



INDEPENDENT COMMUNITY
BANKERS of AMERICA®

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The Farm Credit System Flouts the Law and its Historic Mission

On behalf of the more than 5,800 community banks represented by the ICBA, thank you for convening today's full committee hearing: "*Review of the Farm Credit System.*" We appreciate that Chairman Conaway has sought to have an aggressive oversight of the policies and programs under the Committee's jurisdiction. This type of review is especially important in regards to the Farm Credit System (FCS), a government sponsored enterprise (GSE), which has run amuck of the law and its historical mission.

ICBA noted in previous congressional testimony on credit availability in rural America: "We could raise a number of additional issues regarding FCS abuses. We believe these types of issues and questions warrant a series of separate hearings. There are many concerns Congress should explore in their oversight capacity over the FCS." We continue to urge this committee and its Senate counterpart to conduct a series of in-depth hearings on the FCS's questionable and nontransparent activities.

Not only do we believe further hearings on the FCS are warranted, particularly in advance of a farm bill, but they should involve the full participation of the community banking industry. Community banks are impacted every day by the activities of the FCS and should have a seat at the table when FCS issues are reviewed and discussed. Obviously the FCS prefers not to have the banking industry involved in hearings on the System as they apparently fear their controversial activities will be brought to light in advance of finalizing a farm bill. Transparency is warranted particularly when it involves GSEs.

Adrift from its Historic Mission

Congress created the FCS to specifically serve *bona-fide* farmers and ranchers, farmer cooperatives and a narrow group of businesses that provide on-farm services. However, the Farm Credit Administration (FCA), the System's regulator, in recent years has become a willing accomplice aiding and abetting the FCS's efforts to expand into non-farm financing and has created crafty ways to circumvent the law to accommodate FCS's desires. FCS has sought to morph from a GSE with a narrowly targeted mission of serving agriculture into a generalized rural lender serving all types of borrowers in rural credit markets and even non-farm borrowers in non-rural areas. In this sense, the FCA, quite frankly, has become a captive regulator, often willing to do the System's bidding at the drop of a hat while claiming to be independent.

Illegal Investment Schemes: One example of FCA's capitulation to FCS's expansionist agenda to engage in non-farm lending is the agency's tortured effort to implement its 'Investments in Rural America' program. The FCA allowed FCS lenders to create a series of pilot programs which often included non-farm lending projects. FCA also released a major proposed regulation to allow FCS non-farm lending if such illegal lending was characterized as "investments."

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FCS lenders could, for example, extend credit for hospitals, commercial offices (doctors, lawyers, and dentists), manufacturing facilities, apartment complexes in cities, hotels and motels, trucking and towing companies, auto dealerships, etc.). Any limitations would only be based on the FCA/FCS's lack of imagination.

After five years, the FCA announced it was withdrawing its proposed rule and ending its allowance of FCS rural investment pilot programs. However, these actions were just a dubious sleight of hand by the regulator. While eliminating the pilot programs, the FCA allowed the financed projects to continue through the term of the financing which in some cases will last for decades. The FCA then briefly published on its website a guidance memo instructing FCS lenders on how to apply and gain approval to engage in investment programs that included financing for non-farm businesses, communities, rural areas and infrastructure projects. In other words, even though the FCS lobbied Congress for years to receive expanded powers – appeals that were typically rejected by Congress – the FCA has suddenly and quietly decided to just allow FCS lenders to do whatever they want as long as FCA provides their rubber stamp of approval.

ICBA submitted several letters with comprehensive questions to FCA asking for details on FCA's intentions based on the guidance memo. FCA refused to answer the questions for many months and when finally pressured by the Senate Agriculture Committee, FCA only answered the questions partially. This raises a further question – why is the FCA adamantly against transparency and accountability to taxpayers that are the ultimate backstop against another bailout of the FCS?

When FCA did partially respond to questions, FCA's lame response was its investment authorities are in a separate section of the Farm Credit Act (Act) and therefore financing of FCS investments were virtually unlimited and could go beyond the constraints Congress put in place for the loan making sections of the Act. ICBA adamantly rejects this preposterous interpretation and notes the complete lack of legislative history supporting FCA's position. Congress did not intend to limit the purposes of FCS loan making in one section of the Act and then allow unlimited purposes for FCS financing in another section of the Act.

Similar Entity Provision: Much attention has been focused on FCS activities under the so-called "similar entity" provision of the Act. It was revealed that CoBank, the behemoth FCS lender to cooperatives, made a \$725 million loan to Verizon to buyout Vodafone's interest in a joint venture. Verizon and Vodafone are headquartered in New York City and London and this extremely large loan was not rural in nature nor should it ever have included CoBank's participation.

Verizon (NYSE: VZ) has a market capitalization of over \$200 billion. Vodafone (NASDAQ: VOD) has a market cap of over \$70 billion. Can anyone seriously claim that these Fortune 500, non-rural, non-agricultural corporations headquartered in some of the world's largest cities were what Congress envisioned the FCS and CoBank would be lending to when it enacted, at the FCS's request, the similar entities provisions? We think not.

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This provision was never meant to allow CoBank or any FCS lender to make ineligible loans to large corporations. FCA is again abandoning their regulatory oversight responsibilities to go to any length necessary to allow FCS lenders to make whatever types of non-farm loans they desire. During debate on the 2008 farm bill, ICBA noted that the FCS's Horizon Project proposals were loosely worded and would allow FCS lenders to engage in financing large Fortune 500 companies. FCS representatives haughtily derided this contention and claimed it was misleading. But what has happened since then, even though Congress rejected the misguided Horizons proposal?

CoBank has provided major financing to Verizon, AT&T, U.S. Cellular, Frontier Communications, Constellation Brands, a leading beverage alcohol and liquor company and other very large corporations. Recently CoBank participated in a \$1.5 billion loan to Cyrus One.

In the Verizon instance, CoBank's financing did not target a "rural" telecommunications cooperative. Vodafone is a British multinational telecommunications company headquartered in London and ranks as the world's second-largest mobile telecommunications company in terms of revenues and number of subscribers. Verizon Communications, headquartered in New York City, reported at the time quarterly profits of over \$2 billion and revenues of over \$30 billion and hardly represented a rural telephone cooperative in need of financing by a government sponsored enterprise.

Cyrus One (NASDAQ: CONE), a publicly traded company with a \$4.4 billion market cap, operates 33 data centers across the U.S., the United Kingdom and in Singapore. A data center is a facility used to house computer systems and associated components. Their data centers are not located in rural areas as anyone can see by linking to their locations map (<https://cyrusone.com/data-center-locations/>). Neither is Cyrus One an agricultural entity.

Constellation Brands (NYSE: STZ), a Fortune 500® company with a \$31.8 billion market cap is a leading international producer and marketer of beer, wine and spirits with operations in the U.S., Canada, Mexico, New Zealand and Italy. Constellation is the No. 3 beer company in the U.S. with high-end, iconic imported brands such as Corona Extra, Corona Light, Modelo Especial, Modelo Negra and Pacifico.

CoBank's newly found lending activities appear to be an effort to leverage their GSE advantages deeply into the realm of multi-national, non-agricultural, non-rural and non-cooperative corporate financial deals. CoBank has been, not just a participating lender, but the lead lender, in some of these loans. This is not the purpose for which CoBank and other FCS lenders were created.

Recently FCS representatives have tried suggesting to Congress the 'similar entities' provision is an outgrowth of the 1980's ag crisis. However, this provision was enacted by Congress in the mid-1990's and had nothing to do with the 1980's farm credit crisis a decade earlier. In fact, the intent of Congress was underscored by the FCA's final rule on the similar entity provision which FCA published on January 30, 1997. FCA stated the similar entity rule: "expressly prohibits FCS institutions from participating in nonagricultural loans to similar entities"¹ (underline added).

¹ Final rule, eligibility and scope of financing, January 30, 1997, 62 FR 4429

Congress clearly did not intend for this authority to allow FCS and CoBank to finance any large non-agricultural Fortune 500 corporation as is being done today. Keep in mind the FCA has raised the lending limit for FCS entities to \$1.5 billion and the FCS already has several very large loans in their portfolio. Congress should require a list of these large borrowers and the amounts financed.

If the FCA wants to ignore the legislative history and suggest the activities currently being engaged in by FCS lenders is compliant with their regulations, then both the Act and their regulations need an overhaul to ensure the FCS is complying with their mission to serve agriculture as a GSE. The FCS and FCA need to stop hiding behind excuses such as ‘diversification’ and ‘risk management’ as cover for engaging in non-rural and non-agricultural loans intended to line the pockets of FCS lenders with millions of dollars of profits.

\$10 Billion Line of Credit: On September 24, 2013, the Treasury Department, through its Federal Financing Bank, entered into a \$10 billion note purchase agreement with the FCS Insurance Corporation (FCSIC) to establish a standby line of credit to provide FCS funds at the Treasury’s cost of funds. This line of credit, which the FCA sought in secret, raises a number of serious questions. For example, why did the FCA seek a \$10 billion line of credit at a time when FCS lenders were reporting record profits of \$4.64 billion in 2013?

Why did the FCA not seek Congressional approval? When the FCS failed in the 1980s, the farmland values which the FCS utilized as collateral had collapsed significantly. Yet, the \$10 billion line of credit, according to FCA, is “collateralized” meaning the collateral backing this line of credit could be dramatically reduced. If the FCS were to collapse, as it did in the 1980s, taxpayers would be on the hook once again for a sizeable bailout.

The FCSIC was created to collect premiums from FCS institutions as a backstop in the event of financial deterioration within the System. Why then did the FCA seek and obtain a line of credit from the Treasury’s FFB as additional protection? A report to the FCSIC prepared by the Brookings Institution stated: “FCS should be required to approach the Congress and the administration for legislative help” in seeking a line of credit. Yet, **FCA did not go to Congress** but secretly went to the Treasury to obtain the line of credit. There should have clearly been Congressional hearings on a GSE seeking a \$10 billion line of credit. This is another example of FCA/FCS seeking to avoid transparency and accountability.

FCA and FCS Diminishing Ag Credit Markets

When ICBA has surveyed bankers about their experiences with the FCS the responses are always quite informative. Bankers complain about the FCS cherry-picking activities and notes FCS almost exclusively targets the best and largest farm and ranch borrowers, offers these targeted borrowers below market rates and is willing to set those below market rates at longer terms.

By taking the best borrowers from community banks, FCS weakens the overall community bank portfolios and leaves the less seasoned/younger borrowers and higher leveraged borrowers with community banks. Similarly, if community banks stretch to keep these prime borrowers, community

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banks must accept less return and assume more interest rate risk by fixing the rate for a longer period of time, which is difficult to do based on the short term nature of deposits. Bankers typically point out the FCS largely ignores young, beginning and small farmers. As one banker stated, “FCS wants us to get these types of farmers started first and then later attempts to take them away once they become financially stronger.”

With Farm Financial Stress on Horizon FCS Needs to Focus on Farm Sector

USDA has projected net farm income to decline by 8.7 percent to \$62.3 billion, the fourth consecutive year of declines after reaching a record high in 2013. In addition, farm asset values are forecast to decline by 1.1 percent in 2017, and farm debt is forecast to increase by 5.2 percent. Farm sector equity, the net measure of assets and debt, is forecast down by \$51.2 billion

With low prices expected to continue next year and potentially greater financial stress over the next year and possibly beyond, this is not the time for the FCS to dilute its emphasis on farmers and ranchers by seeking to finance non-farm borrowers. FCS needs to remain focused on its mission as a GSE intended to serve the narrow niche of production agriculture.

Conclusion

We thank the committee for conducting this review of the FCS. The FCA has clearly lost respect for the Act’s constraints established to keep the FCS as a narrowly targeted GSE focused on agricultural lending. By thumbing their noses at the Act, the FCA and FCS are also thumbing their noses at Congress and the history and legislative intent of the Act. If FCA believes the Act is so loose as to allow it to grant any type of financing desired by FCS lenders, then the Act needs to be tightened.

Congress never intended for FCS to be a general purpose rural lender. If the FCA and FCS do not want to play by the rules, there are other lenders that would welcome the enormous subsidies enjoyed by the FCS as a GSE with significant tax and funding advantages. The FCS has an almost non-existent tax burden and should not, as a GSE, be crowding out private-sector, taxpaying community banks from lending markets and should not be abusing their authorities by making indefensible loans to the world’s largest corporations.

A series of hearings focused on FCS abuses and FCA’s complicity in circumventing the law and intent of Congress should be pursued. These hearings should obviously involve the banking industry. We look forward to discussing these and other issues in more depth with committee members. Thank you again for holding this hearing and for the opportunity to submit this statement for the record.

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