December 2, 2015

ICBA Statement on Hearing "*To Review the Farm Credit System*" by the House Agriculture Committee

On behalf of the more than 6,000 community banks represented by the ICBA, thank you for convening today's hearing: "*To Review the Farm Credit System*." When Chairman Conaway convened the House Agriculture Committee on January 21 of this year he pledged to "focus on aggressive oversight of all policies and programs under the Committee's jurisdiction." On September 15, Chairman Conaway referenced once again his "commitment to hold a top-to-bottom review of a full range of issues and policies within our jurisdiction."

This type of review is especially important in regards to the Farm Credit System (FCS), a government sponsored enterprise (GSE) that has run amuck of the law and its historical mission. ICBA noted in our June, 2014 statement 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 secretive activities.

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 FCA in recent years has become a willing accomplice in FCS's efforts to expand into non-farm financing and has derived creative ways to circumvent the law to accommodate FCS's desires. FCS has sought to morph from a GSE with a narrowly targeted mission 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 an independent regulator.

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 lending was characterized as "investments."

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 primarily 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 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 mostly 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. This raises a further question – why is the FCA adamantly against transparency and accountability to the outside world?

FCA finally responded to a few of the questions after pressure from the Senate Agriculture Committee. The gist of FCA's response was that its investment authorities appeared 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 that Congress put in place in 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 but then allow unlimited purposes for FCS financing in another section of the Act. ICBA seeks further answers to the questions we have submitted to FCA and we believe the non-farm financing envisioned by the guidance memo should be halted immediately.

$725 Million Verizon Loan: It appears the FCA was initially unaware that CoBank, the FCS's large lender to cooperatives, had made a $725 million loan to Verizon to buyout Vodaphone's interest in a joint venture. Verizon and Vodaphone are headquartered in New York City and London and this extremely large loan was not rural in nature nor would it be allowed under the provisions of the Act. However, CoBank and the FCA hid behind a provision referred to as "similar entities" lending, but this provision was never meant to allow CoBank or any FCS lender to make ineligible loans. FCA is again abandoning their regulatory oversight responsibilities in an effort 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's Project proposals were loosely worded and would allow FCS lenders to engage in financing large Fortune 500 companies. FCS representatives derided this contention and claimed it was misleading. But what has happened since, even though Congress rejected the misguided Horizons proposal?

CoBank has provided major financing to Verizon, AT&T, U.S. Cellular, Frontier Communications and other very large corporations. In the Verizon example, 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, had just reported quarterly profit 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.

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. This is not the purpose for which CoBank and other FCS lenders were created.

Keep in mind that the FCA has recently 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.

$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 Farm Credit System 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. 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, American 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 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 surveyed bankers about their experiences with the FCS the responses were quite informative. Bankers complained about the FCS cherry-picking activities and stated FCS almost exclusively targets top borrowers, offers these targeted borrowers below market rates and is willing to set those below market rates at longer terms.

By taking top 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 top borrowers, community banks must accept less return and assume more interest rate risk by fixing the rate for a longer period which is difficult to do based on the short term nature of their deposits. Bankers typically stated 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

The USDA has noted farm sector profitability is projected to decline again this year with net cash farm income forecast at $93 billion, down about 28 percent from 2014 levels. Net farm income is forecast to be about $56 billion in 2015, down 38 percent from 2014’s estimate of $90 billion. If realized, the 2015 forecast for net farm income would be the lowest since 2002 in both real and nominal terms and a drop of 55 percent from the recent high of $123 billion in 2013.

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 initial review of the FCS by questioning the FCA. The FCA has clearly lost respect for the Act’s boundaries established to keep the FCS a narrowly targeted GSE. 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 many other lenders that would welcome the heavy subsidies enjoyed by the FCS as a government sponsored enterprise with tax and funding advantages.

A series of hearings focused on FCS abuses and FCA’s complicity in circumventing the law and intent of Congress would be a welcomed next step. We look forward to discussing these issues in more depth with Congress in coming months. Thank you again for holding this hearing and for the opportunity to submit this statement for the record.