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June 1, 2016

The Honorable Pat Roberts
United States Senate
Washington, D.C. 20510

Dear Chairman Roberts:

Thank you for the opportunity to testify at the May 19 hearing (*The Farm Credit System: Oversight and Outlook of the Current Economic Climate*). ICBA appreciated the opportunity to present testimony on our concerns regarding the FCS and the Farm Credit Administration (FCA)'s numerous inappropriate activities. We submit this letter to you for the purpose of including it as part of the hearing record.

Unfortunately, others appearing before the committee, specifically certain of the FCA and FCS witnesses, chose to provide testimony or make oral comments which were highly inaccurate and unreliable. This letter addresses a few of the egregious statements either made during the hearing or provided in written testimony, in order to further explain why reforms are needed for the FCS.

FCS's Inadequate Focus on Young, Beginning and Small (YBS) Farmers

The Farm Credit Council's (FCC) statement seeks to defend the lackluster YBS lending by System institutions. The FCS witness, during oral comments, stated the number of farmers receiving loans in each YBS category as if these categories could be combined. While the FCC's written statement notes that these categories cannot be combined, their statement admits that all three categories can be counted if a single loan is made to a single borrower. FCS's testimony states this is done because FCA requires such double and triple counting and makes the ridiculous and unconvincing statement this methodology provides "the most accurate portrayal of who we serve."

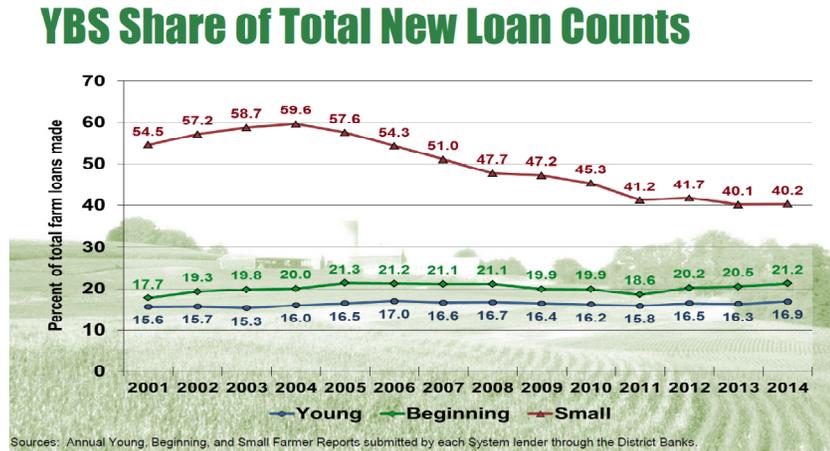
The reality is far different. FCA requires such double and triple counting because it is a way to avoid reporting on the actual number of farmers receiving YBS loans on an individual basis. **FCA should report the number of YBS loans without double and triple counting these loans.** Additionally, if a YBS borrower received two or more loans (real estate, operating, auto, etc.) this single borrower could be counted in the YBS category five, six, seven or more times. The FCA methodology blocks transparency and needs reform.

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FCC’s statement also suggests FCS lending to the YBS categories has increased significantly since 2001. However, a look at the FCA’s charts from recent years reveals a different and more disturbing picture. A chart of the “YBS Share of Total New Loan Counts” reveals that beginning a decade ago in 2006, through 2014, loans to the “Young” farmer category decreased from 17 percent to 16.9 percent; loans to the “Beginning” farmer category remained flat and loans to the “Small” farmer category declined sharply from 54.3 percent of total FCS loans made to 40.2 percent.¹



Again, it must be noted the FCA’s counting methodology is grossly inadequate and the percentages mentioned in FCA’s report are virtually meaningless without counting the number of YBS loans made on an individual basis. Otherwise, the FCA and FCS are seeking to avoid actual transparency to Congress. It was not Congressional intent for the FCA/FCS to count the YBS loans by tripling or more than tripling the number of loans actually made. These triple counting-plus inaccuracies in FCA’s reporting methodology may also apparently apply to the amount of dollars loaned.

100 Years of Lavish FCS Subsidies

The FCC’s testimony and previous claims declare that FCS is not heavily subsidized while misleadingly asserting that commercial banks (which encompass community banks) are heavily subsidized. FCS stated previously, “the Farm Credit System does not operate at taxpayer expense.”² In its May 19 written testimony, the FCS states, “There is no federal funding in Farm Credit.”³

Such claims mislead this committee and Congress. As pointed out in ICBA’s testimony, FCS’s effective tax rate is only 4 percent while commercial banks federal and state tax rate as C Corporations is often 40 percent or more, not counting additional taxes imposed by various states for operating a financial business, mortgage closing fees and so forth.

¹ FCA’s Annual Report on the Farm Credit System’s Young, Beginning, and Small Farmer Mission Performance: 2014 Results, FCA Board Meeting, June 11, 2015, page 7.

² The Farm Credit Council letter to the Honorable Rick Crawford, Chairman, House Agriculture Subcommittee on Livestock, Rural Development and Credit, July 14, 2014, page 4

³ Testimony of Doug Stark, President and CEO Farm Credit Services of America/Frontier Farm Credit on behalf of the Farm Credit System before the Senate Committee on Agriculture, Nutrition & Forestry May 19, 2016, page 7

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According to the FCA, this tax avoidance amounts to hundreds of millions of dollars in subsidies per year to FCS lenders. These subsidies to the FCS are used to price loans at below-market rates in order to steal the best loans from community banks' portfolios. Although an FCA board member stated the FCS tax subsidy is approximately \$600 million per year, we believe the actual amount of the federal tax subsidy is approximately \$1.75 billion annually, or more, if the FCS were taxed as a C Corporation.

Similar Entity Authority Needs to Be Reformed and Restricted

The FCC testimony suggests the FCS understands Congressional concern over the Verizon loan but argues such lending is authorized by the "similar entity" provisions of the Act. The FCC testimony tries to divert attention away from the inappropriate activities of FCS similar entity loans by stating, "We respect the views of the Congress and have imposed a variety of self-discipline measures" regarding similar entity loans.

The System also previously cited a comment by Senator Lugar on similar entity loans in which he stated, "in the case of **agricultural** entities that are similar to System borrowers . . .". The loan to Verizon, AT&T, U.S. Cellular, Constellation Brands and others were not made to "agricultural entities" that are "similar to System borrowers." These loans are being made to some of the largest non-agricultural corporations in America.

Further, contrary to the FCS's claims, there are not "strict limitations" in the Farm Credit Act regarding similar entity authority. An FCS borrower can make up to 50 percent of any of these ineligible loans. This appears to be too high a level given the inappropriate actions by CoBank and FCS lenders. Additionally, the Verizon loan was made to facilitate a transaction between large corporations located in London and New York. These are not rural areas, despite the FCS's previous claim stating, "Senator Lugar provided additional detail regarding how this authority would help the FCS manage the risk associated with the large loans it was involved with *to support agriculture and rural America* (emphasis added)."⁴

The FCS's claim of engaging in "self-discipline" is simply a farcical attempt to avoid Congressional pressure to reform the similar entity provision of the statute and to avoid transparency and accountability. FCC further claims the statute is restrictive due to a limitation of 15 percent of the System's total assets. However, this limitation is overly generous given the FCS now has over \$300 billion in total assets.

In addition, both the FCS testimony and FCA witnesses claimed the similar entity authority compels FCS and commercial banks to work together through loan participations. However, the similar entity loans noted above were syndicated transactions involving some of the largest *international* and national banks in existence, not community banks, a point which FCS and FCA conveniently forget to mention.

⁴ The Farm Credit Council letter to the Honorable Rick Crawford, Chairman, House Agriculture Subcommittee on Livestock, Rural Development and Credit, July 14, 2014, page 6

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Further, contrary to FCS’s previous quotation of Senator Lugar’s comment asserting the similar entity authority does not allow FCS lenders to originate similar entity loans; CoBank was listed as the lead lender and the largest lender in at least the Verizon loan.

A key problem with the similar entity provision is the definition of a “similar entity” loan is very open-ended (i.e. “is functionally similar to an entity eligible for a loan in that it derives a majority of its income from, or has a majority of its assets invested in, the conduct of activities functionally similar to those conducted by” eligible entities. This language needs to be tightened considerably to prevent the types of abuses noted above given FCS’s propensity to exploit any loophole they can.

The bookletter⁵ issued by FCA on March 10, 2016, appears to largely be an attempt by the FCA to provide further cover to the FCS in hopes that Congress will not tighten the similar entity provision of the Farm Credit Act (Act). The bookletter is focused on procedures and processes and avoiding reputational risks – not limiting the inappropriate loan types that FCS and CoBank could make under this open-ended authority.

CoBank’s financing of these entities allowed these very large non-agricultural corporations to better compete against much smaller rural entities providing the same products and services. The ‘similar entity’ legislation was originally drafted by the FCS. But Congress would have laughed the FCS out of the room if FCS had explained the provision by stating it was to allow financing of large non-agricultural corporations both nationally and internationally so they could better compete with small rural businesses. This simply wasn’t the intent of Congress and the ‘similar entity’ authority needs to be reformed in a meaningful way.

Inappropriate Financing of Non-Farm Activities

In recent years, the FCC has sought to position itself as a general purpose provider of credit and financial services to rural America, contrary to the constraints of the Act. The FCC’s goal is to allow virtually open-ended FCS financing for non-farm related activities, beyond the specific, limited, provisions of the Act. FCA has sought to accommodate the request to engage in open-ended non-farm financing by FCS lenders both in terms of allowing FCS lenders to finance all credit needs of agricultural borrowers and the FCA’s recent expansion of FCS lenders’ investment activities.

For example, FCA witnesses claimed that FCS lenders are allowed under the Act, and thus under FCA regulation, to finance *all of the credit needs* of full-time farmers.

⁵ BL-067, Lending to Similar Entities

http://ww3.fca.gov/readingrm/Handbook/_layouts/15/WopiFrame.aspx?sourcedoc=/readingrm/Handbook/FCA%20Bookletters/BL-067.docx&action=default&DefaultItemOpen=1

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However, this is not what the Act states:

SEC. 1.11. PURPOSES FOR EXTENSIONS OF CREDIT.

(a) AGRICULTURAL OR AQUATIC PURPOSES.

(1) IN GENERAL. Loans made by a Farm Credit Bank to farmers, ranchers, and producers or harvesters of aquatic products may be for any agricultural or aquatic purpose and other credit needs of the applicant, including financing for basic processing and marketing directly related to the applicant's operations and those of other eligible farmers, ranchers, and producers or harvesters of aquatic products, except that the operations of the applicant shall supply some portion of the total processing or marketing for which financing is extended (emphasis added).

The FCA has gone beyond the Act (§ 613.3005-Lending objective) in allowing the financing of all credit activities of supposedly full-time farmers, regardless of whether these credit needs are related to the borrowers farming operations.

Yet, the FCS and the FCA seek to persuade Congress that FCS institutions are constantly working together with community banks. This fabrication is the exception, not the rule. By allowing FCS to finance both the non-agricultural credit needs as well as the agricultural credit needs of supposedly full-time farmers, FCA is allowing FCS to steal not only the best agricultural loans from community bank portfolios by leveraging their tax and funding advantages to offer below-market loan rates, but also siphon away some of the best small business loans from community banks.

For example, following the hearing, ICBA received an email from a banker complaining that an FCS lender stole a farm operating line of credit (LOC) from the community bank and also took away a commercial excavating LOC telling the customer it would be easier for the FCS lender if it had both LOCs rather than allowing the customer to have the non-farm LOC with the community bank. This type of disruptive cherry-picking activity, repeated virtually every day by FCS lenders, is indeed an attack by FCS against the community banking industry despite the claims of FCS lobbyists and the FCA they want to work with the community banking industry.

If FCS truly wanted to work in a cooperative and collaborative manner, they would agree to not take non-farm loans out of the portfolios of community banks and not offer below-market loan rates in an attempt to pilfer community banks' best agricultural customers.

Also, our written testimony discusses the FCA's inappropriate efforts to allow FCS lenders to make ineligible non-farm loans if such loans are labeled as "investments." This effort by the FCA is unrelated to the Act's RBIC authorities and therefore allows FCS to make loans, labeled as "investments," which go beyond the loan-making constraints of the Act.

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Farm Credit System Misleads Congress

The FCS has consistently sought to deflect Congressional scrutiny of their lavish subsidies by suggesting that community banks are heavily subsidized, apparently in an effort to justify the FCS's expanded powers requests of Congress and of FCA. For example, the FCC's testimony states, "Unlike commercial banks, Farm Credit institutions cannot fund their loan-making activities through secured deposits guaranteed by the Federal Deposit Insurance Corporation and backed by the full faith and credit of the U.S. government. Instead, we rely on the investment community, which consistently recognizes the value and stability of our Farm Credit System-issued debt securities. Farm Credit System debt securities are NOT explicitly guaranteed by the U.S. government."

FCC's testimony fails to mention that the banks themselves fund the FDIC insurance fund through quarterly assessments. This is not a gift to the banking industry. While banks fund loans through deposits, deposit gathering requires a cumbersome and expensive infrastructure of bank buildings, branches, and staffing and regulatory compliance efforts. The FCS's funding mechanism is quite inexpensive in comparison.

Additionally, FDIC insurance only provides deposit coverage of \$250,000 per borrower account. Further, deposit insurance protects depositors, not the banks themselves. Community banks that have financial problems are closed by the FDIC. However, the FCS was bailed out by the government when it failed in the 1980s.

The FCC is also being misleading when stating that investors rely on the "value and stability of our FCS-issued securities." In reality, investors have historically relied on the FCS's AAA rating due to their being a government-sponsored-enterprise.

Without this government backing, FCS would not have such a high rating on Wall Street and their cost of funding would increase noticeably. The FCC also is not forthright with Congress by stating FCS is not explicitly backed by the government. The FCS is implicitly backed by the government and this implicit backing has in the past become an explicit backing when the FCS was bailed out in the 1980s. In fact, FitchRatings states: "As a government-sponsored entity (GSE), the FCS benefits from implicit government support. Therefore, the ratings and Outlook of the FCS are directly linked to the U.S. Sovereign rating."⁶

The FCC's written testimony also makes the false claim "Just this winter, the Independent Community Bankers Association of America joined in the commercial bankers' chorus to kill Farm Credit." It is interesting the FCC testimony does not provide a source or even a quote to back up this false claim.

⁶ Fitch Affirms Farm Credit System and Farm Credit System Banks' Ratings; Outlook Stable, April, 21, 2015
<https://www.fitchratings.com/site/pressrelease?id=983353>,

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Apparently, the FCC is referencing ICBA's Priority Resolution on the Farm Credit System which states, "If FCS lenders continue efforts to expand into non-farm lending markets, then ICBA urges Congress to either abolish the FCS, or at a minimum restrict the FCS to its historical mission of serving the agricultural marketplace (underscore added)."

The obvious intent of the resolution's wording is to shine a light on the FCS's inappropriate non-farm lending activities and expansion agenda. Apparently, FCS lobbyists do not want a public discussion of their non-farm lending agenda and find it easier to cast misleading aspersions towards ICBA and our community bank members.

During the hearing, FCS's witness misleadingly claimed that ICBA's witness, Mr. Barker, stated his bank had over half of the farm loans in his community. This was apparently to suggest that ICBA's witness should not be complaining about FCS's cherry-picking activities. The FCS witness's statement is untrue. ICBA's witness stated that community banks had over one-half of the ag lending activity from the commercial banking sector. Mr. Barker's bank has approximately 15 percent of the farm loan activity in his community. He would have a much higher percentage if the FCS stopped using their lavish subsidies to pilfer his best loans and customers.

Conclusion

The FCS has sought to paint a false perception of FCS lenders and community banks more often than not working together to provide financing to rural America and participating in healthy lending competition in which both FCS lenders and community banks are able to take loans away from each other. This is blatantly false as community banks are not able to match the below-market loan rates FCS offers to large borrowers. Again, this is largely the result of FCS's tax advantages and low-cost funding.

In attempting to wear the proverbial white hat, the FCC's statement claims, "We have no desire to fight with the commercial bank lobby . . . No community will be improved as a result of political bickering." However, FCS lenders fight against community banks every day by offering below-market pricing to their best customers. Because the FCS does not want to lose their grossly disproportionate subsidy advantages over the community bank sector and because the FCS does not want Congress to impose necessary reforms on the System, its lobbyists paint the picture that things are as they should be between the FCS and the banking sector. Congress should not be misled. FCS's efforts are an attempt to avoid necessary reforms. 100 years of lavish subsidies for the FCS has gone on long enough.

Sincerely,

Mark Scanlan
Sr. Vice President, Agriculture & Rural Policy

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