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July 16, 2015

VIA ECFS

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

Re: *Connect America Fund*, WC Docket No. 10-90; *ETC Annual Reports and Certifications*, WC Docket No. 14-58; *Rural Broadband Experiments*, WC Docket No. 14-259

Dear Ms. Dortch:

As the Federal Communications Commission ("FCC") continues to evaluate the petition filed by the National Rural Utilities Cooperative Finance Corporation ("CFC")[1] seeking a waiver of bank eligibility requirements for rural broadband experiment ("RBE") projects to permit CFC to issue irrevocable stand-by letters of credit ("LOC") to its members that are provisionally selected bidders, CFC wishes to highlight the following as factors supporting its petition.

As further detailed below, CFC is subject to regular financial oversight from both its government and private-sector lenders, all of whom bear CFC's credit risk and have the legal obligation and strong economic self-interest to closely monitor CFC's financial soundness. CFC has a long history of working closely with other federal agencies to improve the electric and telecommunications infrastructure in underserved rural areas, including a strong track record of providing and satisfying letters of credit for its members through the United States Department of Agriculture's Rural Economic Development Loan & Grant Program. CFC's size-by-assets and credit rating undoubtedly meet two of the eligibility criteria for LOC issuers, and it receives financial oversight that is functionally equivalent to that of eligible institutions for purposes of assessing creditworthiness. The Commission also has previously granted waivers in CFC's industry under similar circumstances. Accordingly, CFC respectfully submits that the Commission should grant a waiver of the requirement that LOC-issuers must be an institution insured by either the Federal Depository Insurance Corporation ("FDIC") or the Farm Credit System Insurance Corporation.

CFC is not a depository institution, and therefore does not have a traditional prudential regulator such as the FDIC. Instead, its financial soundness is subject to scrutiny from a number

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1 Petition for Waiver of the National Rural Utilities Cooperative Finance Corporation, WC Docket Nos. 10-90 and 14-58, at 1-2 (filed Jan 21, 2015).

of different private and government sources. First, CFC issues bonds to the Federal Financing Bank ("FFB") in the Department of Treasury that are guaranteed by the Department of Agriculture's Rural Utilities Service ("RUS"), and as of May 31, 2014 has entered into bond purchase agreements with the FFB totaling over $4.9 billion.[2] As part of its guarantee program, RUS periodically audits CFC for compliance with regulatory and contractual requirements. The Bond Guarantee Agreement requires CFC to notify RUS if its credit rating drops below A- (or its equivalent) as rated by at least two of the three nationally recognized credit rating agencies. Dropping below the credit rating threshold triggers requirements to pledge securities as collateral for the bonds, and restrictions on CFC's ability to make cash patronage refunds or dividends to its members.[3] In addition, the Bond Guarantee Agreement incorporates by reference all of the contractual covenants that apply to CFC under its loan agreements with private lenders,[4] which are discussed below.

RUS staff most recently conducted a 10-day on-site audit of CFC's books and records in September 2014, and has since proposed an annual audit process. CFC provided the auditors with access to its books and records, including bank statements, general ledger documents, internal audit procedures, and board minutes; as well as loan-level documentation such as borrower credit recommendations and fund disbursement records. The scope of the audit included, among other things, tests for compliance with the requirements under the RUS Bond Guarantee Agreement and the FFB Bond Purchase Agreement.

This process, in combination with the requirement that CFC submit annually independently audited financial statements and independently determined credit ratings, has been considered by RUS to be a sufficient assessment of CFC's credit risk for approximately $4.3 billion in outstanding unsecured, federally guaranteed debt as of May 31, 2014.[5] As an agency that manages a federal credit program, RUS is required to follow the principles outlined in the Office of Management and Budget's Circular No. A-129, which provides that "[a]gencies must have robust management and oversight frameworks for credit programs to monitor the program's

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[2] *See* CFC 2014 Form 10-K at 2, *available at* https://www.nrucfc.coop/content/dam/cfc_assets/public_tier/Public%20Docs/Investors/NRU_10K_20140828.pdf.

[3] *See* Amended Restated and Consolidated Bond Guarantee Agreement dated as of December 13, 2012 between the United States of America, acting through the Rural Utilities Service, and the National Rural Utilities Cooperative Finance Corporation §§ 9.1-9.2, *available at* http://www.sec.gov/Archives/edgar/data/70502/000007050213000029/gupf_bond.htm.

[4] *See id.* § 9.5

[5] *See* CFC 2014 Form 10-K at 57, available at https://www.nrucfc.coop/content/dam/cfc_assets/public_tier/Public%20Docs/Investors/NRU_10K_20140828.pdf.

progress towards achieving policy goals within acceptable risk threshold."[6] The review provided through the FDIC's bank examination process, while more extensive than required for agency programs, is also designed to meet the unique and systemically vital role that banks—particularly depository banks—play in the economy. Such a review process is not the only way to conduct a robust evaluation of an entity's credit risk. The FDIC's own rationale for bank examinations begins with "ensur[ing] public confidence in the banking system,"[7] a concern that is different from evaluating whether the government can safely rely on an institution's standby letter of credit.

In addition to the oversight provided through its participation in federal programs, CFC also faces the scrutiny of its private lenders on a regular basis. As a non-profit lender to its member utilities, CFC relies heavily on capital and credit markets for financing and is a well-known seasoned issuer (WKSI) as defined in Rule 405 of the Securities Act of 1933, as amended. In addition to its capital market activities, CFC also has credit facilities in place with large, sophisticated financial institutions. Over the past decade, CFC has either entered into a new credit facility or amended an existing facility at least once each year. The credit agreements currently in effect and which were entered into in 2011 impose numerous detailed covenants on CFC:

1. CFC may not engage in any business other than the business contemplated by its by-laws, which are limited to financing activities conducted for its members.[8]

2. CFC will provide to the lender periodic financial information, including its audited and unaudited consolidated balance sheets and the related unaudited consolidated statements of operations, changes in equity and cash flow, all in reasonable detail and certified as to fairness of presentation by CFC's officers.[9]

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[6] OMB Circular No. A-129, "Policies for Federal Credit Programs and Non-Tax Receivables," at 10 (Jan. 2013), *available at* https://www.whitehouse.gov/sites/default/files/omb/assets/a129/rev_2013/pdf/a-129.pdf.

[7] *See* FDIC, Risk Management Manual of Examination Policies, § 1.1, *available at* https://www.fdic.gov/regulations/safety/manual/section1-1.pdf. (last updated Mar. 2015).

[8] *See* CFC Bylaws § 2(b), *available at* https://www.nrucfc.coop/content/dam/cfc_assets/public_tier/Public%20Docs/governance/CFCbylaws_3_11.pdf.

[9] *See* Revolving Credit Agreement dated as of October 21, 2011, among the National Rural Utilities Cooperative Finance Corporation, and JPMorgan Chase Bank et al., § 5.03, *available at* http://www.sec.gov/Archives/edgar/data/70502/000007050212000031/exhibit10_2.htm ("2011 Credit Facility").

3. CFC agrees to permit the lender and its agents to inspect any of the property of CFC and its affiliates.[10]

4. The agreements limit the ability of CFC and its subsidiaries to incur additional debt.[11]

5. CFC is required to maintain a certain ratio designed to measure its ability to service its existing debt. Under the credit agreement, CFC must maintain an adjusted minimum average quarterly times interest earned ratio (the "TIER")[12] of 1.025 to 1.00[13] for the preceding 6 fiscal quarters and CFC may not make any patronage refund payments to its members unless it maintains a ratio of 1.05:1.00.[14] By way of comparison, the RUS' telecommunications infrastructure loan program requires a minimum TIER of 1.0 for its direct loans and a minimum TIER of 1.2 for its loan guarantees.[15] As of May 31, 2014, CFC's average TIER for the preceding 6 quarters was 1.28.[16]

For the past decade, CFC has hosted an annual bank meeting with its lenders in which several representatives from each bank meet with CFC to discuss in detail topics that include: CFC's industry trends, financial performance, funding and liquidity profile, and interest rate and credit risk management. Moreover, each time CFC seeks to refinance, renew, or amend its private credit facilities, CFC must go through its lenders' thorough underwriting process. For each proposed amendment to an existing credit facility, the lenders review and discuss the financial information provided by CFC in its Confidential Information Memorandum ("CIM"). The CIM includes key financial information such as CFC's market position, its loan portfolio, credit rating, and liquidity. Since entering into the current credit facilities in 2011, CFC amended its credit facilities three times, and expects that the agreements will be amended periodically going forward. Similar information is also presented to lenders on an individual basis at meetings held at the request of the bank. Since 2008, there has been at least one bank-requested meeting held every year in addition to the annual lender's meeting.

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[10] *Id.* § 5.08

[11] *Id.* §§ 5.09, 5.11.

[12] Adjusted TIER includes non-GAAP adjustments made by CFC. Adjusted TIER is calculated by dividing adjusted interest expense plus adjusted net income by adjusted interest expense.

[13] *See* 2011 Credit Facility § 5.13

[14] *Id.* § 5.14.

[15] *See* RURAL UTILITIES SERV., TELECOMMUNICATIONS PROGRAM INFRASTRUCTURE LOAN APPLICATION GUIDE at 6-7, *available at* http://www.rd.usda.gov/files/UTP_TelecomAppGuide.pdf.

[16] *See* CFC 2014 Form 10-K at 103.

CFC also has a strong track-record as an issuer of LOCs backing up its members' obligations to organizations designated by, or at the recommendation of, the Federal Energy Regulatory Commission to manage regional electric transmission. As of June 30, 2015, CFC had issued LOCs on behalf of members for the benefit of regional transmission organization activity totaling approximately $100 million. The terms of these LOCs ranged from 4-120 months, with a median term of 99 months.

CFC's credit strength further evidences its fundamental financial soundness. For the fiscal year ended May 31, 2014, CFC experienced no charge-offs related to its electric lending activities, which accounted for over 90% of its outstanding loan portfolio by value.[17] On a consolidated basis, CFC's nonperforming loans totaled only $2 million or 0.01% of total loans outstanding as of May 31, 2014. By comparison, the percent of nonperforming loans for all insured commercial banks in the United States at the end of Q2 2014, as reported by the Federal Reserve Bank of St. Louis, stood at 2.26%.[18] In addition, the vast majority of CFC's loans are provided on a senior-secured basis, with a collateral package that typically includes a mortgage on all assets and revenues of the utility.

Finally, as CFC has stressed in previous filings,[19] granting the waiver petition would enable CFC members who participate in the RBE to obtain LOCs at significantly lower rates than would be available from commercial banks. Indeed, when the Commission previously expanded the eligibility criteria to include institutions insured by the Farm Credit System Insurance Corporation but not the FDIC, it cited the fact that doing so enables "many small rural carriers [who] have a relationship" with a non-FDIC insured LOC issuer to obtain letters of credit.[20] CFC's members are similarly situated and would also be able to obtain lower-cost

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17 *See* CFC 2014 Form 10-K at 97.

18 *See* FEDERAL RESERVE BANK OF ST. LOUIS, NONPERFORMING TOTAL LOANS (PAST DUE 90+ DAYS PLUS NONACCRUAL) TO TOTAL LOANS, data point for 2014 Q2, *available at* https://research.stlouisfed.org/fred2/series/NPTLTL.

19 *See* Comments of CFC, WC Docket No. 10-90 and 14-58, at 6 (filed Mar. 30, 2015).

20 *Connect America Fund*, Report and Order and Further Notice of Proposed Rulemaking, WC Dockets No. 10-90 & 14-58, FCC 14-98, 29 FCC Rcd. 8769 ¶ 60 (rel. Jul. 2014).

LOCs and spend more funds on furthering the purpose of the RBEs and expanding broadband access in rural areas. Accordingly, CFC respectfully submits that the FCC should grant its waiver petition.

Please contact me if you have any questions.

Sincerely,

John T. Nakahata
Counsel to CFC

cc: Neil Dellar
Ian Forbes
Heidi Lankau
Alex Minard