

January 16, 2024

Via Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551
Attention: Ann E. Misback, Secretary
James P. Sheesley, Assistant Executive Secretary

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: Comments/Legal OES (RIN 3064-AF29)

Office of the Comptroller of the Currency
Chief Counsel's Office
400 7th Street, SW, Suite 3E-218
Washington, D.C. 20219
Attention: Comment Processing

Re: Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and Banking Organizations with Significant Trading Activity (Federal Reserve Docket No. R-1813; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008)

Ladies and Gentlemen:

The Federal Agricultural Mortgage Corporation (“Farmer Mac” or “we” or “us”) appreciates this opportunity to respond to the request for public comment on the referenced joint notice of proposed rulemaking (“NPR”) amending the capital requirements applicable to large banking organizations from the Federal Reserve, Office of Comptroller of the Currency, and Federal Deposit Insurance Corporation (collectively, the “Regulatory Agencies”). Farmer Mac recognizes that capital management is a critical component of the safety and soundness of financial institutions. This letter provides observations and insights that we believe support the maintenance of the existing regulatory capital framework.

I. Framework for the Treatment of Securitizations per the NPR

The NPR outlines the proposed framework for the treatment of securitizations. The securitization framework is designed to provide the capital requirement for exposures that involve the tranching of credit risk of one or more underlying financial exposures. The risk of loss posed by tranching varies across classes due to the structural mechanisms that are used to spread exposure across senior and subordinate tranches and distribute the risk of loss on the underlying assets accordingly.



The NPR lays out the proposed changes to risk-weighting of securitizations, including the operational criteria for recognizing the transfer of risk. Any organization that fails to meet these criteria must hold risk-based capital against the transferred exposures as if they had not been securitized. The operational criteria include the following:

1. Exposures are not reported on consolidated balance sheet under GAAP,
2. Transferred credit risk to one or more third parties,
3. Any clean-up calls relating to the securitization are eligible clean-up calls,
4. Securitization does not permit the borrower to draw varying amounts from the underlying exposures within an agreed limit or contain an early amortization provision.

We disagree with this proposal for securitizations. We believe this proposal does not adequately account for the transfer of risk to the investor of the securities through a legal sale of the securities to a variable interest entity (“VIE”) in which the firm retains a “variable interest” but shifts some or all of the credit risk of the underlying assets to the securitization investors. Risk mitigation techniques, such as securitizations, are a vital tool for balance sheet and risk management. Securitizations serve as an important way to transfer a portion of the risk of the underlying assets to investors of the securities through a legal sale; therefore, the full amount of risk exposure should not be disproportionately allocated to the firm based on generally accepted accounting principles (“GAAP”) regarding consolidation.

For securitizations, firms typically sell the assets to the VIE, without recourse, all its rights, title and interest in and to assets on their balance sheet, subject to market-based representations and warranties. We will use mortgage loans in the example below. Pursuant to an agreement, the firm will deliver possession of the promissory notes evidencing the mortgage loans to the custodian at the direction of a depositor and for the benefit of the issuing entity (on behalf of the investors). The cash consideration received by the firm for the sale of the mortgage loans pursuant to the purchase agreement represents the fair market value of the mortgage loans and is comparable to the terms that would apply to a similar transaction between unaffiliated third parties. There is no agreement or provision in the documents that provides that a firm will retain any ownership interest in the mortgage loans. Hence, this represents a legal sale.

Securitizations help provide flexibility for companies, especially during periods of volatility. For example, using the transfer of loans to a VIE during periods of volatile interest rates allows losses on the underlying assets to be absorbed by the subordinate tranches established within the securitization. Utilized as a risk management tool in this manner, tranching securitization helps firms to free up capital to provide capital and credit to consumers for housing, business and more, which is critical to economic growth. Any gains on the transfer of the loans to a VIE are excluded from the firm’s capital position, which is consistent with the treatment of risk-weighted assets; if a firm accounts for the transfer of risk, they should not receive the benefit of recognizing the gain in their capital position. However, if during periods of volatile interest rates, a firm wishes to execute a securitization, the market value of the underlying loans may be below their carrying value. In this circumstance, the loans would be transferred to the VIE at a loss, and the firm would be forced to include this loss in its capital position. This treatment is inconsistent with the treatment of the gain. The solution to this problem is for the firm to consolidate the securitization on its balance sheet, which allows it to legally transfer the credit risk of the underlying assets without generating a loss on sale through GAAP accounting.

Consolidating the assets on the sponsor's balance sheet, in accordance with GAAP, is not the equivalent of the sponsor retaining the credit risk of the pool of assets. Legally, the assets and credit risk are sold to the investors of the securitization. From a bankruptcy perspective, the assets are legally isolated from the estate of the sponsor, which transfers the risk of loss to the investor. The participants in a securitization transaction will typically obtain a legal opinion to support this position.

For risk-based capital ratios, securitizations are risk-weighted in accordance with the transfer of risk to the investors of the securities in accordance with a legal sale. For leveraged-based capital ratios, sponsors must also hold capital against the assets on their balance sheet, therefore, since the assets are consolidated.

Securitizations help firms serve as an important link connecting customers to the capital markets while further diversifying the firm's funding. If the revised framework under the NPR is adopted, it may discourage firms from executing further securitization transactions, particularly those transaction for which the issuing entity is consolidated under GAAP treatment but for which the credit risk has been legally transferred. Firms will retain more credit risk by avoiding securitization, and thus, more risk will be absorbed by the banking and financial services system rather than across capital markets through securitization. This may further adversely impact the accessibility of financing provided to customers, thus limiting access to capital and credit.

II. Framework for the Treatment of Equity Exposures per the NPR

The NPR outlines the proposed framework for the risk-weighting of equity exposures. The NPR would make a number of changes to the calculation of risk-weighted assets for credit risk to equity exposures under the Expanded Risk-Based (ERB) Approach, including eliminating the 100 percent risk weight for non-significant equity exposures up to 10 percent of total capital under the current capital rule. Per the NPR, an equity exposure that is not publicly traded and is not an equity exposure to an investment firm, would need to be assigned a 400 percent risk weight using the ERB Approach.

We disagree with this proposal for the treatment of non-publicly traded equity exposures. This change would lead to higher capital adequacy requirements for financial institutions that engage in the tax equity market, which finance many of the clean energy projects in the United States. In 2021, roughly 50% of the total US wind and solar capacity projects are financed by US GSIB banks, through the tax equity market¹.

First, this significant increase of the risk-weighting of tax equity investment exposure is not a reasonable response to the potential risks posed by the exposure. Tax equity investments are relatively safe due to the predictable nature of payments from the federal government and other project structuring features that allow tax equity investments to function more like a loan than an equity investment. The Federal Reserve treats a tax equity finance transaction as the functional equivalent of a loan if it meets the criteria laid out in 12 CFR 7.1025(c). Thus, it makes more sense for these equity exposures to be risk-weighted like loans rather than other equity exposures that do not have similar structural protections. Second, the proposed capital requirements will impede clean energy projects. According to policy analysis firm Capstone, annual tax equity investments in the clean energy sector could shrink by 80-90% under the proposed rule changes², meaning many projects may never come to fruition.

¹ Keith Martin, [Solar Tax Equity Structures](#), December 14, 2021

² Thomas Dee & Eric Scheriff, [Basel III and the Looming Threat to Tax Equity Market and Clean Energy Industry](#), October 2, 2023

This rule change could have the unintended consequence of hampering the financing of the renewable energy sector, which is counterproductive to the current administration's energy policy, evidenced by the Inflation Reduction Act (IRA) of 2022, and the Infrastructure Investment and Jobs Act (IIJA). These pieces of legislation aim to:

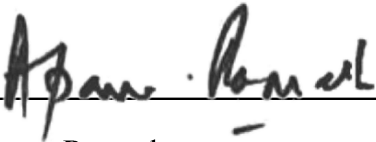
- Reduce greenhouse gas emissions by approximately one billion tons in 2030,
- New clean energy manufacturing investments, including investing billions of dollars in electric vehicle and solar manufacturing,
- Help communities become more resilient and protect them from the disastrous impacts of climate change, including drought, heat, and extreme weather,
- Make the largest investment in clean energy transmission and electric vehicle infrastructure in history.

Tax equity investments are an important vehicle for providing the financing needed to implement the projects needed to transform our nation's energy to a cleaner, more environmental-friendly sector that the current administration is seeking to create. The NPR could have a devastating effect on this transformation and many of the clean energy initiatives may stall in response.

We are requesting the Regulatory Agencies not adopt the proposed frameworks for the treatment of 1) securitizations, and 2) equity exposures outlined in the NPR. We believe the current treatment of securitizations for risk-based capital is appropriate as it properly accounts for the transfer of risk to the securitization investor through a legal sale while not disproportionately allocating the full amount of risk exposure to the firm's capital position. For the treatment of equity exposures, the proposed rule change significantly increases the risk-weighting for tax equity investments, which could have a devastating effect on the financing of projects needed to transform our nation's energy to a cleaner, more environmental-friendly sector that the current administration is seeking to create.

We thank you for the opportunity to comment on the referenced joint notice of proposed rulemaking. Farmer Mac appreciates the Regulatory Agencies' careful consideration of these comments in deciding whether to adopt this proposal.

Sincerely,



Aparna Ramesh
Chief Financial Officer & Treasurer