework, which they deem to be appropriate. For this reason, the commenters suggest that the FCA should make only minor adjustments to the existing liquidity regulation, § 615.5134, rather than comprehensive revisions. In this context, all commenters expressed the view that the proposed rule is excessive, complex, and overly prescriptive.

The commenters also claim that the FCA's proposal would result in undue regulatory burden on System banks because it goes far beyond what they believe is necessary for effective liquidity risk management. The commenters raised a number of substantive issues about the proposed liquidity rule, and they recommended specific revisions for the final rule. The main areas of concern that the commenters raised are:

- The proper roles of both board and management in devising and implementing liquidity policies for the bank;
- The extent to which FCS banks should distinguish or segregate investments held for liquidity management from investments held for other purposes;
- The role of short-term discount notes in the funding strategies of Farm Credit banks;
- The extent to which guidance from the Basel Committee on Banking Supervision (Basel Committee) and the Federal banking regulators [9] about liquidity at depository institutions should influence the FCA's efforts to develop liquidity regulations for FCS banks;
- The lack of a lender of last resort for FCS banks;
- GSE status and the extent to which Farm Credit banks should generate earnings from their investments; and
- Development of a consistent regulatory approach for liquidity at both FCS banks and the Federal Agricultural Mortgage Corporation (Farmer Mac).

V. The FCA's Approach in the Final Rule

The commenters have not persuaded the FCA that the proposed rule is unduly burdensome or overly prescriptive, or that only minor adjustments to the existing liquidity regulation are warranted. Recent financial crises and continuing global economic uncertainty clearly demonstrate that strong liquidity management practices and access to reliable sources of emergency funding are crucial both to the viability of each financial institution, including FCS banks, and to the financial system as a whole. We proposed substantial revisions to § 615.5134 in order to redress vulnerabilities in liquidity management that we identified at System banks in the aftermath of the 2008 crisis.[10] The purposes of this rulemaking are to strengthen the System's ability to withstand future crises by limiting the adverse effects that sudden changes in economic, financial and market conditions may have on the liquidity of FCS banks, both individually and collectively. For these reasons, both the proposed and final rules follow the same basic supervisory and regulatory approaches to liquidity.

The commenters offered many constructive and practical suggestions for improving the regulation that we incorporated into the final rule. Based on these comments, we restructured and refined the rule to make it easier to read, understand, and implement. Additionally, the comments caused us to reconsider and revise some of our positions. As we explain the final rule and how it differs from our original proposal, we will respond to comments about our overall regulatory and supervisory approach to liquidity as well as specific issues arising from each provision of § 615.5134.

A. Reasons for Revising the Liquidity Regulation

Liquidity refers to the ability of financial institutions to pay obligations and fund operations on an ongoing basis at a reasonable cost. Recent financial crises demonstrate how quickly liquidity can vanish at seemingly strong financial institutions, which could impair their viability and jeopardize their survival. If economic or financial conditions quickly or unexpectedly deteriorate, financial institutions may find that their routine funding sources have become too scarce or costly, and that they then do not have sufficient liquid assets to meet their immediate funding needs. This lack of adequate liquidity can threaten the safety and soundness of individual institutions, and the financial system as a whole.

The FCA noted in the preamble to the proposed rule that throughout the 2008 crisis, FCS banks were able to raise funds and pay their obligations in a timely manner. However, the FCA and System commenters drew very different conclusions from the 2008 crisis, especially concerning whether FCS banks need to strengthen both their liquidity reserves and their liquidity risk management practices so they are in the best position possible to weather future financial and economic storms. The FCA identified several vulnerabilities at FCS banks that could adversely affect their liquidity during economic, financial, or market turmoil in the future. For this reason, the FCA proposed to correct these potential weaknesses by proposing substantial revisions to § 615.5134.

In contrast, FCS commenters concluded that the crisis in 2008 vindicated the existing liquidity regulation. Three commenters attribute effective risk management practices under the existing regulatory framework as the reason why System banks had adequate liquidity to continue operations without disruptions throughout the 2008 crisis. Additionally, these commenters point out that System banks, on their own initiative, implemented various measures to improve their liquidity management practices so they could continue their operations unabated whenever financial markets became distressed. For example, FCS banks refined the liquidity standards and measures in the Contractual Interbank Performance Agreement (CIPA).[11] The

[9] The Federal banking agencies are the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the National Credit Union Administration. Prior to July 2011, the former Office of Thrift Supervision jointly issued guidance about liquidity with the other four banking agencies. Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act abolished the Office of Thrift Supervision and transferred its authorities over: (1) Savings and loan holding companies to the Board of Governors of the Federal Reserve System; (2) Federal savings associations to the Office of the Comptroller of the Currency; and (3) State savings associations to the Federal Deposit Insurance Corporation. *See* Public Law 111–203, Title III, § 312, 124 Stat. 1376, 1521 (Jul. 21, 2010).

[10] *See* 76 FR 80817 *supra.* at 80819.

[11] Under provisions of the CIPA, a CIPA score is a calculation that measures the financial condition and performance of each FCS bank. The calculation uses various ratios that take into account the

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banks also voluntarily adopted an additional three-tiered liquidity standard that they implemented through their policies and procedures. One commenter noted that the System adopted other strategies to enhance liquidity, such as adjusting debt maturities and loan pricing, and increasing the amount of highly liquid assets (cash and Treasuries) in their liquidity portfolios. For these reasons, the commenters encouraged the FCA to ''only make minor adjustments to existing regulatory requirements rather than comprehensive revisions.''

Although FCS banks survived the 2008 crisis with their liquidity intact under the existing regulatory framework, the FCA observes that it is not necessarily an adequate or effective bulwark against future market disruptions that would most likely occur under different circumstances. In 2008, the agricultural economy was strong and the System was sound when the housing bubble burst, causing a financial crisis that imperiled the liquidity of the global financial system. In these circumstances, FCS banks were able to continue issuing debt (overwhelmingly short-term discount notes) to investors, who remained confident in the System's ability to meet its obligations, but even then, most investors were only willing to buy very short-term instruments.

In other plausible scenarios, however, distress in the agriculture sector could reduce the income of FCS banks and associations, thus making it more difficult for affected System institutions to pay their debts and fund their operations. As a result, the System's funding costs could rise as investor confidence becomes shaken, and market access could become partially or fully impeded. One or more of the following events could impair the liquidity of System banks:

- A steep drop in commodity prices that adversely affects the repayment capacity of a large percentage of FCS borrowers, thereby reducing the ability of System banks to repay their obligations and fund their operations;
- Extended declines in both commodity prices and agricultural land values would result in significant loan losses at FCS banks and associations, thereby impairing System capital and impeding market access;
- A sudden surge in borrower demand for funds under lines of credit that strains the bank's ability to meet these unfunded commitments at a time of market stress; or
- A large amount of System obligations become due and payable as a severe market disruption is reaching its peak.

Any of these events could impair the viability of one or more FCS banks, thereby constricting the System's capacity to fund its normal operations. Substantially revising and strengthening § 615.5134 mitigates the System's vulnerabilities to such risks, and thereby improves the System's ability to withstand market disruptions in a wide range of circumstances.

The FCA supports the measures that System banks implemented to strengthen liquidity. In our view, the System's efforts and our new regulation complement each other. For example, revised § 615.5134 divides the liquidity reserve into tiers that are similar to the tiers that FCS banks have already established. Additionally, the regulation reinforces enhanced practices at FCS banks to hold more cash and highly liquid investments in amounts sufficient to cover obligations maturing in the next 15, 30, and 90 days.

The rule also strengthens internal controls and risk management practices at System banks. Under the revised regulation, System banks will retain ample flexibility to manage liquidity effectively in future crises, and adjust their strategies to changing circumstances. The new regulation enables FCS banks to further refine CIPA, or make adjustments to debt maturities or investments, as circumstances warrant. As amended, § 615.5134 promotes comprehensive and sound liquidity management at FCS banks. For this reason, our new regulation aids, rather than hinders System banks as they combat liquidity risks in an ever-changing environment.

B. Comparisons and Contrasts With Guidance of Other Regulators

The preamble to the proposed rule frequently referred to guidance that international and Federal regulators developed to enhance liquidity management practices at the financial institutions they regulate. In September 2008, the Basel Committee issued the *Principles for Sound Liquidity Risk Management and Supervision,* which contained 17 core principles detailing international supervisory guidance for sound liquidity risk management. In December, 2010, the Basel Committee issued *Basel III: International framework for liquidity risk measurement, standards, and monitoring (Basel III).* The Federal banking agencies published their Interagency Policy Statement on Funding and Liquidity Risk Management on March 22, 2010, which sets forth the supervisory expectations for depository institutions and their related entities.[12]

We received several comments about the extent to which Basel III and the approach of other regulators influences our new liquidity regulation. System commenters expressed conflicting opinions on this issue. One bank opined that the proposed rule is ''too detailed and prescriptive compared to the principles-based approach'' of other bank regulators. In contrast, two commenters applauded the FCA's efforts to create regulatory requirements for liquidity that are similar to the approach of the Basel Committee and the Federal banking agencies, when it is appropriate to do so. However, they cautioned the FCA not to ''get ahead of these regulators with respect to their consideration and implementation of Basel III.'' A commenter expressed concern that our proposed rule was significantly more onerous than the liquidity requirements imposed on commercial banks.

Our new regulation incorporates many of the principles that the Basel Committee and the Federal banking agencies have articulated on liquidity management because many of these fundamental concepts apply to all financial institutions, including FCS banks and depository institutions. The comprehensive supervisory approach developed by the Basel Committee and the Federal banking agencies effectively strengthens both the liquidity reserves and the liquidity risk management practices at regulated financial institutions. The most important features of the framework of other regulators that we adopted pertain to: (1) A multi-tiered approach to the liquidity reserve that requires FCS banks to keep a sufficient amount of cash and highly liquid investments on hand to pay obligations that fall due in next 15, 30, and 90 days; (2) a supplemental liquidity buffer that provides FCS banks with a stable source of liquidity over a longer period of time; (3) specific policies and internal controls that combat liquidity risk; and (4) contingency funding planning based in part on the results of liquidity stress tests.

This principles-based approach is comprehensive, yet flexible because it applies to all types of financial

capital, asset quality, earnings, interest-rate risk and liquidity of each Farm Credit bank. The CIPA score is compared to an agreed-upon standard of financial condition and performance that each FCS bank must achieve and maintain. The CIPA score is designed as an early warning mechanism that helps monitor the financial condition of each FCS bank.

[12] *See* 75 FR 13656 (Mar. 22, 2010).

institutions, regardless of size, structure, or complexity. This approach is also suitable to FCS banks, both collectively and individually. These principles enhance liquidity throughout the FCS while accommodating differences among System banks in size, business models, and complexity of operations.

As the preamble to the proposed rule explains, and some commenters acknowledge, we tailored these principles and concepts to the System's unique structure and circumstances. Accordingly, we modified the supervisory approach of the Basel Committee and the Federal banking agencies to apply it to the System. As noted above, the FCS is a nationwide network of borrower-owned financial cooperatives that primarily lend to agricultural enterprises in rural areas. Other fundamental differences between the System and depository institutions are: (1) FCS institutions are instrumentalities of the United States and GSEs; (2) their common equity is not publicly traded; (3) the issuance of Systemwide debt securities is the primary source of System funding; and (4) the System has no assured governmental lender of last resort. Generally, the funding sources, asset portfolios, and investment activities of regulated non-System financial institutions are more diversified and complex than those of the FCS. We took all of these factors into account as we developed this new liquidity regulation to meet the unique structure, needs, and circumstances of FCS institutions, and threats they face. Thus, our revised liquidity regulation diverges from the approach of the Basel Committee and the Federal banking agencies when circumstances warrant it.[13]

The commenters asked the FCA not to get ahead of the other regulators in implementing the concepts of Basel III. This request seems to reflect System concerns that our new liquidity regulation will become effective before Basel III.[14] From a supervisory and regulatory prospective, delaying the implementation of this regulation until Basel III is fully phased in is not in the System's best interest because amended § 615.5134 strengthens liquidity at FCS banks and helps protect them from future market upheavals. Although no one can predict when the next market disruption will occur, System banks will be better prepared for it after they make the changes required by this new regulation.

Basel III is not the only basis for the new liquidity regulation. The revised regulation also builds upon the System's own initiatives to improve liquidity management as well as the FCA's experiences from examining liquidity risk management at Farm Credit banks and the Funding Corporation. In this context, the new regulation implements the best practices for liquidity management at FCS banks, and there is no reason for the FCA to delay implementation until Basel III is fully implemented at other financial institutions. Of course, the FCA will closely monitor how the Federal banking agencies adjust Basel III and apply it to the institutions they supervise. As always, the FCA has authority to further amend § 615.5134, or take other appropriate actions concerning liquidity at FCS banks in response to external developments, including changes to the Basel III framework.

Some commenters allege that our new regulatory approach to liquidity is ''too detailed and prescriptive compared to the principles-based approach'' of the other regulators. Yet, we observe that our new regulation follows the core concepts of the principles-based approach of the other regulators by requiring FCS banks to: (1) Retain an adequate stockpile of high-quality liquid assets to cover the next 15, 30, and 90 days; (2) maintain supplemental liquidity over a longer timeframe; (3) improve liquidity risk management practices; and (4) and enhance contingency funding planning. These requirements will put FCS banks in a stronger position to endure and outlast future crises that could impede their access to funding. Although the commenters may view this approach as ''too detailed and prescriptive,'' it is essential from a safety and soundness perspective.

C. Discount Notes

We received two comments about how the new liquidity regulation may adversely affect the ability of System banks to issue short-term discount notes to fund their operations when financial markets are in turmoil. These commenters assert that discount notes are a strong source of System liquidity during times of crisis. From the commenters' perspective, GSE status enables FCS banks to sell discount notes to investors, who seek high-quality investments during times of market turmoil. The commenters ask the FCA to recognize the liquidity that discount notes provide the FCS during times of market upheaval, and avoid promulgating an inflexible rule that compel System banks to lengthen the maturity of their liabilities and hold more low-yielding liquid assets. The commenters expressed concern that the proposed rule would significantly curtail the issuance of discount notes, which in turn, would raise the costs to the System's customer-owners.

Discount notes are one of many tools that System banks have at their disposal to mitigate liquidity risk. The FCA expects FCS banks to develop balanced and flexible strategies that they can utilize under different scenarios, especially when economic and financial conditions rapidly change. System banks should not become overly dependent on discount notes.

Although discount notes performed well in the last financial crisis, their effectiveness is much less certain when the agricultural sector or the FCS is experiencing significant stress. For example, during the agricultural credit crisis of the mid-1980s, investors demanded high risk premiums on all System debt obligations, including short-term instruments.

By encouraging System banks to diversify their repayment sources for maturing debt, the FCA's regulatory approach enhances safety and soundness. FCS banks face potential refunding risks when they replace maturing debt with new debt issuances especially, very short-term discount notes. If market conditions rapidly deteriorate, investors may demand exorbitant premiums for purchasing System debt securities, and/or FCS banks may find few buyers for their Systemwide securities. Including more high-quality liquid assets in their liquidity reserves is a prudent practice because it helps System banks mitigate these potential refunding risks.

Discount notes are currently in high demand primarily because of the System's strong financial condition and its GSE status. As a result, discount notes are an inexpensive source of funding for the FCS, which can help offset the costs that System banks incur

[13] Our regulation adopts many of the basic concepts in the Basel III liquidity framework. However, the FCA's approach is not identical to Basel III. The Basel III liquidity framework established two minimum standards for funding liquidity. The first standard is the Liquidity Coverage Ratio (LCR), which ensures that commercial banking organizations have sufficient high-quality liquid assets to survive a significant stress event that lasts 1 month. The purpose of the LCR is to promote short-term resilience of a bank's liquidity risk profile. The second standard of the Basel III liquidity framework is the Net Stable Funding Ratio (NSFR), which is designed to provide a stable and sustainable maturity structure for a bank's assets and liabilities over a time horizon of 1 year.

[14] Originally, commercial banking organizations would have been required to fully meet the LCR by January 1, 2015. On January 6, 2013, the Basel Committee delayed the full implementation of the LCR requirement until January 1, 2019.

from holding short-term, high quality liquid assets in their liquidity reserves.

For all these reasons, the final rule is likely to lessen System overall usage of discount notes, but it should not significantly affect the program.

D. Lender of Last Resort

In contrast to depository institutions and other financial institutions, the FCS lacks an assured governmental lender of last resort that could inject liquidity into System banks during times of prolonged paralysis in financial markets. Some commenters encouraged the FCA to accelerate its efforts to find an assured lender of last resort for FCS banks so they will have an emergency source of liquidity if their access to the market becomes impeded.

The FCA and Farm Credit System Insurance Corporation (FCSIC) have undertaken efforts to establish an emergency source of liquidity for the System. These efforts, however, are separate from the FCA's supervision and regulation of liquidity risk management at FCS banks. In the absence of an assured governmental lender of last resort, System banks must maintain sufficient liquidity to absorb the impact of market disruptions and economic downturns. Through FCA's effective regulation and supervision of the System, the System banks are able to assure investors that they have adequate liquidity to meet their obligations, even though they have no assured lender of last resort.

E. GSE Status

Two passages in the preamble to the proposed rule addressed the relationship between investments held for liquidity and the System's GSE status.[15] These passages reiterated the FCA's longstanding position that choosing liquid investments *primarily* for their ability to generate revenue is fundamentally incompatible with the System's GSE status.[16]

These preamble statements generated comments from the Council and one FCS bank. Both commenters interpret our preamble statements as suggesting that GSE status prohibits System banks from generating positive earnings from their liquidity reserves and supplemental liquidity buffers. These commenters claim that these statements indicate that the FCA expects System banks to either lose money or break even on their liquidity portfolios. One commenter asserts that nothing in the Farm Credit Act of 1971, as amended (Act) supports the conclusion that the System's GSE status means that investments cannot generate profits, or at a minimum, cover funding costs. Both commenters claim the proposed rules for Farmer Mac specifically recognize income generation as a legitimate investment purpose and allow Farmer Mac to hold profitable assets in its liquidity reserve and supplemental liquidity buffer. As result, the commenters ask the FCA to provide flexibility so FCS banks can also manage their liquidity portfolios ''in a manner to generate reasonable long-term returns and minimize the cost of liquidity management.''

The FCA reiterates its longstanding position that System banks are GSEs and, therefore, the *primary purpose* of their investment portfolios is to maintain adequate liquidity, manage market risks on their balance sheets, and to manage short-term, surplus funds. Although generating positive earnings should never be the *primary* reason why System banks buy and hold marketable investments, the FCA has never expected the banks to incur losses or only break even on investments. When FCS banks select assets for their liquidity portfolios, the FCA expects them to consider the liquidity characteristics of prospective investments as a more important priority than their earnings-generating capacity. The earning streams from such investments are ancillary to the protection that its liquidity reserve and supplemental liquidity buffer provide each System bank in the event that market access becomes impeded.

Maintaining an adequate stock of high quality liquid assets that can withstand turbulence in the markets often means that System banks must forego higher earnings on certain investments. The highest quality liquid assets can be easily and quickly converted into cash at little or no loss compared to book value. For this reason, highly liquid investments entail less risk and, therefore, they tend to generate lower earnings. Higher earning investments, such as certain mortgage-backed securities (MBS), often proved unsuitable as a backup source of liquidity during the 2008 crisis.[17]

F. Farmer Mac

The Council and a System bank commented that the FCA treats Farmer Mac more leniently than FCS banks. According to these commenters, the FCA is imposing more onerous liquidity requirements on System banks than Farmer Mac, and it is encouraging Farmer Mac to generate earnings from investments while discouraging FCS banks from doing so.

The Council raised these issues when it commented on the investment management rules for System banks and Farmer Mac, and we responded to these concerns in the preambles to the final rules.[18] Our approach towards liquidity is the same as it is for investment management. The liquidity requirements that § 615.5134 imposes on FCS banks are not significantly different or more onerous than the liquidity requirements that proposed §§ 652.35 and 652.40 would impose on Farmer Mac. Although the liquidity rules for System banks and Farmer Mac will continue to differ where appropriate,[19] we made changes to this rule and anticipate changes to the Farmer Mac rule to make the requirements more consistent. Separately, the preamble to the final investment management rule for Farmer Mac stated that § 652.15 would allow Farmer Mac to use non-program investments, including those held for liquidity, to primarily generate earnings and enhance returns for investors.[20] We incorporate by reference our response in the preamble to final § 652.15(a) into this preamble.

VI. Section-by-Section Analysis of the Final Rule

In response to the comments, the FCA has restructured and consolidated the final regulation. The nine main provisions of the proposed rule have been reduced to six in the final rule. The FCA combined proposed §§ 615.5134(b), 615.5134(e), and 615.5134(g) into a single provision, final § 615.5134(b), which now: (1) Establishes the liquidity reserve requirement for all FCS banks; (2) addresses the composition of the liquidity reserve; and (3) specifies the discounts for assets held in the liquidity reserve. We have also deleted the FCA's reservation of authority in proposed § 615.5134(i) from the final regulation. Many of the individual provisions of the

[15] *See* 76 FR 80817 *supra.* at 80820, 80823.

[16] *See* 70 FR 51587 (Aug. 31, 2005); 58 FR 63039, (Nov. 30, 1993).

[17] During the global financial crisis in 2008, financial institutions that held non-agency mortgage-backed securities and asset-backed securities experienced credit quality deterioration, increased credit risk premiums, declines in market valuations, and ultimately reduced liquidity.

[18] *See* 77 FR 66362 (Nov. 5, 2012).

[19] Farmer Mac, in contrast to FCS banks, has a line of credit for $1,500,000,000 with the Secretary of Treasury under section 8.13 of the Act. Farmer Mac may issue obligations to the Secretary of Treasury, and use the proceeds to cover losses it incurs in providing guarantees on securities backed by qualified loans. Farmer Mac may draw on its line of credit with the Secretary of Treasury only after it exhausts the reserves it must maintain under section 8.10 of the Act.

[20] *See* 77 FR 66375, 66377 (Nov. 5, 2012).

final rule have been revised and reorganized to address the commenters' concerns and to enhance their clarity.

A. Section 615.5134(a)—Liquidity Policy

The cornerstone of effective liquidity management at each FCS bank is its liquidity policy, which the board of directors adopts and management implements. Existing § 615.5133(c) requires FCS banks to adopt a liquidity policy. However, the only affirmative requirement that it imposes is that bank policies describe the liquidity characteristics of eligible investments that each Farm Credit bank holds to meet its liquidity needs and institutional objectives. The FCA proposed adding a new paragraph to the liquidity regulation, § 615.5134(a), that for the first time would require Farm Credit banks to address specific issues in their liquidity policies. Proposed § 615.5134(a)(1) focused on the responsibilities of the bank's board of directors while proposed § 615.5134(a)(2) specified seven issues that bank policies must address.

1. Board Responsibility

Proposed § 615.5134(a)(1) would require the board of directors of each FCS bank to adopt a written liquidity policy, which must be compatible with the bank's investment management policies under § 615.5133. The preamble to the proposed rule stated that the FCA expects the bank's liquidity policy to fit into its overall investment strategy because effective liquidity risk management is critically important to the bank's long-term viability.[21] The next provision of proposed § 615.5134(a)(1) would require the bank's board of directors to review its liquidity policy at least once every year, ''affirmatively validate'' the sufficiency of its liquidity policy, and make any revision it deems necessary. The purpose of this provision is to compel the board to ascertain whether its policies enable the bank to respond promptly and effectively to events that could threaten its liquidity.[22] The final sentence of proposed § 615.5134(a)(1) mandates that the board of directors ensure that adequate internal controls are in place so that management complies with and carries out the bank's liquidity policy. As the preamble to the proposed rule explained, strong internal controls prevent losses caused by fraud or mismanagement, and enable FCS banks to respond more quickly and effectively when significant market turmoil arises and impedes access to funding.[23]

The Council commented on proposed § 615.5134(a)(1). These comments focused on the proper roles and responsibilities of the board of directors and senior management in developing and executing the bank's strategies for containing liquidity risk. The Council indicated that the FCA failed to recognize that boards of directors and senior management play different roles in developing, approving, and applying policies, strategies, and procedures. From the commenter's perspective, the proposed rule seems to require boards to develop and adopt liquidity strategies and policies, rather than clearly articulating an appropriate risk tolerance level for the bank. The commenter also asserted that it is the responsibility of senior management to develop strategy, policies, and procedures to manage liquidity, which the board then reviews and approves. Finally, the commenter claims that the FCA's approach about the respective roles of boards of directors and senior management on liquidity policy is the opposite of guidance from the Federal banking agencies.

The FCA responds that the board of directors is ultimately responsible for ensuring that the bank always maintains sufficient liquidity so it can pay maturing obligations and fund its operations. The board discharges this responsibility by adopting policies, procedures, and parameters for monitoring, measuring, managing, and mitigating liquidity risk to the bank. More specifically, the board articulates risk tolerance levels, internal controls, and other limits in its policies, while senior management operates within those parameters as it carries out the board's policy. Contrary to the commenters' claims, the plain language of § 615.5134(a)(1) recognizes that the board of directors and senior management have distinct roles and separate powers in protecting the bank's liquidity. In fact, the preamble to the proposed rule acknowledged that senior management, not the board of directors, develops and implements strategies for managing liquidity risk on a day-to-day basis.[24]

The Council suggested a technical revision to the third sentence of proposed § 615.5134(a)(1), which would require the board to review its liquidity policy at least once a year, and ''affirmatively validate'' its sufficiency, and make any revision it deems necessary. The commenter advised us that FCS banks are uncertain about how boards of directors are supposed to ''affirmatively'' validate the sufficiency of the bank's liquidity policy. The commenter also expressed concern that the word ''affirmatively'' creates unnecessary regulatory uncertainty because it is a vague requirement and is, therefore, subject to varying interpretations over time. For these reasons, the commenter asked us to drop the term ''affirmatively'' from § 615.5134(a)(1), and bring it more in line with the approach of the Federal banking agencies.

The commenter has persuaded us that this provision of proposed § 615.5134(a)(1) is vague and susceptible to different interpretations. Boards of directors at Farm Credit banks should clearly understand exactly what § 615.5134(a)(1) requires them to do. For this reason, we have deleted the phrase ''affirmatively validate'' from the third sentence of § 615.5134(a)(1), and replaced it with the word ''assess.'' Final 615.5134(a)(1) now requires the board of directors of each FCS bank, at least once a year, to: (1) Review its liquidity policy; (2) assess the sufficiency of this policy; and (3)make any revisions to the liquidity policy that it deems necessary. This amendment also addresses the commenters' substantive concerns by more clearly differentiating the roles and responsibilities of the board and senior management. By assessing the sufficiency of the liquidity policy, the board evaluates whether senior management has effectively monitored, measured, managed, and mitigated liquidity risk in accordance with the board's existing policy.

2. Policy Content

Proposed § 615.5134(a)(2) focused on the content of the board's liquidity policies. This regulatory provision identifies seven different issues that a Farm Credit bank, at a minimum, must address in its liquidity policies. As noted in the preamble to the proposed rule, the policies of each FCS bank should be comprehensive and commensurate with the complexities of the bank's operations and its risk profile.[25]

Proposed § 615.5134(a)(2) elicited comments from the Council and all four Farm Credit banks. These comments ranged from general statements about the effects that § 615.5134(a)(2) would have on liquidity management at FCS banks to detailed critiques and recommendations about each clause of this provision. All five commenters

[21] *See* 76 FR 80817 *supra.* at 80819.

[22] *Id.*

[23] *See* 76 FR 80817 *supra.* at 81820.

[24] *Id.* at 80819.

[25] *Id.* at 80820.

deemed proposed § 615.5134(a)(2) as too complex, detailed and prescriptive. These commenters urged the FCA to enact a regulatory provision that is more general in nature, rather than specify the content of board policies in detail.

Several commenters expressed concern that § 615.5134(a)(2) would inhibit the banks' ability to effectively manage their liquidity and investments. We received comments that proposed § 615.5134(a)(2), when combined with the new investment management regulation, create a complex layering of regulatory requirements that are both duplicative and unduly burdensome to the banks. The Council commented that our regulation would hamper the banks from taking an integrated risk management approach to investments and liquidity. By detailing what a policy must contain, this commenter claimed that FCA inappropriately interfered with the discretion of the board to direct and oversee liquidity management at the bank.

The FCA declines the System's request to replace § 615.5134(a)(2) with a regulatory provision that is general in nature. This provision is a vital component of FCA's new regulation because it strengthens liquidity risk management practices at FCS banks. By requiring board policies to address specific core issues, the regulation instills greater discipline in liquidity risk management practices that will better enable System banks to outlast adverse economic, financial, and market conditions under differing circumstances and scenarios. Rather than interfering with the discretion of the board to direct and oversee liquidity management at the bank, § 615.5134(a)(2) requires board policies, at a minimum, to focus on those basic core components of liquidity risk management that are crucial to the bank's safety and soundness.

This regulation does not prevent System banks from adopting an integrated risk management approach to liquidity and investments. In fact, prudent risk management requires financial institutions to simultaneously monitor, manage, and mitigate risks to individual assets, various portfolios, and the entire institution. Our regulation requires boards to specifically address liquidity risk as part of their efforts to manage the bank's investments. Nor is this provision duplicative of our investment management regulation because it states that board policies must describe how assets in the liquidity reserve or supplemental liquidity buffer would enable the bank to continue funding its operations if market access is impeded.

One bank commented that our approach compels System banks to engage in management practices that focus on regulatory compliance rather than sound liquidity management. The FCA disagrees with the commenter. No conflict exists between compliance with this regulation and sound liquidity management practices at System banks. To the contrary, regulatory compliance works in tandem with sound and disciplined liquidity management practices at financial institutions. In fact, sound management practices already in place at System banks influenced us as we developed this regulatory requirement.

The Council, on behalf of System banks, offered comments and suggestions about each of the seven different issues that proposed § 615.5134(a)(2) requires every FCS bank to address, at a minimum, in its liquidity policy. As explained in greater detail below, we revised § 615.5134(a)(2)(i) by reducing the number of issues that the board's policy must address from seven to five. Additionally, we modified some of the provisions in § 615.5134(a)(2) to address the commenters' concerns. However, we also retained other provisions of proposed § 615.5134(a)(2) without revision.

Proposed § 615.5134(a)(2)(i) would require the bank's policy to address the purpose and objectives of the liquidity reserve. The preamble to the proposed rule stated that this section of the bank's policies should distinguish the purpose and objectives of the liquidity reserve from the other operations and asset-liability functions of the bank, including management of interest rate risk.[26] Effective liquidity management at a Farm Credit bank should reflect its board's philosophy and position about the purpose and objective of the liquidity reserve.[27] When market access becomes impeded, the liquidity reserve should enable each Farm Credit bank to maintain sufficient cash flows to pay its obligations, meet its collateral needs, and fund operations in a safe and sound manner.[28] The preamble to the proposed rule observed that § 615.5134(a)(2)(i) would help instill greater discipline in liquidity risk management at System banks by requiring them to shift their focus from the financial performance of the liquidity reserve to its primary function as an emergency source of funding.[29]

[26] *Id.*

[27] *Id.*

[28] *Id.*

[29] *Id.*

The Council commented that proposed § 615.5134(a)(2)(i) addresses a ''superfluous and self-evident matter'' that needs no regulation. The commenter also took issue with our position that the board's liquidity policy should distinguish liquidity management from asset-liability management by stating that there is no reason why any bank would confuse the two.

The commenter has not persuaded us to omit § 615.5134(a)(2)(i) from the final rule. Our reasons for incorporating this provision into the revised liquidity rule remain valid and, therefore, we adopt § 615.5134(a)(1)(i) as a final regulation without change. This provision does not add a new regulatory requirement for FCS banks. Since 1993, our investment management regulation at § 615.5133 has required the boards of Farm Credit banks to adopt written policies that address the purpose and objectives of the banks' investments, including those held for liquidity.

Adding a provision to the liquidity regulation that specifically requires bank boards to address the purpose and objectives of the liquidity reserve in written policies strengthens the System's safety and soundness by instilling greater discipline in the liquidity risk management practices at System banks. An integrated approach to all aspects of asset-liability management is crucial to safety and soundness, and in this context, System liquidity reserves must be adequately stocked so each bank can pay its debts and fund its operations when deteriorating economic and financial conditions obstruct market access. The goal of § 615.5134(a)(2)(i) is to prompt boards and senior management to more carefully consider how various types of prospective investments help counteract liquidity risk to their banks. A policy that specifically focuses on the purpose and objectives of the liquidity reserves will guide each bank to select a proper mix of high-quality liquid assets that will counteract liquidity risk to the bank based on the complexity of its operations and its risk tolerance level. In addition to their liquidity reserves, System banks may hold other eligible investments for the purposes of managing interest rate risks and investing surplus short-term funds.

The commenter also disputed our preamble statements that the liquidity reserve is primarily an emergency source of funding. We already responded to this particular comment earlier in the discussion above about GSE status.

Proposed § 615.5134(a)(2)(ii) would require the board's liquidity policy to establish diversification requirements for the liquidity reserve portfolio.[30] For safety and soundness reasons, this diversification requirement would apply both to the liquidity reserve and supplemental liquidity buffer. As the FCA observed in the preamble to the proposed rule, diversification by tenor, issuer, issuer type, maturity, size, asset type, and other factors can reduce certain investment risks.[31] The diversification policy should establish a desired mix of cash and investments that the bank should hold for liquidity under a variety of scenarios, including both normal and adverse conditions.[32] Each bank should tailor its diversification policy so it is consistent with regulatory requirements, as well as the bank's individual needs and financial condition. Additionally, the diversification policy should be revised in response to changes in the business environment and the bank's circumstances.[33] In formulating these criteria, each bank would consider, in light of its needs and circumstances, how diversification would better enable it to always maintain sufficient liquidity to pay its obligations and continue operations if market access is curtailed or fully impeded.

The FCA received comments about proposed § 615.5134(a)(2)(ii) from the Council and a System bank. The Council found this requirement redundant to the diversification requirement in the investment management rule. The commenter asked the FCA to omit § 615.5134(a)(2)(ii) from the final rule, because it ''is unnecessary and * * * creates a complex and confusing layering of the regulatory requirements in the investment area.''

The FCA retains § 615.5134(a)(2)(ii) as a provision in the final rule without revision. Diversification of the liquidity portfolios at Farm Credit banks is essential to the System's overall safety and soundness, especially because the FCS is a GSE that finances primarily the agricultural sector of the economy and it currently has no assured governmental lender of last resort. The liquidity portfolio serves a different function than other segments of the investment portfolio that the bank relies on for other asset-liability risk management purposes. The 90-day liquidity reserve, for example, should be comprised of cash and high quality, shorter-term, and consequently lower-yielding liquid investments, whereas these kinds of assets may not necessarily be suitable for other investment purposes. For this reason, the FCA expects bank policies to focus on, and specifically address diversification of the liquidity portfolio separately from the diversification of other segments of the investment portfolio.

A Farm Credit bank commented on a preamble passage, which stated that the policy must: (1) Address the desired mix of cash and investments that FCS banks should hold under a variety of scenarios; and (2) establish criteria for diversifying assets based on issuers, maturities, and other relevant factors. The commenter stated that these sorts of specific matter can and do change daily, which requires management to quickly respond. From the commenter's perspective, § 615.5134(a)(2)(ii) should not require boards to embed such specific details into a policy that cannot be quickly changed as an adverse scenario unfolds. In the commenter's opinion, this regulatory diversification requirement eliminates senior management's ability to exercise discretion and judgment to respond to a looming threat to the bank's liquidity. This commenter also perceives this and other provisions of proposed § 615.5134(a)(2) as inappropriately blurring the board's responsibilities to set policy parameters with senior management's duty to establish best practices and operational procedures for day-to-day operations.

The FCA responds that this provision requires the board to establish general parameters about diversification. Senior management works within the confines of the board's policy. Senior management should have the opportunity to provide input as the board develops its diversification policy for the bank's liquidity portfolio. This input should result in a diversification policy that enables senior management to adjust the composition of the liquidity portfolio as part of its daily operation of the bank in accordance with board policy.

Proposed § 615.5134(a)(2)(iii) would require board policies to establish maturity limits and credit quality standards for investments that the bank holds in its liquidity reserves. The preamble to the proposed rule explained this aspect of the bank's policies would help management to target and match cash inflows from loans and investments to outflows needed to pay its maturing obligations.[34]

The FCA received a comment about proposed § 615.5134(a)(2)(iii) from the Council. The commenter agrees that the liquidity policy needs to address the composition of investments that System banks hold in their liquidity reserve. However, the commenter asked us to delete this provision from the final rule because the provisions of § 615.5134(b), which pertain to different levels of the liquidity reserve, already addresses this issue with sufficient specificity. The FCA is persuaded by this comment, and it omits this provision from the final regulation.

The preamble to proposed § 615.5134(a)(2)(iii) discussed the credit quality standards for investments held in the bank's liquidity portfolio. According to the preamble, FCS banks may consider the credit ratings issued by a Nationally Recognized Statistical Rating Organization (NRSRO) when it determines the credit quality of a security, but it may not rely solely or disproportionally on such ratings. The FCA also asked for comments on approaches concerning creditworthiness standards for investments. The Council commented that the System appreciated the FCA's position on this issue, and referred us to its comments on this issue in previous rulemakings pertaining to investment management and capital. The FCA plans to address how FCS institutions should use external credit ratings to assess the credit quality of securities in these other rulemakings.

Under proposed § 615.5134(a)(2)(iv), the board's policy should cover the target number of days of liquidity that the bank needs, based on its business model and risk profile. Estimating the target number of days of liquidity that the bank will need to outlast various stress events is an effective tool for managing and mitigating liquidity risks.[35] The preamble to the proposed rule stated that the FCA expects each Farm Credit bank to include a prudent amount of unfunded commitments in its calculation of the target amount of liquidity it will need to survive a liquidity crisis in the markets.[36]

The FCA received a comment about proposed § 615.5134(a)(2)(iv) from the Council. The commenter agreed with this regulatory provision because it concurred that the days of liquidity target is an appropriate and logical risk tolerance measure that boards should include in their banks' policies. The FCA retains proposed

[30] The FCA plans to propose amendments to its eligible investment regulation, which in all likelihood, would address diversification of the entire investment portfolio. FCA's existing § 615.5133(c) requires diversification of credit, market, and liquidity risk in the investment portfolio.

[31] *See* 76 FR 80817, *supra.*

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] *Id.*

§ 615.5134(a)(2)(iv) without substantive change, but redesignates it as final § 615.5134(a)(2)(iii).

Proposed § 615.5134(a)(2)(v) would require bank policies to address the elements of the CFP in proposed § 615.5134(h). The CFP addresses unexpected events or unusual business conditions that increase liquidity risk at Farm Credit banks. One of the objectives of the proposed rule is to strengthen contingency funding planning at System banks. According to the preamble to proposed § 615.5134(a)(v), an effective CFP would cover at a minimum: (1) Strategies, policies, and procedures to manage a range of stress scenarios; (2) chains of communications and responsibility within the bank; and (3) implementation of the CFP during all phases of an adverse liquidity event.[37]

The Council and a System bank submitted comment letters opposing this provision. Both commenters encouraged us to delete this provision from the final rule. The commenters stated that when proposed § 615.5134(a)(v) is read literally, it seems to require the bank board to incorporate the entire CFP into its written policy. They advised us that the regulation should not require banks to document detailed operational procedures for the CFP in their policies. The bank pointed out that management may need to make practical operational changes that would have no significant impact on safety and soundness of the overall CFP. However, any such changes could require board approval if such procedures for the CFP are part of the policy. Accordingly, the commenters advised us that a more prudent approach is to require FCS banks to develop an effective CFP consistent with this regulation.

The FCA agrees with the commenters that it is impractical and burdensome to require the board to incorporate the entire CFP into its written policy. Additionally, incorporation of the CFP into the board's policy could limit management's ability to dynamically modify the CFP as conditions change. For these reasons, the FCA omits § 615.5134(a)(2)(v) from the final regulation.

Proposed § 615.5134(a)(2)(vi) would require the board's policy to address delegations of authority pertaining to the liquidity reserves.

The FCA received no comment about this regulatory provision. Accordingly, we adopt it as final § 615.5134(a)(2)(iv) without revision.

The final provision of proposed § 615.5134(a)(2) would require the board's policy to address reporting requirements, which at a minimum would require management to report to the board at least once every quarter about compliance with the bank's liquidity policy and the performance of the liquidity reserve portfolio. This provision would also require management to report any deviation from the bank's liquidity policy, or failure to meet the board's liquidity targets immediately to the board. The purpose of this provision is to ensure that an effective reporting process is in place, and management communicates accurate and timely information to the board about the level and sources of the bank's exposure to liquidity risk. These reports should enable the board to take prompt corrective action if any problems arise. The FCA expects the board to consider these quarterly reports when it conducts its annual review of the bank's liquidity policy and decides whether to make any revisions pursuant to § 615.5134(a)(1).

The Council commented on proposed § 615.5134(a)(2)(vii). Although the commenter agreed that a quarterly reporting requirement is prudent, it advised us that the requirement that senior management ''immediately report'' any deviation from the bank's policy or any failure to meet the liquidity targets was unworkable. The commenter asked us to clarify what level of deviation or failure would require senior management to ''immediately'' report to the board. The commenter also asked to quantify ''immediately.''

The FCA redesignates proposed § 615.5134(a)(2)(vii) as final § 615.5134(a)(v). We have also revised this provision to address the commenter's concerns. The first sentence of this provision remains unchanged. As such, the board's policy must require management to report to the board at least once every quarter about compliance with the bank's liquidity policy and the performance of the liquidity reserve portfolio. However, the FCA has amended the second sentence of this provision to require management to report any deviation from the bank's liquidity policy, or failure to meet the board's liquidity targets, to the board before the end of the quarter if such deviation or failure has the potential to cause material loss to the bank. This revision, which is self-explanatory, addresses the commenter's concern by requiring early reporting of deviations or failures that threaten the bank's liquidity or viability.

B. Liquidity Reserve and Discounts

The proposed rule contained three separate provisions that established a liquidity reserve requirement, addressed the composition of the liquidity reserve, and specified discounts for assets held in the liquidity reserve. More specifically, proposed § 615.5134(b) articulated the core liquidity reserve requirement for FCS banks, while proposed § 615.5134(e) governed the composition of the liquidity reserve, and proposed § 615.5134(g) specified the discounts for the different assets in bank liquidity reserve. We organized proposed § 615.5134(e) in a table format, while the other two provision were expressed in text.

The Council asked us to incorporate the discount table in the preamble to the proposed rule into the text of the final regulation. The commenter suggested that the table ''would be a superior and cleaner approach than the wording of the proposed regulation text.'' In accepting the commenter's advice, we decided to incorporate the discount table into final § 615.5134(b), rather than keeping it as a free-standing regulatory provision. As we reorganized and restructured the regulation, we realized that the final rule would be easier to read, understand, and implement if we also merged proposed § 615.5134(e) into final § 615.5134(b). We received no substantive comments about the specific discount percentages in proposed § 615.5134(g). Accordingly, we incorporate them into final § 615.5134(b) without amendment.

Proposed § 615.5134(b) would require each Farm Credit bank to maintain at all times a liquidity reserve sufficient to fund at least 90 days of the principal portion of maturing obligations and other borrowing of the bank. The Council and a System bank supported this provision. Accordingly, the FCA is retaining this core requirement as the first sentence of final § 615.5134(b) with one minor, stylistic revision.

The second sentence of proposed § 615.5134(b) would require each System bank to maintain a supplemental liquidity buffer in accordance with proposed § 615.5134(f). As part of our restructuring and reorganization of the final liquidity regulation, this sentence has been removed from final § 615.5134(b), although final § 615.5134(e) still requires all Farm Credit banks to maintain a supplemental liquidity buffer. We received several substantive comments about the supplemental liquidity buffer, which we will address below in the preamble to final § 615.5134(e).

[37] 76 FR 80817, *supra.* at 80821.

The third sentence of proposed § 615.5134(b) would require FCS banks to discount liquid assets in accordance with proposed § 615.5134(g). As addressed above, we have incorporated proposed § 615.5134(g) into final § 615.5134(b) without substantive revision.

The final sentence of proposed § 615.5134(b) states that the liquidity reserve must be comprised only of cash, including cash due from traded but not yet settled debt, and qualified eligible investments under § 615.5140 that are unencumbered and marketable under proposed § 615.5134(c) and (d). Both the existing and proposed regulations specify that the liquidity reserve must be comprised of cash, including cash due from traded but not yet settled debt, and qualified eligible investments under § 615.5140. We received no comment about this requirement.

The final sentence of proposed § 615.5134(b) differs from the existing rule in that it requires all investments held in the liquidity reserve to be marketable under proposed § 615.5134(d). The FCA received several comments about our definition of ''marketability'' in proposed § 615.5134(d), and how this definition applied to the bank's liquidity assets in different situations. The FCA responded to the commenters' concerns by adjusting the definition of ''marketable'' in final § 615.5134(d), and discussing their concerns in the appropriate preamble section below.

Proposed § 615.5134(e) addressed the composition of the liquidity reserve. The first two sentences of the proposed rule contained cross-references to proposed § 615.5134(b) and (e). The FCA has omitted these cross-references from the final rule because they are superfluous now that the FCA has combined all three paragraphs into a single provision.

More substantively, the FCA proposed for the first time to divide the 90-day liquidity reserve into two levels. Under our original proposal, the first level of the liquidity reserve would provide the bank with sufficient liquidity to pay its obligations and continue operations for 30 days if market access became partially or fully impeded during a national security emergency, a natural disaster, or intense economic or financial turmoil. The proposed rule would require FCS banks to use the instruments in the first level of the liquidity reserve to meet obligations that mature starting on day 1 through day 30. Additionally, the proposed rule would mandate that cash and certain instruments with a final maturity of 3 years or less comprise at least 15 days of the first level of the liquidity reserve. The 15-day sublevel would provide the bank with enough cash and short-term, highly liquid assets so it could pay its obligations and fund its operations for 15 consecutive days during an emergency when the debt markets are closed, or the System's funding costs become untenable.

Final § 615.5134(b) divides the liquidity reserve into three levels. This revision is part of our efforts to restructure and reorganize this provision so it is easier to read, understand, and apply, as the commenters requested. However, this revision is not substantive. Under final § 615.5134(b), the first level of the liquidity reserve covers obligations that mature on days 1 through 15. Similarly, level 2 applies to days 16 through 30, while level 3 covers days 31 through 90. This revision improves the clarity of the regulation by more clearly communicating: (1) The exact period of time each level of the liquidity reserve covers; and (2) which assets a bank may hold in each level.

The table in proposed § 615.5134(e) identified the assets that would comprise Level 1 of the bank's liquidity reserve. All of these assets are highly liquid because they are either cash, or investments that are high quality, close to their maturity, and marketable. Under the proposed rule, Farm Credit banks could hold the following assets in Level 1 of their liquidity reserve:

- Cash (including cash balances on hand, cash due from traded but not yet settled debt, insured deposits held at federally insured depository institutions in the United States;
- United States Treasury securities that have final maturities and other characteristics that would best enable the bank to fund operations if market access becomes obstructed;
- Other *marketable* obligations backed by the full faith and credit of the United States [38];
- MBS issued by the Government National Mortgage Association (Ginnie Mae);
- Senior debt securities of Government-sponsored agencies that mature within 60 days, excluding the debt securities of FCS banks and Farmer Mac; and
- Diversified investment funds that are comprised exclusively of Level 1 instruments.

Under the proposed rule, the second level of the liquidity reserve would provide System banks with sufficient liquidity to fund their obligations and continue operations for the next 60 days (days 31 through 90). Under proposed § 615.5134(e), FCS banks would hold Level 2 assets to mitigate liquidity risks associated with a prolonged stress event. Level 2 investments would include:

- Additional amounts of Level 1 investments;
- Government-sponsored agency senior debt obligations with maturities that exceed 60 days, excluding FCS debt securities;
- Government-sponsored agency MBS; and
- Diversified investment funds that are comprised exclusively of Levels 1 and 2 instruments.

The FCA received no comments that opposed the assets that the proposed rule designated for the liquidity reserve. Under final and redesignated § 615.5134(b), Level 1 assets are:

- Cash (including cash balances on hand, cash due from traded but not yet settled debt, insured deposits held at federally insured depository institutions in the United States;
- Overnight money market instruments;
- Obligations of the United States with a final remaining maturity of 3 years or less;
- Senior debt securities of Government-sponsored agencies that mature within 60 days, excluding the debt securities of FCS banks and Farmer Mac; and
- Diversified investment funds that are comprised exclusively of Level 1 instruments.

In the proposed rule, we inadvertently excluded overnight money market investments from the list of highly liquid assets that FCS banks could hold in the first 15 days of their liquidity reserve. Overnight money market investments are promptly convertible into cash at their face value, and as their name implies, they mature overnight. As a result, these assets have characteristics that are similar to cash. Adding overnight money market investments to the list of assets that FCS banks are authorized to hold in Level 1 of the liquidity reserve should raise no objection or controversy. It is a standard practice of financial institutions to hold overnight money market investments for liquidity. For this reason, we have included these instruments in the list of highly liquid assets that FCS banks are authorized to hold in their liquidity reserve.

Under the final rule, the following assets qualify for Level 2 of the liquidity reserve:

[38] Obligations that are backed by the full faith and credit of the United States, but are not marketable, are ineligible for the bank's liquidity reserve under § 615.5134(d).

- Additional Level 1 instruments;
- Obligations of the United States with a final remaining maturity of more than 3 years;
- MBS that are backed by the full faith and credit of the United States as to the timely repayment of principal and interest; and
- Diversified investment funds comprised exclusively of Level 1 and Level 2 instruments.

Under the final rule, Level 3 assets are:

- Additional Level 1 and Level 2 instruments;
- Government-sponsored agency senior debt securities with maturities exceeding 60 days, excluding the senior debt securities of FCS banks and Farmer Mac;
- Government-sponsored agency MBS that the timely repayment of principal and interest is not explicitly backed by the full faith and credit of the United States;
- Money market instruments maturing within 90 days; and
- Diversified investment funds comprised exclusively of Levels 1, 2, and 3 instruments.

The Council and two Farm Credit banks submitted substantive comments about concerns they had with three policy positions that the FCA articulated in the preamble to proposed § 615.5134(e). Only one of these concerns necessitates an adjustment to the regulation. We respond to the two other issues below.

One FCS bank acknowledged that proposed § 615.5134(e) was remarkably close to the practices that FCS banks already follow. According to the commenter, System banks voluntarily maintain 15 days of ''pristine'' liquidity, followed by a sufficient amount of high quality assets that provide liquidity for the next 60 days. Beyond that, FCS banks comply with current regulatory minimum of 90 days of liquidity with other investments. The commenter pointed out that all Farm Credit banks have voluntarily agreed to hold at least 120 days of liquidity.

However, this bank along with the Council commented that proposed § 615.5134(e) introduces greater complexity and burden to liquidity management in a way that does not strengthen the liquidity of any FCS bank. The commenters illustrated the System's concern by pointing to a passage in the preamble to the proposed rule which stated that FCS banks would first draw on the 15-day sublevel in the event of significant stress. The commenters advised us that drawing down instruments in the 15 days of ''pristine'' instruments may not necessarily be the best approach for a bank to take in certain scenarios. According to the commenters, the bank may anticipate more difficult market conditions in the future and, therefore, it may decide that a more prudent approach is to continue holding its most ''pristine'' liquid assets in place. Thereby, other factors may favor the sale of the least ''pristine'' liquid assets first. The commenters expressed concern that our interpretation of proposed § 615.5134(e) would deny System banks the flexibility to determine which assets in the liquidity reserve to draw upon first during a crisis.

The commenters' concerns have merit. The FCA confirms that final § 615.5134(b) does not prescribe which assets in the liquidity reserve a System bank must draw upon first during a crisis. Instead, the final rule will leave this matter to the discretion of the bank. Changes to the text and format of § 615.5134(b) clarify that the final regulation does not require FCS banks to liquidate their most ''pristine'' liquid assets first during times of market stress. Additionally, language in the proposed rule that would have required FCS banks to ''sequentially apply'' specific instruments to obligations that mature within specified timeframes has been omitted from the final rule. Finally, the FCA modified the text of the provision so it requires each Farm Credit bank to structure its liquidity reserve so that it has sufficient assets of various calibers to meet obligations that mature within each of the specified timeframes. These changes signal that each bank has discretion to liquidate assets in whatever order that best serves its interests as it responds to mounting distress in the markets.

Next, the Council asked us to clarify a passage in the preamble which stated that ''each FCS bank must document and be able to demonstrate to FCA examiners how its liquidity reserve mitigates the liquidity risk posed by the bank's business mix, balance sheet structure, cash flows, and on-and-off balance sheet obligations.'' The commenter wanted to know if this preamble statement signals that the FCA is increasing documentation requirements on FCS banks, and subjecting their liquidity practices to more stringent examination. After noting that FCS banks currently document and demonstrate compliance with our liquidity regulations to FCA examiners, the commenter requested that FCA examiners maintain open lines of communication with the directors and senior managers of System banks instead of making examinations of liquidity more rigorous.

The FCA responds that the commenter is misconstruing the preamble passage. The commenter is referring to a broader preamble passage which verified that proposed § 615.5134(e) would allow each FCS bank to exceed the *minimum* 90-day liquidity reserve requirement based on its individual liquidity needs. As the preamble to the proposed rule discussed, each bank must determine the appropriate level, size, and quality of its liquidity reserve based on its liquidity risk profile so it is able to meet both expected and unexpected cash flows and collateral needs without adversely affecting its daily operations and financial condition. The size and level of the liquidity reserve should also correlate to the bank's ability to fund its obligations at reasonable cost.

The preamble passage in question reaffirms the FCA's longstanding position that each FCS bank must be able to demonstrate to FCA examiners how its liquidity reserves mitigate the liquidity risk posed by the bank's business mix, balance sheet structure, cash flows, and on- and off-balance sheet obligations. This preamble statement does not signal that the FCA is changing its approach to examining liquidity at System banks, or that such examinations will now become confrontational. Instead, it indicates how the FCA will apply its longstanding examination approach to the new liquidity regulation.

The Council and a Farm Credit bank commented about the role that MBS and collateralized mortgage obligations (CMOs) issued or guaranteed by a Government agency or a Government-sponsored agency [39] play in a bank's liquidity reserve under proposed § 615.5134(e). Under the proposed rule, FCS banks could hold: (1) MBS issued by Ginnie Mae in Level 1 of the liquidity reserve; and (2) Government-sponsored agency MBS (primarily issued by Fannie Mae and Freddie Mac) in Level 2. The commenters expressed concern that our proposal excluded MBS and CMOs that are guaranteed by Ginnie Mae, Fannie Mae, and Freddie

[39] Our regulation, § 615.5131, defines a ''government agency'' as ''the United States Government or an agency, instrumentality, or corporation of the United States Government whose obligations *are* fully and explicitly insured or guaranteed as to the timely repayment of principal and interest by the full faith and credit of the United States Government.'' The same regulation defines a ''Government-sponsored agency'' as ''an agency, instrumentality, or corporation chartered or established to serve public purposes specified by the United States Congress but whose obligations *are not* fully and explicitly insured or guaranteed by the full faith and credit of the United States Government, including but not limited to any Government-sponsored enterprise.''

Mac from both levels of the liquidity reserve.

These two commenters want the final rule to authorize Farm Credit banks to hold MBS and CMOs issued or guaranteed by Ginnie Mae and the two Government-sponsored agencies in both Levels 1 and 2 of their liquidity reserves because these instruments, in their opinion, are inherently liquid and marketable. The commenters asked us to explicitly recognize that such investments are consistent with the definition of ''marketable'' in § 615.5134(d) because of the ease and certainty of their valuation. The commenters contend that the FCA is more restrictive than the Board of Governors for the Federal Reserve System, which proposed to allow systemically important financial institutions (SIFIs) to include unencumbered government and agency guaranteed MBS and CMO in their 30-day liquidity reserves.[40]

These comments appear to be based on a passage in another section of the preamble which stated that the regulation, in practice, effectively excludes structured investments from the liquidity reserve at FCS banks, although banks could hold these assets in their supplemental liquidity buffer.[41] This same preamble passage carved out an exception that would allow System banks to hold MBS issued by Ginnie Mae in their liquidity reserves because they are highly marketable securities backed by the full faith and credit of the United States.

Our regulatory approach towards the MBS of Ginnie Mae, Fannie Mae, and Freddie Mac is rooted in safety and soundness considerations. A diverse selection of MBS instruments is available in the markets, each exhibiting different credit, prepayment, and other risks. As a result of the risk factors, many of these instruments are less suitable for the higher levels of the liquidity reserve although they may generate more earnings for the bank. The 2008 crisis illustrated the limitations of MBS as a liquidity backstop.

For these reasons, the FCA's regulatory approach assigns different categories of MBS to different levels of the liquidity reserve based on their liquidity characteristics. Final § 615.5134(b) excludes MBS from the first level of the liquidity reserve (days 1 through 15) because they lack the liquidity characteristics of cash, overnight money market instruments, United States Treasuries with a final remaining maturity of 3 years or less, or the senior debt securities of Government-sponsored agencies that mature within 60 days. Under the final rule, MBS and CMOs issued or guaranteed by a Government agency or a Government-sponsored agency qualify for either Level 2 or Level 3 of the bank's liquidity reserve. The liquidity characteristics and risk profiles of these Ginnie Mae, Fannie Mae, or Freddie Mac MBS or CMOs determine whether they belong in Level 2 or Level 3 of the liquidity reserve.

The final rule does not treat all MBS and CMOs of government agencies and Government-sponsored agencies equally, as the commenters requested. As discussed above, Ginnie Mae, Fannie Mae, and Freddie Mac offer a diverse array of MBS, and each exhibits different liquidity characteristics and risk factors. The final rule recognizes these differences by assigning MBS and CMOs issued or guaranteed by Ginnie Mae, Fannie Mae, and Freddie Mac to different levels of the liquidity reserve.

Fannie Mae and Freddie Mac are currently under the conservatorship of the United States Treasury, and their long-term status is uncertain. This complicates the FCA's efforts to devise an approach that balances our safety and soundness concerns with the needs of System banks for flexibility in selecting Ginnie Mae, Fannie Mae, and Freddie Mac MBS for their liquidity reserves. While the ultimate status of Fannie Mae and Freddie Mac is unresolved, the FCA has decided that the full faith and credit of the United States is the standard that determines whether particular MBS or CMOs belong in Level 2 or Level 3 of the bank's liquidity reserve. Under the final rule, MBS that are issued or guaranteed by Ginnie Mae, Fannie Mae, and Freddie Mac qualify for Level 2 of the liquidity reserve if they are explicitly backed by the full and credit of the United States as to the timely payment of principal and interest. Conversely, MBS that are issued or guaranteed by Fannie Mae and Freddie Mac belong in Level 3 of the liquidity reserve if the timely payment of principal and interest are not explicitly backed by the full faith and credit of the United States. The reason the final rule relegates MBS of Government-sponsored agencies that are not explicitly backed by the full faith and credit of the United States to Level 3 of the liquidity reserve is because they could potentially experience reduced marketability during a widespread market crisis.

We are unable to confirm, as the commenter requests, that all Government-sponsored agency MBS are automatically marketable within the meaning of § 615.5134(d). Their ''ease and certainty of valuation'' depends on whether they exhibit low market risks under stressful conditions. We note that the Federal banking regulators continue to require depository institutions to risk weight the MBS of Fannie Mae and Freddie Mac at 20 percent, while the MBS of Ginnie Mae are risk weighted at zero. Under the circumstances, the FCA does not conclude that Fannie Mae and Freddie Mac MBS have the same low risks and ease of valuation as Ginnie Mae MBS. This is another reason why the final rule does not treat all MBS of government agencies and Government-sponsored agencies the same.

The approach that the Board of Governors of the Federal Reserve System follows for SIFIs is not appropriate for FCS banks in this situation. FCS banks are GSEs that primarily finance a single industry, and they have no assured government lender of last resort. Some FCS banks were vulnerable to an overabundance of MBS of Government-sponsored agencies in their liquidity portfolios during the 2008 crisis. SIFIs are large, diversified, and complex organizations that have a different risk profile than FCS banks. In contrast to SIFIs and federally chartered or federally insured commercial banks, FCS banks do not have assured access to the discount windows at Federal Reserve Banks. Under the circumstances, there is no certainty that the Federal Reserve Banks would extend lines of credit to Farm Credit banks during times of stress and accept MBS as collateral.

The preamble to the proposed rule stated that the FCA was contemplating whether to add a specific provision to the final regulation that would require the liquidity reserve to cover unfunded commitments and other contingent obligations. As the preamble observed, unfunded commitments and other material contingent obligations potentially expose FCS banks to significant safety and soundness risk. Requiring FCS banks to hold sufficient liquidity to cover unfunded commitments and other contingencies would mitigate risks that pose a threat to their liquidity, solvency, and viability, but it could also impose significant burdens and opportunity costs on these System banks. For this reason, we asked the public whether the final rule should explicitly require the liquidity reserve to cover unfunded commitments and other contingency, and if so, under what conditions.

The Council, on behalf of System banks, responded that the FCA should wait until the Federal banking agencies

[40] *See* 77 FR 594, 609 (Jan. 5, 2012).

[41] *See* 76 FR 80817 *supra.* at 80822.

finalize Basel III guidance for the calculation of the liquidity coverage ratio and net stable funding ratio. Under the circumstances, the commenter recommended that we subsequently address this matter in another rulemaking, or through policy guidance. The FCA agrees, and has not added a provision addressing unfunded commitments and other contingencies to final § 615.5134(b) during this rulemaking. Instead, the FCA will pay close attention to how the Basel Committee and the Federal banking agencies address unfunded commitments. If appropriate, the FCA will revisit this issue at a later time.

C. Unencumbered Investments in the Liquidity Reserve

Currently, existing § 615.5134(b) requires all investments that System banks hold to meet their liquidity reserve requirement to be free of lien. The proposed rule would expand upon this concept by requiring FCS banks to hold only unencumbered assets in their liquidity reserve. Under proposed § 615.5134(c), an asset is unencumbered if it is free of lien and is not explicitly or implicitly pledged to secure, collateralize, or enhance the credit of any transaction. Proposed § 615.5134(c) also would prohibit any FCS bank from using an investment in the liquidity reserve as a hedge against interest rate risk pursuant to § 615.5135 if liquidation of that particular investment would expose the bank to a material risk of loss. As the FCA explained in the preamble to the proposed rule, unencumbered investments are free of the impediments or restrictions that would otherwise curtail the bank's ability to liquidate them to pay its obligations when normal access to the debt market is obstructed.

The FCA received one comment about proposed § 615.5134(c) from the Council. The commenter agreed that investments in the liquidity reserve must be free of lien, and not pledged for any other purpose. However, the commenter opposed the provision in proposed § 615.5134(c) that would prohibit a Farm Credit bank from using an investment in the liquidity reserve as a hedge against interest rate risk pursuant to § 615.5134 if liquidation of the particular investment would expose the bank to a material risk of loss. Besides claiming that ''material risk of loss'' is an ambiguous standard, the commenter contends that this requirement is ''unreasonably limiting and complex.''

The commenter believes that our regulations should grant System banks greater flexibility to use liquid securities for multiple investment purposes. During normal times, securities that Farm Credit banks hold to manage interest rate risk can also provide liquidity without sacrificing the bank's hedge position. For this reason, the commenter claims that securities used to hedge interest rate risk are not diminished from a liquidity perspective. If economic or financial adversity impedes market access, the commenter asserts a System bank could prudently choose to sell a liquid security held as an interest rate hedge so it could raise funds to pay maturing obligations. Finally, the commenter claims that our position is inconsistent with the position of the Federal banking agencies, which only excludes investments from liquidity reserves when they are used to hedge trading assets.

The FCA retains, without revision, the last sentence in final § 615.5134(c), which prohibits a Farm Credit bank from using an unencumbered investment held in its liquidity reserve as a hedge against interest rate risk if liquidation would expose the bank to a material risk of loss. The objective of this regulatory provision is to require System banks to primarily concentrate on counteracting liquidity risks when they select assets for the 90-day liquidity reserve. As discussed elsewhere in this preamble, System banks must stock the liquidity reserve with cash and high-quality liquid securities that are readily convertible into cash at or close to their book value at times when market access becomes impeded. Farm Credit banks dilute the liquidity reserve's capacity to serve as an emergency source of funding when these assets are used for multiple purposes. The purpose of this provision is to ensure that liquidity is the dominant consideration of a System bank when it purchases a security for inclusion in its liquidity reserve. Farm Credit banks may, however, choose investments for the supplemental liquidity buffer that serve the dual purpose of mitigating liquidity risk and hedging interest rate risk.

Moreover, this provision does not ban System banks from hedging interest rate risk with assets held in the liquidity reserve. Instead, it specifically states that an unencumbered investment held in the liquidity reserve cannot be used as a hedge against interest rate risk *only if* liquidation of that particular investment would expose the bank to a material risk of loss. The FCA disagrees with the commenter that this provision is ambiguous about what constitutes a material risk of loss. Exposure to material risk of loss would depend on the risk profile and financial condition of each bank. A Farm Credit bank could be exposed to a material risk of loss if it must sell investments that double as hedges for interest rate risks in order to pay its obligations and fund its operations when market access is impeded. Once these securities have been sold, the bank will then have an exposure to interest rate risk that is no longer hedged. If its interest rate risk exposure is significant, the bank could incur a material risk of loss.

The Council claims that a Farm Credit bank could pledge these securities as collateral in a secured borrowing (repo) transaction, rather than liquidating its hedge position. A passage in the commenter's letter states that ''when used as collateral, these investments can generate liquidity without loss to the hedge position.''

In response, the FCA notes the repo market for certain types of securities may cease to function during economic or financial crises. In fact, during the 2008 crisis, many financial institutions discovered that they could not pledge many types of securities as collateral in the repo markets although in other circumstances these assets were liquid, marketable, and valuable as collateral. For these reasons, the FCA declines to change its position on this issue.

Finally, we address the Council's comment that our position is inconsistent with the position of the Federal banking agencies, which only excludes investments from liquidity reserves when they are used to hedge trading assets. Farm Credit banks generally hold investments until maturity, rather than trading for profit. As stated above, the final rule allows a System bank to hedge interest rate risk with assets held in the liquidity reserve provided that the hedging activity would not expose the bank to a material risk of loss in a liquidity crisis. Additionally, FCS banks may hold investments that hedge market risks in their supplemental liquidity buffers. From a safety and soundness perspective, the Federal banking agencies' position on this issue is not suitable for the FCS. The FCS is a GSE that lends almost exclusively to a single sector of the economy, it does not take deposits, and it lacks an assured governmental lender of last resort. These reasons justify the FCA's more conservative regulatory approach.

D. Marketable Security

Under our proposal, all eligible investments that a System bank hold in its liquidity reserve must be marketable. Proposed § 615.5134(d) specifies the criteria and attributes that determine whether investments are marketable for the purposes of this regulation. Investments that meet all the proposed marketability criteria would be deemed to possess the characteristics of high-quality liquid assets that are suitable for the liquidity reserve at each FCS bank. Proposed § 615.5134(d)(1) states that an investment is marketable if it:

1. Can be easily and immediately converted into cash with little or no loss in value;
2. Exhibits low credit and market risks;
3. Has ease and certainty of valuation; and
4. Can be easily bought or sold.

We received one comment on this section from the Council on behalf of the four System banks. The commenter stated that the four criteria impose ''an impossible and unworkably vague standard'' and suggested that the FCA adopt an approach that emphasized asset quality rather than marketability. The commenter raised objections to three of the four criteria described above. The commenter did not object to the second criterion, which specifies that a marketable investment displays low market and credit risks.

According to the commenter, the criterion that a marketable investment must be easily and immediately converted into cash with little or no loss in value is particularly problematic. The commenter claims that this criterion lacks specificity because it: (1) Cannot be applied in any consistent manner; and (2) is subject to varying interpretations over time. For this reason, the commenter asked us to revise the first criterion so that § 615.5134(d)(1) simply states that a marketable investment ''can be easily converted into cash.'' In the commenter's view, this change would allow Farm Credit banks to include more investments in their liquidity reserve after applying the appropriate discount. The commenter believes that its recommended approach is more logical and workable, and consistent with safety and soundness.

The FCA responds that section 4.3(c) of the Act requires Farm Credit banks to pledge certain securities as collateral for the debt obligations they issue. This provision of the Act includes marketable securities approved by the FCA as assets that System banks may pledge as collateral for their borrowings.

A Farm Credit bank should be able to sell any instrument that it holds for liquidity quickly and at close to its book value. The sale of a security for which the fair value and book value diverge significantly can affect capital and earnings to the extent that it exacerbates liquidity risks. Of particular concern is a situation where the sale of an investment held primarily for liquidity results in a significant loss. Such an outcome may mean that a System bank will not generate sufficient revenue from the liquidation of an asset to pay its obligations and fund its assets when it is experiencing significant stress. For this reason, we continue to believe that each System bank must be able to sell any investment held for liquidity purposes with no or minimal effect on its earnings. The commenter's suggestion that the final rule allow investments to qualify for the liquidity reserve if the bank can ''easily'' convert them into cash at a steep discount from their book value does not address our safety and soundness concerns. In fact, this recommendation would relax an existing safety and soundness standard rather than strengthen it.

However, the commenter's concern that proposed § 615.5134(d)(1) is not susceptible to consistent application and interpretation over time has merit. For this reason, we have changed ''immediately'' to ''quickly'' so FCS banks have clearer guidance and greater flexibility about converting liquid assets into cash. We consider ''quickly'' to mean hours or a few days even during adverse market conditions.

We received no comment about proposed § 615.5134(d)(2), which states that a marketable security exhibits low credit and market risks. This criterion is a vital safety and soundness standard for investments held in System bank's liquidity reserve. Accordingly, we adopt proposed § 615.5134(d)(2) as a final regulation without revision.

The Council asks the FCA whether proposed § 615.5134(d)(3), which would require marketable investments to have ease and certainty of valuation, would exclude structured investments, such as CMOs, particularly those issued by Government-sponsored agencies, from the liquidity reserves at Farm Credit banks. From the commenter's perspective, such a result would be inconsistent with both: (1) The objectives of the liquidity reserve requirement; and (2) with the approach taken by the Basel Committee and the Federal banking agencies.

The commenter's question stems from the preamble to proposed § 615.5134(d)(3), which stated that an instrument has ease and certainty of valuation if the components of its pricing formulation are publicly available. Additionally, the same preamble passage states that the pricing of high-quality liquid assets are usually easy to ascertain because they do not depend significantly on numerous assumptions. For these reasons, the preamble passage stated that proposed § 615.5134(d)(3) would ''in practice'' exclude most structured investments from System bank liquidity reserves. The preamble noted, however, that certain MBS, such as those issued by Ginnie Mae, are highly marketable under this criterion, and they would qualify for a System bank liquidity reserve.

The FCA responds that § 615.5134(d)(3) does not automatically include or exclude all structured investments, such as CMOs from bank liquidity reserves. Some CMOs have ease and certainty of valuation while others do not. For this reason, the FCA expects each bank to conduct due diligence on CMOs that it is considering for its liquidity reserve, and document its conclusions. Bank management should be able to explain its decision to FCA examiners.

Under proposed § 615.5134(d)(4), the final attribute of a marketable investment is that it can be easily bought or sold. As a general rule, money market instruments are easily bought and sold although they are not traded on a recognized exchange. Otherwise, proposed § 615.5134(d)(4) recognizes securities as ''marketable'' if they are listed on a developed and recognized exchange market. Listing on a public exchange enhances the transparency of the pricing mechanisms of the investment, which in turn, enhances its marketability and liquidity. An investment also would comply with the requirements of proposed § 615.5134(d)(4) if investors can sell or convert them into cash through repurchase agreements in active and sizeable markets, even in times of stress.

The commenter advised us to reconsider our approach to this requirement. The commenter pointed out that exchanges enhance transparency of the price of stock, but not bonds and other debt obligations. Another concern of the commenter is that references to trading on public exchanges may conflict with guidance for the treatment of investments under FASB Fair Value Classification. For this reason, the commenter asks that we omit the phrase ''developed and recognized exchange markets'' and reorganize this provision so it aligns with the approach of the Federal banking agencies.

The FCA acknowledges that this comment has merit. For this reason, final § 615.5134(d)(4) will now state that ''Except for money market instruments, can be easily bought and sold in active and sizeable markets without significantly affecting prices.'' This revision addresses the commenter's concerns while ensuring that instruments in System bank liquidity reserves are marketable because they can be easily bought and sold in active markets where their prices are transparent.

E. Supplemental Liquidity Buffer

The FCA proposed to strengthen liquidity management at Farm Credit banks by introducing the new concept of a supplemental liquidity buffer into this regulation. Proposed § 615.5134(f) would require all Farm Credit banks to establish and maintain a supplemental liquidity buffer that would provide a longer term, stable source of funding beyond the 90-day minimum liquidity reserve. The supplemental liquidity buffer would complement the 90-day minimum liquidity reserve. Whereas the primary purpose of the 90-minimum liquidity reserve is to furnish sufficient short-term funding to survive an immediate crisis, the supplemental liquidity buffer would enable Farm Credit banks to manage and mitigate liquidity risk over a longer time horizon.

Under proposed § 615.5134(f), Farm Credit banks would hold supplemental liquid assets that are specific and commensurate to the risks they face in maintaining stable longer term funding. Besides providing FCS banks with a longer term source of stable funding, each bank could draw on the supplemental liquidity buffer if a heavy demand for funds strains its 90-day minimum liquidity reserve during times of turbulence in the market. This supplemental liquidity buffer provides an additional cushion of liquidity that should enable FCS banks to endure prolonged periods of uncertainty. System banks could also deploy assets in the supplemental liquidity buffer to offset specific risks to liquidity that their boards have identified in their liquidity policies and CFPs.

Proposed § 615.5134(e) contained five provisions. First, as stated above, the proposed rule would require all FCS banks to hold liquid assets in excess of the 90-day minimum in the liquidity reserve. However, the proposed rule does not specify the length of time the supplemental liquidity buffer should cover. Second, proposed § 615.5134(f) states that the supplemental liquidity buffer be comprised of cash and qualified eligible investments listed in § 615.5140. As a result, this regulation would allow FCS banks to hold qualified eligible investments in their supplemental liquidity buffer that they could not hold in their 90-day liquidity reserve. Third, proposed § 615.5134(f) states that each bank must be able to liquidate any qualified investment in its supplemental liquidity buffer within the timeframe established by the board's liquidity policies at no less than 80 percent of its book value. Fourth, the proposed rule would require a Farm Credit bank to remove from its supplemental liquidity buffer any investment that has, at any time, a market value that is less than 80 percent of its book value. These two provisions are designed to limit losses that the bank may incur on assets held in its supplemental liquidity buffer. As we explained in the preamble to the proposed rule, the liquidity and marketability characteristics of qualified investments in the supplemental liquidity buffer would be called into question if their market value were to fall 20 percent or more below book value. Finally, proposed § 615.5134(f) would require the amount of supplemental liquidity that each bank holds, at a minimum, to: (1) Meet the requirements of the board's liquidity policy; (2) provide excess liquidity beyond the days covered by the liquidity reserve; and (3) comply with the applicable portions of the bank's CFP.

The FCA received comments about the supplemental liquidity buffer from the Council and three Farm Credit banks. None of these commenters opposed the new regulatory requirement that all FCS banks establish a supplemental liquidity buffer. In fact, one commenter pointed out that all the banks have mutually agreed to hold a minimum of 120 days of liquidity, and in practice actually have much more.

A Farm Credit bank commented that the supplemental liquidity reserve effectively increases the days of liquidity for System banks. As a result, the commenter claimed the supplemental liquidity buffer will compel System banks to further lengthen the maturity of their liabilities and potentially reduce the issuance of Discount Notes to fund their operations. The FCA has already responded to comments that assert our new liquidity regulation diminishes System reliance on discount notes. Before the 2008 crisis, FCS banks voluntarily held levels of liquidity far in excess of what the FCA requires under this final rule without detriment to the Discount Notes program.

The Council and two banks opposed two provisions in proposed § 615.5134(f) that would require the market value of all qualified investments in the bank's supplemental liquidity buffer to remain at or above 80 percent of book value. These commenters deem this benchmark as an inappropriate regulatory requirement because, in their opinion, it is subjective, inflexible, unduly restrictive, and arbitrary. According to these three commenters, interest rate fluctuations could cause the market value of an asset to fall below 80 percent of its book value, but the asset could, nevertheless, remain marketable and liquid. Although a System bank may be less willing to sell securities that have declined in market value, the commenters point out that it could still liquidate these assets in most circumstances if the need to raise cash arises. From the commenters' perspective, the premise that a 20-percent decline in value impairs the marketability and liquidity of a security lacks sound support or substantiation. For these reasons, the commenters ask the FCA to eliminate these two provisions from the final regulation.

Redesignated and final § 615.5134(e) continues to require every qualified investment in the bank's supplemental liquidity buffer to retain a market value that equals or exceeds 80 percent of its book value. The FCA reasons that the liquidity reserve, combined with the supplemental liquidity buffer significantly fortify each FCS bank and the System as a whole so they can withstand a future financial crisis. Requiring all qualified investments in the supplemental liquidity buffer to retain at least 80 percent of their book value ensures that each FCS bank has a sufficient quantity of high quality liquid assets to outlast adverse economic or financial conditions that obstruct the System's access to the debt market. We are concerned that liquidation of assets at a loss would be problematic at any time, but especially during a crisis. Investments that can be liquidated only at substantial discounts may not provide the bank with adequate funds to pay its obligations when market access becomes impeded and, therefore, they would not comprise a stable funding source during times of financial stress. Also, the resulting recognition of loss could further exacerbate the financial stress being experienced by an individual FCS bank and the entire System. Additionally, if these types of investments could not be liquidated, or could be sold only at a significant loss, the alternative of a repo transaction to provide liquidity at that level of discount would most likely not be available given concerns as to their actual value. This 80-percent requirement ensures that all qualified investments in each bank's supplemental liquidity buffer provide a source of high quality assets that could be used to meet liquidity demands in various (short- to long-term) timeframes.

The FCA has revised its final rule so the 80-percent requirement is less burdensome to FCS banks. The proposed rule would have required banks to apply an 85-percent discount to all assets in the supplemental liquidity reserve that did not otherwise qualify for the different levels of the liquidity reserve. Under final § 615.5134(e), each investment in the supplemental liquidity buffer that has a market value of at least 80 percent of its book value, but does not qualify for Levels 1, 2, or 3 of the liquidity reserve, must be discounted to (multiplied by) 90 percent of its book value. This 90-percent discount is less steep than the 85-percent rate that the FCA originally proposed. Additionally, this 90-percent rate is more consistent with § 615.5134(b)(3) of our existing regulation which establishes a 90-percent discount for securities with greater risks.

F. Contingency Funding Plan (CFP)

The existing regulation requires all Farm Credit banks to have a contingency funding plan that addresses liquidity shortfalls during market disruptions. A CFP is a blueprint that helps financial institutions to respond to contingent liquidity events that may arise from external factors that adversely affect the financial system, or they may be specific to the conditions at an individual institution. The 2008 crisis revealed actual and potential vulnerabilities in contingency planning at FCS banks. As a result, the FCA proposed regulatory amendments that are designed to strengthen the System's contingency funding plans.

Proposed § 615.5134(h) would require each Farm Credit bank to have a CFP that ensures sources of liquidity are sufficient to fund normal operations under a variety of stress events. Whereas the existing regulation only requires the CFP to address liquidity shortfalls caused by market disruptions, the proposed rule would require the CFP to explicitly cover other stress events that threaten the bank's liquidity, such as: (1) Rapid increases in loan demand; (2) unexpected draws on unfunded commitments; (3) difficulties in renewing or replacing funding with desired terms or structures; (4) pledging collateral with counterparties; and (5) reduced market access.

Additionally, the proposed rule would require each FCS bank to maintain an adequate level of unencumbered and marketable assets in its liquidity reserve that could be converted into cash to meet its net liquidity needs based on estimated cash inflows and outflows for a 30-day time horizon under an acute stress scenario. The objective of this requirement is to instill discipline at each Farm Credit bank. As an integral and critical part of its contingency planning, the FCA expects each bank to be able to evaluate its expected funding needs and its available funding sources during reasonably foreseeable stress scenarios. In this context, the FCA expects each System bank to analyze its cash inflows and outflows, and its access to funding at different phases of a plausible, but acute, liquidity stress event that continues for 30 days.

Proposed § 615.5134(h) would require the CFP to address four specific areas that are essential to the bank's efforts to mitigate its liquidity risk. Taken together, these four areas constitute an emergency preparedness plan that should enable the bank to effectively cope with a full range of contingency that could endanger its liquidity. More specifically, the proposed rule would require the CFP to:

• Be customized to the financial condition and liquidity risk of the bank and the board's liquidity policy. As such, the CFP should be commensurate with the complexity, risk profile and scope of the bank's operations;

• Identify funding alternatives that the Farm Credit bank can implement whenever its access to funding is impeded. At a minimum, these funding alternatives must include arrangements for pledging collateral to secure funding and possible initiatives to raise additional capital;

• Mandate periodic stress testing, which would analyze the possible impacts on the bank's cash inflows and outflows, liquidity position, profitability and solvency under a variety of stress scenarios; and

• Establish a process for managing events that imperil the bank's liquidity, and assign appropriate personnel and implement executable action plans that carry out the CFP.

The Council and one Farm Credit bank commented on the proposed rule's provisions governing the CFP. The Council acknowledged that proposed § 615.5134(h) is consistent with the approach of the Federal banking agencies, but it judged the provision as ''too detailed.'' In the commenter's opinion, the provisions of proposed § 615.5134(h) are more appropriate for a policy statement, rather than a regulation. Accordingly, the commenter urged us to revert to the generalized approach of the existing regulation, which in the commenter's view, would grant Farm Credit banks greater flexibility to develop and implement the CFP as circumstances change over time.

The FCA denies this request. As explained earlier, the purpose of this regulatory provision is to correct deficiencies in contingency funding planning at FCS banks that the 2008 crisis revealed.

Contingency funding planning is an essential and crucial element of effective liquidity risk management that enables Farm Credit banks to meet their obligations and continue operations as economic or financial adversity strikes. The FCA's new approach requires the CFP to address specific core issues which are essential to the bank's ability to continue funding its normal operations under a variety of plausible stress scenarios. Additionally, our approach grants FCS banks the flexibility that the commenter seeks by stipulating that each bank must tailor its CFP to its unique liquidity risk profile and tolerance level. In this context, our regulatory approach strikes an appropriate balance by instilling greater discipline in the contingency funding planning process at Farm Credit banks while preserving the banks' flexibility to devise and revise a CFP that addresses its own unique circumstances and conditions.

Both commenters objected to the provision in the proposed rule that would require System banks to conduct periodic stress tests on their cash inflows and outflows, liquidity position, profitability and solvency under a variety of stress scenarios. According to these commenters, additional stress case scenarios are redundant with the investment management regulations, which already require quarterly stress tests. From the commenters' perspective, this new regulatory requirement does not improve effective liquidity management at FCS banks.

The FCA responds that redesignated and final § 615.5134(f)(3) specifically requires stress testing of those factors (such as the bank's cash inflow and outflows, liquidity position, profitability, and solvency) which are key indicators of liquidity. In contrast, the applicable provision of the investment management regulation, § 615.5133(f)(4), focuses on the stress testing in an asset-liability management context. Although some overlap exists, § 615.5133(f) and final and redesignated § 615.5134(f)(3) are neither duplicative, nor in conflict with each other. Instead, the two provisions complement each other as § 615.5133(f) addresses stress testing from a global prospective while final § 615.5134(f) requires specialized stress tests that probe the bank's ability to withstand shocks to its liquidity.

The Council asked the FCA to lessen the stress testing requirement for liquidity, which it views as unduly burdensome. The commenter claims that it would be more effective if managers spent more time on monitoring markets rather than performing ''numerous stress tests of implausible and improbable events.'' From the commenter's perspective, this stress testing requirement does not effectively improve safety and soundness, and the burdens of this provision outweigh its benefits.

The FCA disagrees that stress testing for liquidity will only marginally improve safety and soundness at System banks, or that this regulatory provision is unduly burdensome. The commenter has provided no evidence that stress testing distracts from the bank's ability to monitor markets. Stress tests should be appropriate for the bank's business model and the complexity of its operations. Similarly, stress tests should be based on plausible and probable assumptions concerning stress events that could adversely affect the bank's ability to pay its obligations and continue normal operations during times of economic or financial turbulence. Stress testing is an integral part of effective liquidity risk management that will detect vulnerabilities in the bank's liquidity management early on so management can take corrective action. Appropriate stress testing is an effective liquidity risk management tool that effectively strengthens safety and soundness at FCS banks. From a regulatory perspective, the burdens of the stress testing requirement in final § 615.5134(f)(3) is minimal, while the benefits are great.

The FCA made three non-substantive technical corrections to this regulatory provision. The first sentence of proposed § 615.5134(h) has been broken into two sentences in final and redesignated § 615.5134(f). Additionally, the proposed rule defined stress events as ''including'' specific occurrences, whereas the final rule states that stress events ''include, but are not limited to'' these same occurrences. These changes clarify the scope of this provision without substantively altering its meaning. In the second to last sentence of the main paragraph of this provision, we changed ''based on estimated cash inflows and outflows for a 30-day time horizon under an acute stress scenario'' to ''based on estimated cash inflows and outflows under an acute stress scenario for 30 days.'' This revision corrects the grammar of this provision and enhances its clarity, without changing its meaning. Finally, we made two technical revisions in final and redesignated § 615.5134(f)(3). We changed ''Requiring periodic stress testing, which analyzes the possible impacts'' to ''Requiring periodic stress testing that analyzes the possible effects.'' Changing ''which'' to ''that'' corrects a grammatical error. We corrected the syntax of this provision by changing ''impacts'' to ''effects.'' In the context of this sentence, ''effects'' is more accurate than ''impacts.'' Neither of these revisions is substantive.

G. The FCA's Reservation of Authority

The FCA proposed to strengthen its supervisory and regulatory oversight of liquidity management at Farm Credit banks by adding a new reservation of authority provision to this regulation. Under proposed § 615.5134(i), the FCA would expressly reserve the right to require Farm Credit banks, either individually or jointly, to adjust their treatment of any asset in their liquidity reserves so they always maintain liquidity that is sufficient and commensurate for the risks they face.

The FCA justified this reservation of authority by invoking its Congressional mandate to ensure that FCS institutions comply with applicable laws, fulfill their public policy mission to finance agriculture and other specified activities in rural America, and operate safely and soundly. The Act grants the FCA comprehensive powers to examine, supervise, and regulate the FCS. The FCA reasoned that it must be able to act decisively when a sudden external crisis threatened the System's liquidity.

The Council and a Farm Credit bank opposed proposed § 615.5134(i), and asked the FCA to withdraw it.

After considering comments received, the FCA has decided to omit the reservation of authority from the final regulation. The FCA has comprehensive supervisory authority over all FCS institutions. As a result, the FCA through its examination and enforcement authorities can compel Farm Credit banks, individually or jointly, to promptly take specified action to correct deficiencies in their liquidity management practices if internal or external circumstances so warranted. By approving all obligations that FCS banks issue to fund System operations, and prescribing collateral requirements for such debt, the FCA has an additional mechanism for regulating System liquidity.[42]

As the commenters point out, the FCA may determine in other situations that the best course of action is to relax the liquidity requirements on FCS institutions. In fact, an existing regulation, § 615.5136, authorizes the FCA during an emergency to: (1) Increase the amount of eligible investments that FCS banks may hold pursuant to § 615.5132; or (2) waive or modify the liquidity reserve requirement. As noted in the preamble to the proposed rule, the FCA Board passed a Market Emergency Standby Resolution on November 13, 2008 that would waive the 90-day liquidity reserve requirement for a limited period of time if a crisis shuts or severely restricts the System's access to the debt markets.

For these reasons, the FCA determines it can effectively exercise its supervisory authority over FCS banks during times of economic, financial, or market adversity without inserting the reservation of authority into the liquidity regulation. Because we have omitted the reservation of authority from the final rule, we do not need to address whether it would have violated the APA.

VII. Regulatory Flexibility Act

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

List of Subjects in 12 CFR Part 615

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

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

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

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

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.8, 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,

[42] *See* Sections 4.2(c), 4.2(d), and 5.l7(a)(4)of the Act; 12 U.S.C. 2153(c), 2153(d), and 2252(a)(4).

2279aa-3, 2279aa-4, 2279aa-6, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a) of Pub. L. 100–233, 101 Stat. 1568, 1608.

■ 2. Revise § 615.5134 to read as follows:

§ 615.5134 Liquidity reserve.

(a) *Liquidity policy*—(1) *Board responsibility.* The board of each Farm Credit bank must adopt a written liquidity policy. The liquidity policy must be compatible with the investment management policies that the bank's board adopts pursuant to § 615.5133 of this part. At least once every year, the bank's board must review its liquidity policy, assess the sufficiency of its liquidity policy, and make any revisions it deems necessary. The board of each Farm Credit bank must ensure that adequate internal controls are in place so that management complies with and carries out this liquidity policy.

(2) *Policy content.* At a minimum, the liquidity policy of each Farm Credit bank must address:

(i) The purpose and objectives of the liquidity reserve;

(ii) Diversification requirements for the liquidity reserve portfolio;

(iii) The target amount of days of liquidity that the bank needs based on its business model and risk profile;

(iv) Delegations of authority pertaining to the liquidity reserve; and

(v) Reporting requirements, which at a minimum must require management to report to the board at least once every quarter about compliance with the bank's liquidity policy and the performance of the liquidity reserve portfolio. However, management must report any deviation from the bank's liquidity policy, or failure to meet the board's liquidity targets to the board before the end of the quarter if such deviation or failure has the potential to cause material loss to the bank.

(b) *Liquidity reserve requirement.* Each Farm Credit bank must maintain at all times a liquidity reserve sufficient to fund at least 90 days of the principal portion of maturing obligations and other borrowings of the bank. At a minimum, each Farm Credit Bank must hold instruments in its liquidity reserve listed and discounted in the Table below that are sufficient to cover:

(1) Days 1 through 15 only with Level 1 instruments;

(2) Days 16 through 30 only with Level 1 and Level 2 instruments; and

(3) Days 31 through 90 with Level 1, Level 2, and Level 3 instruments.

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 the United States with a final remaining maturity of 3 years or less.	97 percent.
	• Government-sponsored agency 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
Level 2	• Additional Level 1 investments	Discount for each Level 1 investment applies.
	• Obligations of the United States with a final remaining maturity of more than 3 years.	97 percent.
	• Mortgage-backed securities that are explicitly backed by the full faith and credit of the United States 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.
	• Government-sponsored agency 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.
	• Government-sponsored agency mortgage-backed securities that the timely repayment of principal and interest are not explicitly backed by the full faith and credit of the United States.	
	• Money market instruments maturing within 90 days.	
	• Diversified investment funds comprised exclusively of levels 1, 2, and 3 instruments.	

(c) *Unencumbered.* All investments that a Farm Credit bank holds in its liquidity reserve and supplemental liquidity buffer in accordance with this section must be unencumbered. For the purpose of this section, an investment is unencumbered if it is free of lien, and it is not explicitly or implicitly pledged to secure, collateralize, or enhance the credit of any transaction. Additionally, an unencumbered investment held in the liquidity reserve cannot be used as a hedge against interest rate risk if liquidation of that particular investment would expose the bank to a material risk of loss.

(d) *Marketable.* All investments that a Farm Credit bank holds in its liquidity reserve in accordance with this section must be readily marketable. For the purposes of this section, an investment is marketable if it:

(1) Can be easily and quickly converted into cash with little or no loss in value;

(2) Exhibits low credit and market risks;

(3) Has ease and certainty of valuation; and

(4) Except for money market instruments, can be easily bought and sold in active and sizeable markets without significantly affecting prices.

(e) *Supplemental liquidity buffer.* Each Farm Credit bank must hold supplemental liquid assets in excess of the 90-day minimum liquidity reserve. The supplemental liquidity buffer must be comprised of cash and qualified eligible investments authorized by § 615.5140 of this part. A Farm Credit bank must be able to liquidate any qualified eligible investment in its supplemental liquidity buffer within the liquidity policy timeframe established in the bank's liquidity policy at no less than 80 percent of its book value. A Farm Credit bank must remove from its supplemental liquidity buffer any investment that has, at any time, a market value that is less than 80 percent of its book value. Each investment in the supplemental liquidity buffer that has a market value of at least 80 percent of its book value, but does not qualify for Levels 1, 2, or 3 of the liquidity reserve, must be discounted to (multiplied by) 90 percent of its book value. The amount of supplemental liquidity that each Farm Credit bank holds, at minimum, must meet the requirements of its board's liquidity policy, provide excess liquidity beyond the days covered by the liquidity reserve, and satisfy the applicable portions of the bank's CFP in accordance with paragraph (f).

(f) *Contingency Funding Plan (CFP).* The board of each Farm Credit bank must adopt a CFP to ensure sources of liquidity are sufficient to fund normal operations under a variety of stress events. Such stress events include, but are not limited to market disruptions, rapid increase in loan demand, unexpected draws on unfunded commitments, difficulties in renewing or replacing funding with desired terms and structures, requirements to pledge collateral with counterparties, and reduced market access. Each Farm Credit bank must maintain an adequate level of unencumbered and marketable assets in its liquidity reserve that can be converted into cash to meet its net liquidity needs for 30 days based on estimated cash inflows and outflows under an acute stress scenario. The board of directors must review and approve the CFP at least once every year and make adjustments to reflect changes in the bank's risk profile and market conditions. The CFP must:

(1) Be customized to the financial condition and liquidity risk profile of the bank and the board's liquidity risk tolerance policy.

(2) Identify funding alternatives that the Farm Credit bank can implement whenever access to funding is impeded, which must include, at a minimum, arrangements for pledging collateral to secure funding and possible initiatives to raise additional capital.

(3) Require periodic stress testing that analyzes the possible effects on the bank's cash inflows and outflows, liquidity position, profitability and solvency under a variety of stress scenarios.

(4) Establish a process for managing events that imperil the bank's liquidity, and assign appropriate personnel and implement executable action plans that carry out the CFP.

Dated: April 12, 2013.

Dale L. Aultman,

Secretary, Farm Credit Administration Board.

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