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Fact sheet on amendments and clarifications to the tier 1/tier 2 regulatory capital framework

Today the Farm Credit Administration board adopted a final rule that amends parts 614, 615, 620, and 628 of its regulations. The amendments to the tier 1/tier 2 capital framework clarify FCA's expectations; reduce burden where appropriate; make technical corrections; and incorporate, with appropriate adjustments, the guidance in FCA Bookletter BL-068 Tier 1/Tier 2 Capital Framework Guidance.

The final rule will become effective Jan. 1, 2022, or 30 days after publication in the Federal Register during which either or both houses of Congress are in session, whichever is later.

FCA's objectives in adopting this final rule are the following:

- To amend, correct, and clarify certain provisions in the tier 1/tier 2 capital framework
- To ensure the capital requirements of the Farm Credit System (FCS or System) continue to be comparable to the standardized approach of the federal banking regulatory agencies while accommodating the cooperative structure and the organization of the System

Summary of final revisions

Many of the final revisions incorporate into FCA's capital rule the guidance and direction previously communicated through BL-068. Others address technical or implementation issues identified through the examination process and ongoing monitoring of the System's implementation of the regulation.

- **Safe harbor framework revisions:** The final rule includes two revisions to clarify and simplify the regulatory framework under which System institutions are deemed to have received prior approval from FCA to make cash distributions:
 - *Safe harbor deemed prior approval (§ 628.20(f)(5)(ii)):* The final rule measures the year-over-year change in common equity tier 1 (CET1) capital as of the

- quarter-end in the quarter of distribution instead of using the exact distribution date.¹
- *Common cooperative equity issuance date (§ 628.2)*: The final rule adds a new definition of “common cooperative equity issuance date” to clarify the date on which the holding period (e.g., seven years for CET1 capital) starts for including certain cooperative equities in CET1 or tier 2 capital. In essence, the holding period starts on the end date of the quarter in which the instrument is recognized in the institution’s financial statements.²
 - **Bylaw or board resolution requirements**: The final rule amends the existing requirement under § 615.5200(d) that an institution’s board adopt a redemption and revivement resolution that it must reaffirm each year. Under the final rule, the board is required to adopt the resolution only once, and the institution’s annual capital plan must expressly acknowledge the resolution. In addition, the bylaw and board resolution requirements are moved from existing § 615.5200(d) to new § 628.21.
 - **Farm Credit Leasing Services Corporation**: The final rule no longer requires the Farm Credit Leasing Services Corporation to meet minimum capital and related regulatory requirements as a stand-alone entity because the Leasing Corporation is a wholly owned subsidiary of CoBank. As a result, this amendment results in no change to the amount of capital that must be held to capitalize the Leasing Corporation’s assets.
 - **Lending and leasing limit base (§ 614.4351)**: The final rule amends the computation of the lending and leasing limit base to use total capital instead of permanent capital. In addition, the final rule eliminates the exceptional treatment of stock purchased in connection with a loan participation (§ 614.4351(a)(1)).
 - **Qualified financial contract definitions (§ 628.2)**: The final rule amends the definitions of several terms to maintain comparability with the capital rules of the federal banking regulatory agencies.
 - **Common equity tier 1 and tier 2 capital eligibility requirements (§§ 628.20(b) and (d))**: The final rule amends the criteria that capital instruments must meet to be included in CET1 and tier 2 capital by requiring capital instruments to be paid in (as defined in the Basel III framework). The final rule also includes other technical clarifying and conforming changes to the eligibility criteria for capital instruments.
 - **Capitalization bylaw adjustment (§ 615.5220(a)(6))**: The final rule amends the requirement that an institution’s capitalization bylaws include a reference to parts

¹ For example, a System institution’s board declares a cash patronage on Dec. 16, 2021. To use the safe harbor deemed prior approval, the institution would need to ensure that, after such payment, its dollar amount of CET1 capital on Dec. 31, 2021, equals or exceeds the dollar amount of its CET1 capital on Dec. 31, 2020.

² For example, a System institution’s board adopts a resolution on Dec. 15, 2021, to make a patronage distribution in cash and equity. On Jan. 2, 2022, it makes a general ledger entry that moves the dollar amounts from unallocated retained earnings to an appropriate payable account and allocated equity. The general ledger entry is made effective Dec. 31, 2021, and is reflected in the year-end 2021 financial statements. On April 5, 2022, dollar amounts are assigned to each borrower. In this example, the common cooperative equity issuance date would be Dec. 31, 2021.

615 and 628 with a new provision that requires only a general reference to FCA regulations.

- **Annual report requirement corrections (§ 620.5(f)(3) and (4)):** The final rule includes two technical corrections for annual reporting requirements.
- **Risk weight for cash (§ 628.32):** The final rule amends the provisions governing the risk weighting of cash to avoid redundancy and confusion.
- **Securitization formula corrections:** The final rule corrects three formulas used in the simplified supervisory formula approach under § 628.43(d) and one formula used in the simple risk-weight approach under § 628.52.
- **Unallocated retained earnings (URE) and equivalents (UREE) portion of the tier 1 leverage ratio (§ 628.10):** The final rule clarifies and amends the calculation of the requirement that at least 1.5% of the 4% tier 1 leverage ratio minimum must consist of URE and UREE. Deductions from the numerator include those required under § 628.22(a), (b), and (c). The final rule also makes conforming changes to the tier 1 leverage ratio calculation to include the deductions and adjustments required by new § 628.22(b), consistent with the existing call report instructions for the Consolidated Reporting System (CRS) schedule RC-R.4, item 3, and RC-R.5, item 1.c.
- **Service corporation deductions (§ 628.22(a)(6)):** The final rule requires a System institution to deduct any allocated equity investment in a System service corporation. This requirement is consistent with the treatment of allocated equities among all other System institutions.
- **Adjustments for accruing patronage and dividends (§ 628.22(b)):** The final rule requires the reversal of any accruals of patronage or dividend payables or receivables occurring prior to a board declaration resolution. This requirement incorporates into the regulations existing call report instructions for CRS schedule RC-R.4, item 3.
- **Bank disclosure clarifications (§§ 620.3 and 628.63):** The final rule clarifies certain bank disclosure requirements.
- **Retirement of statutory borrower stock (§ 628.20(b)(1)(xiv)(B)):** The final rule clarifies that System institutions cannot redeem statutory borrower stock if a redemption would cause the institution to fall below minimum regulatory capital requirements. In addition, under the final rule, an institution may redeem up to \$1,000 of a member's statutory borrower stock without a minimum holding period and without FCA's prior approval. FCA made this change in response to public comments. This change eliminates the burden of tracking de minimis amounts of statutory borrower stock (in excess of the statutory minimum) on some System loans of less than \$50,000 at issuance.