

Mr. Chairman and members of the committee, I am pleased to appear on behalf of the American Bankers Association (“ABA”) to participate in this important hearing to discuss national charters for Farm Credit System (“FCS” or “System”) direct lending institutions. We especially want to thank you, Mr. Chairman, for your interest and concern about the future of the System.

I am Dennis Everson, Senior Vice President of First Dakota National Bank in Yankton, South Dakota. I am a past chairman of the ABA’s Agricultural and Rural Bankers Committee and served as chairman of the ABA’s Task Force on 21st Century Agricultural Banking. My agricultural lending career spans some of the best and some of the worst days for American agriculture. During my career, I have worked with the USDA, Farmers Home Administration, the Farm Credit System, and the commercial banking industry. 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.

First Dakota National Bank is a \$320 million community bank in southeast South Dakota. Approximately 44 percent of our loan portfolio are loans to farmers and ranchers in South Dakota and other mid-western states. Despite historically depressed prices for agricultural commodities grown in South Dakota, the competition for good agricultural credit in our service area is very strong. My bank competes with 29 commercial banks, five credit unions, three captive machinery manufacturer credit companies, three seed and fertilizer companies, and Farm Credit Services of America for agricultural loans. I am comfortable in telling you that the competition for agricultural credit is the strongest that it has ever been in the 28 years that I have been an agricultural lender. I welcome that competition and work hard every day to make sure we are offering farmers in our service area the best, lowest cost credit that can be delivered. To ensure that First Dakota has people that know and understand agriculture, we employ 12 agricultural loan specialists and nine support staff to originate and service agricultural loans.

In an effort to better meet the credit needs of farmers, especially smaller and beginning farmers, our bank became the first bank in the nation to be granted preferred lender status through the US Department of Agriculture (“USDA”) Farm Service Agency (“FSA”) Preferred Lender Program (“PLP”). PLP lender status allows us to process USDA guaranteed loan applications using our own forms and credit underwriting standards. PLP lender status has been extremely valuable to us in meeting the credit needs of farmers that do not meet some aspect of our bank’s credit criteria, or the standards imposed by our regulators. We have been very active with the guaranteed loan program and have made over \$22 million in loans under the program since 1990.

The 1980s were very difficult times for farmers in South Dakota and throughout the country. Nationwide, over 300 agricultural banks failed during that period as a result of the farm credit crisis. However, one of the most dramatic indications of just how bad things had gotten in the agricultural economy was the need for a \$4 billion line of credit from the federal government to bail out the FCS.

The financial crisis in which the FCS was mired was precipitated by unfortunate legislative and regulatory changes designed to reinvent a System that was playing an increasingly diminished

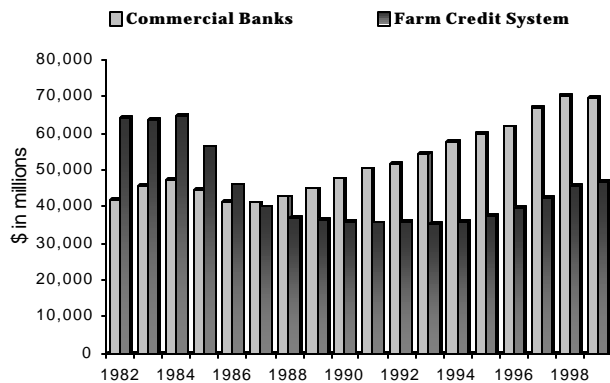
role in the agricultural credit market and the mission of which had long since been met by the private sector.

We are here today to talk, in part, about the legacy of that period. That was a time when reckless lending by the Farm Credit System, America's first Government Sponsored Enterprise ("GSE"), which continues to be the only tax advantaged retail lending GSE in the country, wrought havoc on the farm and rural economy of our nation. It was a time when the System's regulator, the Farm Credit Administration ("FCA" or "Administration"), was assuring Congress and the nation that all was well while in reality their house was burning down. Those of us who lived and worked through that period feel that this latest proposal by the FCA raises the specter that history is repeating itself.

After the crash of the farm economy in the 1980s, it was the banking industry that picked up the pieces and worked to restore the economic health of American agriculture. Following the federal intervention in 1987, the FCS has concentrated and consolidated its business. Outstanding System loans to farmers and ranchers declined from \$64.6 billion (33 percent of the agricultural credit market) in 1984 to a low of \$35.4 billion (25 percent of the agricultural credit market) in 1993. On December 31, 1999, outstanding System loans to farmers and ranchers were approximately \$46.6 billion or 27 percent of all farm debt. During that same period, the banking industry held \$47.2 billion in agricultural loans (24 percent of the market) at the end of 1984, \$54.5 billion in 1993, and \$70 billion (40 percent of the market) at the end of 1999.

I have reviewed with you this recent history because it illustrates three very important points. First, the FCS has assumed a diminished role in a market brimming with competitive providers of agricultural credit. Second, commercial banks have more than filled the void left by the FCS. Third, the national charter initiative is reminiscent of the 1980s in that the System is once again desperately trying to reinvent itself as it has assumed a diminished role in the agricultural credit market and has found that its mission has been all but met by the private sector. Indeed, history does appear to be repeating itself.

Farm Business Debt



Source: USDA

The proposal to grant national charters to System institutions serves no credible public policy purpose, raises serious safety and soundness questions, exposes the American taxpayer to incalculable risk, and destroys any shred of the notion that the FCS is a borrower owned and locally controlled cooperative lending organization. This proposal simply is not in the best interest of the farmers, ranchers and rural residents FCS was chartered to serve.

Our specific concerns about national charters are as follows:

- National charters will serve no credible public policy purpose.
- National charters will have a negative impact on access to credit for small and beginning farmers.
- National charters raise serious safety and soundness concerns and expose the American taxpayer to additional risk.
- The process that FCA chose to implement a far-reaching and fundamental change to the FCS calls into question their status as an independent regulator.

National charters will serve no credible public policy purpose.

The FCS was created in 1916 as a government sponsored enterprise to deliver much-needed credit to under-served populations within the agricultural economy. System institutions have always operated with clearly defined, chartered territories and, as GSEs, enjoy beneficial federal and state tax treatment and have access to lower cost lendable funds. Furthermore, the participation of farmer- and rancher-borrowers in the management, control, and ownership of the System remains central to its mission.

By abandoning clearly defined territories and the principle of local ownership and control, the FCA would undermine essential and core principles of the System. As a result, the question becomes whether GSE status for the System is appropriate or required. Why should a large, nationally chartered lender continue to receive favorable federal and state tax treatment? Why should taxpayers continue to subsidize funding for a large finance company? Why should American taxpayers be placed at financial risk for failures in a System that no longer warrants the benefits of GSE status?

FCA seems to have adopted a “tough love” approach to their regulation of the FCS. By announcing national charters, the FCA has created a system that will have System institutions competing with each other. Why did the FCA, as the safety and soundness regulator of the FCS, decide that it was acting responsibly in setting up a Darwinian system that will result in survival of the fittest FCS institutions and the extinction of the weaker?

FCA made a monumental understatement in their National Charter Booklet (“Booklet”) in advising System institutions regarding national charters:

Each association’s board must choose whether to apply for a national charter. If the association chooses not to apply for a national charter, it still should consider revising its business plan to reflect changes in its operating environment. As other associations with national charters begin to offer products and services to customers in its territory, the competitive environment may change significantly.¹

What public policy benefit does FCA see in developing a process by which System institutions will compete with one another? We have reviewed all public statements made by FCA about

¹ Farm Credit Administration, *National Charters Booklet*, 65 Fed. Reg. 45066, 45073 (July 20, 2000)

their decision and we have been unable to find any credible justification for sending a GSE on such a new and reckless course of internal competition. In what way do we as taxpayers benefit if System institutions prey upon each other for market share? For the last 10 years our members have complained to Congress and to FCA about the pricing practices of System institutions. A clear pattern has emerged; System institutions will consistently under price credit on large deals in order to get the business. We have many documented cases of this practice. FCA has, for the last 10 years, denied that System institutions have engaged in any below market pricing. We disagree. We are very concerned that with national charters, System institutions will engage each other in a disastrous round of low ball pricing that will undermine the safety and soundness of the entire System. FCA fails to acknowledge this problem and fails to address what will happen once System institutions start to cannibalize each other.

FCA would have Congress and the public believe that by eliminating geographic boundaries the system will be insulated from risk due to fluctuating commodity prices, isolated weather-related problems and all sorts of additional risks that FCA pins on defined geographic territories. FCA fails to examine the increased risks that are associated with a local lender venturing forth into new territories without a solid understanding of the new region's peculiarities. FCA fails to establish a case for how national charters will alleviate the system's concentration in lending to a specific commodity. For example, a System institution in Ohio that lends to large hog operations will almost certainly focus on large hog operations in Iowa and North Carolina. Instead of more diversity in commodity lending, we believe that the result will be a continued focus on the same commodities in other areas and an increased concentration in single commodity loan risk.

National charters will have a negative impact on access to credit for small and beginning farmers.

We have great concerns about the negative impact national charters will have on small and beginning family farmers as System institutions seek larger, more profitable loans at the expense of these borrowers. Although FCA recently redefined the universe of farmers that would fit into this category to inflate their claim of serving young and beginning farmers, there is compelling evidence that suggests that System institutions are not serving this sector of the farming population. FCA's national charter proposal will primarily or exclusively benefit large multi-state farm and ranch operations, thus exacerbating this disparity.

The System's record of lending to small family farms, beginning farmers, and socially disadvantaged farmers is spotty. Indicative is the limited participation of System institutions in the FSA guaranteed loan program. As I stated earlier in my testimony, FSA guarantees allow banks and FCS lenders to make credit available to farmers and ranchers that have some sort of credit deficiency that makes it difficult for private sector lenders to make credit available without a guarantee. The maximum loan size that USDA will guarantee is \$700,000 so these loans tend to be to smaller operators. USDA economists have done a great deal of research on the types of borrowers that receive benefits from this program and they also track lender participation. A recent article published by USDA economists Charles Dodson and Steve Koenig² sheds some light on both bank and FCS participation in this program. We believe that the article also

² Charles Dodson and Steve Koenig, *The Targeting of FSA's Guaranteed Farm Loan Program*, Volume 13, Issue 3, American Bankers Association Journal of Agricultural Lending 50 (2000)

provides some understanding of the implications for small family farmers, beginning farmers, and socially disadvantaged farmers should FCA proceed with their national charter initiative.

In the article, the economists note:

...the Farm Credit System (FCS) has made little use of FSA's guaranteed program to fund beginning farmers in...America's Heartland. While commercial banks have made heavy use of the program in Iowa, Nebraska and South Dakota, FCS appears to have made only a handful of loans to beginning farmers in these states.³

The authors went on to note that while banks hold 40 percent of all farm debt, the banking industry accounts for more than 80 percent of all FSA guaranteed loan volume. FCS, which holds 27 percent of all farm debt accounts for just 15 percent of FSA guaranteed loan volume.⁴

An additional observation made by Dodson and Koenig causes us great concern when examining the impact that national charters may have on access to FCS credit by smaller farm borrowers:

Because FCS associations have merged into large organizations in some regions, the delivery [of credit] to beginning farmers in a broad area can be determined by the policies of as little as one association. For example, one large association serves the states of Nebraska, South Dakota, Iowa, and Wyoming.⁵

We believe that your concerns, Mr. Chairman, about the access of small and beginning farm borrowers to FCS capital, if national charters are granted, are justified. FCS institutions that are scouting new territory to set up lending operations will not be looking at small or beginning farm loans. They will concentrate all of their resources on large deals that allow them to place a maximum amount of credit with one borrower. While this type of lending will be the most efficient for them to undertake, we strongly question if this is appropriate for a GSE.

National charters raise serious safety and soundness concerns and expose the American taxpayer to additional risk.

FCA has a checkered past with respect to monitoring and supervising expanded activities. After recklessly expanding in the 1970s and 1980s, the System required a \$4 billion line of credit from American taxpayers in 1987 in order to avoid a complete collapse. Aggressive expansion into new activities by System institutions that lacked adequate experience, combined with the failure of the regulator to vigorously oversee such expansion, are widely agreed to be two of the major reasons why the System failed in 1987. These safety and soundness concerns are especially significant when, as under this initiative, there is no limitation on entry into new markets either by commodity or geography.

³ Id at 54

⁴ Id At 55

⁵ Id

Each System institution is obligated under its charter to lend to all eligible borrowers within its specified territory. Contrary to Congress' intent that all borrowers—from the financially challenged to the most creditworthy—have equal access to the System, in reality national charters will result in all System institutions competing directly with each other, with larger, more aggressive institutions competing vigorously for the business of the largest and wealthiest borrowers.

System institutions are also jointly and severally liable to each other as a safeguard against System-wide failure. History, however, has proven that joint and several liability is at best a weak defense. A conservatively managed institution that has been subjected to ruthless competition within the System will *not* want to provide hard-earned capital to an association that has gotten into trouble because of reckless lending. Once System institutions are called on to support each other with capital infusions, a wave of litigation will overwhelm the fragile system of joint and several liability, just as it ultimately did in the 1980s. This scenario presents a significant risk to the American taxpayer because the last line of defense is another federal bailout.

The process that FCA chose to implement a far-reaching and fundamental change to the FCS calls into question their status as an independent regulator.

The national charter initiative had its genesis in FCA's failed "customer choice" proposal. That proposal, issued in November 1998, elicited hundreds of comment letters in opposition from System institutions and others fearful of the impact of unrestrained intra-system competition. National charters will achieve the same results as those sought in the customer choice proposal. And yet, FCA conceded to allow Congress and the public to comment on the proposal only *after* you, Mr. Chairman, raised concerns about FCA's actions in June of this year.

In response to your concerns, FCA reluctantly agreed to publish its Booklet for public comment. However, FCA was careful to note that the Booklet "is not subject to a notice and comment requirement. Nevertheless, we are providing this notice and additional opportunity to comment to allow input from all interested parties as the FCA Board considers its future chartering decisions."⁶ In short, while the Booklet was published, and FCA received over 900 letters between July 20 and August 31 of this year, the process that FCA initiated on March 8, 2000 was never halted, and has not been subject to a thorough review and comment. FCA never intended to seriously consider the concerns of commentators and they never wavered from their stated intention to grant national charters.

The FCA is supposed to be a bipartisan and independent agency of the executive branch. The FCA's stated mission is to ensure a safe and sound, competitive System to finance agriculture and rural America as authorized by Congress. By ignoring Congress and the public's concerns about this far-reaching and fundamental change to the System, the FCA has ignored its fiduciary responsibility to the public.

⁶ 65 Fed. Reg. At 45067

Conclusion

In summary, we agree with you, Mr. Chairman, that the shift to national charters will translate into new safety and soundness risks as System institutions venture into territories in which they are inadequately prepared to manage risk. We believe that FCA has failed to adequately assess the potential for such problems and has failed to open an adequate dialogue with all stakeholders about this issue. Agricultural lending is very much a “place based” business that is best understood and managed locally. We also share your concern about the ability of FCA to conduct thorough safety and soundness examinations and accurately assess whether a System institution is adequately serving their local service area and meeting the credit needs of all farmers and ranchers and not just those of the larger, wealthier operators.

FCS was created at a time when there were limited choices for credit for American agriculture. Since its creation in 1916, agriculture and agricultural credit have changed greatly. Today my customers have nearly unlimited access to a wide variety of credit opportunities. The fact that these options exist raises the question of why the American public should remain on the hook for the reckless activities of a tax advantaged GSE that has clearly targeted its lending activities to benefit a chosen group of larger, wealthier farmers and ranchers. Given their track record of unsafe and unsound lending in the past, and the lack of enforcement on the part of their regulator, we urge Congress to stop this process before it is too late.

ABA member banks provide more credit to American farmers and ranchers than any other group of lenders. Our members have committed billions of dollars to the industry. We helped to restructure the agricultural economy after the 1980s and we want to take every necessary step to ensure that we never revisit those terrible times again. Thank you for your interest in this issue and I would be happy to answer any questions.