



[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 614

RIN 3052-AC92

Amortization Limits

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) is repealing the regulatory requirement that production credit associations (PCAs) amortize their loans in 15 years or less, while requiring Farm Credit System (FCS or System) associations to address amortization through their credit underwriting standards and internal controls.

DATES: 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 document announcing the effective date in the Federal Register.

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of the final rule are to:

- Repeal regulatory provisions that impose amortization limits on PCA loans; and
- Require associations to address loan amortization in their credit underwriting standards and internal controls.

II. Background

As FCS institutions restructured and merged over the years, and the agricultural economy evolved, FCA periodically issued or revised regulations in part 614 that implement the statutory authorities of System banks and associations to make, participate in, and buy and sell other interests in, loans to eligible borrowers. Pursuant to statute, these regulations also establish how the powers and obligations of the constituent banks or associations are consolidated, and to the extent necessary, reconciled in the successor institutions created by the Agricultural Credit Act of 1987.

In 1997, FCA amended its regulations governing lending authorities, credit underwriting, and loan terms and conditions and provided freestanding PCAs greater flexibility to meet their borrowers' credit needs to

purchase expensive equipment and other chattels. Since 1997, § 614.4040(a)(2) has allowed PCAs, under policies approved by their funding banks, to make loans with maturities of 10 years or less, but amortize them over a period not to exceed 15 years, subject to the following conditions: (1) Each such loan may be refinanced only if the PCA determines at the time of refinancing that the loan meets its loan policies and underwriting criteria, (2) refinancing may not extend repayment beyond 15 years from the date of the original loan, and (3) acquiring unimproved real estate is not the sole purpose of the loan.

In 1997, FCA also made a substantive revision to the agricultural credit association (ACA) lending authority regulation, § 614.4050, to recognize the statutory authority of ACAs to make long-term real estate loans that mature in not less than 5 years nor more than 40 years either under their PCA or their Federal land credit association (FLCA) long-term mortgage lending authority. Also, ACAs are subject to less stringent regulatory requirements than PCAs regarding aquatic loans, and loans that mature between 7 and 10 years.

Over the years in regulatory burden initiatives, we have received comments that there is a discrepancy between PCA and ACA lending authorities. A common criticism is that

the regulations permit ACA parents to make 10-year operating loans to borrowers, without any restriction on amortization, while PCA subsidiaries cannot amortize the same loans for a period longer than 15 years.

III. Synopsis of the Proposed Rule

In response to the restructuring of the System, changes in the agricultural economy, and input we received from the FCS, we published a proposed rule on January 23, 2020,¹ that would repeal the above-mentioned restrictions on the amortization of PCA loans in § 614.4040(a)(2). We also proposed repealing § 614.4040(a)(3) which requires that the maturities on short- and intermediate-term PCA loans are appropriate for the purpose and underlying collateral of each loan, and comply with the association's loan underwriting standards adopted pursuant to § 614.4150 and the general requirements of § 614.4200. The FCA also proposed to restructure § 614.4050 so our lending authority regulation for ACAs would have the same structure and format as comparable regulations for PCAs and FLCAs. As noted in the preamble to the proposed rule, FCA did not substantively amend § 614.4050.²

¹ 85 FR 3867

² See 85 FR 3869 (Jan 23, 2020).

The proposed rule would amend § 614.4200 to require direct lenders³ that amortize loans over a period that is longer than their term to maturity (hereafter "balloon loans") to address loan amortization in their credit underwriting standards. More specifically, FCA proposed to add a new paragraph at the end of § 614.4200 that would require FCS direct lenders to establish loan amortization schedules for balloon loans that are (1) Consistent with their loan underwriting standards that they adopt pursuant to § 614.4150 and, (2) are appropriate to the type and purpose of the borrower's loan, the expected useful life of the asset being financed, and repayment capacity of the borrower.

IV. Comments and our responses

We received six comment letters, two from System banks, two from System associations, and two from trade associations - one representing FCS institutions and the other representing commercial banks. Most of the comments supported the rule as proposed and the repeal of the PCA amortization limit. One System commenter requested that we

³ Currently, all direct lenders operating under titles I and II of the Act are associations. All Farm Credit banks operating under title I of the Act have transferred their authority to make real estate mortgage loans directly to eligible borrowers to their associations. However, FCS banks retain residual authority under section 1.3 of the Act to make mortgage loans directly to eligible borrowers in geographic areas where no association operates. For this reason, final § 614.4200(c) applies to both Farm Credit banks and associations.

reaffirm prior guidance on unrestricted amortization of ACA loans. The commercial bank trade association opposed the repeal of the amortization limits for PCA loans. According to this commenter, repeal of § 614.4040(a)(2) would allow FCS institutions wide latitude to agree to longer amortization periods which could cause FCS borrowers stress when the loans need to be refinanced or repriced and interest rates have risen. In addition, this commenter urged FCA to conduct an analysis of possible negative impacts from relaxing the rules pertaining to loan amortization.

After considering all the comments that we received, we are finalizing the proposed rule without change. The Farm Credit Act of 1971, as amended, establishes the terms to maturity on loans made by direct lenders operating under titles I or II. However, the statute does not prohibit System direct lenders, such as PCAs, FLCAs, or ACAs from amortizing a loan over a period that is longer than its term to maturity. Instead, as discussed in greater detail below, prudent credit underwriting standards and practices at System direct lenders are necessary and appropriate to control the risks inherent in all loans, particularly balloon loans.

An amortization schedule that exceeds the term of the loan is often used by financial institutions to provide borrowers with credit repayment terms that meet their needs. The balloon payment that results when such loans mature is either repaid, or the remaining principal balance is refinanced. The decision to refinance the balloon payment at its due date is based on many factors, including the borrower's financial position to cover payments based on a new amortization schedule, current interest rates, and the remaining useful life of the asset being financed.

Under the final rule, all FCS direct lenders that amortize loans over timeframes that are longer than their terms to maturity must address loan amortization in their credit underwriting standards. As noted earlier, final § 614.4200(c) requires associations that offer balloon loans to set amortization schedules that are consistent with loan underwriting standards required by § 614.4150 and appropriate to the type and purpose of the borrower's loan, the expected useful life of the asset being financed, and the repayment capacity of the borrower.

The FCA expects FCS direct lenders to address these factors not only when extending a loan, but also when deciding whether to renew and refinance the borrower's loan. This regulatory approach strikes a balance between

allowing FCS associations to offer loan products that meet the specific credit needs of each borrower, while ensuring that every loan exhibit sound credit underwriting practices. More specifically, final § 614.4200(c) provides System institutions latitude to develop credit underwriting parameters that meet the diverse credit needs of their borrowers within a regulatory framework that precludes loans from being continually refinanced at maturity by tying loan amortization to each borrower's repayment capacity and the useful life of the underlying asset.

The final rule that the FCA adopts reduces unnecessary regulatory burden on FCS direct lender associations. Offering balloon loans to customers is a business decision. Managing credit risks in loans that amortize over a longer timeframe than their term to maturity is the responsibility of the lender. The most effective and efficient way to control the risks in such loans is through strong credit underwriting standards and practices developed by the lender, rather than prescriptive regulations that substitute an agency's opinion for the financial institution's business judgement. We note that the statutory, regulatory, and supervisory framework for loans that amortize on a different schedule than their terms to

maturity is virtually the same for FCS institutions, commercial banks, and other non-System lenders.

As noted above, a commercial bank trade association opposed repeal of amortization requirements in § 614.4040(a)(2) on PCA loans because the commenter believes that this regulatory provision is necessary to promote safety and soundness. We respond that from 1997 until now, our regulations only addressed the amortization of PCA loans, but not balloon loans originated by FLCAs or ACAs. As a result, long-term real estate mortgage loans made by FLCAs and ACAs, and short- and intermediate-term ACA loans have never been subject to regulatory restrictions on amortization. As explained in the preamble to the proposed rule, the FCA added these amortization requirements to § 614.4040 in 1997 so PCAs would have greater flexibility in the terms they could offer farmers and ranchers to purchase expensive equipment and chattels through loans that matured within 10 years in accordance with the statute. As a result of corporate restructuring of System associations over the past 23 years, there are no longer any stand-alone PCAs. All PCAs have become subsidiaries of ACAs, which have authority to make short-, intermediate, and long-term loans.

In this context, it becomes clear that the amortization limits for PCA loans in § 614.4040(a)(2) were not designed for safety and soundness. Corporate restructuring rendered the requirements in § 614.4040(a)(2) obsolete. As we stated in the proposed rule, FCA views loan amortization as a credit underwriting issue, not a legal authority issue. For these reasons, we are adopting the final rule, as proposed.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the final rule would 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 614

Agriculture, Banks, banking, Flood insurance, Foreign trade, Reporting and recordkeeping requirements, Rural areas.

For the reasons stated in the preamble, part 614 of chapter VI, title 12 of the Code of Federal Regulations is amended as follows:

Part 614 - LOAN POLICIES AND OPERATIONS

1. The authority citation for part 614 is revised to read as follows:

Authority: 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128; 12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2097, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2201, 2202, 2202a, 2202d, 2202e, 2206, 2206a, 2207, 2211, 2212, 2213, 2214, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a-2, 2279b, 2279c-1, 2279f, 2279f-1, 2279aa, 2279aa-5; sec. 413 of Pub. L. 100-233, 101 Stat. 1568, 1639 (12 U.S.C. 2121 note).

2. Section 614.4040 is amended by revising paragraph (a) to read as follows:

§ 614.4040 Production credit associations.

(a) *Short- and intermediate-term loans.* Production credit associations are authorized to make or guarantee short- and intermediate-term loans and provide other financial assistance for a term of:

(1) Not more than 7 years;

(2) More than 7 years, but not more than 10 years, as set forth in policies approved by the funding bank; or

(3) Not more than 15 years to producers and harvesters of aquatic products for major capital expenditures, including but not limited to the purchase of vessels, construction or purchase of shore facilities, and similar purposes directly related to the operations of producers or harvesters of aquatic products.

* * * * *

3. Section 614.4050 is amended by:

a. Removing the introductory text;

b. Revising paragraph (a);

c. Removing paragraph (b);

d. Redesignating paragraphs (c) and (d) as paragraphs (b) and (c) respectively;

e. In newly redesignated paragraph (c) (1) (i) introductory text, removing "(a)" and adding "(a) (1)" in its place;

f. In newly redesignated paragraph (c) (1) (ii) introductory text, removing "(b) of this part" and adding "(a) (2) of this section" in its place;

g. In newly redesignated paragraph (c) (2) (i), removing "(a)" and adding "(a) (1)" in its place;

h. In newly redesignated paragraph (c) (2) (ii), removing "(b)" and adding "(a) (2)" in its place; and

i. In newly redesignated paragraph (c) (3), removing "(c)" and adding "(b)" in its place.

The revision reads as follows:

§ 614.4050 Agricultural credit associations.

(a) *Terms to maturity on loans.* Agricultural credit associations are authorized to make or guarantee, subject to requirements of § 614.4200:

(1) Long-term real estate mortgage loans with maturities of not less than 5 nor more than 40 years, and continuing commitments to make such loans; and

(2) Short- and intermediate-term loans and provide other similar financial assistance for a term of not more than:

(i) 10 years; or

(ii) 15 years to aquatic producers and harvesters for their aquatic operations.

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4. Section 614.4200 is revised by adding paragraph (c) to read as follows:

§ 614.4200 General requirements.

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(c) *Loan amortization.* If a direct lender amortizes a loan over a period of time that is longer than the term to maturity under § 614.4000(a), § 614.4010(a), § 614.4030(a), § 614.41040(a), or § 614.4050(a)(1) or (2), it must establish a loan amortization schedule that is:

(1) Consistent with its loan underwriting standards adopted pursuant to § 614.4150; and

(2) Appropriate to the type and purpose of the loan, expected useful life of the asset being financed, and the repayment capacity of the borrower.

Dated: August 19, 2020. Dale L. Aultman,
Secretary,
Farm Credit Administration Board.

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