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June 23, 2004

Director  
Loan Making Division  
Farm Service Agency  
U.S. Department of Agriculture  
1400 Independence Avenue, SW  
Stop 0522  
Washington, DC 20250-0522

Re: Proposed Rule: Guaranteed Farm Ownership and Operating Loan Requirements; 7 CFR Part 762, 69 Federal Register, No. 86, pp. 24537, May 4, 2004.

Dear Sir or Madam:

The American Bankers Association (“ABA”) is pleased to offer comments on the proposed rule to revise the Farm Service Agency’s (“FSA” or “the Agency”) regulations regarding guaranteed loans and especially the acceptability of FSA guaranteed loans as collateral for Federal Home Loan Bank advances. The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country. ABA member banks make the majority of farm loans that are guaranteed by FSA, and the positive relationship between the banking industry and USDA has accounted for much of the success the program has enjoyed over the years.

In general, we appreciate that FSA has taken into consideration many of the comments made by many program users over the years. This short regulation clears up many areas of confusion that users have brought to FSA’s attention over the years, and some of the proposed changes will improve program delivery. Unfortunately, some changes included in the proposed rule will have a negative effect of the delivery of the program to farmers and ranchers. Our support and concerns are detailed below.

#### **7 CFR, Sec. 762.106 – Preferred and Certified Lender Programs**

We applaud the removal of the requirement (in 7 CFR Sec. 762.106 (c)(8)) that institutions applying for Certified Lender Status (CLP) send all of their forms to FSA for approval. We agree with FSA that field offices are familiar with these forms and it is unnecessary for institutions applying for CLP status to have to

apply to the FSA's Washington office. We appreciate the removal of this regulatory burden.

Similarly, we applaud the removal of the requirement that FSA approve the designated person(s) to process and service guaranteed loans. Under the proposal (7 CFR Sec. 762.106 (c)(8)), the bank designates the person(s), without FSA prior consent. This is a determination properly left to the financial institution and FSA is to be commended for removing the additional step previously required.

ABA also applauds revisions to 7 CFR Sec. 762.126 (e), which will help to resolve past confusion about proper lien positions for security on new guaranteed loans. Especially noteworthy is the increased flexibility afforded lenders that refinance chattel secured loans with a new real estate secured loan. By no longer requiring a lien on both loans, lenders will be better positioned to provide non-guaranteed credit to their customers for future borrowing needs.

### **7 CFR, Sec. 762.124 – Interest rates, terms, charges and fees**

We applaud and agree with the Agency's concerns about unscrupulous fees being charged by certain bad actors. The ABA condemns any practices that deceive, defraud or otherwise take unfair advantage of consumers. We are, however greatly concerned, and oppose the Agency's proposal to limit fees on guaranteed loans to those that are no greater than those charged to un-guaranteed customers for similar transactions. We are concerned about the unintended consequences of the proposed rule. FSA should be trying to expand the number of private sector lenders that participate in the program. We believe that limiting loan fees will result in fewer banks and other lenders being willing to make guaranteed loans, because of the reduced income potential. FSA's intention to limit fees will likely lead to fewer banks participating in the guarantee program which in turn will result in producers having fewer credit choices, leading them to pay more for credit.

We oppose such a limitation because:

- Loans guaranteed by FSA under the Farm Ownership ("FO") and Operating Loan ("OL") programs, are by definition, impaired credits. Lenders still have to certify to FSA that the proposed loan could not be made to the customer without a guarantee from FSA. An impaired credit has unique characteristics that require more services from the lender. In addition, FSA requires more reporting, more careful collateral control, and more thorough financial analysis of guaranteed loans than are required by lenders for standard (unimpaired) loans. Banks, and their regulators, generally do not like impaired credits, and, as a result, they require more time and attention, all of which requires greater expenditures from the bank.

- Guaranteed loans require greater financial analysis which, in turn, requires greater expenditures by the lender. FSA guaranteed loans require the bank to do an annual financial review, annual collateral inspection, and annual cash flow projection for the next crop season. All of this is important because the cash flow margins are generally much smaller; again, the bank is dealing with an *impaired* credit. The additional effort creates additional expense, and as a result, profitability on the asset is reduced.
- The Agency fails to provide the public with any documentation that excessive loan fees are a widespread problem. We believe that in the vast majority of cases, fees are appropriate, and, more importantly, set by the open market. Producers have many choices available to them when it comes to credit, and they have ample opportunity to vote with their feet. We believe that producers will continue to seek good loans on good terms from good lenders.
- While the Agency has done a good job over the last decade in improving the guaranteed loan program, there is more to be done. Loan fees charged by lenders are an example, we believe, of why there must be much more done to simplify and streamline the guaranteed loan program. We, and other users, have recommended additional changes that would increase program delivery efficiency, and would make it less likely that lenders would charge special fees in order to provide guaranteed loans. One example: we have strongly advocated that the Agency establish a de minimis levels on collateral losses following loan liquidation. Current procedure requires the lender to account to the Agency for all collateral, even if the items in question are deceased, obsolete, junk, abandoned. We have long advocated for a set dollar de minimis level that would allow lenders, and Agency staff, to settle loss claims quickly if the unaccounted dollar value of collateral fell below the established levels.

### **7 CFR, Sec. 762.159 -- Pledging of guarantees**

The banking industry has eagerly waited for this rule since 1999 when the Federal Housing Finance Board (“the Board” or “the Finance Board”) revised its own regulations to allow for the pledging of Federally guaranteed loans for Federal Home Loan Bank advances. At that time, the Board made it explicitly clear that Federally guaranteed loans were eligible collateral for the Federal Home Loan Banks and that such loans could be treated as unimpaired collateral. However, FSA regulations were not in sync with the Finance Board’s regulation and FSA guaranteed loans continue to be difficult, if not impossible, for Federal Home Loan Banks to accept as collateral. In the nearly five years that have passed since the Federal Housing Finance Board’s action the FSA has had numerous discussions with bankers and Federal Home Loan Bank officials about the issue. Therefore we had expected that the proposed rule would meet the needs of all parties. Unfortunately, that does not appear to be the case.

FSA has finally provided explicit language to allow banks to pledge the guaranteed loans to the Federal Home Loan Banks and Federal Reserve Banks. However, the Agency does not provide users with any information about how to make the pledge -- there is no proposed format to be followed. While this seems like a rather simple matter to correct, it would be helpful for the agency to develop specific guidance on doing so.

Of far greater concern however, is the following language from the proposed rule:

*“ the guarantee will **be unenforceable** until a new eligible lender is substituted.....The guarantee will not cover a loss that results... ”*

The value of pledging a guaranteed loan to a Federal Home Loan Bank is negated by the proposed rule. FSA guarantees are full faith and credit guarantees made by the United States Treasury to the holder. As a full faith and credit guarantee, banks should be able to pledge these guarantees in exchange for nearly 100% par/collateral value. The Federal Home Loan Banks provide lendable funds to member banks that pledge collateral for advances. FSA guaranteed loans should be treated the same as Treasury certificates and other high value liquid assets because of the Federal full faith and credit guarantee. Under the proposal, the value of that guarantee is negated, and the Federal Home Loan Banks would be prudent to treat FSA guarantees the same as any other farm loan, and therefore their value as collateral for additional lendable funds would be significantly discounted.

The result is that smaller rural banks that are active FSA guaranteed lenders, will be denied additional lendable funds, and may be unable to make additional loans if funding tightens. USDA's role should be to encourage private sector lenders to pledge their guaranteed loans for full value advances so they can continue to make credit available to rural America. The proposal does just the opposite.

Further, FSA is not the only USDA Agency that provides credit guarantees. We are greatly concerned about the impact the proposed rule will have when the Federal Home Loan Banks look at other USDA guarantees--- especially in the areas of housing and business and industry lending. In addition, we are concerned that other Federal Agencies that provide credit guarantees may copy FSA's lead. In short, this rule has the potential to negatively impact many other Federal credit programs, to the detriment of rural America.

In order to avoid these negative consequences, the agency must re-write the rule in a way that provides for the guarantee to be enforceable at all times. Further, it is not clear to us where FSA has the authority, in law, to declare that a full faith and credit guaranty is unenforceable.

## **Conclusion**

In conclusion, the American Bankers Association applauds the FSA's efforts to reduce regulatory burden on guaranteed lenders. However, the Agency's efforts to address fees and pledging of guaranteed loans is seriously flawed and both

must be reconsidered. We appreciate this opportunity to share our views with the Agency and hope that our concerns will assist the Agency in revising the proposal to ensure that the guaranteed program can serve rural America in meaningful ways for years to come.

If you would like to discuss any of these issues in greater detail, please do not hesitate to contact the undersigned at (202) 663-5480 or John Blanchfield, Director, ABA Center for Agricultural and Rural Banking, at (202) 663-5100. Thank you.

Sincerely,

Joseph Pigg  
Senior Counsel