

February 2, 2015

The Honorable Pat Roberts
Chairman
Senate Committee on Agriculture, Nutrition
& Forestry
328A Senate Russell Building
Washington, D.C. 20510

The Honorable Debbie Stabenow
Ranking Member
Senate Committee on Agriculture, Nutrition
& Forestry
328A Senate Russell Building
Washington, D.C. 20510

Dear Chairman Roberts and Ranking Member Stabenow:

I am writing to you on behalf of the members of the American Bankers Association (ABA) who are alarmed at the growth and questionable practices of the *federally subsidized* Farm Credit System (FCS). As outlined below, many of these practices raise serious questions regarding the wisdom of providing continued federal tax subsidies to an entity that no longer serves a demonstrated market need, looks to major U.S. corporations as its customers, operates in the dark without transparency to its farmer-owners, and has quietly expanded its business model to compete directly with financial institutions that have difficulty serving their customers in the face of such government-subsidized competition. We strongly urge you to conduct annual oversight hearings that look into these important issues.

As you know, the FCS was created in 1916 to provide credit to farmers at a time when credit was not readily available. Since then, rural markets have changed with a diverse range of private sector lenders now available to meet broader market needs. Yet, in the face of this diminishing need, the FCS has grown exponentially, now with total assets of *\$267 billion – much larger* than the median sized farm bank with \$102 million in assets that competes with the FCS every day. In fact, the FCS has dramatically expanded its assets over the last decade, *adding \$127 billion in assets and nearly doubling its size over such a short period*. If FCS were a bank it would be the *ninth largest bank in the country*. In addition to raising safety and soundness concerns, such growth merely amplifies its negative effect on local market competitors.

While the size of such a government-subsidized entity should raise questions for policymakers over the appropriateness of government policies that facilitate growth, there is likewise the impact that FCS's tax-favored status has on the federal deficit. In 2013, the FCS enjoyed a tax subsidized net profit of \$4.6 billion while paying just 4.8 percent in combined federal, state, and local taxes. If the FCS had been taxed at the federal bank rate of 31 percent, the FCS would have paid \$1.3 billion in taxes. The FCS's tax subsidy will cost the American taxpayers an estimated \$6.73 billion over the next five years. Policymakers should question the wisdom of continuing to provide such subsidies in the face of pressing needs elsewhere.

It has been over a decade since the Committee has undertaken a dedicated review of the Farm Credit System. We respectfully request that the Committee conduct annual oversight hearings to

examine the growth, financial practices, and regulations of the FCS. Specifically, we believe that the Senate Committee on Agriculture and the relevant subcommittee should examine:

- **Similar entity lending.** The Farm Credit System is allowed, with the permission of the Farm Credit Administration, to make *similar entity* loans to borrowers that may be similar to eligible FCS borrowers. For instance, the FCS is allowed to make loans to rural telephone cooperatives. Remarkably, the FCS has used that narrow authority to expand heavily into telecom lending. For example, the FCA has allowed FCS to make loans of \$725 million to Verizon, \$300 million to Frontier Communications, \$225 million to U.S. Cellular, and \$200 million to AT&T. Additionally, under the similar entity provision, FCS recently participated in a line of credit deal for Cracker Barrel Restaurants valued at \$750 million and a \$27 million loan to St. Joseph’s College in Indiana. We do not believe allowing the FCS to use its tax advantaged subsidy to participate in corporate lending was Congress’s intent with similar entity lending. The Farm Credit Administration (FCA), the FCS regulator, has allowed these practices to go too far.
- **Indirect lending.** A number of FCS institutions own or invest in indirect money lending operations that enable producers to borrow taxpayer subsidized money from the Farm Credit System without being members of the lending cooperative. These programs work under highly questionable “loan participation” rules approved several years ago by the FCA. 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, and closes the loan. 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, GSE borrowing privileges and deep tax subsidies. Moreover, despite these indirect lending programs now accounting for a significant percentage of the growth of the FCS, tracking the growth of these questionable operations has been very difficult to do based on the financial information supplied by the FCS lenders and as reported by FCA. Indirect lending can be higher risk lending. Congress should examine these programs to determine if they present a safety and soundness threat to the FCS and to the taxpayers who are ultimately on the hook for any FCS failure.

- **Retained mineral rights.** 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. We understand that some FCS institutions continue to hold extensive mineral rights (some dating back to the 1930s) that, in some cases, are now very valuable. Other than hearsay, it is very difficult for the farmer-owners of a FCS institution to ascertain what the present market values of such mineral rights are. We question why a taxpayer-subsidized GSE should hold any

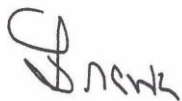
mineral rights beyond the amount of time it takes to market and sell such rights. We believe it is important for FCS farmer-owners to understand what the present market value is of such rights, because it may be in their best interests to demand these rights be sold.

- **Questionable practices involving the sale of Federal Crop Insurance.** There have been numerous regulatory and legal challenges in many states involving the marketing and sale of Federal Crop Insurance by FCS lenders. We question why the Farm Credit System, a tax advantaged Government Sponsored Enterprise, is in the business of selling Federal Crop Insurance in the first place. We believe this situation demands a comprehensive review by Congress.
- **Shadow banking activities.** While the Farm Credit System 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. FCS institutions have become very adept at using language that is intended to make producers believe that they are the same as banks when it comes to banking services. This is just one example from a FCS website: “Our online banking platform is a free service designed to help you better manage your business, saving you time and money. Through [our service] you can quickly and easily view loan and investment balances, initiate transactions, and access a suite of cash management tools.”

These are but some of the practices that should be closely scrutinized by policymakers of both parties. We believe that such a review of the FCS will disclose compelling evidence that the FCS’ tax subsidy has outlived its usefulness, skewing markets in ways that waste government resources, raise safety and soundness concerns, and greatly harm the ability of local banks to help their communities grow and prosper. Government should not pick winners and losers in the marketplace, whether it is the agricultural economy or elsewhere. Fair competition in the marketplace will ensure the availability and affordability of agricultural credit.

As the committee of oversight for FCS, it is critical that all aspects of the FCS, especially their financial practices in areas outside of FCS’s mission, be closely scrutinized and thoroughly examined.

Sincerely,



Frank Keating

cc: Members of the Senate Committee on Agriculture, Nutrition & Forestry