

## A REVIEW OF AG CREDIT ISSUES

On behalf of the more than 52,000 community bank locations across the nation represented by ICBA, we thank Chairman David Scott, Ranking Member Austin Scott, and members of the Subcommittee for convening today's hearing: "Review of Credit Conditions – Report from the Farm Credit Administration (FCA)." We are pleased to submit this statement for the record to provide the perspective of thousands of community banks that serve the agricultural credit needs of farmers and ranchers across rural America. We also highlight some key issues related to FCS competition and the role of the Farm Credit Administration in our statement.

### COMMUNITY BANKS SERVE FARMERS & RANCHERS

ICBA looks forward to further hearings on the ag credit conditions facing our nation's farmers and ranchers from a community bank perspective. To emphasize the important role that community banks play in serving agriculture we note that as of the first quarter 2019, there were 1,315 farm banks representing nearly one-quarter of all FDIC-insured institutions. During the first quarter 2019, agriculture loans held by FDIC-insured institutions totaled \$184 billion. Community banks hold nearly 70 percent (\$127 billion)<sup>1</sup> of total agriculture loans. When including all community banks of less than \$10 billion in asset size, these banks hold approximately 80 percent of all ag loans from the banking sector.

### COMMUNITY BANKS PRESENCE IN RURAL AMERICA

There are thousands of community banks in rural areas. In fact, community banks were almost three times more likely than noncommunity institutions to locate their offices in a nonmetro area<sup>2</sup> according to the FDIC and were four times more likely to operate offices in rural counties. In fact, community banks remain the only banking presence in

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<sup>1</sup> FDIC 2019 Annual Risk Review – Section III – Key Bank Risk Issues: Agriculture; page 17

<sup>2</sup> FDIC Community Bank Study, December 2012, page 4

more than 600 counties (nearly 20 percent of all U.S. counties) and they continue to hold the majority of banking deposits in rural counties and small cities.<sup>3</sup>

## **ONGOING CONCERN REGARDING THE FARM ECONOMY**

With the farm economy now in its sixth year of low commodity prices and reduced farm incomes from the 2013 peak and with agricultural exports under pressure from the China trade dispute, it is extremely important to have the 2018 farm bill's safety net in place including commodity price protections and crop insurance combined with the informal income assistance payments via the market facilitation payments (MFP).

Generally stable farmland prices in many, though not all, states have allowed many producers to restructure their loans and shore up working capital. USDA's guaranteed farm loan programs have also assisted many community banks to continue working with family farmers and ranchers. The farm bill's increased loan limits to \$1.75 million will be helpful, but given the rise in farm debt, we believe that this level may need to be increased modestly going forward. Agricultural debt now exceeds \$416 billion and could rise in the future.

While USDA projects net farm income to increase about 5 percent to \$88.0 billion in 2019, this level is driven largely by government payments. The \$88 billion level is also about 35 percent below the 2013 peak of \$136.5 billion in net farm income and slightly below the average from 2000 to 2018 of \$90 billion. Community banks will continue working with their customers to ensure their survivability and success even in these difficult times.

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<sup>3</sup> Federal Reserve Bank of St. Louis *REVIEW*, May/June 2013, page 201

## FCS EXPANSION THREATENS RURAL COMMUNITIES

These and similar facts regarding the unique and ongoing presence and service of community banks to our rural citizens and our farmers and ranchers underscore the importance of ensuring an economic and competitive environment in rural America that allows community banks to remain viable. It is particularly important to ensure that community banks are not disadvantaged vis a vis the competitive landscape with institutions such as the Farm Credit System (FCS, System). The FCS is a huge financial conglomerate with over \$276 billion in total loans and \$354 billion in total assets.

As a government-sponsored-enterprise (GSE), the System enjoys significant tax and cost of funds advantages over private-sector, tax-paying community banks. Although commercial banks hold slightly more of the overall agricultural credit (42 percent versus 41 percent) compared to the FCS, the FCS has a significantly higher percent of the farm real estate loan volume. The latter reality is due to the FCS's tax exemptions for real estate/mortgage debt which allows FCS lenders a huge advantage when competing for the same borrowers and same financial purposes.

The significant advantages of a unique retail GSE are why ICBA and the nation's community banks oppose expansion of the FCS into non-farm lending, realizing such expansion comes at the expense of community banks and the viability of our rural communities. Recognizing this disparity in competitive advantages for FCS lenders, members of both the House and Senate have introduced legislation that would allow community banks some, but not all, of the tax benefits the FCS enjoys. The "*Enhancing Credit Opportunities in Rural America (ECORA)*" Act (S. 1641 and HR 1872) would exempt from taxation interest income on farm real estate and also rural home mortgages in towns of less than 2,500 residents. This legislation would allow community banks to continue working with their farm and ranch customers particularly in these perilous times and we urge members to cosponsor the legislation.

## KEY ISSUES PERTAINING TO THE FCA

Since the FCA is testifying today, we would like to briefly highlight a few recent regulatory issues that have arisen regarding the FCS.

**Young-Beginning-Small (YBS) Farmers.** The FCS recently published a Notice of Proposed Rule Making regarding the FCS's YBS programs. The FCA asked numerous questions regarding how to best count the metrics for determining YBS access to FCS lending. ICBA pointed out there are numerous ways for the FCA/FCS to inflate the actual lending to the YBS category.

Our fundamental recommendation is to ensure at least one category of reporting counts just the number of actual YBS borrowers in all categories – but not all categories combined. The present methodology allows FCA/FCS to count individual borrowers multiple times. If they fall into all three of these categories (Y-B-S) they can be counted three times.

Further, if two FCS lenders participate in, or share, a YBS loan, the same borrower can be counted an additional three times. Thus, one YBS borrower can be counted at least six times in the FCA's YBS numbers. This type of misrepresentation for YBS lending activity doesn't give Congress a meaningful yardstick to measure this category of FCS lending even though it is of great concern to Congress. As FCS institutions consolidate and merge, how great will the decline be if YBS numbers are reported as we recommend? We suspect the decline, if recorded accurately, could be considerable.

**Buying, Selling or Holding USDA Guaranteed Loans from Non-FCS Lenders.** FCA published a proposed rule which closed for comment yesterday (Nov. 18). Since this issue is pending, we have attached our comment letter for members to review.

ICBA opposes allowing FCS lenders to buy, sell and hold the guaranteed portion of USDA loans originated by non-FCS lenders. We believe this duplicates the secondary market activities of Farmer Mac, the actual secondary market created by Congress to increase liquidity in rural America, particularly among community banks. We do not believe Congress intended for FCS to create a duplicate secondary market that could undermine Farmer Mac's ability to serve this sector of the market. We question that the statute actually allows FCS to engage in such transactions from non-FCS lenders as the statute doesn't reference non-FCS lenders. We have asked FCA to withdraw the proposal or to limit such transactions between FCS lenders only and to ensure such transactions occur only with USDA and Farmer Mac and not with non-FCS lenders. Limiting these transactions to FCS lenders selling to or buying from Farmer Mac will actually enhance the secondary market, not diminish it.

**FCS Proposal for Blanket Self-Approval of Investments.** The FCS has sought in recent years to skirt the case-by-case oversight of the FCA for approving “investments.” Although congressional agriculture committees wisely rejected such proposals during debate on the 2018 farm bill, the FCS has run to the appropriations committee urging inclusion and adoption of report language urging such laxity by the regulator.

ICBA opposes removal of the FCA’s upfront case-by-case approval and oversight of risky investment activities by FCS lenders. Further, we oppose the investment scheme in which FCS investments can be made for non-agricultural purposes. We have also attached our letter to the congressional appropriations committees regarding this issue which provides a detailed explanation of our opposition.

## CONCLUSION

Mr. Chairman and members of the subcommittee, thank you once again for conducting this hearing on such an important issue. We look forward to discussing the banking industry’s perspective on agricultural credit issues as we work together to assist our nations farmers and ranchers.



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November 18, 2019

Via Electronic Submission: [reg-comm@fca.gov](mailto:reg-comm@fca.gov)

Mr. Barry F. Mardock  
Acting Director  
Office of Regulatory Policy  
Farm Credit Administration  
1501 Farm Credit Drive  
McLean, VA 22102-5090

RE: RIN 3052-AD35, FCA proposed rule Organization; Funding and Fiscal, Affairs, Loan Policies and Operations, and Funding Operations; Investment Eligibility *Federal Register*, Vol. 84, No. 181, Wednesday, September 18, 2019

Dear Mr. Mardock:

On behalf of the nation's community banks, with over 52,000 locations, the Independent Community Bankers of America (ICBA) writes to share our views regarding the Farm Credit Administration's (FCA, agency) proposed rule (PR) to allow Farm Credit System (FCS) institutions to purchase, sell or hold the guaranteed portion of USDA loans.

The agency notes that these loan guarantees would be ones originated by non-FCS lenders. Although not stated, these non-FCS lenders would primarily be from the hundreds of community banks that utilize the USDA guaranteed loan programs in addition to a handful of larger non-community bank lenders.

### **ICBA Position on FCA Proposed Rule**

ICBA opposes FCA's proposal for many reasons. FCS lenders have long desired to operate their own secondary market and FCA's proposal would lay the groundwork for allowing them to do so. The duplicate and redundant secondary market activities pursued by the FCS would occur to the detriment of Farmer Mac, the institution actually established by Congress to operate in a secondary market role. Although the FCA is charged with regulating both the FCS and Farmer Mac, we notice the rationale expressed in the proposed rule is exclusively from the vantage point of FCS lenders with no consideration of its potentially damaging impact on Farmer Mac.

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## Proposal's Objectives Unsubstantiated and Unwarranted

FCA's proposal allows the FCS to duplicate an important secondary market activity of Farmer Mac's, the buying, selling and holding of USDA guaranteed loans from non-FCS lenders. The first two objectives of the proposal (augmenting the liquidity of rural credit markets and reducing the capital burden on community banks and other non-System lenders) are completely consistent with the purposes of Farmer Mac as a secondary market provider but have little to do with FCS's role in rural credit markets.

Community banks do not depend on FCS lenders for reducing capital burdens as there already exist other financial sources to accomplish this objective. The third objective, enhancing the ability of associations to manage risk, could more appropriately be accomplished if FCS associations actually were to use Farmer Mac as a secondary market as Congress intended instead of trying to create their own secondary market. Additionally, there are numerous other ways for FCS associations to manage risks that do not diminish Farmer Mac as evidenced by FCA rulemaking on investments in recent years.

The PR states that an impetus for the proposal was concern by two community bankers and a representative from a USDA office and a broker-dealer. FCA does not explain why the existing secondary market activities operated by Farmer Mac would not accommodate any such secondary market activities in the absence of the FCS and we therefore conclude this rationale by FCA lacks merit.

## Proposal's Interpretation of Statute Misaligned

We also disagree with FCA's interpretation of statute as the basis for this proposal. FCA states, "The statutory provisions that are most relevant to this rulemaking are sections 2.2(11) and 2.12(17), which authorize System associations to 'buy and sell obligations of or insured by the United States or of any agency thereof or of any banks of the Farm Credit System.'"

Regarding the referenced statutes, they do not reference buying and selling guaranteed portions of USDA loans from **non-FCS lenders**, the aim of this proposal. These statutes reference buying and selling of loans insured by government agencies or loans **of FCS lenders** – not non-FCS lenders. Further, section 5.17(a)(9) which allows FCA enumerated powers to "prescribe rules and regulations necessary or appropriate for carrying out this Act," is not relevant since the proposal is not warranted or necessary for the reasons stated in this comment letter.

FCA also did not adopt the current proposal as part of its earlier investment rulemaking, which FCA claimed was based on statute. FCA suggests it erred in not doing so in last year's final rule on investments. However, we believe FCA was correct in not doing so previously and errs in this proposed rulemaking. FCA simply does not need to adopt this proposal at this time and the statute does not support the proposal.



## Unintended and Harmful Impact of the Proposal

Allowing the FCS, a financial conglomerate with over \$350 billion of assets, to now operate a duplicate secondary market by mimicking Farmer Mac's activities in this space will be quite disruptive to Farmer Mac. This in turn will harm several hundred community banks that actively conduct business with Farmer Mac and thus already accomplish the first two stated objectives in the proposal. But we stress the ability of community banks to accomplish these two objectives is the result of utilizing Farmer Mac – not FCS lenders.

As a large financial conglomerate, FCS has many more sources of income than Farmer Mac's limited charter allows and will utilize the billions of dollars in annual profits FCS lenders accumulate to underprice business activity from Farmer Mac. FCS will routinely lowball the pricing found on Farmer Mac's rate sheets.

FCA, the regulator of Farmer Mac, provides no indication they will protect Farmer Mac from encroachment and manipulation by the larger, more financially powerful FCS. For some curious reason, Farmer Mac's interests seem completely disregarded by the FCA's proposal, even though the FCA is charged with ensuring, through proper regulation, the financial health of Farmer Mac.

While FCA notes they have a cap on FCS investments based on 10 percent of overall loans, given the gigantic size of the FCS's loans and assets, which would approximate one of the 11<sup>th</sup> largest bank in the U.S. if FCS were considered a bank, and the relative small size of USDA's guaranteed loan portfolios, this 10 percent cap hardly represents a meaningful cap against FCS completely dominating the secondary market for USDA loan guarantees.

## FCA Mischaracterizes the Secondary Market

FCA's proposed rule makes the astonishing claim that "The final rule (previous investments rule) may have an unintended impact by causing 40 percent of the existing buyers to be excluded from the secondary market." Quite frankly, ICBA views this statement as extremely misleading since there are multiple other outlets for secondary market activities other than the FCS. FCS's absence from the secondary market would not meaningfully impact the ability of market participants to locate buyers and sellers. This proposal is just a power and money grab by FCS.

ICBA also disagrees with FCA's statement that "More importantly, USDA loan guarantees contribute to the flow of adequate and affordable credit into rural areas, which is related to the System's mission as a government-sponsored enterprise." FCS's absence from the robust secondary market will not negate the "adequate and affordable" flow of credit to rural areas. These types of misleading, exaggerated statements, rather than add substance to the proposal actually undermines its credibility.



## Conclusion

For the reasons stated above, FCA should withdraw the proposed rule or limit it to loan purchases and sales of USDA guarantees between FCS lenders as that is what the statute states. FCA could also require FCS institutions to buy the guaranteed portion of such loans only from Farmer Mac or sell the guaranteed portion of USDA loans that FCS originates to Farmer Mac if transacting outside the sphere of FCS lenders.

This approach would actually enhance the secondary market rather than eventually diminishing its functionality as FCS seeks dominance over it. FCS's activities should not seek to replace or usurp Farmer Mac's secondary market role but this is precisely what the proposed rule allows.

Thank you for considering our views. Should you desire to discuss the contents of this letter please feel free to contact our staff at: [Mark.scanlan@icba.org](mailto:Mark.scanlan@icba.org).

Sincerely,

/S/

Mark Scanlan  
Sr. V.P., Agriculture and Rural Finance



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November 14, 2019

The Honorable John Hoeven  
Chairman  
Senate Appropriations Subcommittee  
Agriculture Appropriations  
FDA & Related Agencies  
Washington, DC, 20510

The Honorable Sanford Bishop  
Chairman  
House Appropriations Subcommittee  
Agriculture, Rural Development,  
FDA & Related Agencies  
Washington, DC, 20515

The Honorable Jeff Merkley  
Ranking Member  
Senate Appropriations Subcommittee  
Agriculture, Rural Development,  
FDA & Related Agencies  
Washington, DC, 20510

The Honorable Jeff Fortenberry  
Ranking Member  
House Appropriations Subcommittee  
Agriculture, Rural Development,  
FDA & Related Agencies  
Washington, DC, 20515

Dear Chairmen Hoeven and Bishop and Ranking Members Merkley and Fortenberry:

On behalf of the nation's community banks, with over 52,000 locations, I write to express our appreciation for your ongoing bipartisan efforts to enact FY 2020 appropriations as part of HR 3055. However, we must also express our opposition to the Farm Credit System's (FCS, System) efforts to expand their powers by the appropriations process.

We have serious concerns with a conferenceable item in report language which directs or strongly urges the FCS's regulator, the Farm Credit Administration (FCA), to explore options to enhance FCS lending and investment opportunities or create an expedited approval process to finance community facility (CF) "investments" in lieu of obtaining case-by-case approval from the FCA.

In recent years the FCS has sought to pressure the FCA to allow comprehensive or blanket self-approval authority to pursue "investments" instead of obtaining case-by-case approval aimed at adhering to proper risk management and safety and soundness protocols while ensuring their activities are appropriate for the narrowly defined mission purposes of a government sponsored enterprise (GSE) with tax and funding advantages over private-sector, tax-paying community banks. FCS suggested similar language during the 2018 farm bill debate, but Congress **rejected** the request. It is inappropriate for FCS to now seek inclusion of their **policy** goals in an appropriations bill.

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The FCA addressed the rapidity of their investment approval process in an August 2017 FCA board meeting when then board Chairman Dallas Tonsager stated:

*“I hope system institutions will continue to use the fast-track approval process the Agency has established to build partnerships that provide needed investments in rural communities.”<sup>1</sup>*

Thus, FCS institutions have a fast-track approval process available if they are concerned about timeliness of approvals. But we emphasize that a community facility project doesn't come together overnight but typically only after months of review and coordination among community leaders, giving plenty of lead notice to a financing institution.

In reality, the FCS apparently seeks to replace case-by-case approval authority with a comprehensive, blanket self-approval process to create a large internal Wall Street styled mega-financing unit – hardly the role of a “farmer-owned cooperative.” Any suggested “partnerships” would only be between FCS's investment finance group, large financial institutions and their new-found customers, relationships often achieved by potentially displacing community banks' in local markets since FCS would have sole authority to pick and choose their “partners.” Community banks can already finance community facilities as private-sector, tax-paying, general-purpose lenders. This policy request contains no joint financing or participation requirements.

FCS's desired policy change could present significant danger to the entire Farm Credit System, preventing FCA from assessing beforehand the riskiness of new investments. For example, FCA noted<sup>2</sup>: *“During the financial crisis, many of these securities became distressed and illiquid. As a result, these institutions experienced a significant deterioration in investment asset performance and quality which increased their liquidity risk profile . . . when market access was tenuous and stressed.”* Obviously, the FCS regulator has great concerns, even if not voiced publicly, about a broad-based, self-approval authority removing FCA from timely, up-front oversight.

We are not aware of any actual evidence of delayed approvals for FCS CF financing. Indeed, at an April hearing before the House Ag Approps Subcommittee, one FCS entity noted they had \$760 million in CF financing. Their claim does not support FCS's assertion of a tedious approval

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<sup>1</sup> <https://www.fca.gov/newsroom/archive-of-updates>; September 14, 2017, [Approved Minutes of August 10, 2017, FCA Board Meeting](#) (PDF, 9 pages).

<sup>2</sup> Dec. 9, 2010 booklet, BL-064, *Farm Credit System Investment Asset Management*.

process. Certainly, the USDA, which has billions of dollars in CF loans, doesn't forfeit their oversight and loan approvals to the financing whims of FCS entities.

In general, ICBA opposes the System's investment scheme since it often usurps the Farm Credit Act's lending constraints and comprises loans that are typically non-agricultural in nature. As a GSE, the FCS was created to serve a narrow segment of farmers and ranchers and businesses that meet their on-farm production needs. FCS can use these advantages to "muscle out" community banks from local markets anytime they choose if they are allowed a broad financing mandate.

Since this is a policy issue, we request the final conference report replace this language with a request for the congressional agriculture committees to conduct a hearing to further explore the significant issues involved. Thank you for your attention to our request.

Sincerely,

/s/

Mark Scanlan  
Sr. V.P., Agriculture and Rural Finance

cc: House and Senate Appropriations Committees