

February 1, 2016

The Honorable K. Michael Conaway
Chairman
Committee on Agriculture
U.S. House of Representatives
1301 Longworth House Office Building
Washington, D.C. 20515

The Honorable Collin Peterson
Ranking Member
Committee on Agriculture
U.S. House of Representatives
1305 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Conaway and Ranking Member Peterson:

I am writing to you on behalf of the members of the American Bankers Association (ABA) to thank you for your hearing on December 2, 2015 to review the Farm Credit System (FCS). The hearing was very informative and provided a great deal of insight into a number of lending practices within the FCS. The ABA believes that this hearing was in the national interest and that there are significant reasons to hold annual oversight hearings of the FCS, which are outlined below.

As a follow up to the hearing, we believe that the House Committee on Agriculture should continue to examine the following activities of FCS:

- **Lending outside the mission.** This issue seems to be of the utmost concern to members of the Committee and is of great concern to our members as well. We believe the Farm Credit Administration (FCA) has allowed the FCS to go too far in their determination of similar entity loans. Similar entity authority was intended to be a narrow authority that would allow FCS institutions to be involved with commercial lenders on loans that are similar to traditional FCS loans. Instead, this authority has been extended to make loans to any entity that may be remotely tied to agriculture, and more egregiously, to large telecommunication companies and national restaurants. We do not believe allowing the FCS to use its tax-advantaged subsidy to participate in corporate lending was Congress' intention with similar entity lending and urge the Committee to eliminate these practices. We also request the Committee to follow up with FCA on instances, in which, it required FCS institutions to divest similar entity participations where the FCA thought there was reputational risk and where the institutions should not be lending. Additionally, the Committee should ask the FCA to provide specific examples. The Committee should also further the examination of loans that are being made for non-agriculture purposes, particularly for casinos, like the Saratoga Raceway in New York and lending for college tuition and vacation homes as advertised by Cape Fear Farm Credit, which has explicitly stated that it can "offer loans for automobiles, college tuition, investments [and] vacation homes."
- **Indirect lending.** Indirect lending has become a large part of FCS's profile over the past several years. With a potential downturn in the agricultural economy, it is important to pay even more attention to any programs that are related to agricultural equipment financing. As you may recall, a number of FCS institutions own or invest in indirect money lending

operations that enable producers to borrow taxpayer-subsidized-money from the FCS, being members of the lending cooperative. These programs work under highly questionable “loan participation” rules that were approved several years ago by the FCA, the FCS regulator. As we understand it, a producer seeking machinery and equipment loans applies for credit to purchase equipment at the machinery dealership. The dealer takes minimal financial information from the farmer and submits the application to the FCS lender, who in turn does the credit underwriting, completes all of the loan documentation, funds the loan, and closes it. The farmer then makes his or her payments to the FCS institution. Various FCS lenders have concealed their presence in the loan by operating under various names, including “AgDirect.”

We do not believe such schemes are an intended outcome of the benefits bestowed by Congress on the FCS – namely, Government Sponsored Enterprise (GSE) borrowing privileges and deep tax subsidies. These indirect lending programs now account for a significant percentage of FCS’s growth, but tracking the growth of these questionable operations has been even more problematic due to the fact that this financial information is supplied by the FCS lenders and as reported by FCA. Indirect lending can be higher risk lending and we respectfully believe that the Committee should examine these programs to determine if they present a safety and soundness threat to the FCS and to the taxpayers, who are ultimately liable for any FCS failure.

- **Shadow banking activities.** Deposit taking was another important topic discussed during the hearing. While the FCS is not allowed to accept customer deposits, many FCS institutions are engaged in shadow banking activities that closely mirror services provided by the banking industry. These activities include, but are not limited to, deposit taking, cash management, and credit cards. The Farm Credit Administration (FCA) explained that FCS institutions simply hold the funds and let customers withdraw them over time, similar to a line of credit. However, as you will see in the attached document, these accounts will actually earn interest and are completely liquid, which is very similar to a checking account at other financial institutions. Not only are FCS institutions not allowed to hold deposits, but even more troubling is that unlike financial institutions, these accounts are not insured, and therefore, are more risky to the consumer.
- **Retained mineral rights.** During the hearing, Committee Members expressed their concerns with the FCS and its banks retaining mineral rights on foreclosed properties. In fact, it was discovered that some FCS institutions continue to hold extensive mineral rights (some dating back to the 1930s) that, in some cases, are now very valuable. It is interesting to note that the Farm Credit Amendments Act of 1985 prohibited FCS institutions from retaining mineral rights on any properties the FCS foreclosed upon, but did not require FCS lenders to divest earlier acquired rights. Prior to the 1985 Act, it was common practice for FCS lenders to strip mineral rights from farm properties following foreclosure and retaining them even after the property was resold. Other than hearsay, it is very difficult for the farmer-owners of an FCS institution to ascertain what the present market values of such mineral rights are. We question why a taxpayer subsidized GSE should hold any mineral rights beyond the amount of time it takes to market and sell such rights, when one considers

that other financial institutions are required to divest property acquired through bankruptcy within five years. In 2003, the Farm Credit Bank of Texas sold its mineral rights, so we hope that members of the Committee acknowledge this is not uncommon practice and there is clearly a precedent for the sale of mineral rights.

- **Lending to Young, Beginning, and Small Farmers.** Lending to young, beginning, and small farmers and ranchers (YBS) by the FCS has decreased from 30% of FCS's total loan portfolio in 2003 to 15% in 2014. Demonstrably, proving that YBS lending is not a priority for the FCS. However, we believe that YBS lending should be a priority and that all FCS institutions should increase their overall YBS lending to justify their GSE status along with the considerable benefits achieved by being a GSE. Additionally, the method by which FCS considers a YBS borrower should be examined to verify that individuals are considered once for any category and not once for each category. We believe this will produce more accurate results on YBS lending.

On behalf of the ABA, I once again thank you for calling the hearing to examine the Farm Credit System. The FCA, and by extension, the FCS, needs continued oversight by the House Agriculture Committee. We believe there is a need to increase the availability and affordability of agricultural credit for all farmers and ranchers. This will be achieved through increased transparency of the FCS from annual oversight hearings by the Committee and by further examining the aforementioned issues. This will provide greater safety and soundness for the farmers, ranchers, financial institutions, and any others who work with the FCS.

Sincerely,

Handwritten signature of Bob Nienhoff in black ink.

cc: Members of the House Agriculture Committee
Members of the Senate Agriculture, Nutrition and Forestry Committee