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FCA'S PROPOSED REGULATIONS ON NATIONAL CHARTERS

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

FEBRUARY 26, 2001

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CONTENTS

Page

HEARING:

Monday, February 26, 2001, FCA's Proposed Regualtions on National Charters 1

APPENDIX:

Monday, February 26, 2001 45

DOCUMENT(S) SUBMITTED FOR THE RECORD:

Monday, February 26, 2001 107

Monday, February 26, 2001

STATEMENTS PRESENTED BY SENATORS

Lugar, Hon. Richard G., a U.S. Senator from Indiana, Chairman, Committee on Agriculture, Nutrition, and Forestry 1

Thomas, Hon. Craig, a U.S. Senator from Wyoming 6

Hutchinson, Hon. Tim, a U.S. Senator from Texas 8

Crapo, Hon. Mike, a U.S. Senator from Indiana 10

WITNESSES

(PANEL I)

The Honorable Jim Leach, a Representative from Iowa 2

(PANEL II)

Reyna, Hon. Michael, Chairman of the Farm Credit Administration, accompanied by: Ann Jorgensen, FCA Board Member 13

(PANEL III)

Barry, Dr. Peter, Professor of Agricultural Finance, University of Illinois, Urbana, Illinois 37

Burns, Phillip, Chairman, Farmers and Merchants National Bank West Point, Nebraska 30

Leighty, Dale, President, First National Bank of Las Animas, Las Animas, Colorado 32

Webster, Jack, President and CEO, Farm Credit Services of America, Omaha, Nebraska 28

Williams, Bobby D., Grain Farmer and Board Member, Heritage Land Bank, Tyler, Texas 25

APPENDIX

PREPARED STATEMENTS:

Lugar, Hon. Richard G. 46

Leach, Hon. James A. 47

Barry, Peter J. 97

Burns, Philip 76

Jorgensen, Ann 66

Page

PREPARED STATEMENTS—CONTINUED
Leighty, Dale 84
Reyna, Michael M. 50
Webster, Jack 71
Williams, Bobby 68
DOCUMENT(S) SUBMITTED FOR THE RECORD:
Testimony of Ed Hester, Chairman of the Board, Federal Land Bank Association of North Mississippi, FLCA 108
Testimony on Behalf of AgFirst Farm Credit Bank 110
Letter submitted by Robert A. Carson, Marks, MS 111
Letter submitted by Jack A. Anderson, St. Johns MI 113
Letter submitted by Donald E. Ludy, Director, Valley AgCredit 114
Letter submitted by James D. Kirk, President and CEO, AgAmerica, FCB 115
Letter submitted by Carl Higbea, member of the Board of Directors of AGRIBANK FCB 117
Letter submitted by Allaire P. Palmer, board member, Farm Credit of Maine, ACA 118
Letter submitted by Daniel J. Corey, board member, Farm Credit of Maine, ACA 119
Letter submitted by J. Allen Akkerman, President, Valley AgCredit 120
Letter submitted by Henry E. McPherson, Director, Farm Credit of Maine, ACA 122
Letter submitted by Raymond Parks, Chairman of the Board of Directors, Agricultural Credit Association, Idaho 123
Letter submitted by R.K. Laird, Chairman, and James F. Martin, Jr., Vice Chairman, First South Agricultural Credit Association 124
Letter submitted by Jeremy Oliver, Sr. VP-Corporate Finance & Information Services, AGCountry, Farm Credit Services 126
Letter submitted by Raymond J. Nowak, President and CEO, Farm Credit of Maine, ACA 127
Letter submitted by Robert M. Tetrault, Chairman of the Board of Directors, Farm Credit of Maine, ACA 128
Letter submitted by Donnie Winters, President and CEO, Farm Credit Services, Louisville, Kentucky 129
Letter submitted by Daryl Oldvader, Chief Executive Officer, Farm Credit Services of Western Missouri 130
Letter submitted by Jim McKissick, Vice President of Brand Marketing & Communications, AgStar Financial Services, ACA 131
Letter submitted by Don E. Wenell, CEO, AgCountry, Farm Credit Services 132

FCA'S PROPOSED REGULATIONS ON NATIONAL CHARTERS

MONDAY, FEBRUARY 26, 2001

U.S. SENATE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:30 a.m. in room 328, Russell Senate Office Building, Hon. Richard G. Lugar (Chairman of the Committee) presiding.

OPENING STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Present: Senators Lugar, Thomas, Hutchinson, and Senator Crapo.

The CHAIRMAN. This meeting of the Senate Agriculture Committee is called to order.

The hearing today will hear testimony concerning the Farm Credit Administration's proposed rule on National Charters. This regulation outlines the procedures for allowing Farm Credit System institutions to conduct agricultural lending outside their traditional geographic boundaries.

For those of us with oversight responsibilities over the Farm Credit System, today's hearing is a good indication that the system is healthy and competitive. During the mid-1980s, when the Farm Credit System was suffering financial difficulties, this Committee worked to help put together a legislative package that allowed the Farm Credit System to weather those challenges. As a result of those efforts, the system finds itself on sound fiscal ground.

Although we celebrate the system's convalescence, today's purpose is to explore whether the Farm Credit Administration has gone beyond its grant of authority through its proposal on National Charters. The Farm Credit Administration has wisely put this proposed rule out for a 30-day comment period, but there are several public policy questions raised by this action that deserve our committee's review and scrutiny; and thus, this hearing.

First and foremost, does the Farm Credit Administration have the statutory authority to provide its associations with National Charters? I will be interested, as will all Senators, in the various views of witnesses on this topic.

Even if the Farm Credit Administration has the legal authority, does the granting of National Charters advance a valid public policy, as well as the Agency's mission statement? The Farm Credit System and its regional lending limitations have been in existence

for over three quarters of a century, providing a dependable and competitive source of credit for agriculture. Today's hearing will explore whether National Charters will strengthen competition in agricultural lending, or whether it will lead to greater consolidation among Farm Credit institutions and community banks.

Our first witness will be the Honorable Jim Leach of Iowa, who as chairman of the House Banking Committee, thoughtfully explored through a hearing on this issue last year the issues that we are discussing today. Our second panel consists of the Honorable Michael Reyna, Chairman of the Farm Credit Administration and the Honorable Ann Jorgensen, Board Member of the Farm Credit Administration. Our third panel is made up of representatives from the Farm Credit System, the banking industry and the academic community.

We look forward to the individual testimony provided by these witnesses, and our questioning of them. It is indeed a great pleasure to have Jim Leach before the Committee. He is a dear friend and a very wonderful person to work with in the Congress. We thank you for starting us out this morning.

[The prepared statement of Chairman Lugar can be found in the appendix on page 46.]

Jim.

STATEMENT OF HON. JIM LEACH, A REPRESENTATIVE FROM IOWA

Mr. LEACH. Thank you, Chairman Lugar, and I'm pleased to be with my good friend, Mr. Thomas, as well.

I don't have a formal statement, but I have some notes I'd like to go over with you. I would say, Mr. Chairman, that I'm in my 25th year in the U.S. Congress, and I've testified before the U.S. Senate less than half a dozen times. I consider this issue that you are addressing today of seminal significance, and that is why I requested to come and speak before you.

And I must tell you, there are very few issues that I feel stronger about. This proposal to allow the Farm Credit System, to have National Charters, and to in effect decentralize decision making within the GSA community, has major philosophical and market implications. It in effect will expand, and I want this statistic understood, 30-fold the number of Government-sponsored enterprises in the American economy. That is the meaning of National Charters for decentralized Farm Credit System entities.

Each of these new Government-sponsored enterprises will have power greater than Fannie Mae and Freddie Mac. Each will be empowered at their own volition by a captive board, which has been proven by this approach to have the power to authorize credit, not just for farmers, which is what the Farm Credit System was established to serve. And it was established to serve farmers under the assumption, which was probably valid at the time, that credit availability in the farm economy was very weak.

It will be allowed to make economic development loans, business loans, car loans, housing loans in all likelihood. You don't know where the limit will be because each of these will have National Charters.

If you look at the market implications, there will be cherry picking and there will be predatory financing. There's a possibility that commercial interests will capture these institutions. And let me give an example. Let us say you're a major company that may make agricultural equipment. Why wouldn't you go to the nearby Farm Credit System entity and say, look, for 1/16th of a percent, you do all of our credit financing henceforth. Why should that big company need to go to the private capital markets, when it can go to the U.S. Government, in effect, for financing?

If we look at public implications, you'll have Treasury management of borrowing absolutely thrown topsy-turvy. Because after all, what GSEs have is what might be defined under a constitutional term in an analogous way as a letter of mark on the capital markets. That is, these are financial entities that have the power of the U.S. Government given to them to reach into the capital markets.

No one in this whole process has indicated that there is a need. Is there a lack of credit for business loans in America? Is there a lack of credit for real estate loans in America? Where is the lack of credit? We have the freest capital markets in the history of the world, and yet, this entity is coming and saying, we should socialize credit to a greater extent.

Now, there's this theoretical thought that what a National Charter means may be simply to allow a bigger Farm Credit System entity in one State to give loans for agriculture in another State. But I will tell you, the issue isn't whether an Iowa Farm Credit System entity wants to compete with a New York Farm Credit System entity for a Nebraska farm loan. First, there is zero need for that, there is absolutely no proven need. And beyond that, in the history of real estate credits, non-local decision making has always been a prescription for disaster. It has never at any time been anything other than that.

To the degree that one can say maybe there is a place somewhere that doesn't have adequate credit, which I don't believe, because a rural Farm Credit System entity can draw on the capital markets, just as a larger one tied to a larger State. But you can share credit between them if you have to.

What is at issue here is new activities for which no one has shown need or demand, other than the Farm Credit System managers that have come to a captive board. Let me talk a little bit about captive boards. Several years ago, a rule was put out for this, and it failed to get any support.

Last year, the board put out a booklet as a way around formal rulemaking. We submitted this booklet to the General Accounting Office, and asked whether or not it conformed with United States law. The General Accounting Office came back and said it did not.

In other words, and I want to be very careful in my words here, this board attempted an illegal end-run of the U.S. Congress and the Executive Branch, which did not support their efforts. I want to repeat as carefully as I can, an illegal end-run.

Now, because it was forced by the General Accounting Office ruling to come back in a formal way, and you were so right in your opening statement to say, does it have the legal authority in a rule, or is this a process, it has come back in the most unseemly manner at a time of Administration transition. And as you know, and Mr.

Thomas knows, and I thank the gentleman from Arkansas for coming, the new Bush Administration has put under review late Clinton Administration rulemaking. And then the Administration requested that people go a little bit slow on new rulemaking until it gets its time and place.

But what we have here is not late Clinton Administration rulemaking which is the concern of many in the Republican party. We have a board of Clinton appointees who have made a rule in this Administration that in effect is to be put in place in an unseemly 30-day comment period before people have had a chance to think through what is the right philosophy and the right policy.

All over the world, we are telling Governments that they ought to have market-oriented reforms. This runaway Government agency, and I stress this, is proposing massive socialization of credit in the greatest free market economy in the world, at the very same time we're saying to other countries that they ought to go to more market reforms.

Finally, let me just say, so that there's an understanding by perspective, as the former chairman of a committee of some jurisdiction over the financial industry, I've objected to a number of initiatives in the Office of the Comptroller of the Currency, I've objected to a number of policies of Freddie Mac, of Farmer Mac, that have been aimed at expanding, I believe, outside the judgment of the markets, as well as the law.

But this is the single greatest act of administrative arrogance I have ever seen. The issue isn't what's good for the Farm Credit System. As a system, all systems want greater power. The issue is what's good for the American economy, and whether you want to have a market system or whether you want to have socialized credit. And what we have here is a system generated proposal, a captive Federal regulatory agency, proposing to massively change the nature of rural finance, under the assumption that America's commercial banks, America's savings and loans, America's credit unions, America's insurance companies, America's financial companies and real estate and a whole host of other companies, do not have the capacity to serve our market economy.

I think it is preposterous. I think it is philosophically out of step. And I believe that it is an attempt to usurp the jurisdiction of the U.S. Congress by a very small numbered board, as well as thumb the nose at the Executive Branch. And I believe that this board proposal should be absolutely rejected.

And I apologize for being as unbalanced as I have in this presentation, because I am one who thinks the Farm Credit System has served the farm economy well over the years. But to the degree it moves outside service to the U.S. farmer, I think it's going to lose an awful lot of support in the farm community. And to the degree it, has the implication of consolidating finance, I think will be moving in a less competitive way in the American financial system.

And finally, I would just stress again, the issue here is whether or not there's a case for socializing credit to a greater extent than it's already occurred.

I thank you all.

[The prepared statement of Mr. Leach can be found in the appendix on page 47.]

The CHAIRMAN. Well, thank you very much, Mr. Leach.

Let me just ask the question I raised in my opening comments, and you acknowledged that—— does the Farm Credit Administration have the statutory authority to provide its associations with National Charters? Will you state your view on that question?

Mr. LEACH. It's a close call. Clearly, the booklet approach that it proposed last fall was defined to be in violation of two laws of the U.S. Congress. To me, it's inconceivable that a board would think through rulemaking it would have the power to change the entire mission of the Farm Credit System. And I believe it should happen by law itself.

I will tell you that in a court of law, there is a general deference to Executive Branch Agencies under the Administrative Procedures Act. So I cannot define how a court would rule.

I would say you would be confronted with a very unique situation in a court setting, however, because this would be one of, in fact the only instance I know of, where the Court would be caught in a little bit of a bind, where it is, the general administrative law precedent is that courts give deference to administrative agencies unless there is a capriciousness that's proved on the other side.

But in this case, you would have in all likelihood the Executive Branch itself against the Executive Branch Agency. And so how a court would rule in that setting becomes much more difficult. And I can't predict that. All I can say is that I consider this to be thoroughly unseemly, and I would think you'd need an act of Congress to make this abrupt change.

I would only say that because the Agency will come and say, we just have these small steps in mind, well, small steps lead to other steps, and this becomes the most uncontrolled process imaginable. The history of GSEs is a desire for expanded power. All GSEs try to spread their wings.

So one of the great questions is, do you nip this type of thing in the bud or do you have an inevitability of more power through the socialized credit mechanism of GSEs.

The CHAIRMAN. My second question follows whether or not there is statutory authority, is it a good idea in terms of extension of Farm Credit? The testimony often in the past, by that I mean in the last two decades, has been on occasion that Farm Credit was deficient in many agricultural regions of the country. You come from a district in Iowa which obviously has Farm Credit needs, and we have Senators present today who will testify from their standpoint.

Mr. LEACH. I have never in my State found any deficiency. In fact, if you talk to competitors of the Farm Credit System, you'll see that they are everywhere I know of in America. There are very aggressive lending policies by the Farm Credit System toward farmers. I know of no case where it isn't. And if one can show me cases where the Farm Credit System is not, I would be amazed.

Beyond that, under its current authorities, because it has a claim on the U.S. Government borrowing system, there is no Farm Credit System that is denied credit availability. For example, if you take a commercial bank setting, a commercial bank has to rely upon getting deposits, usually from a local base. And sometimes these deposits are hard to come by, and one might argue a commercial

bank might have a hard time getting deposits at one time or another.

But that argument never applies to the Farm Credit System. Across the country, they have an ability to draw upon a national pool. And so, maybe someone can find a Farm Credit System entity that chooses not to be aggressive. But I'm hard pressed to know of it.

The CHAIRMAN. During Congressman Leach's testimony, we've been joined by two additional Senators. Senator Thomas was here at the beginning, and I postponed any additional statements at that point until we had sort of an accumulation, if possible. But let me ask now, Senator Thomas, if you have an opening comment and/or questions of the witnesses. I will ask that of each of the other two colleagues.

STATEMENT OF HON. CRAIG THOMAS, A U.S. SENATOR FROM WYOMING

Senator THOMAS. Thank you very much, Mr. Chairman. You've kind of got the freshman class here on your committee today, which is welcome.

I don't have a statement, but I am, although I've been involved, certainly aware of the Farm Credit activity in Wyoming, I've not been involved in the background of it. I understand what you're saying is, where it appears that this was simply an effort to expand the lending field for any particular, you're saying it will change the role of these lender?

Mr. LEACH. Well, there can be only one purpose of this,Senator, and that is to make new types of lending, that is, to expand the powers of the Farm Credit System. And that means business loans, it means car loans, it means any kind of loan you want to visualize. And the case will be made that the jurisdiction of the Farm Credit System is not farms, it's the rural community.

And that's really good for the Farm Credit System manager. But I would say, just as strongly as I can note that this is a grant of power greater than Fannie Mae or Freddie Mac. And it can be done on a national basis.

One of the things that will occur here, and one of the arguments, by the way, is it will make it easier for the Farm Credit System to follow their big national customers. And let's take my State as an example. The only argument that I've ever heard of this is that it means that a large hog producer, and let's abstractly say in North Carolina, where the center of hog production is, will be able to take a captive Farm Credit System entity and make its loans more easily nationwide.

Well, if you think about the Farm Credit System, in its original Charter it was to serve individual farmers of modest means. And I believe this inevitably is a big agribusiness approach that will end up pushing what in effect are bigger and bigger entities that become conglomerates, whether it be in hogs, or let me just give another example. As I read this potential intent, does this mean that a Cargill, a John Deere, two wonderful American companies, can suddenly go to the Farm Credit System for all their credit needs? And what you've done is socialize credit for anyone that claims an agribusiness, for IBP, for Tysons Foods.

These are great American companies, but do they need to go to the U.S. Government for their credit? And I would tell you, these companies probably don't even know about this proposal.

But once it becomes law, I just ask, if any of you are treasurers of a major agribusiness company, isn't your first thought going to be that you're going to go to the closest FCS entity, and actually the smaller the better, because it doesn't matter how big or small a Farm Credit System entity is, because it has the power to tap into the Government credit market. And you will have a case, and they will say, absolutely, we'll provide you all the credit you want.

Well, again, you talk about a concentration. I have a great deal of respect for all of these entities. But does that disadvantage the local elevator? Or now, does the local elevator have to go to the Farm Credit System? And then, what is the role of a community bank?

The CHAIRMAN. Really, it doesn't specifically change their mission, but you think it will expand it, just by the nature of the——

Mr. LEACH. Oh, it totally changes their mission. It makes them a service of business, it makes it a service of all of the credit circumstances in maybe towns under 50,000, maybe States that are principally agricultural. Who knows.

The CHAIRMAN. Well, I'd be very involved over here, in trying to, with our FAIR bill and so on, trying to ensure that the Government is not expanding beyond into areas that could be reasonably done in the private sector.

It's my understanding that the local units, there's not a vote of the local units to move forward with this. Are you aware of that one way or the other?

Mr. LEACH. I will say this. There have been, at various times, concerns that smaller Farm Credit System entities will be competing against larger. But if you wonder about what the System has pressed downward, when the booklet approach came out, many, many Farm Credit System entities immediately applied for a national charter, because they knew the implications. There would be nothing competing against them, and all sorts of new powers for them.

It has dawned on them that the implications are the cherry picking of every local business. Let's say, Mr. Thomas, you're the manager of a Farm Credit System entity in a nice, rural community. Well, you know who the nice, local businesses are as well as a local banker. You will simply come and say, we can borrow from the Government at a given rate, and we'll give you a lower interest rate loan.

Now, here let me mention there's a macroeconomic phenomenon that's fast emerging on the American scene. And that macroeconomics is that America is now a non-saving economy. And to the degree we do save, we're increasingly going towards putting our money as a society into investments like the stock market. So it's harder and harder and more expensive for local institutions to raise capital.

By the same token, we in the Congress, because of a strong economy, have been able to depress our debt efforts, and we're paying back debt. But what this means is, in all possibility, especially for what we call the marginal cost of funds of the extra dollar that

might come into a financial institution, the Government's cost of funds, relatively speaking, may go down. The private sector may go up. And this means that the competitive position of all government-sponsored Enterprises increases dramatically.

With this type of step, you could well have an absolutely calamity on private sector financial businesses. It could be the greatest unfair competition in modern times.

Senator THOMAS. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Thomas.

Senator Hutchinson.

STATEMENT OF HON. TIM HUTCHINSON, A U.S. SENATOR FROM TEXAS

Senator HUTCHINSON. Thank you, Senator Lugar. Thank you for calling the hearing today, and Chairman Leach, it's good to see you again. Good to have you over.

Mr. LEACH. I'm honored to be with you, sir.

Senator HUTCHINSON. You make some very strong statements, and a very clear position, I think. You repeatedly call this the socializing of lending or the socializing of credit. You kind of mitigate a little bit at the end by saying this system has served farmers well. So do you object to what the current credit system, the way it operates?

Mr. LEACH. No, I support the current System, and so do farmers. And a very interesting point, Senator, is there is no——I mean, I represent a farm State. We consider it the greatest farm State, although California has greater production. In 25-years, I've never had a farmer come to me and say, Jim, I want the Farm Credit System not to serve just me. I want it to serve everybody else.

And I will tell you, farmers want the Farm Credit System for themselves. And to the degree that you make the Farm Credit System serving, in many cases, their competitors, you're going to have support within the farm community potentially decline.

Now, I'm confident that the System has probably gone out and gotten some farm group some place to endorse it. But for the life of me, no individual farmers I have ever represented have come to me and said, we want the Farm Credit System for others rather than for us. And I believe that to the degree it goes outside serving the farmer, it will lose support politically and socially.

Senator HUTCHINSON. I am a new member to the Committee, and am just now becoming familiar with some of these issues. Explain to me simply, you've done a good job in response to Senator Thomas, but what will be the practical implications? If you have a National Charter, when you talk about agribusiness, when you talk about the Tysons, how is the mission changed by this rule?

Mr. LEACH. Well, it changes in two ways. They're looking to follow the bigger agribusiness customer. But frankly, that isn't that much of a problem today, because they serve some types of agribusiness customers fairly well. But they don't serve big corporate businesses, for example, the Deeres of the world. They serve those people that are into production.

But what they want to solve is rural economic development, which is the key thing. And that has a natural attractiveness, all of us that come from rural States. But what that means is that

they want to give business loans. And people shouldn't be misty-eyed about it. They want to socialize credit for American business. And then they will define towns under 50,000. The Farm Credit System wants to get into real estate services. They want to get into car loans. They just want to do everything in finance.

And what happens is, once you set up this structure, if you're the manager of a local Farm Credit System agency, or if you're one of the regional district managers, you see an infrastructure out there, and you say, why can't we expand, because we have this great infrastructure. It's very natural.

But there's no community demand for it. And it simply is another tap on the Federal treasury that is going to jeopardize, I believe, America's private market system.

Senator HUTCHINSON. So the socialized credit, as you've called it, is okay for small, individual farmers, but we shouldn't expand that into business and the broader——is that a fair——

Mr. LEACH. Well, we have developed GSEs for limited purposes. One purpose, for example, in housing. For Fannie and Freddie, we developed a secondary market. And also for the Federal Home Loan Bank System, it serves as a secondary market for housing loans.

Another GSE we——

Senator HUTCHINSON. You have no objection to it?

Mr. LEACH. No, I don't.

Senator HUTCHINSON. Is that socialized credit, though?

Mr. LEACH. Yes, it is. Yes, it is. But Congress tried to do it with as limited a purpose as possible. By the way, Freddie Mac, when it was set up, was set up as a year and a half trial. It was intended to be privatized. They ended up privatizing ownership and keeping their public powers, a very unique circumstance.

In any regard, each of these GSEs wants to expand their authority and spread their wings as widely as they can. It's an understood phenomenon. And it's up to the public decision makers to say, do you want to have a private economy or do you want to have a greater socialized credit.

Now, in the Farm Credit System, the idea was that it looked like credit in agriculture was going to be very difficult to come by, So for the sake of the family farmer, we established this System.

But let me give you an example of the types of abuses that come into play. We have established another secondary market for agricultural loans called Farmer Mac, a really wonderful intended institutional arrangement. It didn't quite work for its intended purposes on a profit-making basis, because community banks wanted to keep their good loans and would only want to give a bad loan to Farmer Mac.

So what happened to Farmer Mac? One American commercial bank bought a third interest in it. One-third. And then to make money, because it's a money losing proposition, all it does basically speaking today is arbitrage. That is, they take down Government credits at a given amount and then they buy lesser rated securities. For example, you take down a Government credit, let's say, at a given time, at 6-percent for a given tenure, time period, and then you buy a bond, whether it be AAA or B, BB. And you buy it at 7-percent.

So you take down your Government credit at one rate and you arbitrage with other types of credits to other rates that have nothing to do with agriculture. These are powerful, powerful entities, each one going in new ways that were never conceived by the U.S. Congress. That is what——and by the way, Farmer Mac has less than $100 million equity, and it has billions of dollars of arbitrage activities.

And it's an absolutely political science umbrage, the way it operates. And what you're going to have here is some Farm Credit System with national charters, not local charters, coming up with new ways to tinker with the system. And outsiders are going to figure it out very quickly and take advantage of it.

Senator HUTCHINSON. I spent a good part of last week in the delta of Arkansas talking, learning, studying agriculture in our delta and where the availability of credit means the difference in survival or bankruptcy for these farmers. It's your contention that a National Charter works against the welfare and the benefit of individual farmers?

Mr. LEACH. Well, let me ask you how it helps them any more. Your local Farm Credit System entity can serve them fully. Absolutely fully. If they claim that the loan is too big, they can share it with other Farm Credit System entities in other parts of the country. What farmer is not served by the Farm Credit System, and what farmer is going to be better served by this?

And then, who is it that these people want to serve? If you go to the agricultural area, is it going to be a hog producer from out of State? Is that helpful for the Arkansas hog producer? You're a razorback State. I don't know. You've got to tell me, you have to name, I mean literally name a farmer that's going to be helped by this.

Now, you might say that the farmer may invest in a business in town and that maybe you can come up with some lower priced loans for that, and that's true. That's quite possible.

Senator HUTCHINSON. Or you could argue that economic development in general is going to benefit the area and therefore benefit——

Mr. LEACH. You could. Then the question is, do you want to do this through the Government credit mechanism, or maybe you represent a lot of community banks that don't function. I don't know.

But I will tell you, in rural Iowa, we are unbelievably competitive in sources of credit. Just unbelievably competitive.

Senator HUTCHINSON. Thank you. I know my time has long overexpired.

The CHAIRMAN. That's fine, and those were important questions.

Senator Crapo.

STATEMENT OF HON. MIKE CRAPO, A U.S. SENATOR FROM INDIANA

Senator CRAPO. Thank you very much, Mr. Chairman. And Chairman Leach, I, too, appreciate having you over here in the Senate with us. I served with you in the House and appreciated those days and learned to work very closely with you there.

As a matter of fact, I served there on the Commerce Committee when we worked for many years on the financial services mod-

ernization legislation and came over here and ended up, for one of my committees, serving on the Banking Committee working on it as we finally put legislation together that achieved passage.

And one of the pieces of the Gramm-Leach-Bliley financial services modernization legislation that I and many other members from States with large rural constituencies and strong agriculture bases fought to include was one that enhances small bank access to the Federal Home Loan Bank System by removing certain membership requirements and making it easier for small banks to have access to FHLB advances for AG and capital.

This provision, I think, gives small banks access to cheaper capital. And one of the reasons that this was so important was that it allows them to better compete with the Farm Credit System that has access to cheaper capital.

Could you tell me how this new proposal that we're talking about today would impact, if you could, or if you have an opinion on it, how it would impact the ability of our private sector financial institutions to meet the lending needs of our ag community?

Mr. LEACH. Well, you raise a very profound feature of the financial modernization package. That is, a lot of people don't realize that aspects of the financial modernization were designed to serve rural America dramatically. And so if you're an individual farmer, for example, in Arkansas, you'll be able to go to the Farm Credit System for a loan. You'll also be able to go to a commercial bank, which will also have the capacity to tap into the Federal Home Loan Bank System, which is another GSE.

So you will have more sources of credit than you've ever had before. The farmer is really in the driver's seat on finance today. If market prices were only a little bit better. And so I don't see how this enhances in any way the individual farmer. What it does do is take the Farm Credit System and give it new jurisdictions, new powers that are unknown in their full dimension.

Senator CRAPO. Well, thank you. And I'm sure you know, coming from your State, that in agriculture today, one of the big problems is frankly getting continuing financing for operations of farming operations that are not able to meet their financial obligations. As I understand your testimony, it's your belief that the proposal that is on the table is one that would not increase the availability of capital or financing to farm producing entities. Is that correct?

Mr. LEACH. It does not increase in any way whatsoever to any individual farmer any credit availability. It probably increases credit availability to competitors of modest sized farmers, because it will make credit availability easier for large agribusiness.

Senator CRAPO. I know you've basically said this in a number of different ways, but I'd like you to one more time just briefly describe to the Committee, what was the original purpose of the Farm Credit System?

Mr. LEACH. The Farm Credit System was set up at a time when we were looking at serious problems of credit in the Agriculture community, to serve individual farmers, particularly of modest means. And it's ironically the success of the Farm Credit System that has caused it to want to look to new and greater market penetrations.

So I consider this to be a very natural desire within the System managers, but not one that has anything to do with the individual farmer, and everything to do with whether or not the System ought to be serving non-farmers.

Senator CRAPO. With regard to those non-farmers that you reference there, regardless of the question of whether there is a need to expand basically a Government supported financial system for those farmers, well, I guess the question I'm getting at is, is there a need for a new source of lending for those non-farm entities, or those non-farm production services that would be reached by this proposal?

Mr. LEACH. Right now, in rural America, as we all know, there are some real traumas that are largely based on pricing. But if you add up the sources of credit, whether they be the Commercial Banks, Insurance Companies, the Farm Credit System, there are three Government-sponsored enterprises that currently serve rural America: Farm Credit System, Commercial Banks that can tap into the secondary market; two other Systems, one is the Federal Home Loan Bank System, which under the recent modernization law they can now do, and then thirdly, Farmer Mac.

So basically speaking, there are three GSEs serving agriculture. No other part of the American economy has anything like that. And partly, I think, because of this competition within the GSEs, the Farm Credit System would like to get out and serve new markets that are non-farm markets. And that is really what's at issue today, whether the U.S. Congress wishes to change the mandate of the Farm Credit System into a non-farm mandate.

And my own view is that we ought to keep it as a farm mandate rather than a non-farm mandate.

Senator CRAPO. Thank you.

The CHAIRMAN. Thank you very much, Senator Crapo.

Mr. Leach, we thank you very much for coming and spending this time and responding to these questions of Senators who have quite an interest in this subject.

Mr. LEACH. Thank you. I appreciate your courtesy.

The CHAIRMAN. It's a privilege now to call before the Committee the two sitting board members of the Farm Credit Administration. They are the Chairman and Chief Executive Officer, Michael Reyna, and Ann Jorgensen.

We welcome both of you.

Let me just say for benefit of the Committee and those following the hearing, last month I had a very good opportunity to visit with both Chairman Reyna and Ms. Jorgensen about affairs over at the Farm Credit Administration. This committee has oversight for Farm Credit, as we recited a little bit of the history that was much more difficult during the 1980s, the 1990s being a happier time.

But new members of the Committee will know that the Committee has taken seriously this responsibility. Credit for farmers and for rural communities in our country is the prime responsibility of the Committee. And Farm Credit Administration, in our judgment, has done well by all of these folks.

Now, at the time of our visits, I was informed that a 30-day rule or 30-day hearing period would commence. And so one reason for having this hearing today, we're about, by my calculation, about

10-days into the 30-days. There are still 20-days to be heard. And it was important, even though there are all sorts of priorities of the Committee, to move swiftly, so that a number of parties could be heard in public. This may or may not stimulate others who will wish to inform the System of their views. But we certainly wanted to make certain at a timely point that we fulfilled our responsibility, and we are grateful to both of you for coming this morning to present your thinking, the case to be made for the rule you proposed.

I'll ask you to testify, Chairman Reyna, and if you have additional testimony, Ms. Jorgensen, we'd be pleased to hear from you likewise.

STATEMENT OF HON. MICHAEL M. REYNA, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION ACCOMPANIED BY: HON. ANN JORGENSEN, FCA BOARD MEMBER

Mr. REYNA. Mr. Chairman and members of the Committee, my name is Michael Reyna, Chairman and Chief Executive Officer of the Farm Credit Administration. Joining me is my fellow board member, Ann Jorgensen, who I might note returned from her anniversary trip to be here with us today.

The CHAIRMAN. We thank you.

Mr. REYNA. I'm pleased to be here with you today to discuss the role of the Farm Credit Administration and the Farm Credit System in providing sound, dependable and affordable credit to American farmers and ranchers, their cooperatives, rural utilities, rural homeowners, in both good times and bad. I'm pleased to report to you that the financial condition of the System is strong, despite the challenges and difficulties facing agriculture.

I plan to use this opportunity to explain our proposal and proposed regulation concerning National Charters for System institutions. Just briefly, the FCA is an independent Executive Branch agency of the Federal Government. It Charters, regulates and examines all System institutions. The responsibility of FCA is to ensure that System institutions operate safely and soundly and comply with all applicable laws.

The FCA's governing body is a full time three member board. The President, with the advice and consent of the Senate, appoints each FCA board member for a six-year term. The President designates one board member as Chairman of the Board, who serves until the conclusion of that member's term. The Chairman also serves as the FCA's chief executive officer.

I have provided written testimony to the Committee, and I'd like to skip ahead to the issue that's before the Committee today, if I might.

The CHAIRMAN. The full testimony will be made a part of the record.

Mr. REYNA. Thank you.

Perhaps the biggest challenge facing the System is the fact that it is a single sector lender in a shrinking market. The number of farmers and ranchers has steadily declined since the System was founded in 1916. However, the System's mission, to finance agriculture in both good times and bad, remains the same. And in con-

trast, the System's competitors can abandon agriculture during recessions, and lend instead to the other sectors of the economy where profit potential is greater and credit problems fewer.

Loan portfolios of System institutions, as single industry lenders, are concentrated in agricultural commodities. Some of the larger System institutions have successfully diversified the Agricultural commodities in their loan portfolios. As of September 30, 2000, however, there were 197 instances at 135 associations where loans to a single commodity exceeded capital.

The System lends overwhelmingly to agriculture, which is the sector of the economy that is particularly vulnerable to changes in commodity prices, currency fluctuations, bad weather, diseases, pests and other difficulties. The System's market share slipped during the farm crisis of the mid-1980s. During the 1990s, the System's market share rose modestly and then leveled off.

Historically, the Charters of many System associations have confined their operations to geographic areas where the agricultural economy is dependent upon two or three commodities. These geographic barriers make it increasingly difficult for associations to compete. Trade creditors are not subject to geographic limitations, and geographic restrictions on commercial banks have eased in the past decade. New technology, such as e-commerce, also expands geographic markets for lenders and other financial service providers.

Obviously these commodity and geographic concentrations pose a special challenge to the System and to FCA as a safety and soundness regular. The System is responding to these challenges. Many System associations have merged, consolidated or restructured their operations in the past three-years. As a result, these associations have become more efficient, which lowers cost of credit to farmers, improves customer services and increases earnings to these borrower-owned institutions.

System institutions have also embraced technological innovation, and they routinely use the internet to reach customers. These changes are good, but more is needed to assure that the System can meet the challenges facing a single industry lender in an economic environment that is undergoing continual and rapid change.

If the Farm Credit System is to remain a viable source of credit for American's farmers, ranchers and rural communities, as Congress directed, it must be able to respond to these changes in these markets that it serves. This is not a new concern. Our proposed rule on National Charters would help the System modernize its credit delivery structure, and at the same time maintain safe and sound operations. The National Charter rule would end FCA's practice, and I stress it is a practice, of generally issuing exclusive territorial Charters to direct lender associations.

The FCA's authority to grant and amend Charters to System institutions is clear and unambiguous. The courts have reaffirmed this authority on several occasions. With limited exceptions, Farm Credit statutes do not require exclusive charters for System institutions. Instead, the FCA, as a matter of policy and practice, usually issued exclusive Charters to direct lender associations.

Notwithstanding this fact, the territories of a number of associations have overlapped for some time. Over-chartering has not posed any safety and soundness concerns. Again, just to digress for just

a moment, there's in excess of 200 counties in the United States right now where over-chartering currently exists. About 100 or more of those have been over-chartered for upwards of eight-years, and again, no safety and soundness concerns.

The Agricultural Credit Act of 1987 encouraged the Farm Credit System to restructure by creating four new types of institutions: Farm Credit Banks, Agricultural Credit Banks, Federal Land Credit Associations and Agricultural Credit Associations. This restructuring has led to numerous instances of overlapping territories and competition among associations. This has led to the increasing public discussion and debates over whether FCA should end its policy of exclusive Charters for direct lender associations.

Our proposed National Charter rule culminates a decade of discussion and debates about how to ensure that the System remains safe and sound and relevant to farmers, ranchers and other rural residents who borrow from it. In May of 1990, the Secretary of the Treasury issued a report on GSEs that recognized the System faced unusual business risks. This report acknowledged that System Charters limit the operation of individual associations to specific regions, causing an institution's performance to rise and fall with the fortunes of a single crop or perhaps those with a limited number of customers.

Although the Secretary's report made no recommendation on how best to address the problem, it generated much thought, discussion and debate. It actually didn't formally recommend the consolidation of System institutions, but it certainly implied that, that was the direction that would best suit the System. I actually happen to disagree on that point.

The FCA raised the first question about ending the policy of geographically exclusive Charters in 1994 when it asked the public to comment on a proposed board policy statement to end non-exclusive Charters. At other times during the past decade, FCA has sought input and ideas from a wide variety of sources, including the general public, academicians and policy experts. In July of 1998, the board issued a philosophy statement that, among other things, announced support for abolishing geographic restrictions on System institutions. The first major step in implementing this philosophy occurred in 1998 when FCA published the rule that would have repealed regulations that required notice and consent when a direct lender made or participated in loans in a territory of another association.

The Agency received over 200 letters, considerable comments during the 180-day comment period. Reaction was split. The board suspended action in early 2000 to study the matter further.

In April of 2000, the board adopted a final rule that repealed notice and consent requirements that applied to System institutions who bought participation interests in loans that a commercial bank made in the territory of another System institution. By repealing these regulations, the FCA board authorized System institutions to participate in loans that non-System lenders, banks and others, made, and made to eligible farmers and ranchers anywhere in the United States.

The FCA did not repeal the notice and consent requirements for direct lending. Instead, the board announced in March of 2000 to

remove geographic barriers by granting National Charters to System direct lenders that apply for them. The FCA sent a booklet to all System institutions that provided guidance on National Charters. We also posted our booklet on the web site at that time.

After this initial process, about 97-percent of all eligible institutions indicated an interest in an expanded or National Charter. The booklet imposed no new System requirements or no new requirements on System institutions. And what it did is indicate the board's willingness to accept a National Charter application from any direct lender that voluntarily applied for one.

Our Charter initiative sparked an intense public interest and debate when the booklet was published in the Federal Register, and we received over 1,000 comments on the National Charter initiative. Several parties raised procedural concerns about the booklet. They believed that the law requires FCA to pursue notice and comment rulemaking for National Charters.

While FCA's legal counsel continues to believe that the Agency may issue or amend Charters without conducting a formal rulemaking, the board decided to go ahead and propose a rule. A rulemaking dispels any doubt that this initiative does not comply with applicable administrative procedure laws. Second, the rule will establish strong business planning requirements for any association that applies for and receives a National Charter. And third, the rule requires associations that request and receive a National Charter to comply with all existing FCA regulations that impose strong and enforceable capital, loan underwriting and internal control requirements on all System institutions.

Before I describe our national proposal rule in greater detail, I want to reiterate that the ideas expressed in the proposal are not new. Indeed, FCA and the System and Commercial Banks and the Trade Associations, Academicians, policy experts have debated the removal of geographic restrictions on System institutions for several years. The FCA adopted a proposed rule on January 11th of 2001 and sent it to the House and the Senate Ag Committees for 30-day review. The rule was published in the Federal Register on February 16th for a 30-day comment period. And I want to assure you that we'll seriously consider and carefully weigh all substantive comments that we receive about this proposal.

I want to speak briefly about the criteria for National Charters. The proposed rule would establish clear standards so the direct lender associations may apply for and receive and operate safely and soundly under a National Charter. The National Charter authorizes a direct lender association to exercise all powers conferred onto it under the Farm Credit Act and FCA regulations throughout the United States and the Commonwealth of Puerto Rico, or within the territories that FCA specifies.

And again, at this point, I want to stress that it's geographic broadening of the Charter. It has no effect on new products or services. That is not the change in the Charter that is being proposed here.

National Charters will not initially include the territories of certain associations that currently operate in Alabama, Mississippi, New Mexico and parts of Louisiana. The statute requires shareholders in these associations and their funding banks, in some

cases, their boards of directors, to consent before FCA can add the territory to the Charter of any other System institution. There are protected areas that do not authorize FCA to over-charter those areas. FCA initiated separate rulemaking so that the farmers and ranchers who own those associations in those particular four States will have an opportunity to vote on whether to allow other associations to serve their territories.

No direct lender or association under cease and desist order that's become final is eligible to request a National Charter. Once an association receives a National Charter, the FCA reserves the right to restrict the association's operations if it fails to operate safely and soundly. Each association that receives a National Charter will be assigned a local service area. For existing associations, LSA is the local territory that they served immediately before receiving a National Charter. Under the proposed rule, each association with a National Charter must offer credit and related services in its LSA.

Additionally, the LSA requirement will ensure that the System as a whole carries out its public policy mission of extending credit and related services to farmers, ranchers and other eligible customers in every part of the United States. Therefore, each association with a National Charter must provide dependable, sound and adequate, competitive and constructive credit and related services to all eligible, creditworthy customers within its LSA on a priority basis, consistent with safe and sound lending practices.

FCA expects each Nationally Chartered Association to make special efforts to serve young, beginning and small farmers in the LSA.

The proposed rule establishes procedures that each association must follow when it applies for a National Charter. Additionally, each association that applies for a National Charter must comply with new regulatory and business planning requirements, and at a minimum, an acceptable business plan must include a mission statement, internal and external factors that are likely to affect the Association during the planning year, quantifiable goals and objectives, pro forma financial statements for each year of the plan, an operating budget, a capital adequacy plan, and a detailed plan for activities within the LSA. These business plans must be updated each and every year.

Each Nationally Chartered Association must comply with statutes and regulations that govern capital adequacy, loan underwriting and servicing requirements, internal controls, consumer protection, equal credit opportunity and fair lending practices. Additionally, the FCA will allow only direct lender associations that operate in accordance with capital, asset quality, management, earnings, liquidity, interest rate sensitivity and other safety and soundness standards to lend and offer related services nationally.

In conclusion, Mr. Chairman, members, the Farm Credit System must meet the challenges of a rapidly changing agricultural economy to achieve its mission of providing sound and dependable and affordable credit to farmers, ranchers and their cooperatives. This System has made significant progress in building and maintaining its financial strength in the past decade so that it can better serve customers. However, the pace of change in the rural economy is

quickening. And the System must remain ever vigilant if it is to remain relevant to farmers.

Improving geographic diversity, reducing industry concentration of System loan portfolios is essential for mitigating safety and soundness risks. The FCA board believes that the proposed rule on National Charters ensures that the system remains a dependable source of credit for farmers in a competitive and rapidly changing environment.

I thank you for the opportunity to address this committee about the challenges facing both FCA and the System, and to explain the proposed rule on National Charters.

I'd actually like to take just a moment, if I might, to share with you some words that took place probably three and maybe even four-years ago, just briefly. From June of 1996, Comptroller of the Currency, Eugene Ludwig: "Rewriting the laws that govern banking and financial services must be based on fundamental principles, principles that respect rather than fight market forces that are shaping the banking industry."

Later that year, he also said before the annual financial services forum of the New York State Bankers Association, "Financial modernization is first and foremost a safety and soundness issue. Strategic risks in this case, the risk of not being able to provide or not being able to offer the products and services that the market demands, is in the long term the most important risk facing the financial industry today. In our dynamic economy, if banks are not able to offer new products, to evolve as the market evolves, they will not survive as a healthy entity."

Ricky Helfer, former FDIC Chairman, said in 1997, "Modernization of the Financial System is necessary to achieve an efficient and competitive financial services industry. Financial modernization should strengthen banking organizations by allowing diversification of income sources and better services to customers. The lessons we draw from these events, which are major regional and sectoral downturns, is that attempts to ensure safety and soundness of the Financial System, the Institutions must be allowed to diversify."

And finally, I will share this. From a book entitled The History of the Eighties: Lessons for the Future, it's quoted, "The rise in the number of bank failures in the 1980s had many causes which were beyond the regulators' power to influence or offset. These included broad economic and financial market changes. The structural weaknesses that inhibited geographic diversification and made many banks vulnerable to regional and sectoral recessions."

The promotion of diversification geographically is not new. Other financial regulators have noted it, commented on it and served as the basis for far broader financial modernization efforts that took place last year.

Thank you, Mr. Chairman. I'm happy to answer any questions.

[The prepared statement of Mr. Reyna can be found in the appendix on page 50.]

The CHAIRMAN. Well, thank you very much, Mr. Chairman.

Let me just comment briefly on some of the testimony that you did not have an opportunity to present, but which is a part of our record, which is important in the history of this subject. And those

who experienced the Congressional and banking trauma of the 1980s are certainly aware of those items you touched upon during that time because the savings and loan crisis consumed much of the attention of the Congress for years and the Farm Credit crisis for at least the better part of three-years, as I recall.

And in 1987, at the time the new legislation was being formulated and was finally passed, in the Chart that you have presented, derived from the Department of Agriculture data, you had a crossover in which commercial banks took a larger share of farm debt. And they've continued to maintain that to the present.

Prior to that time, the Farm Credit System, when I take a look at this chart, had from 32- to 35-percent of farm debt. Essentially in those days, commercial banks were more in the 24, 23 category. But now, it's about 41-percent for commercial banks, 26-percent for Farm Credit, more or less, as you've presented it. And there is no particular reason why that necessarily would change. But these are the two largest sources. Life insurance company loans are another large source, and have not been mentioned today, roughly 23-percent. And then various other individuals and situations, in some States more prominent than others.

You've mentioned in your own testimony, portions that you did not recite this morning, the Farm System's outstanding loans were 16.3-percent to farmers less than 35-years of age. That is a very, very important item. The testimony before our committee about the aging of American agriculture, the opportunities for young farmers to get into it are a very, very important factor, and you've recognized that, as would be appropriate for the Farm Credit System.

And 20.7 percent were beginning farmers with 10-years of experience or less. That might include some of the group that were 35 or younger. But once again, a critical element in terms of the dynamism of American agriculture if there are to be replacements out on our farms. And 57.9 percent were to farmers who had annual sales of $250,000 or less. As we've heard in previous testimony, on the restructuring of American agriculture, the $250,000 level is significant, because only 8-percent of American farm entities have sales of more than $250,000. But they do arguably about 85-percent of the business.

So we have an extraordinary dilemma as we begin to take a look at another Farm Bill. As most Americans are not aware, the high degree of that which is done in livestock and crops is by a very small number of people.

But in any event, the bulk of your loans are to those who are less than the 8-percent, who are very important, and who really need credit and one could argue, the most commercially viable of the farms, the ones from which most income is derived by those farmers from the farm, as opposed to almost each of the entities that is smaller.

Now, the dilemma you point out later on is that given the lack or the decline of income coming from farms in the last two- or three-years, and some can cite longer periods in certain parts of the country, this has put some stress upon lenders such as your institutions, who in fact are feeling this pain and the uncertainty of repayment. There was a sigh of relief in many banks, whether they were private or Farm Credit, when the double AMTA payments

were received this year, and people, country banks, whichever form they were, got paid. And it led to a feeling that there might be another year for many of these entities who were in jeopardy.

But as you point out, this is a problem. If this is the bulk of your portfolio and it's under some stress, in other words, there may be a declining spread in terms of interest rates, and all you have been building ever since 1987, a substantial amount of capital, which gives you safety margins, that cannot necessarily be taken for granted. So you have cited other banking authorities outside agriculture who talk about spread of loans, as opposed to the concentration that you have.

This is a part of our dilemma. Clearly, the Farm Credit situation was set up to help farmers, to help people in agricultural America. And one of our debates throughout the 1980s was, are they being well enough served, are there enough sources. In some counties of America, the answer apparently was no. So the question is, how do you fill in that void, so that all of us, wherever we are, receive credit because a lot of agriculture is remote by definition. There are not large population centers, as there are in urban areas.

So on the one hand, the idea is to provide a Federal entity that helps everybody. On the other hand, we want that Federal entity to remain viable. And that was the dilemma we faced in the mid-1980s. There wasn't going to be much credit if the whole thing collapsed.

So as a result, as you recall, as a historian of all this, there were estimates before this committee that as much as $11 billion of guaranteed loans, or some type of Federal safety net, might be necessary to work out over the course of many years the problems of the Farm Credit System.

Now, my recollection is that fortunately, it took about $1.4 billion, and those loans were fairly promptly repaid by the System, to its credit and to all who were involved in it. So as a result, all the dilemmas that faced the savings and loan and the fallout from that did not attend this, and that's a credit to the Farm Credit System, it's a credit to this committee and our House counterpart and others who really worked line by line through that legislation for the better part of a couple of years. And it has worked well since.

But now you come today and you point out there are some trends. And they are disturbing ones to all of us. Fewer farmers, fewer entities at all that are out there. And those who are young are especially troubled because of the difficulty of capital accumulation. And maybe through our own farm policies an increase in land values every year now for several years. So that if you are in a buying mood, you've got more of a problem, and more of a credit problem, certainly.

So I sketch in all this as you would have if the Committee had asked you to recite the whole paper. But I think these are important facts and they are part of the record.

Now, having said all that, it's your statement, as I understand it, that you believe you have statutory authority to issue this rule, to call for the 30-day comment, as you have, to listen to what everybody has to say, take seriously these comments as well as our hearing today and the comments that may be made, and then to

proceed. Is that essentially your position or do you want to comment on that?

Mr. REYNA. Senator, I think you've accurately captured the essence of my comments. It has been the FCA's practice since at least 1933 to issue exclusive Charters. In more recent years, as I mentioned, there has been some over-chartering of territories when it made sense to do that as a result of mergers and consolidations. What we would do with this rule is to end that practice. The statute does not prohibit the issuance of a National Charter, nor does it require the issuance of exclusive Charters. It's been a regulatory or administrative practice.

The CHAIRMAN. In his testimony, Congressman Leach was highly critical of the activities you took last year, feeling that this did not bring about a rulemaking process or 30-days and so forth. But nevertheless, you did not proceed. And when we visited earlier this year, as you recall from our conversation, which is a confidential conversation, but this part of it, I think is fair to say, that I thought there would be some concern if this occurred without there being a formal rule and a 30-day period. You shared that view.

And I indicated we would probably want to have a hearing, which in fact we are having, because I believe this is good public policy to do, so that everybody understands the situation. Whatever may be the history, as you mentioned, back as early as 1994, long before your tenure or that of Ms. Jorgensen on this board, there was comment about this geographical situation. So it's not an entirely new item, it sort of spreads over six- or seven-years.

But nevertheless, it has probably come for reasons you've suggested in your testimony today, namely, real problems out in farm country with your clients, with the spreads, with districts that maybe have, as you point out, only two or three crops that are prominent. And if those two or three are in very difficult shape simultaneously, so might be the Farm Credit entities who are servicing them.

So for all these reasons, you're suggesting it is prudent now, not in a time of crisis like the mid-1980s, or with the whole thing underwater, that we try to think about this. But nevertheless, it has its controversies. That's the reason we are all being heard and many more will be heard. And you heard from a lot of people last year, as it turned out.

But I appreciate the opportunity to explore these situations, for you to make your case as well as others who have studied this, have a strong interest in it to do theirs.

I'd like to call upon my colleague now, Senator Crapo, for his comments and questions.

Senator CRAPO. Thank you very much, Mr. Chairman.

Chairman Reyna, one of the issues I want to get into is just what the original Charter and purpose of the Farm Credit System was and is, and whether this proposal is going to change that at all. As I understand it, and I'd like you to correct me if I'm wrong on this or elaborate, but the original purpose seems to have been to provide a lower cost sort of access to capital for farm producers by providing a system of financing in which there is, because of the Government guarantees, a cheaper access to capital.

And that this effort was not intended to result in creating a new competitive entity that would be competitive with the private sector, but that the loans were intended primarily to be available for those who could not get financing in the private sector's general system. Am I correct about that?

Mr. REYNA. Ninety-five percent.

Senator CRAPO. Okay, why don't you correct it.

Mr. REYNA. Unlike the programs that USDA operates that serve as lender of last resort, the Farm Credit System doesn't have a Congressional mandate to do that. The mandate that Congress has issued to the System is to serve all types of agricultural borrowers that have a basis for credit, large, medium and small. But they have to have a basis for credit, which means they have to have repayment ability.

So the programs or the products that are offered by the Farm Credit System are not specifically targeted at limited resource or any other type of small borrower.

Senator CRAPO. So there's no requirement under the law as you see it that there be a lender of last resort element in the activities of the Farm Credit System?

Mr. REYNA. No, I agree that there is not. I also think that the System as devised by Congress is working. USDA and its programs serve a very important role in the marketplace. Before this position I served as a Farmers Home director in California, running those programs for a period of time.

The Farm Credit System does not have the same mandate or mission. It is to provide a dependable and competitive source of credit for agriculture in rural America. That is outlined in the preamble of the Act. And I think that the mission is still valid today, the need is still valid today.

Senator CRAPO. One of the criticisms that is very aggressively made by those in the private sector who provide agricultural financing is that it's not fair for the Federal Government to basically provide support or subsidy to a Farm Loan System and that loan system then be in direct competition with the private sector. How would you respond to that criticism?

Mr. REYNA. I understand the concern. But contrary to what some might suggest, I actually think that the presence of the Farm Credit System as a Government-sponsored enterprise in the marketplace actually creates lower rates for the borrowers. And I think as a regulator, and when you're judging public policy, you have to look through to the ultimate borrower, the ultimate beneficiary of whatever change or modification is being proposed. I think you have to see what impact it's going to have.

Whether it's good or bad per-se for a Farm Credit institution or a bank or other type of lender is secondary to the benefit that ultimately would accrue to the borrower. So if you've got a farmer out there that would benefit from competition as a result of the modification or proposed rule, I would say it's a good policy.

Senator CRAPO. To shift gears for just a moment, do I understand your testimony correctly to be that it is your belief that if this proposed rule is not adopted that the safety and soundness of the System would be jeopardized?

Mr. REYNA. I'm saying that currently, with the narrow geographic territories and the commodity concentrations that exist in the portfolios of Farm Credit Institutions, that is not healthy. As a regulator, I have to sit here and tell you, that is not healthy to have. And I would be derelict in my duty if I did not come before Congress, this committee, and tell you that it is of the utmost importance to provide for the geographic diversification of these institutions, and more so when times are good, because when times are bad, it will be far too late.

Senator CRAPO. Another argument that is made against the proposal which you've heard some here earlier, in the testimony of Chairman Leach, is that there is a belief that the proposal will expand the lending activities of the participating members of the Farm Credit Service. In essence, you've probably heard that there will be loans provided in a broader arena of activities and if I understood your testimony, you indicated that no new products or services would be authorized by this rule.

Why is it that this argument is being made? There is a very widespread belief that this rule will result in significantly expanded new products and service activities.

Mr. REYNA. I can understand that there may be a concern, and I would suggest that those that have the concern should actually read the rule closely, because there are no new products or services.

I can only speculate, and this was before I joined this board, there were lawsuits back and forth that involved the Agency and its effort to redefine eligibility that competitors of the Farm Credit System didn't particularly like. So there is a fear possibly, a residual fear possibly, that this rule somehow, some way, broadens the authorities, the lending authorities.

What you're going to have in this situation is an institution that has particular lending authorities today, it's granted a National Charter, and tomorrow has the exact same lending authority. So if you don't like the lending authorities that a System association has today, you're not going to like them tomorrow, because they're exactly the same.

Senator CRAPO. Just one last question for clarification. It's my understanding that a lending association can lend outside its geographic area now, with permission of the resident lending association. Is that correct?

Mr. REYNA. That is absolutely correct. It is also more costly in some instances to do that, and it's not always granted. If I could just use an example, if you and I are lenders, and you want to make a loan to a farmer in my territory, in the current System structure, you'd have to come to me and tell me, I want to make a loan in your area, and I need your approval to do that. I could say no. I might not even be making a loan to that farmer, but I could say no. You wouldn't be able to serve that farmer, I'm not serving that farmer, so the farmer is unserved.

That happens today. Unserved by the System, I should say. The farmer might be able to go to a bank or some other type of lender and get credit, or USDA. This board did take action to allow the System to participate in loans that are made by banks, by the non-System lenders, so they would share the risks and the profit that

goes along with that. And we did away with the consent and notice that's required for those types of loans that are made. That is currently in court and has yet to be resolved.

Senator CRAPO. Thank you.

The CHAIRMAN. Thank you very much, Senator Crapo.

Chairman Reyna, as you have heard, Congressman Leach stressed from his experience as Chairman of the Banking Committee some reservations people have in financial circles about the changes in what might occur. And they touch upon another theme that Chairman Leach did not bring up, but that many have around this table, that is agricultural concentration generally.

Now, last year, the Committee took action to try to provide for much more antitrust authority and scrutiny of agriculture by having a person in the USDA. There are some on the Committee who feel we ought to appropriate one of the positions and the Department of Justice should move you more aggressively in this area. But from hearing to hearing, a great deal was said about concentration, in the Cattle industry, in the Hog industry, in the Poultry industry and others.

Today, Congressman Leach mentioned specifically two companies for illustrative purposes. He didn't allege that they're making loans or dealing with you, but Cargill and John Deere, for example, two large and well respected American firms. And at least I gathered his testimony was that these firms might find it useful to begin picking up ties with Farm Credit System, and might do so in a fairly wholesale way.

Can you offer any illumination on what their possibilities are? Mr. Leach was saying they haven't maybe thought about the law yet, they haven't see, or the rule promulgated. But once they do, not only for these two, but for a whole raft of fairly large firms in America, ideas may light up as to the potential of this. And therefore, whatever might have been the best intention of Farm Credit, the implications of activity would be something else.

Can you offer words of assurance, neutrality? What sort of thoughts do you have?

Mr. REYNA. The first thing that occurs to me is that the particular scenario you just outlined could occur with or without National Charters. This rule does not preclude or enhance the ability of a Farm Credit institution to enter into an alliance or a type of partnership that you've described.

The CHAIRMAN. So it's neutral on the concentration issue, as we're hearing it, from any form?

Mr. REYNA. Correct.

The CHAIRMAN. Ms. Jorgensen, you've sat silently through all of this. Let me just ask you to speak up if you have something to say.

[Laughter.]

I appreciated very much your statement, which speaks for itself very eloquently, and is a real contribution to our record. But before we conclude work of this panel, I wanted to acknowledge your presence and to ask you to speak if you would like to.

Ms. JORGENSEN. Well, thank you very much. I appreciate being here, and the Members of the Committee.

Chairman Reyna's statement speaks well for what the Board discussed and the position of the Board, and I really don't have any-

thing to add. And as you mention, I did present a statement, I didn't present testimony.

I'd be happy to answer any questions at this point.

Thank you.

[The prepared statement of Ms. Jorgensen can be found in the appendix on page 66.]

The CHAIRMAN. Your statement will be made a part of the record, so that it will be testimony for this hearing.

We thank both of you for coming and for your service. Again for the record, and for those who follow this board, there are at prime strength three members. So you will be joined hopefully with a nominee of President Bush at an early time. I would just pledge on our part, as I have told you both privately, that we will act upon that nomination as rapidly as possible, because boards work best when they have their full membership.

We have had this problem with the CFTC Commission Board from time to time, of vacancies, one or two or thereabouts. So we will try to encourage the Administration to take this as seriously as all of us have to date to get another member to help you.

We thank you both for coming and for your testimony.

Mr. REYNA. Thank you, Senator.

The CHAIRMAN. The Chair would like to call now a panel comprised of Mr. Bobby D. Williams, a grain farmer and board member of the Heritage Land Bank of Tyler, TX; Mr. Jack Webster, President and CEO, Farm Credit Services of America in Omaha, NE; Mr. Phillip Burns, Chairman of the Farmers and Merchants National Bank of West Point, NE; Mr. Dale Leighty, President of the First National Bank of Las Animas, Las Animas, Colorado; and Dr. Peter Barry, Professor of Agricultural Finance at the University of Illinois in Urbana, IL.

STATEMENT OF BOBBY D. WILLIAMS, GRAIN FARMER, CHAIRMAN OF THE BOARD, THE FARM CREDIT COUNCIL

Mr. WILLIAMS. Good morning, Mr. Chairman. Thank you for the opportunity to appear before you today to discuss the Farm Credit Administration's proposal in regard to the regulation to permit Farm Credit System institutions to seek National Charters.

I'm Bobby Williams. I'm Chairman of the Board of the Farm Credit Council, which is the National Trade Association representing the Institutions of the Farm Credit System. I also serve as a member of the Board of the Heritage Land Bank, ACA headquarter in Tyler, TX. However, today, Mr. Chairman, I would like to address the Committee from the perspective of my primary occupation as a farmer.

The CHAIRMAN. Let me just interrupt for a moment, Mr. Williams, because you got started before I got everybody all comfortably seated.

Mr. WILLIAMS. I'm sorry, Mr. Chairman.

The CHAIRMAN. That's all right. I was just going to greet you and indicate that if possible, to confine your testimony to five minutes. We're not in a great hurry today and in the event you cannot get done in five-minutes, that will be fine. But if you can, that would be helpful, then we will begin questioning and the dialogue, really, of our distinguished panel.

We're delighted that you're here, and please proceed. I apologize for the interruption.

Mr. WILLIAMS. I noticed that when Mr. Webster gave me a hard look, Mr. Chairman.

[Laughter.]

With our son, we currently farm about 3,200 acres near Wolf City, Texas, which is near Dallas, Texas. Not only am I your typical Farm Credit borrower, I'm a typical family farmer. I'm not a large conglomerate or a huge integrated operation that some have suggested is the prime focus of the Farm Credit System. I can assure you that I'm the norm in our portfolio, and not the exception.

Mr. Chairman, before I discuss the National Charter proposal, I want to thank you and your colleagues for what you've done for agriculture. I can tell you from a very personal experience that had it not been for the aid that you provided farmers and ranchers in the last few years, our ag economy would be in a very severe economic depression. We certainly thank you and we applaud you for what you have done.

I have borrowed from the System since 1975. Over that time, I have seen a lot of change——I've served as a director for over 20-years——change in agriculture and change in the Farm Credit System.

Mr. Chairman, I hear a lot of accusations about the System and what we're doing and how we're trying to pull away from serving family farmers, pulling away from serving young and beginning farmers. It's interesting to me that those accusations all come from those outside the Farm Credit System and they really don't understand how we operate or they would really just like to see us go away. I would challenge anyone that can believe these accusations to come and spend some time with us at our board room in Tyler and listen to the concerns expressed by those board members and really listen to what we have to deal with on an ongoing basis.

Being a director of a System institution imposes on me the responsibility to make sure that the present and future generations of farmers and ranchers have the option of being served by a cooperative financial institution that they own. To accomplish that, change is necessary. Over the past couple of years, change has been constant for our association. We have merged, we've converted our association from being an agent of the Farm Credit Bank of Texas, we were operating as a Federal Land Bank Association, to being a direct lending, Federal Land Credit Association and we have just completed our conversion to an Agricultural Credit Association.

Even with those changes, we recognize that maybe we have not done enough to ensure that our customers are insured the best service that they deserve. Our motive in this has not been to move away from serving agriculture, Mr. Chairman, quite the opposite. Our motive has been to structure a modern financial institution that can effectively serve its stockholders, the present ones, and be there to serve the next generation.

I'm very proud to tell you that when our association became an ACA, and gained the authority to extend operating lines of credit, those production credits, our son, Eric, who is a seventh generation

farmer from Wolf City, was the Institution's first customer. That's my motivation for being here today, sir.

The Farm Credit Administration has proposed that System institutions have the flexibility to obtain National Charters. This represents a change, but it's not a change that impacts who we are eligible to serve or our cooperative structure. It's just a change that will allow us as directors and allow our management teams to have another option.

This regulation means flexibility, flexibility for our institutions. But more importantly, it gives flexibility to our borrowers, the farmers and ranchers. With this regulation in place, I have the possibility of having another option, another choice of lenders, and I really like that.

Mr. Webster will address a number of issues in greater detail. There are two things I want to emphasize. First, whether a Farm Credit Institution serves a limited number of counties, as in the case of my institution, or many States, as in the case of Mr. Webster's institution, or the entire country, which is permitted under the rule, or would be permitted under the rule, the control of those institutions is a responsibility of the Board of Directors of those institutions.

Second, we're not going to ignore our responsibility to continue to work with young and beginning farmers. If anyone is sensitive to the needs of young farmers, it is parents who are farmers and who direct these institutions. From experience, we know that credit is not the solution for a young farmer, but it is a tool, and we'll continue to make sure that the appropriate tools are in place for young and beginning farmers, and that their needs are addressed.

Sir, I see I'm out of time. If I may have one additional minute.

Mr. Chairman, to that end, I want to use this opportunity to make the Committee aware of a major new effort that is being launched by the Farm Credit System Foundation. Within the next week, the Foundation will be launching an internet- based project to reach thousands of young and beginning farmers to provide them a vehicle to express their views regarding the existing barriers to their success in agriculture. Our goal is to develop the first comprehensive picture of young and beginning farmers far beyond what the Agricultural census of the USDA can provide.

We will make the results available to you so that in your efforts, as you write a new farm bill, you will have far more information than you've ever had to deal with the needs of this critical segment, which is the future farmers and ranchers of America. the Farm Credit System Foundation is pleased to sponsor this effort, and we'll be happy to provide you with a full briefing at your convenience.

Again, thank you for the opportunity to appear before you today. After the completion of Mr. Webster, we will be glad to take any questions that you may have for us. Thank you, sir, and excuse me for starting before the time.

[The prepared statement of Mr. Williams can be found in the appendix on page 68.]

The CHAIRMAN. Well, thank you very much for your testimony, Mr. Williams. We will ask each of the five panelists to make their

remarks before we start the questions, so we will have the full colloquy at that point.

I would just interject at this moment that clearly, you've offered the Committee some information of more general import with regard to the Farm Bill. And I would hope that each one of you who are here today, as you have those opportunities, will do that. This is a time of the gathering of the best wisdom that we can from people all over America on what the facts are on individual farms or collections of people as either young or old or what have you.

So that kind of data would be very, very welcome.

Mr. Webster, we'd like to have your testimony.

STATEMENT OF JACK WEBSTER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT SERVICES OF AMERICA

Mr.WEBSTER. Thank you. Good morning, Mr. Chairman and Senator.

My name is Jack Webster. I'm President and Chief Executive Officer of Farm Credit Services of America.

I'm appearing today on behalf of the Farm Credit Council, the National Trade Association representing the Institutions of the National Farm Credit System. Farm Credit Services of America provides loans and related services to 43,000 agricultural producers in Iowa, Nebraska, South Dakota and Wyoming. We're headquartered in Omaha. We're a cooperative, owned and governed by the farmers we serve. At year-end, we had over $5 billion invested in agriculture.

Mr. Chairman, before I address the subject of the hearing, I want to echo what Mr. Williams said regarding the support this committee has demonstrated for American agriculture. Without it, conditions in the rural economy would be dire. We heartily support the assistance you provided, and urge you to continue to address the needs of agriculture, while markets remain depressed.

Thank you very much, Mr. Chairman, for calling this hearing. We welcome the opportunity to come before the Committee and talk about what we are doing to improve our service to farmers and ranchers. The System is chartered by Congress for a very specific reason: to serve agriculture. I started in the System in 1974, and I remember back then what the Act said, and this is from memory, but it's to improve the income and well-being of the American farmer and rancher through the extension of sound and constructive credit.

So I was challenged a little bit by some of the comments earlier, and I'm glad it was asked about. But the mission is not limited by the term modest means. We look for sound, constructive credit to improve the farmer's capability in the field. That is our mission. It's set out clearly in the Farm Credit Act. We are cooperatively owned and controlled. We're a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit.

To accomplish this mission, we are expected to keep the Institutions of the System modern, efficient and competitive. We are expected to provide farmers and ranchers a choice amongst lenders, and we must have the wherewithal to be a reliable source of credit, able to serve all types of farmers, in good times and bad. The cur-

rent service territory limitations under which we operate date back to the 1920s. The regulator at that time made an administrative decision that agriculture as it existed then would best be served by institutions with limited service territories. Back then, a farmer's geographic location, where they lived, where they farmed, was the determining factor in their choice of a lending institution.

Needless to say, 80-years has brought a lot of changes to agriculture and to the financial services industry. Today farmers buy inputs from, gather information from and market their products to entities all over the globe. The internet provides them instantaneous access to the global marketplace. Globalization has brought with it the promise of expanded markets and the challenge of global competition, and yet the farmer-owners of the Farm Credit System have seen their lending institutions remain geographically limited, in a global economy that knows no geographic limitations. They face arbitrary and outdated restrictions that no longer make sense in our modern world.

National Charters will ensure that farmers and agribusinesses have access to the broadest range of lenders. The National Charter regulation will provide farmers and agribusinesses with a choice of lenders to best meet their needs. Farm Credit System lenders are limited to serving agricultural and rural communities. As essentially single sector lenders, we face concentrated risk. Unlike other lenders, we cannot move away from agriculture when the economy softens. We are here to serve agriculture and rural America in good times and bad. We work every day to mitigate the risk inherent in single sector lending.

Farm Credit single sector risk is further concentrated in many cases by geographic risk. An institution can find itself facing a territory-wide drought or similar agricultural catastrophe. By moving beyond local geography, Farm Credit institutions can alleviate some of this geographic risk.

National Charters will not change the cooperative nature of the Farm Credit institutions. They will continue to operate on the concept of one stockholder, one vote. Farm Credit institutions will continue to be owned and controlled by their member customers. Farmer control will remain a fundamental principle of the System.

An institution that receives a National Charter would be required to amend its current business plan to ensure that first and foremost, it will provide loans and financially related services to the customers in its originally chartered or local service area. The conditions of the National Charter set forth in the proposed regulation would require an institution to recognize and act on its obligation to serve all eligible borrowers in its local service area.

National Charters will not change who is eligible to get a loan from the Farm Credit. The National Charter regulation will provide no new lending authority for FCS institutions. The competitive balance between Farm Credit and commercial banks will not be altered by this regulation.

It is important to remember that commercial banks have done very well competing in agricultural credit markets. According to USDA, commercial banks have gained market share in agriculture credit markets in 12 of the last 15-years.

Mr. Chairman, thank you for the opportunity to testify today. We strongly support the FCA's proposed regulation. We believe it provides more choices for farmers, helps diversify risk in Farm Credit institutions, and helps preserve Farm Credit's cooperative structure. Importantly, we note that the FCA action does not alter the competitive balance between Farm Credit and commercial banks, and is fully authorized by law.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Webster can be found in the appendix on page 71.]

The CHAIRMAN. Thank you, Mr. Webster.

I'd like to call now upon Mr. Burns for his testimony.

STATEMENT OF PHILLIP BURNS, CHAIRMAN, FARMERS AND MERCHANTS BANK, WEST POINT, NE

Mr. BURNS. Mr. Chairman and members of the Committee, I am Phil Burns. I'm Chairman of the Board of the Farmers and Merchants National Bank in West Point, Nebraska. I'm pleased to appear today on behalf of the American Bankers Association, to participate in this important hearing to discuss National Charters for Farm Credit System direct lending institutions.

We thank the Committee for holding this hearing, because this proposal by the Farm Credit Administration represents a dramatic departure from the way in which the Farm Credit System has operated for over 80-years and poses a real potential for harm to producers, taxpayers and to rural America. We urge Congress to stop this process before it's too late.

There are a number of factors to keep in mind when considering this National Charter proposal. The Farm Credit System has assumed a diminished role in a market brimming with competitive providers of agricultural credit. Banks and other private sector lenders have more than filled the void left by the Farm Credit System. The National Charter initiative is reminiscent of the 1980s in that the System is once again desperately trying to reinvent itself in order to justify their continued existence.

This initiative would further the specific targeting of the Federal subsidy accorded Farm Credit System borrowers to the largest, wealthiest producers, those that need Government help the least.

Since 1916, System institutions have operated with clearly defined territories. As a Government-sponsored enterprise, they enjoy beneficial Federal and State tax treatment, and have a distinct competitive advantage through their access to lower cost lendable funds. By abandoning clearly defined territories and the principle of local ownership and control, the FCA would undermine the essential and core principles of the System. As a result, the question becomes whether GSE status for the System continues to be appropriate.

National Charters will for the first time have System institutions competing with each other. There is no credible justification for sending a GSE on a new and reckless course of internal competition. For years, our members have complained to Congress and the FCA about the pricing practices of the System institutions. We are very concerned that with National Charters, System institutions

will engage each other in a disastrous round of lowball pricing that will undermine the financial health of rural America.

The FCA would have Congress and the public believe that System institutions are shackled to an antiquated system of geographic territories, and that by eliminating geographic boundaries, the System will be insulated from regional risk. The truth is that System institutions have a number of options available that they can use to diversify their loan portfolio, either geographically or by commodity. System institutions currently have authority to lend in any part of the United States with the concurrence of the System institution that is serving the territory they wish to enter. System institutions may use existing loan participation regulations to participate in any qualifying loan made by a non-System lender.

An examination of the proposed regulatory framework raises a number of public policy concerns. First, we have great concerns about the negative impact National Charters will have on small and beginning farmers as System institutions seek larger, more profitable loans at the expense of these borrowers. The FCA's National Charter proposal will primarily benefit, large multi-State, farm and ranch operations.

Second, the FCA reminds System lenders that there is a public policy mission of the System to provide credit to all eligible and creditworthy customers within their local service area. However, the FCA proposes no specific enforceable or measurable regulatory sanctions that would ensure that local farmers and ranchers continue to have access to the Farm Credit System lender. In fact, they do not propose to restrict in any way non-local lending of System institutions. Specific limitations should be applied to a System institution's lending activities outside of their local service area.

Third, the 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. The FCA fails to establish a case for how National Charters will alleviate the System's concentration in lending to a specific commodity. Instead of diversity in commodity lending, we believe that the result will be a continued focus on the same commodities but in other geographic areas, and in fact, will increase concentration and single commodity loan risk.

Fourth, the proposal would fundamentally change Farm Credit System Institutions from the locally owned and operated institutions envisioned by Congress into national lenders with no local perspective. The participation of local farmer and rancher borrowers and the management, control and ownership of the System have always been central to its mission. The FCA should require that the 425,000 owners of the Farm Credit System vote on the question of whether their institutions should apply for a National Charter.

The Farm Credit System was created at a time when there were limited choices to secure credit for American agriculture. National banks like mine did not have authority to loan money on farm real estate in 1916. The world has changed much since then. Today seed companies, equipment manufacturers, fertilizer producers, life insurance companies and foreign banks are all aggressive providers of agricultural credit. The fact that these options exist raises the

question, why should the American public remain on the hook for the reckless activities of a retail lending, tax- advantaged GSE that has clearly targeted its lending to benefit large, wealthy farmers and ranchers.

Given their track record of unsafe and unsound lending gin the past, and the lack of enforcement on the part of the regulator, we urge Congress to stop this process before it's too late.

Thank you for allowing us to be here. I'll be more than willing to address any questions at the appropriate time. Thank you.

[The prepared statement of Mr. Burns can be found in the appendix on page 76.]

The CHAIRMAN. Thank you very much, Mr. Burns.

I'd like to call now on Mr. Leighty for his testimony.

STATEMENT OF DALE LEIGHTY, VICE CHAIRMAN, INDEPENDENT COMMUNITY BANKERS OF AMERICA; PRESIDENT, FIRST NATIONAL BANK OF LAS ANIMALS, LAS ANIMAS, CO

Mr. LEIGHTY. Thank you. I'm Dale Leighty, and I'm here today representing the Independent Community Bankers of America. Thank you for conducting this hearing.

Mr. Chairman, the old perception that bankers and the Farm Credit System can't agree on anything is not true. We agree with the many FCS Associations who oppose this proposal. I ask that the hearing record include these sample letters of opposition. The bottom line is that the proposal is such a fundamental change with such major negative public policy implications that it should be thrown on the scrap pile of bad policy ideas.

[The information referred to can be found in the appendix on page 107.]

FCS associations express concerns that this new direction is a dramatic change in the FCS that would benefit only the large FCS lenders at the expense of the smaller ones, would hurt the cooperative nature of the FCS, and undermine service to family farmers. One Farm Credit System association wrote that in their Farm Credit district, a survey showed that more than a majority of the Associations are opposed to the National Charter approach.

With such opposition, we ask, why is FCA only providing a 30-day public comment period? The basis for much of the opposition to this proposal is that there is little, if any, need for this proposal. The System already has mechanisms in place, as has been mentioned earlier, to allow for customer choice through granting routine concurrence for borrowing and the use of reciprocal territory agreements, which ensures customers have choices.

Also, the System can already diversify risk if institutions choose to use available authorities. For example, associations can achieve diversity both across geographic regions and across commodities by sharing loans with other associations, so-called loan participations. Loan sharing allows associations to share the profits or losses of their loans, and can be done anywhere in the U.S. Participations have the added advantage of relying on the local association's knowledge of the customer base, and various risk factors inherent in that particular geographic region. And they won't drive out local lenders.

In addition, the USDA has loan guarantee programs and Farmer Mac has a secondary market program to purchase loans. Both of these are in place to help lenders reduce risks. Yet USDA economists report that FCS has not utilized the USDA loan guarantee programs to any significant degree.

Mr. Chairman, why adopt this proposal when FCS institutions are currently not utilizing existing risk reduction tools? This proposal completely ignores other risks that result from venturing into unfamiliar geographic areas and climates where they have little, if any, previous lending experience. And why does it make sense for associations to compete, when competing associations are jointly and severally liable for each other's failures?

The board of one FCA association stated, "Risks could develop to such a scope and scale as to trigger losses that would impact the remainder of the System institutions." Another wrote, "We have seen too often where the efforts to build and agricultural loan portfolio by offering low market rates or easy credit terms and conditions have led to problem loans, risky portfolios, and failed farming operations."

Another wrote, "In our opinion, this is a classic safety and soundness issue, which puts member investment in System institutions at risk." In fact, one FCS association wrote, "We are convinced of the following. Safety and soundness are being totally ignored."

These legitimate concerns need to be taken seriously, Mr. Chairman. This proposal will hurt family farmers, not help them. The impacts are likely to include the need to offset low interest rates made to the large borrowers by higher interest rates to smaller farmers and reduced earnings to the associations and their stockholders. Also, when associations are forced to merge or go out of business, there will be fewer credit choices.

The more profitable farmers in more profitable geographic areas will be targeted, because the smaller loans will not be viewed as cost efficient. In fact, they have pointed out that in those territories where there is already limited over-chartering of FCS territories, this is precisely what is now occurring.

Some FCS comments were, intra-System competition is for only large loans, associations are only interested in soliciting large, out of territory loans that have adequate volume to cover the extra expense of handling, and will contribute towards association efficiency, cost per dollar loaned. There will not be any competition for the smaller loans, as they are not cost efficient. Competition for the large loans will result in reduced interest rate spreads for these loans, and an offsetting increase on small and marginal loans.

Is this the type of policy you want in place for rural America and for your family farmers? Is this the role you have envisioned the Farm Credit System playing?

Local service area plans are insufficient. Yes, the FCA has said they will require local service area plans, or LSAs, to supposedly ensure a commitment to the Association's existing territories. Requiring LSAs in the first place simply gives credence to all the arguments against them, especially the arguments that National Charters will only foster cherry picking. Why else would LSAs be required?

But will LSAs be sufficient? Answer: no. They are based on self assessments and self evaluation by the Association applying for a National Charter. LSAs do not require any targeting of young, beginning or low income farmers. So the focus on out of territory lending is totally geared to large credits. There are no requirements, no portfolio goals, for example, that struggling family farmers by the primary objective for venturing into new territories.

Further, the policy does not increase service to low income farmers within LSAs by the local lender. It only requires a plan be in place, but provides no criteria for the plan, no goals, nothing measurable, meaning, business as usual. The new policy allows the associations to self-assess themselves, as part of their application, and report on how good of a job they feel they are doing in their local service areas.

A few questions. Why are there no portfolio limitations on the amount of lending activities the associations can do outside of their LSAs? Why is FCA proposing local associations need to go outside of their district bank territories? Will there be transparency and open public scrutiny of these LSAs, or will they be hidden from the public's view? If an association closes down, who serves the LSA?

Who makes up the loss of local community investment, now that the local association will need to divert resources to fight the incoming competition from non-LSA lenders? Why is there no requirement that the non-LSA lenders be required to make a financial commitment to the community where they are seeking loans from? Who makes up the loss to the local tax base when large tax-advantaged GSE privileged lenders take away large loans, since income taxes won't go into the local community?

Will the same level of income taxes be required to be paid to the community where the large GSE lender is located as they would if made by private sector lenders? Obviously not. Does this mean local tax increases to maintain the tax base in these communities? And who makes up for the loss of local economic activity when funds are not recycled through the rural community where the borrower is located?

One association wrote, "Even with the LSA requirements, a likely result over time will be for associations to place less emphasis and focus on smaller, less profitable loans in marginal agricultural areas, and increase efforts in areas with stronger agricultural and larger, more profitable loans."

Unfortunately, the removal of boundaries could result in fewer associations due to interest system competition, and therefore lead to higher interest rates over time. Obviously this would not be beneficial for our customers.

Mr. Chairman, it is inconceivable that Congress wants to provide less help and poorer service to family farmers. But both perspectives, FCAs and opposing FCS associations, can't be correct. They are mutually exclusive. It is a matter of basic economics. Family farmers will not be targeted by out of territory lenders under this proposal, because it will cost more to underwrite service and monitor their loans made from many States away.

To be viable, local lenders must be able to lend to a broad cross section of constituents in their market. They can't be profitable lending only to the marginal or less profitable customers. But this

is a prospect that many local lenders would face, since the large, aggressive FCS lenders would engage in predatory pricing to snatch away the better farm loans.

This proposal has no monitoring or oversight controls to prevent predatory pricing. FCA does little policing in this regard currently, and this proposal only guarantees that the larger System entities will undercut the market to get the business.

As one FCS association wrote, "We are totally opposed to the removal of geographic boundaries of System entities which would no doubt promote predatory pricing and loss of local control." Another wrote, "Better rates and better terms will only occur if one of the competing system entities is willing to earn less than the market would dictate. Therefore, we are uneasy with the proposal in this extremely competitive environment."

Section 1.1 of the Farm Credit Act, which states Congressional objectives, is often cited by FCA. But this section has a proviso which states, provided that in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders. Yet FCA does not provide sufficient regulatory controls in this area to accompany their regulatory proposals. The Act may need legislative changes to require better performance. And FCA should be conducting periodic surveys of rates and making them publicly available.

FCA has admitted that they have not conducted a formal economic cost benefit or needs analysis of the impact of this proposal. With such dramatic changes possible and likely, one would think that would be required of the FCA. This raises the public policy question of why small, locally based lenders, like our $98 million bank, should be forced to compete with a multi-billion dollar Government sponsored enterprise. Does anyone around this table believe that the remaining multi-billion dollar GSE lenders need to keep their tax advantages and low cost GSE funding access in order to compete with my small depository institution? Is that fairness?

Many members of Congress will talk often in the months ahead about our future trade negotiations with other countries, and will stress the need not only for free trade, but also for fair trade. As community bankers, we ask for the same thing: some basic fairness in competition in the rural credit markets.

The Department of Treasury recently commented on this proposal, warning: "First, we believe the proposal would reduce the focus of Farm Credit System associations, focusing on serving all eligible borrowers in their local areas, and diminish the System's local cooperative structure. Second, the proposal would likely allow a Government advantaged competitor to increase market share, which in the long term could affect competitiveness in Agricultural Credit Markets. We did not recommend National Charters or any form of interest system competition. It might well diminish competition and innovation in the medium to long term, by driving other competitors from the market."

Finally, I ask the Committee to be wary of arguments that FCS needs this proposal because they serve a single sector. And please don't believe the statements that "FCS must continue to make loans to agriculture when other lenders can abandon agriculture in

search of more profitable opportunities elsewhere." These types of statements completely mischaracterize this debate and our rural agricultural credit markets.

FCS was given tax advantages and access to unlimited low cost funding as a Government-sponsored enterprise, precisely because they were created to serve a single sector, agriculture, and created at a time in the early part of the last century when we had credit gaps. Should FCS continue to receive GSE benefits if they now want to focus on largest loans across the country? It becomes questionable, and don't forget, they also get to choose who they lend to within this sector.

A couple of years ago, FCA proposed a broad scope and eligibility proposal which included allowing loans to be made to farmers and agribusiness for both farm and non-farm purposes. It was modestly scaled back due to complaints. Farm Credit's non-ag lending already includes providing mutual funds, credit cards, student loans, home equity loans which can be used for any purpose, vacation loans, loans to dentists and anesthesiologists, for recreational purposes and on and on. This argument of being limited to a single sector has worn quite thin, and it is clear that FCA wants to push the expanded powers envelope even further in the future.

Where will this lead with National Charters? Will Cole Bank, working through its direct lender associations, or will FCS banks and lenders form national alliances with national car companies to provide consumer auto financing for Ford or GM cars in towns of 50,000 and under population? What about financing all the consumer loans for Home Depot, home remodeling projects in rural towns? What about teaming up with the national businesses to provide financing for furniture sales, office equipment, computers, if they serve rural America?

In regards to other lenders abandoning farmers, let me state, there are thousands of community banks serving agriculture. And in most communities, there are several community banks competing for the same business in addition to other competitors. Community banks are not going to go seek profit opportunities elsewhere by leaving our communities in tough times.

Mr. Chairman, FCA and the FCS, despite all the talk about wanting more competition, have a terrible record for implementing the other financial institutions program, intended by Congress to allow banks, credit unions and other groups to access the funding windows of the FCS. Only 24 exist, despite decades of statutory authority. We urge FCA to host a meeting of OFIs to gather input and begin developing a working program.

National Chartering is fraught with problems. It dramatically changes the structure of the System, will lead to rapid consolidation and loss of local control, encourages predatory pricing with no controls, will lead to large, aggressive FCS lenders cherry picking the best loans, with no specific targeting requirements to serve family farmers. It could lead to alliances with large commercial businesses for non-farm lending.

The System has been quite profitable as it is currently structured, generating over $1 billion in annual net profits for the past decade. FCA should withdraw their proposal and promote options that would be much less disruptive. This proposal raises serious

concerns. We would be glad to work with the Committee and the FCA in discussions to explore the needs of the Rural Credit Markets, especially the needs of beginning and low income farmers.

But we ask that community bankers be included in such discussions. Otherwise, FCA is making decisions that will have broad impact on all lenders and borrowers in Rural Credit Markets, but only listening to a select few, even within its own constituency. And that simply can't be good for the whole of rural America.

Thank you.

[The prepared statement of Mr. Leighty can be found in the appendix on page 84.]

The CHAIRMAN. Thank you very much, Mr. Leighty.

The staff has certainly done a good job in inviting four very articulate witnesses, and we appreciate the testimony of each of you.

Now we will hear from Dr. Peter Barry, Professor of Agricultural Finance, University of IL. I hope not an uncomfortable position, having heard this debate presently. We look forward to your testimony.

STATEMENT OF PETER J. BARRY, PROFESSOR OF AGRICULTURAL FINANCE, CENTER FOR FARM AND RURAL BUSINESS FINANCE, UNIVERSITY OF IL, URBANA

Dr. BARRY. Thank you, Mr. Chairman and Senator, other members of the Committee. My name is Peter Barry. I am a Professor of Agricultural Finance at the University of IL, and Director of the Center for Farm and Rural Business Fiancee.

Most of my career has addressed work in agricultural finance, including many projects and activities with industry groups, agency groups and policy groups. Currently, for example, my colleagues and I are finishing an assignment with the FCA about risk-based capital requirements for Farmer Mac.

I have a long acquaintance with the National Chartering issue, having completed a study in 1991 for the FCA entitled "Competition Within the Farm Credit System: Concepts and Options." This study conceptualized the issues and identified options, including the currently proposed approach for intra-System competition, with each option evaluated by a common set of criteria. Since it began in 1916, the Farm Credit System has had considerable evolution, including restructuring, new authorizations, contemporary management techniques, and an arms-length regulator. National Chartering is another step in this long-term modernization process.

My testimony addresses five issues: competition, risks, reliability, cooperative organization and structural change, and regulatory considerations. Competition among System institutions should offer more choices for farmers and enhance the competitiveness of rural financial markets. Greater competition could especially benefit parts of the U.S., the southeast, the northeast, parts of the west, where historically strong branch banking systems generally have been less committed to agriculture, in contrast to the more prevalent community banking in the midwest and plains. Table 1 in my written testimony illustrates the differences in Farm Credit System market shares and competitive positions across selected States and regions.

In going forward, the monitoring of commercial bank financing of agriculture will be important as bank consolidations continue to occur. For risks, National Chartering initially could bring greater uncertainties about unfamiliar territories and about the collection of information for new borrowers, thus giving value to institutional discipline and regulatory oversight. Over the longer term, geographic expansions should add to the risk-bearing capacity of the System institutions, perhaps yielding small reductions in farmers' interest rates.

The FCS mandate for reliable lending and its cooperative organizations should also continue to constrain aggressive geographic expansion. Most farm borrowers prefer knowledgeable, established, reliable lenders, which implies the need for major institutional commitment to serving expanded territories. Concerns may also arise about how National Charters could affect younger, smaller and less wealthy borrowers. The dominance of the System's farm real estate lending in the past can skew its customer base more toward farmers who can afford to purchase and finance farm land, in contrast to the practice by younger farmers, in Illinois, at least, to lease most of the land they operate.

Extensive structural change in agriculture is making it much harder to generalize about a customer base. As indicated by recent initiatives, the System seems committed to further serve young, beginning and limited resource farms. Structural change of the Farm Credit System itself has been rapid, with the pace of reductions of lending associations exceeding that of commercial banks. A patchwork structure has emerged, in that at least two of the large multi-State associations are larger than two of the Farm Credit Banks.

The National Charter concept could facilitate or motivate further structural change. Perhaps it already has.

Regarding regulations for National Chartering, the FCA's proposed rules published in the February 16 Federal Register squarely address matters of safety and soundness, local service obligations and effective business planning. A key implementation factor is for the FCA to follow through effectively in examinations, reporting and other regulatory processes, to ensure the system meets its mandated mission.

Thank you very much for the opportunity to offer this testimony.

[The prepared statement of Dr. Barry can be found in the appendix on page 97.]

The CHAIRMAN. Thank you very much, Professor.

Let me just begin the questioning by raising a point I think that Mr. Leighty has made, and that is that there appears to be some opposition within the Farm Credit System to the National Chartering idea. And you cited, Mr. Leighty, as a part of your testimony, a list of institutions that have expressed this. Maybe you would like to say more about that.

But I'd like to ask Mr. Webster or anyone else to comment on this. What about that? Is there a debate going on within the System? Is the testimony we heard today from those in Farm Credit reflective of that, and can you make further comment or assertion? Then I would like to hear from the Farm Credit witnesses.

Mr. LEIGHTY. I believe you have been provided with copies of letters, that is the source of those comments.

[The information referred to can be found in the appendix on page 107.]

The CHAIRMAN. But I think you implied that, as a matter of fact, I jotted down that losses could jeopardize the entirety of the System, at least assertions were being made, apparently in some of these letters or through other testimony you've heard. Is that a serious concern, that the entire system could be jeopardized by this principle we're debating today?

Mr. LEIGHTY. That's simply a perspective of one of the commenters of the Farm Credit System Associations that sent in a letter.

The CHAIRMAN. Mr. Webster, what sort of debate do you have within your circles on this?

Mr. WEBSTER. Mr. Chairman, it's interesting to have the bankers quote our differences, but we have them. I would say that the focus is on, whether we're focusing on an institution or the farmer-rancher. I've listened to testimony this morning that talks about institutions.

We are a strong advocate of National Charters for one reason: it puts the choice within the American farmer or rancher. Let them choose who they want to do business with. And yes, that could challenge some institutions, because that farmer may choose to do business with someone who they believe has more expertise, better programs, maybe just somebody they have a good relationship with. And in fact, our association, which is a large multi-state, we believe with the adoption of National Charters we in fact will lose some customers to some adjoining associations. And we think that's okay.

In fact, we think if a farmer is near one of our borders and chooses to have a relationship with another lender, other than ours, that they should not have any red tape to go through. They'll walk, and we'll learn from that. And we'll ask why they went there, what could we do to serve them better.

The CHAIRMAN. Dr. Barry, you've sort of summarized from your extensive scholarship in the history of this, going from 1916 onward, various evolutions of the System that this current National Chartering idea seems to be part of the flow. In other words, maybe I don't characterize correctly what you're saying, but at least potentially, a natural part of the evolution of the Farm Credit System. Is that true, or does this have some abnormal or risky qualities that are not really consistent with what might be sort of a secular trend?

Dr. BARRY. I think it is true with respect to what's happening in financial markets. The System itself in the late 1980s allowed the banks for cooperatives to merge if they so chose, and operate on a national territory. Three of them did for a while, now there's just one. In commercial banking, we've seen significant breakdown of geographic restrictions on banking. And with a phase-in over a long period of time towards basically a national market now, if banks choose to participate in it.

Of course, community banks still have a good niche. So as I mentioned in my testimony, it does seem like a natural evolutionary process to me.

The CHAIRMAN. Mr. Williams, as a farmer and likewise board member of a bank involved in the System, you are strongly in favor of the rule proposal for reasons that you've stated in your testimony.

Mr. WILLIAMS. Yes, sir.

The CHAIRMAN. But as you've heard this debate, at least today, are there problems that you can foresee in which conceivably, even though this might be an advantage to farmers, the thoughts I think Mr. Burns suggested or Mr. Leighty, that the Farm Credit Administration might even have been reckless in terms of expansion of its activities in behalf of agriculture around the country, subsidized by American taxpayers generally, advantaged by loan differentials that were part of the System.

Do you have any response to that idea?

Mr. WILLIAMS. Mr. Chairman, I don't see risk for our association. In our district, the Tenth District, which covers five States, we do not see any strong opposition to it. There may be some associations opposed to this. I would like, if the Chair would allow me to, I would like to share one example of how a National Charter might work, and we're not speaking of a National Charter to go into Nebraska, where Mr. Webster is. We're speaking of going to an adjoining county or an adjoining association.

We live one half mile from the county line. My son drives 100-miles to our association office. He can drive 14-miles to another association and get the same service. Maybe we should be satisfied to drive 100-miles, but if he should have any dispute, any problems, should we be locked in forever to deal with that association and drive 100-miles?

Another problem we're experiencing is we have gone from 48 FLBAs, land bank associations, down to 16. We have formed ACAs. There is a spider web of territories. We're not sure where our territory is, because it's overlapped with other ACAs, other FLBAs or FLCAs. So we're already into a problem of our territories. We see this National Charter issue, or this National Charter, as a way to correct a lot of those problems that we're speaking about, getting authority to make a loan in a county that is adjoining to us.

The CHAIRMAN. Mr. Burns, what would be wrong with that, letting the farmer drive 14-miles as opposed to 100?

Mr. BURNS. I would suspect, apparently there's been for some period of time a history within the System that associations that cover different territories, particularly that border one another, have reciprocal agreements, that if you or one of your customers comes to us, we can loan to them, if one of ours goes to you, you can go to them. I would suspect that Mr. Williams' son would have a choice today to drive the 14-miles as opposed to the 100.

One, they have to ask for concurrence from the territory in which they want to enter, and apparently they have to receive approval for that. But that system's in place already. There were in the comment periods that were issued both for this proposal and the customer choice proposal, from back a couple of years ago, a lot of associations that are opposed to this concept, in fact, the System institutions, actually made reference to that, and are concerned because there's already a system in place to address those issues. And yet, this would make it a national thing, expand it.

The CHAIRMAN. Senator Crapo, would you have questions for the witnesses?

Senator CRAPO. Thank you, Mr. Chairman. I just have a couple of questions.

It's already been noted, and the Chairman picked up on it, that there is some disagreement among the Associations themselves as to whether this rule is a good idea. And this question is for any of the panelists. Do we have an understanding about what the majority position is nationwide of the Associations, whether it's in support of or opposition to this rule?

Mr. WILLIAMS. Mr. Webster pointed out that we do have Council support. We took a position some time ago on the National Charter issue. The Council is made up of 21 representatives from 7 different districts throughout the United States, and this is a unanimous concurrence, that we support National Charters.

Going back to the Tenth District at home, we had a meeting about 10-days ago, and our legislative officer provided an explanation about the hearing and what would be covered. And we did not hear any opposition from representatives from those associations in regard to a disagreement or being against National Charters.

Now, I didn't say that some may not be there, but they did not verbalize that at the time.

Senator CRAPO. Right. If I understand you correctly, then, you're saying that you are not aware of what the total distribution is of support or opposition nationwide, but from your experience, you would believe there is support?

Mr. WILLIAMS. Support, yes, sir.

Senator CRAPO. Anybody have any other information or data on that?

All right. Well, the only other question I have right now is for you, Dr. Barry. You've heard the argument made here that one of the things that's probably, or that may happen as a result of this proposed rule is that you will see internal competition among the associations, and that the larger, more well-financed associations will go in and cherry pick the good loans in the other areas, resulting in driving, at least as I understand the argument, driving those who are not as well-financed out of business, and actually impacting competition in a negative way.

Could you comment on that argument?

Dr. BARRY. Well, it's a valid question to raise. As I indicated, I think there's enough safety mechanisms in place as competition might expand to protect against those kinds of things happening. Again, many farmers prefer to develop good relationships with lenders, and to be known and have their business understood well, whether they are small, medium, or very large.

And so to the extent cherry picking might happen, that would probably result in a natural migration of borrowers to lenders to whom they really want to do business with, and to have the flexibility to do that.

Mr. WEBSTER. May I address that, Senator?

Senator CRAPO. Certainly.

Mr. WEBSTER. We've got to remember that we are controlled by a board of directors that are farmers and ranchers from our terri-

tory. They're not going to look kindly upon their institution pricing products differently several States away than they're getting locally. We see that as something that's been thrown up. In fact that just will not happen very well. If it does happen, the controls are in place. Clearly our board of directors would be very concerned about that practice, and it would not be condoned within our entity. And I think it would not be condoned elsewhere.

Mistakes could be made. But I can't envision a practice of doing that, that could gain the support on an ongoing basis from a local board of directors. In fact, our capital was raised in Iowa, Nebraska, South Dakota and Wyoming. If we have a National Charter, I can assure you, the primary emphasis of the use of that capital will be Iowa, Nebraska, South Dakota and Wyoming.

Senator CRAPO. Thank you. I have no further questions, Mr. Chairman.

The CHAIRMAN. Well, thank you very much, Senator Crapo.

This is not a question that any of you can answer, but I will raise it for this comment period. Earlier, Congressman Leach indicated that the incoming Administration of President Bush had asked that we go slow on additional rulemaking until the Administration had some opportunity to sort out all of the attempts at rulemaking or regulations that were made during the last few weeks of the last Administration.

This is neither here nor there with regard to the merits of what we're discussing today. Nevertheless, we are in that milieu of a good number of regulations, some of them pertaining to agriculture, forestry and other things we're interested in, and which those who are coming into authority, sometimes slowly, because the nomination and confirmation process takes some time with a new Administration.

This idea that we have today is, has been suggested historically, not an entirely new one, but nevertheless, this is a significant rule. One reason that I asked the Board members, Mr. Reyna and Ms. Jorgensen, to participate in a hearing on this, even though the public as a whole may participate for 30-days, is really to elevate the issue and its timeliness, so there would be opportunity for those to offer this testimony, which you have, and which others may be stimulated to do, having heard you.

Now, that is not a reason why the rule is either good, bad or indifferent. But it may very well be that other departments of the Government, as they have competent people coming to those desks and those responsibilities, will want to make a comment. I have at this point no testimony, say, from the White House or the Department of the Treasury or other relevant people who sometimes have things to say about rules. But that may come forward, and if so, we will try to publicize that, so that will be a part of the overall consideration of those who are taking part in the hearing today.

I would ask staff of Senators who have not been able to attend to be certain that the testimony of each one of you, the full record of the hearing we have to date, long before it can be officially published, be put in the hands of those Senators, so they will have the same benefit, at least, of your written testimony. And staff, I know, will ably give some gist of the conversation we had and the questions and answers.

Do any of you have a final comment? If so, I would certainly entertain that.

If not, I express the appreciation of all of us to you for coming, some of you at long distance and inconvenience, to be a part of this hearing. I think it's been an important one, and we've had very good sharing of views.

The hearing is adjourned.

[Whereupon, at 11:59 a.m., the Committee was adjourned, to reconvene at the call of the Chair.]

APPENDIX

FEBRUARY 26, 2001

Opening Statement
Chairman Richard Lugar
Hearing on FCA's National Charter Regulation
February 26th, 2001

Today the Senate Agriculture Committee will hear testimony concerning the Farm Credit Administration's proposed rule on national charters. This regulation outlines the procedures for allowing Farm Credit System institutions to conduct agricultural lending outside their traditional geographic boundaries.

For those of us with oversight responsibilities over the Farm Credit System, today's hearing is a good indication that the System is healthy and competitive. During the mid-1980's when the Farm Credit System was suffering financial difficulties, this Committee helped put together a legislative package that allowed the Farm Credit System to weather its challenges. As a result of these efforts, the System finds itself on sound fiscal ground. Although we celebrate the System's convalescence, today's purpose is to explore whether the Farm Credit Administration has gone beyond its grant of authority through its proposal on national charters.

The Farm Credit Administration has wisely put this proposed rule out for a 30 day comment period, but there are several public policy questions raised by this action that deserve our Committee's review and scrutiny. First and foremost, does the Farm Credit Administration have the statutory authority to provide its associations with national charters? I will be interested in the various views of witnesses on this topic.

Even if the Farm Credit Administration has the legal authority, does the granting of national charters advance a valid public policy as well as the Agency's mission statement? The Farm Credit System and its regional lending limitations have been in existence for over three-quarters of a century providing a dependable and competitive source of credit for agriculture. Today's hearing will explore whether national charters will strengthen competition in agricultural lending or whether it will lead to greater consolidation among Farm Credit institutions and community banks.

Our first witness is the Honorable Jim Leach of Iowa, who, as Chairman of the House Banking Committee, thoughtfully explored through a hearing this issue last year. Our second panel consists of the Honorable Michael Reyna, Chairman of the Farm Credit Administration and the Honorable Ann Jorgensen, Board Member of the Farm Credit Administration. Our third panel is made up of representatives from the Farm Credit System, the banking industry, and the academic community. I look forward to the individual testimony provided by these witnesses.

Comments Prepared for Delivery*
before the Senate Committee on Agriculture, Nutrition and Forestry
by Representative James A. Leach
February 26, 2001

It is an honor to appear before this panel, whose chairman I hold in such high regard.

In almost 25 years in the Congress I have testified only a handful of times on the Senate side. I come before you today because I believe the national chartering issue has such major philosophical and market implications.

From a philosophical perspective national charters will expand 30-fold the number of Government Sponsored Enterprises (G.S.E.s) in the country, each with powers potentially greater than any existing G.S.E.s, such as Fannie Mae and Freddie Mac.

The question that must be asked is whether a system established to serve individual farmers of modest means should be turned upside down and directed to serve the non-farm and large argri-business community. The question that also must be addressed is whether any case whatsoever has been put forward that credit should be further socialized in the free-est capital markets in the world.

Given the multi-billion dollar government bail-out of this system in the 1980s, the question of safety and soundness must also be raised. And from a competitiveness perspective, will predatory financing and cherry picking of loans occur and will large businesses, with capacities to tap private credit markets, find it in their, but not the public's interest, to do their financing with "captive" F.C.S. entities?

In this context, it should be stressed that the Farm Credit System was given a powerfully advantageous role in agricultural finance because credit demands of family farmers appeared at various junctures in our history to exceed the capacities of the market. But no compelling studies have been provided that show that America's community banks, savings and loans, credit unions, insurance companies, mortgage and a host of special purpose finance companies are unequal to the demands of the new markets that F.C.S. managers want to penetrate.

The issue isn't whether an Iowa F.C.S. entity needs additional powers to compete with a New York F.C.S. entity for a Nebraska farm loan. There are no particular cost of funds advantages between regions when the source of funds is the same national Treasury related market. Out-of-region agricultural financing is prone to mistakes and there is simply no or de minimus demand for such among the client base the Farm Credit System was set up to establish.

What is driving the issue is not the need for modifications in older farm lending practices but a

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*Summarized in delivery.

desire of F.C.S. managers to expand system powers to match commercial lending activities of the private sector. This market broadening desire is reflective of the natural instinct of all G.S.E.s to expand their powers and the reason Congress must be ever watchful that the intent of law is maintained and that law itself is not made elsewhere, in this case by a 3-member board, of which I believe only 2 individuals, both appointed by the last administration, are currently sitting.

Here, let me stress two perspectives. One is that in my time in Congress I have observed the O.C.C. overreach its authorities; I have observed Fannie and Freddie stretch their charters and, particularly with arbitrage activities, skew the markets; I have seen Farmer Mac, a well-intentioned G.S.E., become one-third owned by a commercial bank and, on a percentage basis, abuse its public trust far greater than other G.S.E.s with arbitrage activities designed to reward stockholders but not serve farmers. I cite these examples to make clear that the F.C.S. is doing what is natural for governmentally privileged institutions: it is trying to expand it privileges at the expense of our market economy.

The second perspective is that no G.S.E. abuse to date comes close to matching the gall of this one. After seeking several years ago comments on a rule to advance a similar objective and finding common sense objections to be compelling, the Board of the Farm Credit Administration attempted an end run of the law and this last Fall adopted a "booklet" approach detailing procedures by which individual F.C.S. entities could seek broader powers. Upon a review I requested the G.A.O. found that this F.C.S. tactical approach was flawed, designed to circumvent the Administrative Procedures Act and the Congressional Review Act. The same Board that attempted to violate the law now wants to take advantage of an administration in transition and in another process umbrage ignore the new Administration's request that agencies not submit proposed rules until reviewed by its appointees.

The issue isn't a question of one administration versus its successor. The Clinton Treasury, after all, objected to this undertaking. What we have here is an egregious example of a run-away regulatory agency attempting to change the nature of finance in America at a time when the Administration has few appointments in place and other priorities preoccupying its agenda.

Chairman Lugar was prescient in asking whether the Board has the rule making authority to change the system's mission without a Congressional authorization. I would be doubtful, but these judgements are ultimately made by the courts. While the courts under administrative law precedents give extraordinary deference to executive branch agencies, the unprecedented scenario that could develop is a judicial proceeding in which the Executive branch may find itself siding against an Executive agency. The bigger picture is that a Board of two, having attempted to pursue an illegal course this past fall, is now seeking to usurp the authority of Congress and defy the will of the Executive. Administratively this is unseemly; substantively, it is folly.

The irony could not be greater that at the very time we are urging countries around the globe to turn to market reforms, a U.S. government agency is suggesting we need more socialized credit.

The issue shouldn't be what's good for F.C.S. managers and, symbolically, huge hog confinement operators who have multi-state investments, but what's good for the country and the

family pork producer. This means local control, local lending, and maintenance of a F.C.S. mission that serves family farmers, not their multi-state competitors or non-farm business.

In conclusion, let me stress that this proposed rule is an agenda of F.C.S. managers, not the farmers the System was created to serve. There is no sentiment in rural America that the Farm Credit System become a tool for a large agri-business elite or for non-farm interests. We in the Congress can be expected to support the Farm Credit System in the mission it was given, but that support is likely to erode if the System adopts the non-farm approach the system's managers prefer.

Farm Credit Administration

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Testimony of the Honorable Michael M. Reyna
Chairman and Chief Executive Officer
Farm Credit Administration
Before the
Committee on Agriculture, Nutrition, and Forestry
United States Senate
February 26, 2001

Mr. Chairman, members of the committee, I am Michael Reyna, Chairman and Chief Executive Officer of the Farm Credit Administration (FCA or Agency). Joining me is my fellow Board member Ann Jorgensen. I am pleased to be here with you today to discuss the role of the FCA and the Farm Credit System (System) in providing sound, dependable, and affordable credit to American farmers and ranchers, their cooperatives, rural utilities, and rural homeowners in both good and bad economic times. I am pleased to report to you that the financial condition of the System is strong despite challenges and difficulties in the agricultural economy. I plan to use this opportunity to explain our proposed regulation concerning national charters for System associations.

FARM CREDIT ADMINISTRATION

The FCA is an independent agency in the Executive branch of the Federal government. It charters, regulates and examines all System institutions. The responsibility of the FCA is to ensure that System institutions operate safely and soundly and comply with applicable laws. The FCA's governing body is a full-time, three-member Board. The President, with the advice and consent of the Senate, appoints each FCA Board member for a six-year term. The President

designates one of the Board members as the Chairman of the Board, who serves until the conclusion of that member's term. The Chairman also serves as the FCA's Chief Executive Officer (CEO).

THE FARM CREDIT SYSTEM

Congress established the System in 1916 because long-term mortgage credit for farmers and ranchers was scarce. During the 1920s and 1930s, Congress expanded the System so it could extend short- and intermediate-term operating credit to farmers and ranchers and finance their cooperatives. Today, the System finances agricultural production, processing and marketing operations, certain farm-related businesses, rural housing, agricultural cooperatives, rural utilities, and the import and export of agricultural commodities. Within the scope of the Farm Credit Act of 1971, as amended (Act), System banks and associations offer their customers a wide array of loans, leases, and financially-related services that meet their needs. According to section 1.1 of the Act, the mission of the System is to "be responsive to the credit needs of all types of agricultural producers having a basis for credit."

The System is the oldest Government-sponsored enterprise (GSE) in the United States. Although the Federal government provided the original capital for System institutions, the farmers, ranchers, and cooperatives who borrowed from System banks and associations retired the government capital by 1968. Today, borrowers own the System banks and associations, which operate as cooperative financial institutions.

System banks, associations, and service corporations serve all 50 States and the Commonwealth of Puerto Rico. As of January 1, 2001, the System was composed of 147 institutions. Six Farm Credit Banks fund 28 production credit associations (PCAs), 38 Federal land credit associations (FLCAs), 11 agricultural credit associations (ACAs), and 52 ACA parent

organizations.[1] PCAs make short- and intermediate-term loans; FLCAs make long-term mortgage loans; and ACAs make short-, intermediate-, and long-term loans. Different System banks and associations own four service corporations that are organized under section 4.25 of the Act. These federally chartered service corporations perform functions and services for their owners, but the statute prohibits them from extending credit and providing insurance services.

The Farm Credit Banks also fund 22 other financing institutions (OFIs), which are non-System financial institutions, such as commercial banks or their affiliates, agricultural credit corporations, and production livestock associations. OFIs use the funds they borrow from Farm Credit Banks to make short- and intermediate-term loans to farmers, ranchers, and other eligible borrowers. The Act allows Farm Credit Banks to fund OFIs on the same terms as PCAs.

One agricultural credit bank (ACB) lends to agricultural and aquatic cooperatives, rural utilities, and the parents, subsidiaries and affiliates of these borrowers. The ACB also finances the export and import of agricultural commodities and farm supplies, and it provides international banking services to agricultural cooperatives and their counterparties. Additionally, the ACB funds four ACA parent organizations that serve New York, New Jersey, and the New England States.

All seven System banks own the Federal Farm Credit Banks Funding Corporation (Funding Corporation), which sells debt securities to investors. The proceeds of these securities fund the loans that System banks and associations make to their borrowers. Earnings from these

[1] The ACA is the parent company with two wholly owned subsidiaries, a PCA and a FLCA. The ACA, PCA, and FLCA operate as an integrated lending business with loans made through the appropriate subsidiary. The ACA, PCA, and FLCA are jointly and severally liable for the full amount of the indebtedness to the bank under the General Financing Agreement. In addition, the three associations agree to guarantee each other's debts and obligations, pledge their respective assets as security for the guarantee, and share each other's capital. The three institutions have a common board and management and a common set of shareholders. Under the Farm Credit Act of 1971, as amended, the FLCA is exempt from Federal income taxes.

loans enable System banks to repay the principal and interest on System debt securities. The United States is not liable for the repayment of System debt securities.

Congress established the Farm Credit System Insurance Corporation (FCSIC) to insure the principal and interest on all consolidated System debt securities. As of December 31, 2000, the FCSIC fund had a balance of $1.45 billion to protect investors and, ultimately the taxpayers, from loss. Additionally, the Act requires the FCA to appoint FCSIC as the conservator or receiver of insolvent System institutions. My colleague, Ann Jorgensen, serves as the Chair of FCSIC.

The Federal Agricultural Mortgage Corporation (Farmer Mac) is another component of the System.[2] Farmer Mac provides a secondary market for agricultural real estate and rural housing mortgages.

SERVING YOUNG, BEGINNING, AND SMALL FARMERS

As the Committee is well aware, the agricultural economy is constantly changing and farmers often restructure their operations as they strive to become more efficient. The System cannot succeed unless it responds to changes in the markets that it serves. As I noted earlier, the Act states that the mission of the System is to serve all types of agricultural producers who have a basis for credit. The System finances every sector of the agricultural economy throughout our nation. As the statute requires, it serves all types of producers -- large, medium, and small.

The FCA has made a concerted effort to improve the service that System banks and associations provide to young, beginning, and small farmers. Since 1980, the Act has required the System to develop special programs to meet the credit needs of young, beginning and small

[2] Farmer Mac has no liability for the debt of other System institutions, and the other System institutions have no liability for Farmer Mac's debts. Farmer Mac is an investor-owned corporation, not a member-owned cooperative. Commercial banks, insurance companies, other financial institutions, and System banks and associations may own

farmers. In 1998, the FCA issued a policy statement that asked each System Board of Directors to renew its commitment to be a reliable, consistent, and constructive lender to this group of farmers. Although the FCA recognized that the System already financed a significant number of young, beginning, and small farmers, the policy statement noted that more could be done. The policy statement identified a number of steps that System institutions could take to increase their lending to this group of customers.

Just recently, the FCA asked each System institution for information on its young, beginning, and small farmer program. The FCA will use this information to compile a report on successful and innovative practices that improve service to these farmers. We plan to send this report to every System institution so the ideas and experience of other institutions will help it to strengthen its own program. This information will help the FCA to identify the strengths and weaknesses of the young, beginning, and small farmer programs of individual System institutions. As a result, the FCA will no longer rely exclusively on numbers that are nationwide averages.

The most recent numbers on loans to young, beginning, and small farmers and ranchers are from year-end 1999. At that time, 16.3 percent of the System's outstanding loans were to farmers who were 35 years of age or younger, 20.7 percent were to beginning farmers with 10 years or less of farming experience, and 57.9 percent were to small farmers who had annual sales of $250,000 or less. Concurrently, 12.2 percent of the total dollar volume of loans outstanding were to young farmers, 17.9 percent were to beginning farmers, and 34.4 percent were to small farmers.

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voting stock in Farmer Mac. The Office of Secondary Market Oversight is a separate office in the Farm Credit Administration that regulates and examines Farmer Mac.

THE CURRENT CONDITION OF THE FARM CREDIT SYSTEM

The System's Strengths

The quality of loan assets, risk-bearing capacity, stable earnings, and capital levels collectively reflect a healthy Farm Credit System that has rebuilt its financial strength and improved its management systems. Despite various external factors affecting agriculture, such as reduced export demand, adverse weather conditions, and low commodity prices, the System's strong financial position will help it weather adverse effects from potential deterioration in the agricultural economy.

System banks and associations have earned and retained sufficient income over the past twelve years to rebuild their capital. For example, since 1994, the System has steadily earned $1 billion or more each year. This has resulted in a large capital cushion that will enable the System to absorb losses and remain a viable lender to agriculture during downturns in the agricultural economy.

The quality of the System's loan portfolio has remained generally favorable despite continued adverse economic conditions in the agricultural sector and a slight deterioration in the performance of certain loans to cooperatives. Signs of deterioration have yet to materialize in the System's loan portfolio or performance, and early warning indicators are much more positive than in the mid-1980s when the System last experienced serious asset quality problems.

Loan volume continues to grow, while levels of nonaccrual and nonperforming loans[3] consistently remain low. Delinquent loans also remain minimal at less than half of one percent of total loans.

[3] Nonperforming loans consist of nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due.

The System continues to build capital through increased loan volume and earnings. Total capital as a percentage of total assets has increased from 14.2 percent as of September 30, 1996, to 15.6 percent as of September 30, 2000. All institutions met their regulatory ratio requirements, and most greatly exceeded them. Permanent capital ratios at System banks and associations ranged from a low of 9.94 percent to a high of 38.2 percent compared to the 7.0 percent regulatory requirement.

Better management practices have resulted in stronger loan underwriting standards at most System institutions. Improved loan underwriting standards usually results in sound loans. Additionally, these standards insulate an institution's capital from excessive risk in a challenging operating environment.

As a result of improving their management and internal controls, System institutions have been diligent in identifying and dealing with troubled loans early on. Also, improved asset/liability management practices have enabled System banks to effectively manage interest rate risk.

The FCA currently rates all System institutions, except one small association, in the two highest of the five Financial Institutions Rating System (FIRS) categories. As of September 30, 2000, institutions with composite ratings of 1 or 2 represented more than 99 percent of all rated institutions. FCA assigns every System institution a rating for capital, assets, management, earnings, liquidity, and sensitivity to interest rate fluctuations. Every institution receives a composite rating and a rating for each of the six individual rating components at least quarterly to ensure assigned ratings reflect current risk and conditions in the System. Currently, no System institution is under an enforcement action. In addition, our examiners provide

continuous oversight of System institutions to ensure that risk in the System is adequately monitored and addressed.

The Challenges Ahead

Economic stress in agriculture, however, is beginning to temper this good news.

As this Committee knows all too well, prices for many agricultural commodities are low while farm production costs, particularly for energy, are increasing. As a result, the profit margins of many farmers are squeezed. Federal support for agriculture over the past several years have been necessary to help farmers repay their loans. Obviously, farmers, System institutions, and the FCA would much prefer that more favorable commodity prices would generate higher profits and better income for agriculture. In addition to strong capital and diligent management at System banks and associations, Federal assistance to farmers has also played an important role in helping the System earn income and maintain the quality of its loan portfolio.

Two indicators of profitability, net interest margins and net interest spreads, have been trending downward since 1995. ROA has also followed a declining trend for the past six years, but it increased in 2000. Although these downward trends raise concerns, they also stress why retained earnings and strong capital are crucial to the continued financial strength of System institutions.

The allowance for loan losses continues to be adequate to cover risk in the loan portfolios. Since 1993, the System has steadily increased its Allowance for Loan Losses to almost $2 billion in the past year. This increase is necessary to address the stress in the farm economy. However, nonaccrual loans decreased slightly in the past year.

A Single-Industry Lender

Perhaps the biggest challenge facing the System is the fact that it is a single-industry lender in a shrinking market. The number of farmers and ranchers has steadily declined ever since the System was founded in 1916. However, the System's mission is to finance agriculture in both good and bad economic times. In contrast, the System's competitors can abandon agriculture during recessions, and lend instead to other sectors of the economy where the profit potential is greater and the credit problems are fewer.

The loan portfolios of System institutions, as single-industry lenders, are concentrated in agricultural commodities. Some of the larger System institutions have successfully diversified the agricultural commodities in their loan portfolios. As of September 30, 2000, however, there were 197 instances at 135 associations where loans to a single commodity exceeded capital. The System lends overwhelmingly to agriculture, which is the sector of the economy that is particularly vulnerable to changes in commodity prices, currency fluctuations, bad weather, diseases, pests, and other difficulties.

The System's market share slipped during the farm crisis of the mid-1980s. During the 1990s the System's market share rose modestly and then leveled off.

Historically, the charters of many System associations have confined their operations to geographic areas where the agricultural economy is dependent on two or three commodities. These geographic barriers make it increasingly difficult for associations to compete. Trade creditors are not subject to geographic limitations, and geographic restrictions on commercial banks have been eased in the past decade. New technology such as e-commerce also expands the geographic markets for lenders and other financial service providers.

Obviously, these commodity and geographic concentrations pose special challenges to the System and the FCA, as its safety and soundness regulator. The System is responding to these challenges. Many System associations have merged, consolidated, or restructured their operations in the past three years. As a result, these associations have become more efficient, which lowers the cost of credit to farmers, improves customer services, and increases the earnings of these borrower-owned institutions. System institutions also have embraced technological innovation and they routinely use the Internet to reach customers.

These changes are good. But more is needed to assure that the System can meet the challenges facing a single-industry lender in an economic environment that is undergoing continual and rapid change.

NATIONAL CHARTER PROPOSED RULE

If the Farm Credit System is to remain a viable source of credit for America's farmers, ranchers, and rural communities, as Congress directed, it must be able to respond to changes in the markets that it serves. This is not a new concern. Our proposed rule on national charters would help the System modernize its credit delivery structure, and at the same time, maintain safe and sound operations.

The national charter rule would end the FCA's practice of generally issuing exclusive territorial charters to direct lender associations. The FCA's authority to grant and amend the charters of System institutions is clear and unambiguous. The courts have reaffirmed this authority on several occasions. With limited exceptions, Farm Credit statutes do not require exclusive charters for System institutions. Instead, the FCA, as a matter of policy and practice, usually issued exclusive charters to direct lender associations. Notwithstanding this fact, the

territories of a number of System associations have overlapped for some time. Overchartering has not posed any safety and soundness concerns.

Historical Background

The Agricultural Credit Act of 1987 encouraged the Farm Credit System to restructure by creating four new types of System institutions -- Farm Credit Banks, agricultural credit banks, Federal land credit associations, and agricultural credit associations. This restructuring led to numerous instances of overlapping territories and competition among associations. This has led to increasing public discussion and debates over whether the FCA should end the policy of exclusive charters for direct lender associations.

Our proposed national charter rule culminates a decade of discussion and debates about how to ensure that the System remains safe and sound, and relevant to the farmers, ranchers, and other rural residents who borrow from it. In May of 1990, the Secretary of the Treasury issued a report on GSEs that recognized that the System faced unusual business risks. This report acknowledged that System charters limited the operation of individual associations to specific geographic regions, causing an institution's "performance [to] rise and fall with the fortunes of a single crop or perhaps with those of a limited number of customers."[4] Although the Secretary's report made no recommendation about how to best address this problem, it generated much thought, discussion, and debate.

The FCA first raised the question about ending the policy of geographically exclusive charters in 1994 when it asked the public to comment on a proposed Board policy statement on non-exclusive charters.[5] At other times during the past decade, the FCA has sought comments,

[4] Report of the Secretary of the Treasury on Government Sponsored Enterprise, May 1990, page D-15.
[5] 59 FR 17543 (April 13, 1994).

input, and ideas from a wide variety of sources, including the general public, academicians, and policy experts.

In July 1998, the FCA Board issued a Philosophy Statement that, among other things, announced support for abolishing geographic restrictions on System institutions. The first major step in implementing the FCA Board's Philosophy Statement occurred in November 1998, when the FCA published a proposed rule that would have repealed regulations that required notice or consent when a direct lender made or participated in loans in the territory of another association. The Agency received over 200 letters and considerable comments during the 180-day comment period. Reaction was split. The Board suspended action early in 2000 to study the matter further.

In April 2000, the FCA adopted a final rule that repealed the notice and consent requirements that applied when a System institution bought participation interests in loans that a commercial bank made in the chartered territory of another System institution. By repealing these regulations, the FCA Board authorized System institutions to participate in loans that non-System lenders, including commercial and community banks, made to eligible farmers and ranchers anywhere in the United States.

The FCA did not repeal the notice and consent requirements for direct lending. Instead, the Board announced plans on March 8, 2000 to remove geographic barriers by granting national charters to System direct lenders that apply for them. The FCA sent a Booklet to all System institutions on May 3, 2000 that provided guidance on national charters. We also posted this Booklet on our Website. After this initial process, approximately 97 percent of all eligible associations indicated an interest in a national charter.

The Booklet imposed no requirements on System institutions. Instead, it communicated the FCA Board's willingness to accept national charter applications from any direct lender that voluntarily applied for one. Because our National Charter Initiative sparked intense public interest and debate, we published the Booklet in the *Federal Register* in July 2000[6] and requested comment. We received over 1000 comments about national charters.

However, several parties raised procedural concerns about the Booklet. They believed that the law requires the FCA to pursue a notice and comment rulemaking for national charters. While FCA's legal counsel continues to believe that the Agency may issue or amend charters without conducting a rulemaking, the Board decided to propose a rule. A rulemaking dispels any doubt that this initiative does not comply with applicable administrative procedure laws. Second, a rule will establish strong business planning requirements for any association that applies for and receives a national charter. Third, a rule requires associations that request and receive a national charter to comply with existing FCA regulations that impose strong and enforceable capital, loan underwriting, and internal control requirements on all System institutions.

Before I describe our proposed national charter rule to you in greater detail, I want to reiterate that the ideas expressed in this proposal are not new. Indeed, the FCA, the System, commercial banks and their trade associations, academicians, and policy experts have debated the removal of geographic restrictions of System associations for several years.

The FCA Board adopted the proposed rule on January 11, 2001, and sent it to the House and Senate agriculture committees for a 30-day review. The proposed rule was published in the *Federal Register* on February 16, 2001 for a 30-day comment period. I want to assure you that

[6] 65 FR 45066 (July 20, 2000).

the FCA will seriously consider and carefully weigh all substantive comments that we receive about the proposed national charter rule.

Criteria for National Charters

The proposed rule would establish clear standards so direct lender associations may apply for, receive, and operate safely and soundly under a national charter. A national charter authorizes a direct lender association to exercise all powers conferred on it under the Farm Credit Act and FCA regulations throughout the United States and the Commonwealth of Puerto Rico or within any lesser territory that the FCA specifies.

National charters will not initially include the territories of certain associations that currently operate in Alabama, Mississippi, New Mexico and parts of Louisiana. The statute requires the shareholders of these associations, their funding banks, and in some cases, their boards of directors to consent before the FCA can add their territory to the charter of any other System institution. The FCA initiated a separate rulemaking so the farmers and ranchers who own the associations in these four states will have the opportunity to vote on whether to allow other associations to serve their territories.[7]

No direct lender association that is under a cease and desist order that has become final is eligible to request a national charter. Once an association receives a national charter, the FCA reserves the right to restrict the association's operations if it fails to operate safely and soundly.

Each association that receives a national charter will be assigned a Local Service Area (LSA). For existing associations, the LSA is the territory that they served immediately before they obtained a national charter. Under the proposed rule, each association with a national charter must offer credit and related services in its LSA. Additionally, the LSA requirement will

[7] 65 FR 26776 (May 9, 2000); 65 FR 58486, (Sept. 29, 2000).

ensure that the System, as a whole, carries out its public policy mission of extending credit and related services to farmers, ranchers, and other eligible customers in every part of the United States. Therefore, each association with a national charter must provide dependable, sound, adequate, competitive, and constructive credit and related services to all eligible and creditworthy customers within its LSA on a priority basis, consistent with safe and sound lending practices. The FCA expects each nationally chartered association to make special efforts to serve young, small, and beginning farmers in its LSA.

The proposed rule establishes the procedures that each association must follow when it applies for a national charter. Additionally, each association that obtains a national charter must comply with new regulatory business planning requirements. At a minimum, an acceptable business plan must include:

- A mission statement;
- Internal and external factors that are likely to affect the association during the planning year;
- Quantifiable goals and objectives;
- Pro forma financial statements for each year of the plan;
- An operating budget
- A capital adequacy plan; and
- A detailed plan for activities in the LSA

These business plans must be updated every year.

Each nationally chartered association must comply with statutes and regulations that govern capital adequacy, loan underwriting and servicing requirements, internal controls, consumer protection, equal credit opportunity, and fair lending practices. Additionally, the FCA

will allow only direct lender associations that operate in accordance with capital, assets, management, earnings, liquidity, interest rate sensitivity, and other safety and soundness standards to lend and offer related services nationally.

CONCLUSION

In conclusion, Mr. Chairman, the Farm Credit System must meet the challenges of a rapidly changing agricultural economy and achieve its mission of providing sound, dependable, and affordable credit to farmers, ranchers, and their cooperatives in both good times and bad. The System has made significant progress in building and maintaining its financial strength in the past decade so it can better serve its customers. However, the pace of change in the rural economy is quickening, and the System must remain ever vigilant if it is to remain relevant to farmers. Improving geographic diversity and reducing industry concentration in System loan portfolios is essential for mitigating safety and soundness risks. The FCA Board believes that the proposed rule on national charters ensures that the System remains a dependable source of credit for farmers in a competitive and rapidly changing economy.

I thank you for the opportunity to address this committee about the challenges facing both the FCA and the System and to explain to you the proposed rule on national charters. I would be pleased to answer any questions at this time.

Statement by Ann Jorgensen
Member of the Board
Farm Credit Administration
Committee on Agriculture, Nutrition, and Forestry
United States Senate
February 26, 2001

Mr. Chairman, Senator Harkin, and Members of the Committee, I appreciate the opportunity to submit the following statement on National Charters for the hearing record.

Based on the extensive information I have to date, I strongly support the removal of geographical boundaries within the Farm Credit System (FCS/System). And, I believe the Farm Credit Administration (FCA) has the existing statutory authority to issue and amend charters including granting nationwide charters.

Mr. Chairman, my decision to support the removal of these artificial boundaries did not come easily or quickly. Since I came to FCA, more than three and one-half years ago, I have studied this issue and listened to and reviewed the input from Congress, farmers and ranchers, the System, various banking representatives, industry experts, and other interested parties. I highly value and respect this input; however, given what I have learned thus far, I think this initiative is a necessary step in maintaining an adequate and viable Farm Credit System in good times and bad for today's farmers, ranchers and rural America, as well as for future generations.

I believe the FCS, as a Government Sponsored Enterprise (GSE), fulfills a vital need in maintaining a competitive agricultural credit market. The System ensures eligible borrowers access to the best competitive rates possible for financing as well as a wide array of services.

Agriculture and the financial services industries are changing rapidly—driven by dramatic changes in technology, business structures, and the markets. There is no question this evolution is occurring and it is occurring quickly. Farmers and ranchers are responding and transforming their operations, as are the financial institutions. Farmers and ranchers and rural areas should have the same opportunities as the rest of America to access modern financial services, and FCS must adapt to meet these needs.

As financial institutions transform themselves, e-commerce will play an ever-increasing role. National Charters will allow the FCS to participate in this revolution. With nationwide charters, farmers and ranchers will be able to conduct business over the Internet and choose to borrow from an institution where cost structures, business philosophy, products and System institution expertise best meet their individual needs. I believe the demand to conduct business over the Internet from the agriculture sector will continue to increase rapidly. If the FCS is to remain an efficient source of credit for agriculture, nationwide charters are critical to the associations' ability to meet their customers' demands.

As a regulator, I view the safety and soundness of the System to be my most fundamental responsibility. I want to emphasize that National Charters **will not** provide new or additional lending authorities to the FCS. However, they will allow System institutions to better manage

risks. The FCS associations should be given greater opportunity to diversify commodity and geographical concentration risks, which will in turn, strengthen the safety and soundness of the System.

Safety and soundness is further improved through the FCA Board's recently proposed guidelines for National Charter applications. FCA is enhancing its due diligence process by establishing evaluative criteria and standards to review National Charter applications.

Associations will be required to revise their business plans before they access new markets. They will be required to adopt new goals and strategies. They must have demonstrated strong risk bearing capacities-both from a financial and management standpoint. The FCA Office of Examination will review these plans and give input prior to the FCA Board's decision on each charter application. During the examination process, staff will also evaluate whether the association has complied with their previously stated goals.

In addition to safety and soundness, it is important to make certain the System meets its public policy mission. Before granting a National Charter, FCA will require an institution to create a plan to adequately serve eligible customers in its local service area (LSA) before lending nationwide. Associations will also have to spell out their goals for serving young, beginning and small farmers.

I do want to add that I feel strongly that associations know their customers' needs best and they should build their plans based on those needs. However, let me assure you FCA staff will continue to review FCS association's plans before and during the examination process to determine whether they have met their stated goals within the parameters set by FCA and within statutory limits. From my personal observation since joining FCA, I can attest to the fact that FCA is vigilant in its examination process.

Mr. Chairman, in conclusion, I firmly believe removing geographical boundaries is the right thing to do to ensure a viable Farm Credit System for the present and for the future. National Charters will allow farmers and ranchers the choices other consumers and businesses currently enjoy. It will help ensure that adequate, sound and constructive credit remains available to farmers and ranchers in good times and bad.

Again, thank you for allowing me to submit this statement for the record.

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THE FARM CREDIT COUNCIL
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Testimony of
Bobby Williams
Chairman of the Board
The Farm Credit Council

Before the
Committee on Agriculture, Nutrition and Forestry
United States Senate

February 26, 2001
Washington, DC

Good morning Mr. Chairman. Thank you for the opportunity to appear before you today to discuss the Farm Credit Administration's proposed regulations to permit Farm Credit System direct lenders to seek national charters. My name is Bobby Williams. I am chairman of the board of the Farm Credit Council which is the national trade association representing the institutions of the Farm Credit System. I also serve as a member of the board of Heritage Land Bank ACA that is headquartered in Tyler, Texas. However, today Mr. Chairman, I want to address the committee from the perspective of my primary occupation as a farmer.

With our son, we currently farm 3200 acres of grain crops in the area around Wolfe City, Texas. We also operate a grain elevator and a trucking business. Not only am I your typical family farmer, who relies on income from both my farm and farm related businesses to make ends meet, but I am also a typical customer of the Farm Credit System. I am not a large conglomerate or a huge integrated operation that some have suggested is the prime focus of the Farm Credit System. As a matter of fact neither are any of my fellow board members on the Heritage Land Bank board. Yes, Farm Credit institutions serve large, integrated farming operations, but I can assure you that I am the norm in our portfolio, not the exception.

Mr. Chairman, before I discuss the national charter proposal, I want to thank you and your colleagues for the assistance you have provided agriculture. I can tell you from personal experience if it had not been for the aid that you have provided farmers and ranchers in recent years, the U.S. agricultural economy would be in a severe economic depression. I applaud you for what you have done and commit that we in Farm Credit will do whatever we can to support your continued efforts to ensure that agriculture remains a viable profession.

I have been involved with the Farm Credit System for many years. I have borrowed from the System since 1975 and have served as a director for 20 years. Over that time, I have seen a lot of change – change in agriculture and change in the Farm Credit System. Mr. Chairman, I hear a lot of accusations about the System, about how we want to move away from serving family farmers, or how we are going to be taken over by large corporate interests or how we don't care about serving young farmers. It is interesting to me that those accusations all come from those outside of Farm Credit who don't understand how we operate or who would just like to see us go away. I would invite anyone who truly believes those accusations to come and spend some time with us in our board room in Tyler, listen to the concerns expressed by family farmers and consider what we have to deal with on an on-going basis.

Mr. Chairman, I am not appointed to my position on the Heritage Land Bank board, the farmers and ranchers who use our institution elect me to that position. My job is to make sure that our management team is doing everything possible to serve our customers in the most cost effective and efficient manner they can. I have a fiduciary responsibility to the stockholders of that institution to make sure that it is run in a safe and sound manner, and I take that responsibility very seriously. I can assure you that the examiners of the Farm Credit Administration who review our institution's performance take that responsibility very seriously as well.

But more than anything else, being a director of a System institution imposes on me the responsibility to make sure that future generations of farmers and ranchers have the option available to them of being served by a cooperative financial institution that they own. To accomplish that, change is necessary.

Over the past couple of years, change has been a constant for our institution. We have merged once, converted our institution from being an agent of the Farm Credit Bank of Texas as a Federal Land Bank Association to being a direct lending Federal Land Credit Association, and we have just completed the conversion to an Agricultural Credit Association. Even with those changes, we recognize that we may not have yet done enough to ensure that we can provide our owners with the best service they deserve. As a result, we are talking to one of our neighboring associations about another possible merger.

Our motive in all of this has not been to move away from serving agriculture, Mr. Chairman – quite the opposite. Our motive has been to structure a modern financial institution that can effectively serve its stockholders and be there to serve the next generation. I am proud to tell you that when our institution became an ACA and gained the authority to extend operating lines of credit, our son, Eric, who is the seventh generation farmer from Wolfe City, was the institution's first customer. That is my motivation for being here today.

The Farm Credit Administration has proposed that System institutions have the flexibility to obtain national charters. This represents a change, but it is not change that impacts who we are eligible to serve or our cooperative structure. It is just a change that will give us as directors and our management teams another option as we continually look at how we can best serve farmers and ranchers. This regulation means flexibility – flexibility for Farm Credit institutions, but

more importantly, flexibility for farmers and ranchers. With this regulation in place, I have the possibility of having another choice of lenders and I like that.

As a farmer, I like the idea that there may be someone else out there in the future who is going to be interested in competing for my credit. As a director of a System institution, I like the idea that more competition is going to challenge our management team to be even more responsive to the needs of our customers.

While Mr. Webster is going to address a number of issues in greater detail, there are two things I want to emphasize. First, whether a Farm Credit institution serves a limited number of counties as in the case of my institution, several states in the case of Mr. Webster's institution, or the entire country as would be permitted under the rule, ultimately the control of the institution is the responsibility of the farmers and ranchers that serve on the boards of directors of these institutions. We are not going to let management build business around the country by charging others lower rates of interest with better terms than they are offering our base of customers back home. Again, as individual directors, we stand for election. We have constituencies that are not going to accept that type of behavior. Approving a business plan that involves cutting rates to cherry pick trophy credits is not a formula for director longevity nor is it a formula for a safe and sound operation. Our ownership won't allow it.

Second, we are not going to ignore our responsibility to continue to work with young and beginning farmers. If anyone is sensitive to the needs of young farmers, parents who are farmers and who direct these institutions are. From experience, we know that credit is not a solution for a young farmer. It is a tool, and we will continue to make sure that the appropriate tools are available to young and beginning farmers and that their needs are addressed.

Mr. Chairman to that end, I want to use this opportunity to make the committee aware of a major new effort that is being launched by the Farm Credit System Foundation. Within the next week, the Foundation will be launching an internet based project to reach thousands of young and beginning farmers and to provide them a vehicle to express their views regarding the existing barriers to their success in agriculture. Our goal is to develop the first comprehensive picture of young and beginning farmers, far beyond what the agricultural census and USDA has been able to achieve. We will make the results of this effort available to you, so that as you write the next farm bill, you will have far more information than you have ever had before regarding the needs of this critical segment that will be our future farmers and ranchers. The Farm Credit System Foundation is pleased to sponsor this effort and we would be happy to provide you a full briefing on it at your convenience.

Again, thank you for the opportunity to appear before you today. We appreciate your past efforts on behalf of the Farm Credit System. I look forward to answering any questions you might have for me.

THE FARM CREDIT COUNCIL
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Testimony of
Jack Webster
President, Farm Credit Services of America

On behalf of
The Farm Credit Council

Before the
Committee on Agriculture, Nutrition and Forestry
United States Senate

February 26, 2001
Washington, DC

Giving Farmers A Choice
Removing Geographic Limitations On Farm Credit System Institutions

Good morning Mr. Chairman and members of the committee. My name is Jack Webster. I am president and chief executive officer of Farm Credit Services of America. I am appearing today on behalf of the Farm Credit Council, the national trade association representing the institutions of the Farm Credit System.

Farm Credit Services of America provides loans and related services to 43,000 agricultural producers, rural residents, and agricultural businesses in Nebraska, Iowa, South Dakota, and Wyoming. Headquartered in Omaha, Nebraska, we are a cooperative, owned and governed by the farmers we serve. At year-end, we had over $5 billion invested in agriculture and rural communities.

Mr. Chairman, before I address the subject of this hearing, I want to echo what Mr. Williams said regarding the support this Committee has demonstrated for American agriculture. Without it, conditions in the rural economy would be dire. The additional assistance provided by Congress during this period has meant the difference between solvency and bankruptcy for many producers. We heartily support the assistance you have provided and urge you to continue to address the needs of agriculture while markets remain depressed.

Thank you very much, Mr. Chairman, for calling this hearing. We welcome the opportunity to come before the Committee and talk about what we are doing to improve our service to farmers and ranchers. The Farm Credit System is chartered by Congress for a very specific reason – to serve agriculture. Our mission is set out clearly in the Farm Credit Act. Farm Credit is to provide a cooperatively owned and controlled "permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit." To accomplish this mission, we are expected to keep the institutions of the System

modern, efficient and competitive. We are expected to provide farmers and ranchers a choice amongst lenders, and we must have the wherewithal to be a reliable source of credit able to serve all types of farmers in good times and bad.

You know all too well, Mr. Chairman, what can happen if we fail to keep the practices and operations of the System up to date. You also know that since the 1980's Farm Credit has accomplished its mission effectively while rebuilding its capital base and ensuring that all past financial assistance is repaid. While we recognize that some of our competitors would delight in the System no longer being an active player in the marketplace, we know that agriculture would be ill-served with that result.

The current service territory limitations under which Farm Credit associations operate date back to the 1920's. The regulator at that time made an administrative decision that agriculture as it existed then would be best served by institutions with limited service territories. Back then, a farmer's geographic location – where they lived and farmed --was the determining factor in their choice of a lending institution. Needless to say, eighty years has brought a lot of changes to agriculture and to the financial services industry.

Today, farmers buy inputs from, gather information from, and market their products to entities all over the globe. The Internet provides them instantaneous access to a global marketplace. Globalization has brought with it the promise of expanded markets and the challenge of global competition. And yet the farmer-owners of the Farm Credit System have seen their lending institutions remain geographically challenged in a global economy that knows no geographic limitations. At a time when the internet has wiped out boundaries and borders, the farmers who want to use the cooperative Farm Credit System face geographic hurdles if they want to access financing from a System institution other than the one that is specifically authorized to serve their location. They face arbitrary and outdated restrictions that no longer make sense in our modern world.

To their credit, the Farm Credit Administration recognized this situation and came to the conclusion that it was time that the administrative decision made some 80 years ago be reversed and that System institutions no longer be limited by specific geographic boundaries. A lot has been made of the fact that FCA originally proposed this change without undertaking a formal rulemaking. While legal scholars can debate that issue, we need not waste time here this morning on it. FCA has proposed a formal rulemaking and the public now has the opportunity to comment on it.

The Farm Credit Act provides FCA the responsibility and authority to grant and amend charters for Farm Credit institutions. As part of its comments to the FCA on the National Charter booklet, the Farm Credit Council sought and obtained a legal analysis of the agency's authority to issue national charters to FCS lenders. We would be happy to make that available to the Committee for your consideration.

FCA's proposed regulation will provide farmers and ranchers with the opportunity to choose the Farm Credit System institution that best meets their credit needs. The proposed regulation sets out the process that a System institution must follow if it desires to obtain a national

charter or something less than a national charter. That process includes specific requirements that an institution must meet before it can obtain an expanded geographical service area.

The agency has clearly responded to those who believe we will abandon our currently chartered territories and seek greener pastures elsewhere. They have put in place a requirement that we give preference to serving customers in our current territory by designating that territory as our "local service area." They are suggesting that we provide them significant information regarding how we are serving that area today, who might be underserved there today and what our plan would be to meet there needs, prior to them providing any change in our service territory. As Mr. Williams indicated, the board of directors of a Farm Credit institution sets our direction. Mr. Chairman, the philosophy I have put forward, based upon direction from my board, is that with a national charter in place our loan officers would not to pass by any eligible borrower we are not currently serving in our territory to get to a borrower outside of that territory.

Modern agriculture has grown more complex and specialized. So too, have the financial institutions that serve it. Even a territory that is perceived as homogeneous as our four states is home to wildly divergent agricultural operations. Each of these operations needs a lender that understands its individual financial needs and has the capacity to fully serve them. Building the expertise to serve these varying enterprises is the challenge facing all agricultural lenders today.

Different financial institutions manage this challenge differently. Boards and management teams structure their institutions to serve their markets as they see them. Expertise, capacity and desire to serve various market segments are unique in every financial institution. Farmers and agricultural businesses fighting to innovate and succeed cannot afford to be stuck with a lender ill-equipped to help them win that fight.

Farm Credit institutions have few alternatives today as they work to build the capacity to serve evolving agriculture. Tied to a specific geographic territory, these institutions are forced to merge with others in order to stay competitive. Mergers however, limit farmers' choices. National charters are an alternative to mergers, offering Farm Credit institutions the opportunity to build capacity to serve without merging.

National charters will ensure that farmers and agribusinesses have access to the broadest range of lenders. The national charter regulation will provide farmers and agribusinesses with a choice of lenders to best meet their needs.

Farm Credit System lenders are limited to serving agriculture and rural communities. As essentially "single-sector lenders," Farm Credit institutions face concentrated risk. Unlike other lenders, Farm Credit cannot move away from agriculture when the farm economy softens. We are committed, both by law and inclination, to serving agriculture and rural America in good times and bad. We work every day to mitigate the risk inherent in single sector lending.

Farm Credit's single sector risk is further concentrated in many cases by geographic risk. An institution can find itself facing a territory-wide drought or similar agriculture catastrophe. By moving beyond local geography, Farm Credit institutions can alleviate some of this geographic risk.

We recognize that extending loans in unfamiliar territory can pose risks as well. However, effective management, strong regulatory oversight, and the benefits of geographic diversification more than offset those risks. My institution is proof of this. Today, we operate over four states. While our competitors complain that we are too aggressive in serving the marketplace, FCS of America is not the dominant player in our area. We are meeting our mission of service to agriculture and building the financial strength to enable us to continue to meet our mission in the future.

The Farm Credit Administration has demonstrated that they are fully capable of examining multi-state institutions. FCA is a full-fledged safety and soundness regulator with the full breadth of authorities necessary to oversee System operations and to take enforcement actions should they be necessary. In addition, Farm Credit institutions are subjected to specific, risk-based capital requirements. As of September 30, 2000, capital as a percentage of total assets in the System equaled 15.5%.

Unique among GSEs, the Farm Credit System has a self-funded insurance fund that is in place protecting investors and, ultimately, the taxpayers. System institutions have paid premiums to build it to the congressionally mandated secure base amount of 2% of outstanding debt.

National charters will not change the cooperative nature of Farm Credit institutions. They will continue to operate on the concept of one stockholder, one vote. Farm Credit institutions will continue to be owned and controlled by their member/customers. Farmer control will remain a fundamental principle of Farm Credit.

No institution is being required to adopt a national charter. The decision to do so will be made by each institution's board of directors based on their own analysis as to what is best for their institution as they seek to serve agriculture.

An institution that receives a national charter would be required to amend its current business plan to ensure that, first and foremost, it will provide loans and financially related services to the customers in its originally chartered or local service area. The conditions of the national charter set forth in the proposed regulation would require an institution to recognize and act on its obligation to serve all eligible borrowers in its local service area.

Before initiating activities in a broader geographic area, a Farm Credit institution is required to submit a revised business plan, approved by the institution's board of directors, which clearly demonstrates how the institution will operate outside its current territory. The plan must give special attention to how the institution will maintain safe and sound operations.

Today, System institutions serve the many diverse entities that comprise U.S. agriculture, including larger-sized farmers and smaller-sized farm operators and everything in-between. Farm Credit will continue to be responsive to the credit needs of all types of agricultural producers just as we are doing today.

Reviewing FCA's data on the System's service to young, beginning and small-sized farm operators demonstrates what Farm Credit is doing to serve these groups. The last available

comprehensive data gathered by FCA is from 1999. That data shows that Farm Credit made $7.3 billion in loans that will benefit young farmers, $10.7 billion that will benefit beginning farmers and $20.6 billion that will benefit small farmers.

National charters will not change who is eligible to get a loan from Farm Credit. The national charter regulation will provide no new lending authority for FCS institutions. The competitive balance between Farm Credit and commercial banks will not be altered by this regulation. It is important to remember that commercial banks have done very well competing in agricultural credit markets. According to the U.S. Department of Agriculture, commercial banks have gained market share in agricultural credit markets in 12 of the last 15 years.

In fact, Mr. Chairman, we would urge this committee to continue to focus on changes that need to be made to help modernize the Farm Credit System. Commercial banks have had many new opportunities opened up for them as a result of the Gramm-Leach-Bliley financial services reform legislation. That legislation gave the majority of commercial banks (and virtually all agricultural banks) direct access to GSE funding through the Federal Home Loan Bank System for all types of agricultural lending. As a result commercial banks today:

- benefit from access to the same GSE funding as Farm Credit,
- have a depository based, funds gathering mechanism directly backed by the taxpayers,
- have access to the Federal Reserve funding window that Farm Credit does not enjoy,
- have greater operating flexibility than Farm Credit institutions,
- are not subject to statutory borrower rights requirements (as are System institutions),
- have a lower cost of regulation,
- have substantially expanded their agricultural loan market share,
- have experienced high profit levels, and
- have failed to return any of those profits to their borrowers through patronage programs.

Mr. Chairman, thank you for the opportunity to testify today. We strongly support the FCA's proposed regulation. We believe it provides more choices for farmers; helps diversify risk in Farm Credit institutions; and helps preserve Farm Credit's cooperative structure. Importantly, we note that the FCA action does not alter the competitive balance between Farm Credit and commercial banks and is fully authorized by law.

I would be pleased to answer any questions the committee might have.

TESTIMONY OF

PHILIP BURNS

on behalf of

THE AMERICAN BANKERS ASSOCIATION

presented to the

COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY

U.S. SENATE

February 26, 2001

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 thank the committee for holding this hearing because this proposal by the Farm Credit Administration ("FCA" or "Administration") represents a dramatic departure from the way in which the Farm Credit System has operated for over 80 years and poses a real potential for harm to producers, taxpayers, and rural America. We urge Congress to stop this process before it is too late.

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.

I am Phil Burns, chairman of Farmers and Merchants National Bank in West Point, Nebraska. I am a past chairman of the ABA's Agricultural and Rural Bankers Committee and I am a past president of the Nebraska Bankers Association. Farmers and Merchants National Bank is an $80 million bank located in Cuming County, Nebraska. Our total loan portfolio is $76 million, 79 percent of which is agricultural credit extended to farmers and ranchers in our service area. Our customers' heavy concentration in livestock has helped to mitigate the effects of record low prices for most of the crops grown in our area. However, our customers are not immune to the economic downturn in agriculture and generous government payments in 1999 and 2000 have helped our producers tremendously. The response by Congress to the needs of production agriculture has helped the financial services industry avoid widespread credit problems like we faced in the 1980s.

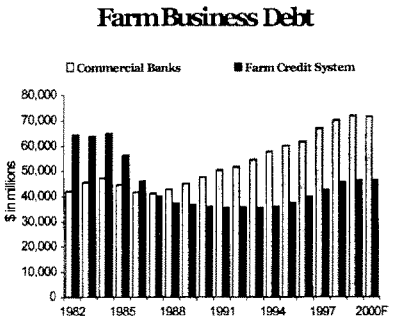
The 1980s were incredibly difficult times for farmers and ranchers and their lenders in Nebraska and throughout the country. While over 300 commercial banks nationwide failed during that period as a result of the farm credit crisis, a $4 billion line of credit from the federal government bailed out most Farm Credit System institutions in 1987. The financial crisis in which the FCS was mired was precipitated by expansive legislative and regulatory changes designed to reinvent a System that was playing an increasingly diminished role in the agricultural credit market.

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") and 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 FCA, 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 may mean 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, 2000, outstanding System loans to farmers and ranchers were

approximately $46.1 billion or 26 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 $71.4 billion (41 percent of the market) at the end of 2000.

I have reviewed 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.



Source: USDA

We believe that granting national charters to System institutions would serve no credible public policy purpose; would negatively affect small, beginning, and economically disadvantaged farmers; would raise serious safety and soundness questions; would expose the American taxpayer to incalculable risk; and would destroy 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 the System was chartered to serve.

National Charters Will Serve No Credible Public Policy Purpose

The FCA would have Congress and the public believe that System institutions are shackled to an antiquated system of frozen geographic territories and 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 the FCA pins on defined geographic territories. The truth is that System institutions have available a number of options by which they can diversify their loan portfolio either geographically or by commodity. System institutions have always had the authority to lend in any territory with the concurrence of the System institution that is serving the territory they wish to enter. In reality, the proposal for national charters has nothing to do with better serving farmers and ranchers; it has everything to do with expanding market share by larger System institutions at the expense of smaller System institutions.

Also, System institutions may use the loan participation regulations, approved by the FCA in April 2000, to participate, up to 100 percent, in any qualifying loan made by a non-System lender. While we are concerned about the potential impact of this regulation, it has been adopted and if the FCA were truly pursuing an agenda designed to improve the flow of GSE credit into

rural America, and to diversify the FCS risk profile, they would demand that System lenders work closely with and participate in loans with banks and other private and public credit providers to ensure that all rural Americans receive the benefits of the System's GSE subsidy.

The FCS was created in 1916 as a government-sponsored enterprise in large part because national banks and many state banks were prohibited from making real estate loans.[1] As a GSE, the System enjoys beneficial federal and state tax treatment and has access to lower cost lendable funds. It has been estimated that the subsidy afforded to the FCS by virtue of its GSE status amounts to over $1 billion per year.[2]

The FCA seems to have adopted a "tough love" approach to their regulation of the FCS. By granting national charters, the FCA would create a system that will have FCS institutions competing with each other. Why did the FCA, as the safety and soundness regulator of the cooperative FCS, decide that it was acting responsibly in proposing a Darwinian process that will result in survival of the fittest FCS institutions and the extinction of the weaker?

The 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.[3]

What public policy benefit does the FCA see in developing a process by which System institutions will compete with one another? We have reviewed all public statements made by the FCA about 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 the FCA about the pricing practices of System institutions. A clear pattern has emerged: despite a federal statute that prohibits their doing so[4], System institutions will consistently under price credit on large deals in order to get the business. We have many documented cases of this practice, yet the FCA has continued to deny that System institutions have engaged or do engage 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. The FCA fails to acknowledge this problem and fails to address what will happen to all lenders once System institutions start to cannibalize each other.

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[1] Bert Ely, *The Farm Credit System: Reckless Past, Doubtful Future* 5 (1999)
[2] Id at 20
[3] Farm Credit Administration, *National Charters Booklet*, 65 Fed. Reg. 45066, 45073 (July 20, 2000)
[4] 12 USCA §2001(c)

An examination of the proposed regulatory framework[5] raises a number of public policy concerns. First, the proposed rule provides only 30 days for public comment.[6] A proposal of this magnitude should be open to public comment for a considerably longer period of time so as to allow thorough review by the greatest possible number of people.

Second, the proposal devotes a considerable amount of space to the notion of Local Service Areas ("LSA"). The "Supplementary Information" portion of the proposed rule reads in part:

> The FCA believes the LSA requirement will ensure that the System carries out its public policy mission of extending credit and related services to farmers, ranchers and other eligible customers in every part of the United States...Therefore, each association with a national charter must provide dependable, sound, adequate, competitive, and constructive credit and related services to all eligible and creditworthy customers within its LSA on a **priority basis**...[7]

While the FCA reminds System lenders that the public policy mission of the System is to provide dependable, sound, adequate, competitive, and constructive credit to all eligible and credit worthy customers within their local service area, the FCA proposes no specific, enforceable or measurable regulatory sanctions that would ensure that local farmers and ranchers continue to have access to a FCS lender. The FCA does not propose to restrict, in any way, the non- LSA lending of System institutions. Furthermore, despite its statement that LSA lending be done on a priority basis, the FCA does not include such a requirement in its proposed regulations. The words in the "Supplementary Information" section sound like a commitment to LSAs; however, there is no specific enforceable regulation proposed to give power to the symbolic words. If Congress agrees that this is an important goal, specific limitations should be applied to a System institution's lending activities outside of their LSA.

National Charters Will Have a Negative Impact on Access to Credit for Small, Beginning and Economically Disadvantaged Farmers

We have great concerns about the negative impact national charters will have on small, beginning and economically disadvantaged family farmers as System institutions seek larger, more profitable loans at the expense of these borrowers. Although the 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. The 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 economically disadvantaged farmers is spotty. Indicative is the limited participation of System institutions in the FSA guaranteed loan program. 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

[5] 66 Fed. Reg. 10639 (February 20, 2001)
[6] Id at 10639
[7] Id at 10640

for private sector lenders to make credit available without a guarantee. The maximum loan size that USDA will guarantee is $731,000 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 Koenig [8] sheds some light on both bank and FCS participation in this program. We believe that the article also provides some understanding of the implications for small family farmers, beginning farmers, and economically disadvantaged farmers should the 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, the FCS appears to have made only a handful of loans to beginning farmers in these states.[9]

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. The FCS, which holds 27 percent of all farm debt accounts for just 15 percent of FSA guaranteed loan volume.[10]

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.[11]

The FCS institutions that are scouting new territory to set up lending operations will not be looking for small loans, beginning farmer loans or loans to economically disadvantaged farmers and ranchers. 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

The 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

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[8] Charles Dodson and Steve Koenig, *The Targeting of FSA's Guaranteed Farm Loan Program*, Volume 13, Issue 3, *Journal of Agricultural Lending* 50 (2000)
[9] Id at 54
[10] Id At 55
[11] Id

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.

The 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. The 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 would logically 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.

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 FCA is Abandoning Cooperative Principles with National Charters

The creation of the FCS as a member owned cooperative was a brilliant stroke on the part of Congress in 1916. Who else but the farmers and ranchers that had a stake in the System's success could better govern and manage the activities of the System? The participation and ownership of farmer- and rancher-borrowers in the management, control, and ownership of the System was central to its mission. As of June 30, 2000 the System had over 425,000 stockholder-owners.

To better understand and to gain some perspective on the nature of a cooperative, we consulted the seven Cooperative Principles as outlined by the International Cooperative Alliance.[12] By proposing to grant national charters to System institutions, it is clear that the FCA is abandoning the basic cooperative principles of member ownership and member control. The second, third, fourth and seventh Principles each mention the concept of democratic member control of a cooperative.[13] Yet, the FCA does not require in its proposed rule that the 425,000 owners of the FCS vote on the question of whether their institution should apply for a national charter.

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[12] International Cooperative Alliance *Rules, Policies, Procedures, and Standing Orders*, Section II, Article 5 (November 1997)
[13] Id

In fact, the Farm Credit Act of 1971 ("Act") requires System institutions to assure representation from all areas of its territory and as nearly as possible from all types of agriculture practiced within the area.[14] The proposed rule does not modify these requirements in any way. Since these requirements would apply to a System institution's LSA, as the board structure of an institution changes to accommodate both geographic and agricultural diversity, control of the producer-owners located in an institution's LSA will be diluted. Furthermore, it is questionable whether such minimal involvement in the operations of an association rises to the level of "shareholder control." Therefore, all System institutions seeking a national charter should be required to put the issue to a vote of that institution's farmer- and rancher-owners.

Conclusion

In summary, we believe that 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 the FCA has failed to adequately assess the potential for such problems. Agricultural lending is very much a "place based" business that is best understood and managed locally. We also question the ability of the 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. Finally, we question whom the FCA is working to benefit, because there has been no call for national charters among the 425,000 owner/stockholders of the System.

The 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. I have been an agricultural banker for 29 years and I have never before seen the level of competition that exists today for agricultural credits. Seed companies, equipment manufacturers, fertilizer producers, life insurance companies, and foreign banks are aggressive providers of agricultural credit. 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 retail lending, 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. However, should Congress allow this process to proceed, the FCA should adopt specific limitations on lending activities by System institutions outside of their LSA and System institutions should be required to submit to their farmer- and rancher-owners the question of whether they should apply for a national charter.

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.

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[14] 12 USCA §2203

Statement Of

DALE LEIGHTY

On Behalf Of The

Independent Community Bankers of America

Before The

Senate Agriculture Committee

February 26, 2001

Statement of Dale Leighty - ICBA
Senate Agriculture Committee
February 26th, 2001

FCA National Charter Proposal

Thank you. Senator Lugar and Senator Harkin, we appreciate the Senate Agriculture committee's interest in conducting this timely hearing today. My name is Dale Leighty, and I currently serve as the Vice Chairman of ICBA's Agriculture-Rural America Committee and I am also the President of the First National Bank of Las Animas in Las Animas, Colorado. Ours is an $80 million asset bank and with approximately $60 million in loans, most of which are agricultural credits. Our town has 2,500 people and our county has 5,500 residents.

Mr. Chairman, the ICBA, with two-thirds of our member banks located in small communities of under 10,000 population, has a long standing interest in ensuring credit availability to our nation's farmers, small businessmen and women and other credit consumers in our nation's rural communities.

ICBA is the only national trade organization that exclusively represents the interests of our nation's community banks, representing 5,300 institutions at more than 17,000 locations nationwide. Community banks are independently owned and operated and are characterized by attention to customer service, lower fees and small business, agricultural and consumer lending. ICBA members hold nearly $486 billion in insured deposits, $592 billion in assets and more than $355 billion in loans for consumers, small businesses and farms in the communities they serve. Our member banks employ 239,000 citizens in the communities they serve.

We Agree With Many in the FCS - National Charters Are Bad Public Policy

Mr. Chairman, the old perception that bankers and the Farm Credit System can't agree on anything is not true. We agree with the many Farm Credit Associations who are opposed to this proposal. Since none of these institutions are at today's hearing, I ask that the sample letters I have brought along be placed into the hearing record. My testimony today will emphasize some of these many points of agreement that we share with these FCS associations in opposition to removing geographical boundaries and allowing intra-system competition within this GSE - the only GSE that would have such an arrangement.

The opposing FCS associations expressed concerns that this new direction is a dramatic change in the FCS that would benefit only the large FCS lenders. They argue it would hurt the cooperative nature of the FCS and undermine service to family farmers. They further argue it is simply a way for large FCS associations, that had not adequately serviced their existing geographical territories, to cherry-pick the best loans away from other lenders.

In fact, one Farm Credit System association wrote that in their Farm Credit District a survey showed "that more than a majority of the associations are opposed to the 'National Charter' approach." Also, based on contacts their management had with association representatives across the country, quote, "we find support is 'luke warm' and only exists at all primarily due to the belief that this is the only approach which FCA will support."

FCA withdrew the proposal without explanation when it was labeled "customer choice". FCA subsequently developed a national charter booklet, then attempted to adopt national charters without a public comment period and even now wants to allow only a 30 day public comment period. Clearly the evidence is this proposal has not been embraced enthusiastically except by a few and it has generated many concerns and questions.

What are some of the points of our agreement with FCS institutions on why National Charters are bad public policy? The bottom line for both banks and many FCS institutions, based on their written comments, is that there are much simpler, much easier, less disruptive and less painful ways to achieve the same objectives. That FCA doesn't embrace these simpler, less disruptive solutions, suggests the stated objectives are not the primary objectives for this proposal, which greatly concerns us.

One initial point to consider is that there is little, if any, need for this proposal. In fact, I would like to submit for the record the arguments proponents of national charters have stated - all of them you will see refuted by FCS associations themselves!

Let me summarize a partial list of concerns:

1) This proposal will not enhance service to family farmers - it is designed to appeal to large borrowers!
2) In addition, it will do nothing to provide loans to struggling borrowers who cannot now find credit.
3) It is likely to lead to much greater consolidation of FCS local lenders and therefore a greater concentration of economic power among fewer, larger FCS lenders at a time when many have raised concerns over concentration of America's farms and agri-businesses.
4) The proposal is unnecessary - there are much simpler, less disruptive ways to achieve the proposal's stated goals;
5) The proposal is driven by the large institutions within the FCS who will have the financial leverage and resources to drive smaller FCS associations out of business while driving some commercial banks either out of ag lending or out of business;
6) The proposal could undermine the majority of farmer-borrowers now using the System and lead to a loss of local, farmer-oriented control;
7) The proposal will likely disrupt rural credit markets and in many cases could make credit more expensive to family farmers;
8) The proposal is controversial and not enthusiastically embraced within the Farm Credit System;
9) The proposal will lead to a crowding out of private sector lenders in markets that are already competitive, well served and efficient;

10) The proposal will further open the door to a focus on non-agricultural lending by the FCS.

Not a Customer Choice Issue

When this proposal was originally presented by FCA a couple years ago it was labeled "customer choice". The argument then for removing geographical boundaries was supposedly that large farm customers, with operations in more than one state, were prevented for shopping for their choice of FCS lenders. This was not true then nor is it true now. As pointed out by FCS associations, FCS associations typically grant concurrence for such loans routinely and many have reciprocal territory concurrence agreements in place which ensures the customer has lender choices.

Not a Diversification Issue

As of late, the most often cited argument made by proponents is that the proposal will allow the System to reduce risks by being able to diversify across territories and across commodities. But the System can already do this through loan participations. Participations are loan sharing arrangements where the association originating the loan can share in the profits (or losses) of the shared loans with another association. These participations can be done anywhere in the U.S. and have the added advantage of relying on the local association's knowledge of the customer base and various risk factors inherent in that particular geographic region.

Relying on loan participations would be far less risky and far less disruptive than causing the loss of many local lenders from serving agriculture.

In addition, the USDA has loan guarantee programs and Farmer Mac has a secondary market program to purchase loans. Both of these are in place to help lenders reduce risks. Yet, USDA economists report that FCS has not utilized the USDA loan guarantee programs to serve beginning, socially disadvantaged or higher risk farmers anywhere near the level that commercial banks have. I ask that this attachment also be entered into the hearing record.

The bottom line is that there are already several mechanisms in place to reduce risks for System lenders. It appears, however, that they are not utilizing these programs. This raises the question Mr. Chairman, *why adopt this proposal when FCS institutions are currently underutilizing existing risk reduction mechanisms?*

Will Increase - Not Decrease - Safety and Soundness Risks

FCA and other proponents argue the proposal will, due to greater diversity of loan portfolios and territories, reduce safety and soundness risks. At the same time, proponents completely ignore other risks that result from venturing into unfamiliar geographic areas and lending on commodities and in climates where they have little, if any, previous lending experience.

An important question is why it makes sense for associations to compete when competing associations are jointly and severally liable for each other's failures?

The board of one FCA association wrote they had "concerns about how the FCA would maintain safety and soundness control of the lending and operational risks the System entities might pursue. These risks could develop to such a scope and scale as to trigger losses that would impact the remainder of the System institutions."

Another association wrote, "Agriculture can be very volatile and one needs to understand the borrower's operation in order to understand the risks. We have seen too often where the efforts to build an agriculture loan portfolio by offering low market rates or easy credit terms and conditions have led to problem loans, risky portfolios and failed farming operations."

Another FCS association representative wrote, "I firmly believe we should not put our capital at risk by venturing into areas or industries where we do not have the resources or expertise to properly service the business." Yet another FCS association wrote, *"Internal competition cannot be policed by FCA or the System itself and may well lead to the System's failure, rather than guaranteeing its success. (Emphasis added)"*

Another FCS association representative wrote, "Better rates and better terms, etc., will only occur if one of the competing System entities is willing to earn less than the market would dictate. Therefore, we are extremely uneasy with the proposal to engage in a free-for-all among System institutions in this extremely competitive environment. In our opinion, this is a classic safety and soundness issue, which puts member investment in System institutions at risk."

Further, FCA has stated that risks will be controlled through FCA examinations and their authority to correct deficiencies. But the FCA only conducts examinations of institutions once every 18 months and no longer requires prior approval of new product offerings. It does little good to shut the gate once the cows have gotten out.

In fact, one FCS association wrote, *"We are convinced of the following: the safety and soundness risks of the proposed intra-System competition are being totally ignored."* Another wrote, "We do not believe that the Farm Credit Administration has the ability to regulate Associations with nation-wide charters; and, will lead to Safety and Soundness concerns when Associations start lending in areas in which they have little expertise."

Will HURT - Not Help - Family Farmers

FCA has stated that this proposal will help family farmers. In fact, they have said it will help *all* family farmers. Really? Not according to the many FCS associations who feel forced to apply for national charters to remain on the same competitive playing field as their FCS brethern. These associations believe, and we concur, that more profitable farmers in more profitable geographic areas will be targeted because the smaller loans will not be viewed as cost efficient. *In fact, they have pointed out that in those territories where there is already limited overchartering of FCS territories this is precisely what is NOW occurring.*

Some of their comments are:

"Open competition may cause FCS to only serve more profitable geographic areas or commodities and avoid areas that are not as profitable or desirable."

"Intra-system competition is for only large loans - Associations are only interested in soliciting large out-of-territory loans that have adequate volume to cover the extra expense of handling and will contribute towards association efficiency (cost per dollar loaned). There will not be any competition for the smaller loans, as they are not cost efficient."

"We conclude that the principal reason for the new philosophy is to create the necessity for associations to merge. We do not believe such mergers will improve service to our customers."

"Competition for the large loans will result in reduced interest rate spreads for these loans, and an offsetting increase on small and marginal loans."

"Even with the LSA requirements (Emphasis added), a likely result over time will be for associations to place less emphasis and focus on smaller, less profitable loans in marginal agricultural areas, and increase efforts in areas with stronger agriculture and larger, more profitable loans."

"There is no valid argument that supports the claim that a competing association is going to seek to expand their young, beginning, small and minority program outside their local service territory (LSA). No, the loans being sought will be only the large, high quality accounts ("cherry picking")."

"Please re-consider this philosophy statement and see it's negative impact to agricultural borrowers. Who will finance the young farmers of tomorrow? Someone down the street might, but no one across the nation is going to give the first consideration. All of us will go after the same operators and when the holes in financing agriculture develop, we will be too fragmented to fix. Let's please look at alternatives for the customer's sake, not for the sake of District banks or associations."

"Unfortunately, the removal of boundaries could result in fewer Associations due to intra-System competition and therefore, **lead to higher interest rates over time** (emphasis added). Obviously, this would not be beneficial for our customers."

"The basis for opposition centers primarily on the possibility that the small and/or marginal customers the system is to serve will be adversely affected by the proposal."

"Young, beginning, small and minority customers will be underserved in the rush to compete for larger, more profitable loans. This would be in direct conflict with congressional intent and FCA's own regulations."

Mr. Chairman, it is inconceivable that Congress wants to provide less help and poorer service to family farmers. But both sets of perspectives - that of the FCA and other supporters and that of FCS associations opposed to this proposal - can't be correct. They are mutually exclusive viewpoints. We are not simply speculating here - it is a matter of basic economics. Family farmers will not be targeted by out of territory lenders under this proposal because it will cost more to underwrite, service and monitor loans that could be many states away from the originating lender.

They certainly won't be going after the less viable credits. The ultimate consequence of this isn't better service, it's the potential for fewer credit choices and poorer service. To be viable, local lenders must be able to lend to a broad cross section of constituents in their market. They can't be profitable lending only to the marginal or less profitable customers. But this is a prospect that many local lenders, including both local banks and local FCS associations, would face since the large, aggressive FCS lenders would engage in predatory pricing to snatch away the better farm loans.

FCA has shown little interest in policing predatory pricing tactics, another concern raised by both bankers and FCS associations and FCA is not implementing any new safeguards or oversight mechanisms in this area.

Local Service Area (LSA) Plans Are Insufficient To Guarantee Service to Family Farmers

The FCA has suggested that they would be able to guarantee, through LSA plans, that FCS lenders would continue to service their local territories before venturing into new territories and that this will ensure the new policy targets family farmers. But the LSAs are totally inadequate for several reasons. Let me mention a few of these reasons.

First, FCA does not require any targeting of young, beginning, socially disadvantaged or family farmers by the lenders venturing into new lending areas. So the focus on out of territory lending is totally geared to large credits. There are no requirements, no portfolio goals for example, that struggling family farmers be the primary objective for venturing into new territories.

Second, the policy does nothing to increase service to these market segments - young, beginning, socially disadvantaged or family farmers - within existing territories by the "local" FCS lender. It only requires a plan be in place but provides no criteria for the plan, meaning "business as usual". The new policy allows the associations to "self-assess" themselves as part of their application and report on how good of a job they feel they are doing in their local service areas. This amounts to self-assessment and self policing of their ongoing activities. Commercial lenders have to comply with much more stringent Community Reinvestment Act (CRA) requirements upon which they are examined, graded on and held accountable to transparent and public scrutiny. There are also no requirements for increased use of the USDA guaranteed farm loan programs, for example. So we will see no improvement in the current situation in which bankers often complain that FCS associations ignore the higher risk credits and use their GSE tax and funding advantages to go after larger credits in their existing markets. Only self-assessments and

self-evaluation.

Third, there are no portfolio limitations on the amount of lending activities the associations can do outside of their territories. So if an FCS association is currently only marginally effective in serving its existing LSA, it could under this plan suggest it is doing a fine job in its LSA and commit a large portion of its resources to pursuing large credit deals in other areas. *How much of their portfolios would FCS institutions be required to commit to the LSA under FCA's proposal?* 95%? 90%? 80%? 70%? 60%? 50%? 40%? It's undefined and not even required in this proposal, so no one knows.

Fourth, these liberal LSAs will inevitably weaken even further over time as associations merge, causing confusion. LSAs will inevitably cover larger and larger geographic regions making them anything but "local". They certainly won't provide the local lending presence and local community presence that community banks provide. Plus, if an FCS association closes shop, what happens to its LSA? Will there no longer be any association obligated to serve the failed association's LSA?

Fifth, there is no requirement that the non-LSA FCS lenders be required to make a financial commitment to the *community* where they are seeking loans from. This will erode community involvement and community support from the LSA lender who will divert resources to fight the incoming competition from non-LSA lenders. Local communities will suffer. Rural communities will suffer.

Sixth, LSAs are not sufficient to keep FCS focused on its public policy mission. The System continually uses the banner titled "modernization" when it pushes for new powers. There has been quite a bit of "modernizing" within the FCS lately as evidenced by all of the new regulatory policies we've seen over the past few years. I want to emphasize that the System has been quite profitable as it is currently structured - generating over $1 billion in annual **net** profits for the past decade.

Since other GSEs have social obligations, I suggest its time to "modernize" the System by mandating certain financial and/or portfolio obligations aimed at targeting young, beginning, socially disadvantaged and family farmers. Congress could mandate a certain, significant, percentage of FCS associations' loan portfolios or profits be committed to beginning farmers or socially disadvantaged farmers, for example. This could be a benefit to these market segments that may actually have the greatest need in American agriculture and would truly be a "modernization" that serves a valuable social purpose – a fundamental reason GSEs exist.

Will Allow Predatory Pricing

Supporters in the FCS have suggested that this proposal will increase competition, which they suggest is the basis of banker complaints about the proposal. The latter is completely untrue as the supporters know. What they don't tell you is that the only increased competition will be for

the largest credits and the only way to get these larger credits is to underprice the market - to engage in predatory pricing.

Let me emphasize this - The booklet establishes no new monitoring and oversight mechanisms in regards to monitoring for predatory pricing even though considerable concern was expressed over this issue by FCS institutions. Section 12 U.S.C. 2001 Section 1.1 of the Farm Credit Act, which states what the Congressional policies and objectives for FCS activities are concludes with this language:

> "**Provided**, that in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders to borrowers of equivalent credit-worthiness and access to alternative credit."

Yet, FCA does not provide regulatory controls in this area to accompany their regulatory proposals which they always justify using Section 1.1 of the Act. There is nothing in this proposal to guard against large, aggressive FCS lenders engaging in predatory pricing. And this is an area of FCA regulations that has gotten little or no attention. It leads us to conclude this section of the Act may need legislative changes to require enforcement of these provisions. *FCA should be conducting periodic surveys of FCS and competitors' rates and making them available for public scrutiny.*

No Legitimate Economic, Cost-Benefit or Needs Analysis Has Been Conducted

FCA has admitted that they have not conducted a formal economic, cost-benefit or needs analysis of the impact of this proposal. With such dramatic changes possible and likely, one would think that would be required of FCA. All the FCA has said is that it has conducted various discussions and briefings. Mr. Chairman, the FCA certainly never contacted any community bankers to discuss needs, trends or how to better serve our rural communities.

Contrary to suggestions that the Treasury Department has somehow been involved in or endorsed the move towards removal of territorial boundaries within the FCS, I point out that is not the case. In a November 30, 2000 letter Treasury sent a letter to FCA Chairman Reyna making the following comments:

> *"First, we believe the proposal would reduce the focus of Farm Credit System associations focusing on serving all eligible borrowers in their local areas and diminish the System's local cooperative structure. Second, while not directly expanding the lending powers of the Farm Credit System associations, the proposal would likely allow a government-advantaged competitor to increase market share, which in the long term could effect competitiveness in agricultural credit markets . . . We have not undertaken a formal legal review of the charter proposal or the process by which it was done."*

In Treasury's October testimony to the House Banking Committee the Treasury Department noted several concerns including the following:

"Such a policy (national charters) raises serious questions about the proper mission of the System. . . such changes may also over time tend to diminish the local, cooperative nature of that System and have long-term effects on the competitiveness of the agricultural lending markets. In particular, they will allow expansion of a government sponsored enterprise - which are traditionally created to correct a market failure - at a time when markets are functioning competitively and even growing."

*"we believe that the System's current structure is an important part of maintaining local focus. . . we did **not** recommend national charters or any form of intra-System competition. . . it might well diminish competition and innovation in the medium- to long-term by driving other competitors from the market."*

National Charters Remove Local Control of FCS by Farmer Borrowers

FCA's booklet states that national charters "provide more geographic diversification for selecting eligible stockholder directors" (pg 2). This will lead to loss of local control of FCS association boards since potential board members will now be eligible from anywhere in the U.S.

Sample concerns expressed by FCS association include the following:

"... we are totally opposed to the removal of geographic boundaries of system entities which would no doubt promote predatory pricing and loss of local control."

"it (removal of geographic boundaries) would allow a segment of the system to use this statement as a self serving catalyst to create a political power base to control future system activities based on their own agenda, rather than the grass roots ownership and management teams currently existing."

"FCA's new philosophy appears to direct changes not necessarily beneficial to the customer or end user, but more to affect internal politics, control, and breaking up what has been a most successful member-owned and controlled organization."

"Our fear is that the mission mandated by the Congress to provide sound and constructive credit to all eligible borrowers may be sacrificed as we move away from the influence of localized governance through economies of size."

"Specifically, the (FCS Association) board questioned how farmer-director representation would be maintained in such an environment."

"Intra-system competition at the association level will distort the "grass roots" representation by producing board representation motivated by salaries and perks rather than borrowers' needs."

"we believe the process you have put into motion may cause the loss of local identity for associations and create large organizations that may not be responsive to local needs."

"...we fear the loss of grass roots control of the Farm Credit System. . .".

Clearly many FCS association recognize that this policy will lead FCS away from locally controlled boards. In fact, FCA's proposal requires this dilution of local representation by allowing borrowers to serve as directors "regardless of geographic location". And each association will be required to "ensure that borrowers from its chartered territory are adequately represented on its board of directors". When chartered territories cover the entire nation, the governance of associations is *anything but local.*

Shifts FCS Away from Serving Agriculture

FCA and other supporters suggest this proposal is somehow necessary because FCS is a single sector lender and they suggest that FCS must continue to serve the needs of agriculture when other lenders can "abandon farmers and seek profit opportunities elsewhere". This is just not an accurate picture of rural credit markets. These arguments, of course, forget to note that FCS was given GSE privileges precisely because they are intended to serve a specific sector – agriculture – at a time early in the 20th century when there were some financing needs in agriculture.

Also, bankers have noted that in recent years the FCA has begun to talk about its mission not only in terms of serving agriculture, but in terms of serving "rural America". That is quite a leap. In fact, the FCA a couple of years ago proposed a broad "scope and eligibility" proposal which included allowing loans to be made to farmers and agri-businesses for both farm *and non-farm purposes*.

Although that proposal was eventually scaled back somewhat after numerous complaints, it is clear that FCA has been expanding FCS's activities into non-farm lending areas. These include providing mutual funds, credit cards, student loans, home equity loans which can be used for *any* purpose, vacation loans, loans to dentists and anesthesiologists for recreational purposes, and on and on. My point, Mr. Chairman, is that this argument of "being limited to a single sector" has worn quite thin and it is clear that FCA wants to push the expanded powers envelope even further in the future.

Where will this lead with national charters? Will CoBank, working through its direct lender associations, or will FCS banks and lenders, form national alliances with national car companies to provide consumer auto financing for Ford or GM cars in towns of under 50,000 population? What about financing all the consumer loans for Home Depot home remodeling projects in "rural" towns? What about teaming up with national businesses to provide financing for furniture sales, office equipment, computers, etc., if they serve "rural America". What is in place to prevent this under a future FCA eligibility proposal, or even without one? What major national business wouldn't want to allign themselves with the benefits of a GSE lender? What credit demand would FCS be providing that is not being well met now by private sector lenders?

In regards to "other lenders abandoning farmers", let me state that this is simply misleading because it ignores the fact that there are several thousand commercial banks that provide

financing to agriculture. In many of our communities our community banks could not exist without the agriculture sector because it is the largest segment of our loan portfolios.

In most communities there are *several community banks competing for the same business* in addition to other competitors. Since community banks like ours serve their communities my bank is not going to go "seek profit opportunities elsewhere" by leaving our community in tough times. And by the way, my regulator would frown upon me as a Colorado community banker if I started to make loans in California and Florida and New Jersey simply by editing or updating an annual business plan. And of course, even as a community banker serving the needs of my community, I am still required to comply with CRA.

FCA/FCS's Terrible OFI Record

Mr. Chairman, I want to simply point out that the FCA and the FCS, despite all the talk about wanting more competition, have a terrible record for implementing the Other Financial Institutions (OFI) program intended by Congress to allow banks, credit unions, and other groups to access the funding window of the FCS. This would be one positive way more credit could be made available to rural America. But today there are only two dozen OFIs even in existence even though the statutory authority has existed for many decades. The OFIs that do exist get no board representation, no policy input and FCA has not responded to our request to host a meeting of OFIs to gather input and begin developing a workable program.

Congress expected the OFI program would be a significant, substantive program when it passed the authorities. It is time Congress prod the FCA to revise this program and we can share a number of ideas in this regard. But we shouldn't let the FCA proceed with national chartering unless they address the concerns we have raised today and until they have taken care of something as fundamental as the OFI program to ensure more credit is available from other providers when their association numbers become drastically reduced.

Conclusion

I believe its easy to see that the FCA National Chartering proposal is fraught with problems. It dramatically changes the structure of the System, will lead to rapid consolidation and loss of local control within the System, will encourage predatory pricing with no controls in place to monitor these practices and will lead to large aggressive FCS lenders cherry picking the best loans with no targeting requirements to serve family farmers outside their LSAs. The proposal has a weak and liberal local service area requirement that will become anything but "local" and could lead to alliances with large commercial businesses for non-farm lending purposes.

None of the borrowers served by the FCA's plan lack adequate credit choices. The rural credit market is quite competitive with a number of creditors in addition to the FCS and banks vying for business. We don't need to have larger operators and large ag businesses getting special loan deals that will be offset by raising interest rates on smaller borrowers. I've outlined a number of concerns. There are also many questions as I've indicated.

Additional questions would be:

- Why the FCA doesn't equalize voting procedures for stockholders of all associations consistent with the voting requirements being put in place in Mississippi, Alabama, New Mexico and Louisiana?

- How can an association's charter expand to a national scope without affecting the charter or district boundaries of the district bank with which it is affiliated?

- How can an association have the obligation to provide service to only a small part of its chartered territory?

- Since this policy will lead to rapid consolidation and mergers of FCS associations, with national charters soon to be in place, how can FCA comply with 12 U.S.C. 2252, Sec. 5.17 (a)(2)(A) requirements that "where stockholders of one or more associations did not approve the merger, the charter of the new or merged association shall not include the territory of the disagreeing association or associations"?

- If an association is unable to survive and closes down, will there be an association obligated to served the failed association's LSA?

It would be easy to expand the lists of both the questions and the concerns, but I believe the point is clear – **FCA should withdraw their proposal and promote options that would be much less disruptive to the rural credit markets**. These options would include loan participations and reciprocal concurrence agreements. Thank you Mr. Chairman

Testimony of

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February 26, 2001

Farm Credit Administration National Chartering Proposal

Committee on Agriculture, Nutrition and Forestry

United States Senate

National Chartering Testimony

Good morning Mr. Chairman and other committee members. My name is Peter Barry. I am a professor of agricultural finance and Director of the Center for Farm and Rural Business Finance at the University of Illinois.

During my 35 year professional career, I have been an educator, researcher, and publisher in the area of agricultural finance. Included have been numerous projects, presentations, and collaboration with industry and policy groups embracing national and state banking associations and their members, federal banking regulators, agribusinesses, state government programs, the Farm Services Agency, the Farm Credit Administration, the Farm Credit System Institutions, Farmer Mac, and others. Currently, my colleagues and I have completed an assignment working with the Farm Credit Administration on the development of risk-based capital requirements for Farmer Mac.

I have a long acquaintance with the "National Chartering" issue of the Farm Credit System. In 1991, the Farm Credit Administration under chairman Harold Steele, asked me and a colleague to conduct a study on "Competition Within the Farm Credit System: Concepts and Options". It was an informational analysis motivated by provisions in the Agricultural Credit Act of 1987 that allowed selected instances of over-chartering of FCS territories, including common national territories for the then three remaining Banks for Cooperative (now all combined into CoBank). The topic was believed to be of increasing importance in the future. The study emphasized the conceptualization of the issues and the delineation of several options (including the currently proposed approach) for intra-system competition, each of which was evaluated according to a common set of criteria (e.g., competition, uniform treatment, risk, efficiency, control, funding costs, reliability, and others). Thus, intra-system competition issues have been under consideration for a long time and have now been manifested in terms of the 1998 FCA

Philosophy Statement on Intra-System Competition and the National Charter approach. Clearly, the national chartering issue is not important just for its legal changes, but also for the structure, competitive position, and performance of the Farm Credit System Institutions.

Since the FCS was initially established in the early 1900s, first with an emphasis on financing farm land and then with broader authorities, the System has had the mission of providing specialized, concentrated, and reliable financing to agriculture, agricultural cooperatives, and other borrowers, under the cooperative ownership and guidance of its farm borrowers/patrons. Institutional restructuring, new authorizations, contemporary management techniques, and an arms-length regulatory agency have allowed the system to evolve along with the modernization of the rest of the financial markets, domestic and international. The proposed breakdown of exclusive territories through the effects of national chartering is another step in the modernization process. Few other non-government lenders serve exclusive territories, nor do other government-sponsored enterprises except for the Federal Home Loan Bank System.

Several factors warrant consideration in evaluating the National Charter issue. I will address these factors as follows: competition in rural financial markets, risks and risk management, reliability and cooperative organization, structural changes of the Farm Credit System Institutions, and regulatory considerations.

1. Competition in Rural Financial Markets

Competition among FCS institutions is intended to offer wider choices for agricultural borrowers and enhance the competitiveness of rural financial markets, which tend to lag behind urban markets in the breadth of credit availability and other financial services (Barry and Ellinger). Greater competition could be especially beneficial in geographic regions of the US (e.g., the Southeast, the Northeast, and parts of the West) where historically strong branch banking systems have been less committed to agricultural

lending. In the past, commercial banks' shares of the agricultural credit market have been stronger in locations (e.g., Illinois and other Midwestern and Great Plains state) where community (unit) banks were more prevalent. The current (Dec. 31, 1999) configurations of FCS market shares of farm real estate and non real estate debt are shown in Table 1 for selected states and regions. Substantial variation occurs, especially in non real estate lending, implying considerable differences across regions in the relative competitive positions of different types of lenders.

Recently, structural change in banking is bringing greater market shares of farm debt for larger non-agricultural banks. Monitoring the competitive position of commercial banks in the financing of agriculture over the next five to ten years will be important as structural change continues to bring bank consolidations and concentration of banking activities. Our work has shown that the rate of decline of "agricultural banks", to date, has been similar to that of non-agricultural banks, but this could change in the future if only the stronger, better managed, and more soundly capitalized community banks prevail in the importance niche market of agricultural lending (Barry and Escalante).

2. Risks and Risk Management

National chartering could lead to contrasting risk effects in the long-term versus the near term. Institutions that broaden their market and further diversify their loan portfolios should be able to further reduce their credit risks. As a result, interest rates to farmers could decline, although such reductions likely would be relatively small. In the nearer term, risks could increase if the FCS institutions enter new, unfamiliar territories without the benefit of past lender-borrower relationships and the valuable information about credit worthiness of borrowers that arises from these relationships. Overly zealous marketing of loans whether over the Internet or in person, or both, could lead to adverse

selection of new borrowers and further heighten credit risks. Discipline by institutional management and regulatory oversight would then take on greater value. Mergers among FCS institutions arising from national charters would also mitigate the new risks of geographic expansion, by maintaining the presence of loan personnel familiar to agricultural borrowers. On balance, an orderly, responsible approach to intra-system competition should minimize risk concerns in the near term and add to the long-term risk bearing capacity of the Farm Credit System.

3. Reliable Lending and Cooperative Organization

The FCS combination of a mandate for reliable lending, specialized and relationship-based lending, and the cooperative organization should continue to discipline and constrain institutional aggressiveness in geographic expansion. Most farm borrowers prefer to have knowledgeable, established, and reliable lenders who can function as financial partners and whose stake in a borrower's operation increases as the farmer's indebtedness increases. Thus, maintenance of a strong presence in an association's local service area likely will continue to be a high priority. Furthermore, the one person, one vote cooperative concept increases the likelihood that the local representation from a variety of business sizes and structures will continue to be strong.

Past studies have indicated that FCS borrowers tend to be larger, wealthier, and older than the population of agricultural borrowers (Koenig and Dodson; Ryan and Koenig). These characteristics might suggest a degree of selectivity among borrowers by the FCS institutions. Whether this is the case or not this is difficult to tell, and questions could arise about how national charters and geographic suspension could affect younger, smaller, and less wealthy borrowers.

However, the dominance of farm real estate lending by the FCS institutions ($30.0

billion of farm real estate loans versus $15.9 billion of non real estate loans on 12/31/99) may at least partially explain these characteristics. Generally, higher incidences of farm land ownership (and financing needs) by farmers are associated with larger, older, and wealthier farmers who can meet the equity capital needs of real estate lending, either through their own savings accumulated over time or through inheritance of farm land from parents. Our farm record data from Illinois clearly indicate the dominance of leasing of farm land by younger farmers as a means of financing the control of farm land, and the tendency for farm ownership to increase as farmers grow older (Ellinger et al). Thus, it is natural to expect that the FCS customer base might be as characterized above. Moreover, larger FCS institutions resulting from the national chartering process should have a greater capacity to serve younger, smaller, and limited resource farms, through dedicated lending programs. Both Congressional intent and recent FCS initiatives are emphasizing these programs.

At the same time, however, agricultural production is becoming increasingly harder to describe as consolidation and vertical coordination by farmers with input suppliers and processors continue to expand. "One size fits all" is not applicable to the structure of agriculture. The Farm Credit System's mission is to serve all of the structural dimensions of the agricultural sector, and to do so in a viable, equitable, and safe and sound fashion. Adapting credit programs and financial services to meet an evolving and adapting agricultural sector presents challenges for all types of agricultural lenders. Greater flexibility for the FCS institutions in choosing lending territories is consistent with this evolutionary process.

4. FCS Structural Change

Structural change of the FCS institutions has been a major component of the

modernization process. The goals have been to streamline operations, offer full service credit, reduce risks, gain operating efficiencies, and to further centralize various servicing offerings. Significant reductions of the number of banks and associations have occurred, with the pace of reduction of associations recently exceeding that of commercial banks. A patchwork of types and sizes of institutions has been the result. Two of the large, multi-state associations are even larger in loan volume than two of Farm Credit Banks.

Further structural change is logical to expect, and the national charter concept could (and perhaps has) accelerate this process. Except for the statutorily mandated, intra-district bank consolidations contained in the Agricultural Credit Act of 1987, Congress (and the FCA) has taken the approach of providing conditions that facilitate or motivate institutional restructuring within the FCS. The national charter concept appears to be another facilitating/motivating step.

5. Regulatory Issues

In its proposed rules for regulating Farm Credit System Institutions with national charters, the FCA clearly establishes its safety and soundness standards, together with a priority emphasis on associations' service to Local Service Areas (LSAs). The discussion in the recently published proposed rule (*Federal Register*, February 16, 2001) squarely addresses the needs for effective business plans for associations relative to expanded territories. It also requires applicants for national charters to address potential conflicts of objectives, and effects on organization efficiencies, customer service, risk management, and operational capabilities. Risks and risk tolerance levels must be identified as a part of the chartering application, and complete attention given to capital adequacy, loan underwriting requirements, loan servicing requirements, internal controls, and compliance with regulations. These considerations are treated extensively and comprehensively.

Similar guidelines are set forth by which national charter applicants must document service to their LSAs. A key implementation factor, then, is for the FCA to follow through on effective oversight and control by means of the examination, reporting, and regulatory processes.

In closing, I will note that the original FCA proposal for moving away from exclusive geographic territories addressed both borrowing by eligible borrowers from the FCS associations, and borrowing by the FCS associations from the district banks. Currently, the proposed national chartering focuses on only the first of these two components. The second will likely soon follow, and a case could be made that additional FCS bank consolidations are economically sensible.

Thank you for the opportunity to offer these observations.

Table 1. Farm Credit System Market Shares, Selected States, Dec. 31, 1999

	Non Real Estate Debt	Real Estate Debt
	---------- %	----------
US	19.4	32.2
Alabama	28.2	39.9
Georgia	37.0	24.8
Mississippi	14.6	26.4
South Carolina	51.0	49.7
Florida	33.6	17.4
Illinois	11.3	30.1
Indiana	20.0	27.6
Iowa	7.7	24.8
Nebraska	7.2	26.4
Kansas	8.5	36.2
North Dakota	22.8	38.9
South Dakota	10.9	31.9
Washington	10.1	27.8
Idaho	20.0	40.0
Montana	7.3	22.9
California	20.1	34.9
Virginia	41.2	50.6
North Carolina	50.1	30.1
Kentucky	29.4	25.3
Maryland	40.2	50.1
Tennessee	28.8	42.0
Pennsylvania	31.2	25.2
New York	37.1	39.2
Vermont	51.5	35.6
Arkansas	20.6	33.0
Texas	9.2	43.9

Source: ERS/USDA

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Koenig, S. and C. Dodson "Comparing Bank and FCS Farm Customers." *Journal of Agricultural Lending*, 8 (Winter 1995): 24-29.

Ryan, J. and S. Koenig "Who Holds Farm Operator Debt." *Agricultural Income and Finance*, AIS71, February 1999, ERS/USDA, Washington, DC.

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DOCUMENTS SUBMITTED FOR THE RECORD

FEBRUARY 26, 2001

Testimony of
Ed Hester
Chairman of the Board
Federal Land Bank Association of North Mississippi, FLCA
Before The
U.S. Senate Committee on Agriculture, Nutrition and Forestry
Washington, D.C.

February 26, 2001

Mr. Chairman and members of the Committee, my name is Ed Hester. I am the chairman of the Federal Land Bank Association of North Mississippi, FLCA and am testifying today on behalf of all the Federal Land Credit Associations in Louisiana, Mississippi and Alabama. Collectively, we represent over 5,700 stockholders and over $1.7 billion in outstanding loan volume.

We would like to take this opportunity to respond to issues that some have raised regarding the 1992 amendments to the law and how these provisions pertain to the national charter regulation. We are pleased that FCA has recognized these provisions in terms of providing a stockholder vote in the states of Louisiana, Alabama, and Mississippi before a national charter can be issued in these states.

We have a unique situation in my part of the country, Mr. Chairman, and it needs to be treated differently (as FCA has proposed).

In the late 1980s, as you may recall, when the Farm Credit System needed federal financial assistance, the lending institution in this three-state region went into (what is called) receivership – where the federal regulator (FCA) had to step in and take over. The assets were sold to the highest bidder, which was the Farm Credit Bank of Texas, who stepped up to the plate and took a financial risk in purchasing the loans of a failed financial institution. FCA gladly approved this sale, which included, as part of the agreement, an "exclusive charter" to the new owner. This exclusive charter is important because part of the incentive for Texas to purchase these assets was the knowledge that they would have the benefit of being insulated from competition from *within* the System so that they could rebuild the capital, the reputation and the quality of available credit in this region. In other words, the federal government made a contractual agreement: in exchange for the Texas Bank stepping in and assuming the financial risks associated with this failed institution, FCA granted them an exclusive charter -- not to be shared by anyone else in the System -- because FCA wanted and needed Farm Credit to be restored in these three states. And this arrangement is still in effect today (a copy is attached).

In addition, Congress codified this arrangement in statute in 1992 (attached) when questions were raised about its legality. This law, which was agreed to by all parties, remains in effect today and we strongly support it for the reasons I've just stated.

Although First South ACA argues that the playing field is not level and that the treatment under FCA's proposed national charter regulation is unfair, we view this matter as a fundamental property right. For example, if a failed business is purchased and the new owner dedicates time and money and reputation rebuilding that business, the previous owner -- or anyone else for that

matter -- does not have the right to step in and reclaim that business without compensating the rightful owner (the 5th amendment to the Constitution insists on this principle).

However, we also recognize that we are a cooperative institution and are owned by the farmers and ranchers we serve; and for this reason, we support the need to conduct a stockholder vote as FCA has proposed. We believe that our shareholders have a fundamental right to determine the business model of their cooperative financial institution that was created to serve them. Furthermore, the federal laws that apply to the Farm Credit System (attached) specifically state that our charter cannot be altered without a stockholder vote whereby a majority of shareholders agree that such an action be taken. This law applies specifically to our geographic area due to the financial failure of the System institution that previously served this region.

In other words, this is a unique situation in the Farm Credit System. But it applies in my part of the country for very legitimate and necessary reasons and that is why FCA has proposed this regulation in its current fashion and that is why we support it.

We recognize that First South ACA, which operates in this same region (but with *different* lending authority) also would like to share the lending authority that is *exclusive* to the institutions I represent today. With that in mind, we have offered to discuss a business merger of our institutions, in accordance with what the law prescribes in this situation -- to create a new entity that shares lending authorities, customers and geographic territory. However, this option has been repeatedly rejected by First South ACA; because, although they publicly claim to want what's fair for their borrowers, what they really want is the fruit of our labor… they want something for nothing… they want to renege on the previous agreement because it's not working out for them as well as they originally envisioned. And rather than consider merging and relinquishing some of the control of their institution for the good of their borrowers… in other words, rather than making *business* decisions, First South ACA has decided to make *political* decisions by asking you to change the law (and by holding this regulation hostage until they get what they want).

We support the current law that protects our stockholders' right to vote on these important issues and we support the continued recognition that this is a unique situation in the Farm Credit System -- one that should be treated differently for the reasons I've addressed in this statement.

Thank you for the opportunity to testify today. I will be glad to respond to any questions.

Written Testimony

On Behalf of *Ag*First *Farm Credit Bank*

Before the
Committee on Agriculture, Nutrition and Forestry

February 26, 2001 Hearing
Farm Credit Administration's Proposed Regulation on National Charters

On behalf of the management of *Ag***First** *Farm Credit Bank*, I am writing to provide an update on FCS issues.

*Ag***First** *Farm Credit Bank* is part of the Farm Credit System and is a federated cooperative, which means that other lending cooperatives own us. The 24 Farm Credit Associations that own us also borrow money and obtain key services from us. They are spread over 15 Southern and Eastern states as well as the Commonwealth of Puerto Rico. Today, the Bank and Associations serve over 79,000 farmers, ranchers and homeowners with close to $10 billion in loans. These Associations have done a remarkable job of generating earnings and sharing their profits with their borrowers, as true cooperatives should. Since 1988, they have paid out over $1.2 billion in patronage refunds, with $723 million paid in cash.

Recently, the independent federal regulatory agency with oversight responsibility for FCS institutions issued regulations that would provide farmers with the ability to choose among a wide range of FCS lenders like those in our district. That agency, the Farm Credit Administration (FCA), is proposing to allow FCS lenders to apply for a national charter to serve agricultural producers throughout the nation. Up until now, every Farm Credit lender was chartered to serve a particular territory. We understand the FCA's regulatory proposal, when implemented, would remove artificial geographic barriers and allow farmers to seek financing from the Farm Credit lender that best suits their individual needs. We have a concern that national charters may not encompass all 50 states.

We believe that the first priority of FCA, in the event it proceeds with the implementation of national charters, should be to support a simultaneous implementation of Title I and II authorities for <u>all</u> System direct lenders with its proposed removal of geographical boundary restrictions. In order to truly promote customer choice, national charters should be applicable to and available to Associations in all 50 states.

If implemented equitably, we believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in Farm Credit System institutions. At the same time, it will ensure that we continue to focus primarily on serving the farmers and ranchers of our local service area.

Robert A. Carson
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Marks, MS 38646
(601)326-3261

2-20-01

Dear Senator Lugar:

I commend you and your committee for probing the National Charter proposal by the Farm Credit Adm. Those who oppose the concept do not want competition. I blame no one for wanting a "fair advantage". I encourage you to seek testimony that points out who is being hurt by the ABA position. ABA is a very powerful lobby and has done a very good job in bringing the operating conditions of Commercial Banks to the state-of-the-art in commercial and agriculture lending. FCA is now attempting to do the same for Ag. lending by the Farm Credit System for the benefit of its borrowers and owners. Farmers, Ranchers, Aquatic Producers, and Ag Business deserve the same operating conditions that Commercial Bank Regulators have permitted the Commercial Banks interest to have.

I support Natl. Charters if it applies to all 50 States. You may not be aware that in 1972 Congress created a condition that gifted Alabama, Mississippi, and Louisiana in a very different set of operating conditions. This condition, if permitted to continue, will deny Farm Credit Owners and Borrowers full participation of the advantages brought by Natl. Charters. FCA, ABA, and Farm Credit Council are fully aware of this and the conditions that brought it about. I suspect that you will get little to no testimony about this, as it is a sticky point in Farm Credit. Congress created this and Congress need to correct it. Discrimination has gone on long enough. If Natl. Charters are good in 47 States,

why are they not good for 50 States? I encourage you to explore the problem and demand a solution that will make Farmers and Ranchers in Ala., Miss., and La. equal recipients of all FCA programs. Until this is done, I will oppose Natl. Charters. Farm Credit owners and members deserve the right to borrow from any Farm Credit institution they like. I am a borrower of the local A.C.A. and F.L.C.A. where I live and farm, a member of the Board of Ag. Fund Farm Credit Bank in Columbia, S.C. and a Board Member of Farm Credit Council. Each of these organizations has heard me address this issue many times - they know my position and stand. I hope you will hear from them about this inequity. I support Natl. Charters. They will be good for those associations who wish to have one, but only if Charters apply to all Farm Credit Assoc. on a level playing field.

Again, I say thank you for your interest. I hope you will see fit to approve FCA's plan to bring Farm Credit into the 21st Century.

Yours truly,
R. A. Carson

Senator Richard Lugar
U.S. Senate
Washington D.C.

Feb 22, 2001

Dear Senator Lugar:

This is in regard to the National Charter issue for Farm Credit banks that your Ag Committee is holding hearings on in the near future. I am a farmer from Michigan (and a member of the AgriBank Board of Directors) who would very much like to see this acted on in a positive manner. It seems to me that national charters would not only give farmers more choices for their financing needs but also ultimately lead to a lower more efficiently run farm credit system.

Thank you for your consideration.

Jack A. Anderson

Jack A. Anderson
6522 W. Colony Rd.
St. Johns, MI 48879

Valley Federal Land Bank Association, FLCA
Valley Production Credit Association

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Valley AgCredit

February 22, 2001

The Honorable Richard G. Lugar
United States Senate
Washington, DC 20510

Dear Senator Lugar:

We understand that the Senate Agriculture Committee will hold a hearing on Farm Credit System (FCS) issues in the coming weeks. As a representative of the Board of Directors of Valley AgCredit, I am writing to provide our collective position on the national charter issue.

Valley AgCredit as part of the cooperative Farm Credit System, is owned and governed by nearly 2000 farmers and ranchers located primarily in the Southern San Joaquin Valley region of California.

Recently, the Farm Credit Administration proposed regulations that would provide farmers with the ability to choose from a wide range of FCS lenders like Valley AgCredit. The proposed regulation would allow FCS lenders to apply for a national charter to better serve agricultural producers.

Valley AgCredit and its members strongly support vigorous competition among farm lenders. The FCA's regulatory proposal would result in farmers gaining the flexibility to seek financing from the Farm Credit lender that best suits their individual needs. As a result it will increase the competition for farm loans and result in improved efficiency of those providing this service.

The regulation would also allow our institution to diversify its agricultural portfolio. By lending across a broader geographic area, we will be able to diversify risk, while maintaining farmer control over our lending cooperative. This diversification will make our institution stronger and better able to serve our customers in good times and bad. And while geographic diversification is important, we are committed to ensure that producers in our local service area, including young, beginning and small producers, continue to receive the primary focus of our institution's lending effort.

On behalf of Valley AgCredit and its many members, I hope you will support this important initiative for farmers.

Sincerely,

Donald E. Ludy, Director

cc:	Jesse Helms	Craig Thomas	Patrick Leahy	Zell Miller
	Thad Cochran	Wayne Allard	Kent Conrad	Debbie Stabenow
	Mitch McConnell	Tim Hutchinson	Thomas Daschle	Ben Nelson
	Pat Roberts	Mike Crapo	Max Baucus	Mark Dayton
	Peter Fitzgerald	Tom Harkin	Blanche Lincoln	

AGAMERICA FCB
Western Farm Credit Bank

3636 American River Drive 95864-5996
P.O. Box 13106
Sacramento, California 95813-4106
916-485-6033

James D. Kirk
President and
Chief Executive Officer

February 21, 2001

The Honorable Senator Richard Lugar
United States Senate
Washington, DC 20510

Dear Senator Lugar:

I understand that you are planning to hold a hearing on Farm Credit System (FCS) issues before the Senate Agriculture Committee. On behalf of AgAmerica, FCB and the Western Farm Credit Bank, I am writing to provide an update on FCS issues.

Since March of 1997, the AgAmerica, FCB and the Western Farm Credit Banks have been operating the two district banks under joint-management. We provide $13.7 billion in loan funds to 26 direct lending institutions, who in turn provide over $15 billion to producers in the states of Alaska, Arizona, California, Hawaii, Idaho, Iowa, Montana, Nevada, Oregon, South Dakota, Utah, Washington, and Wyoming.

Recently, the independent federal regulatory agency with oversight responsibility for FCS institutions issued regulations that would provide farmers with access to loans from a wide range of FCS lenders. That agency, the Farm Credit Administration, is proposing to allow FCS lenders to apply for a national charter to serve agricultural producers throughout the nation. Up until now, every Farm Credit lender was chartered to serve a particular territory. The Farm Credit Administration's regulatory proposal, when implemented, will remove artificial geographic barriers and allow farmers to seek financing from the Farm Credit lender that best suits their individual needs. The regulation will result in increased competition for farm loans. We recognize that varying views have been expressed that would have offered different means that may have accomplished the same result. However, we reaffirm our support for this philosophical direction as positioning the FCS to best respond to trends in agriculture and the financial markets.

As farming continues to change, so must the Farm Credit System. Perhaps the three most significant trends in agriculture today are the economy, the changing role of government, and vertical integration. Each affects how the FCS works with farmers and ranchers. For the FCS to compete, it must focus on the needs of its borrowers, it must provide added value, it must be easy and accessible to work with, and most importantly, it must have the ability to follow the customer across current chartered territories. The entire Farm Credit System must be more flexible. We believe that the FCS must be afforded the opportunity to move forward in exploring structural changes and improving the delivery of financial

products and services – whether there are district lines between funding banks, or lines between associations – so that we can better serve our borrowers and compete in the market. It will impede our progress if we try to hold onto a charter design that was established so many years ago.

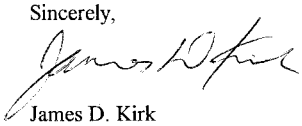
The changes taking place in the agricultural finance industry are creating greater levels of competition. The combination of consolidation and technology enable our competitors to present even more formidable challenges to Farm Credit direct lenders than they have posed in the past. Today, with the exception of borrowing from the Farm Credit System, farmers have the ability to access financing from whatever financial institution that might best serve their needs, regardless of geography. We support the concept of customers having a choice in selecting Farm Credit financing opportunities.

From our standpoint, the regulation will allow our institutions to which we loan funds the ability to diversify their agricultural portfolio. As a single sector (agriculture) lender, we are exposed to concentrated risk. By lending across a broader geographic area, we will be able to diversify some of that risk.

We strongly support providing farmers with more options for financing. We believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in Farm Credit System institutions. At the same time, it will ensure that we continue to focus primarily on serving the farmers and ranchers of our local service area.

We hope you share our support for this important initiative. We would be pleased to discuss this issue in more depth at your convenience.

Sincerely,



James D. Kirk

cc: Senate Agriculture Committee
House Agriculture Committee
Western Association CEOs
AgAmerica Association CEOs

Dear Senator Lugar,

I am writing to express support for the Farm Credit Administration's proposed regulation to grant National Charters. As a borrower of the system and also a member of the board of directors of AGRIBANK FCB, I feel this is a positive step for Farm Credit.

I believe the National Charter initiative is a positive step by the agency to remove unnecessary regulatory constraints on System institutions. There is a real need to remove outdated geographic constraints, which only hinder efforts by System institutions to provide value to their borrower owners.

We understand that the FCA's National Charter initiative is being opposed by banking groups. We believe the banker's arguments against this positive initiative are without merit. In our view the bankers appear much less concerned about the welfare of American agriculture than they are with their own bottom line.

We believe the bankers are once again attempting to interfere with the way our credit institutions are structured and operate. The Farm Credit Administration's proposed rule would allow farmers – those who own the associations – to decide. This may not be a popular idea among commercial bankers but it makes a great deal of sense for American agriculture.

I ask that you support National Charters if the issue comes before the Senate Agriculture Committee.

Please Contact me if you have any questions about National Charters and the Farm Credit System.

Yours sincerely,

Carl Higbea
03600 Domersville Rd.
Defiance, Ohio 43512

Phone (419) 428-3035

Farm Credit of Maine, ACA

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Southern Region and Executive Office
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February 22, 2001

The Honorable Richard Lugar, Chairman
Agricultural, Nutrition and Forestry Committee
United States Senate
306 Hart Senate Office Building
Washington, DC 20510

Dear Senator Lugar:

We understand that the Senate Agriculture Committee will hold a hearing on Farm Credit System (FCS) issues in the coming weeks. As an elected board member of Farm Credit of Maine, ACA, I am writing to provide an update on FCS issues.

I am associated with Highland Farms, Inc., a family-owned dairy farm milking 260 registered Jerseys in York County. Farm Credit of Maine, ACA is a cooperative, owned and governed by the farmers and producers like me. Farm Credit of Maine, ACA is part of the Farm Credit System. Farm Credit of Maine, ACA provides loans and related services to producers in our local area.

Recently, the Farm Credit Administration proposed regulations that would provide farmers with the ability to choose from a wide range of FCS lenders like mine. The proposed regulation would allow FCS lenders to apply for a national charter to better serve agricultural producers.

As a producer and as a board member of Farm Credit of Maine, ACA, I strongly support vigorous competition among farm lenders. I believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in Farm Credit System institutions.

The FCA's regulatory proposal would result in farmers gaining the flexibility to seek financing from the Farm Credit lender that best suits their individual needs. As a result it will increase the competition for farm loans.

The regulation also would allow our institution to diversify its agricultural portfolio. By lending across a broader geographic area, we will be able to diversify some of our risk, while maintaining farmer control over our lending cooperative. This diversification will make our institution stronger and better able to serve our customers in good times and bad. And while geographic diversification is important, as a farmer-elected board member, I will ensure that producers in our local area, including young, beginning and small producers, continue to receive the primary focus of our institution's lending effort.

I hope you support this important initiative for farmers.

Sincerely,

Allaire P. Palmer

Allaire P. Palmer
Director

Farm Credit of Maine, ACA

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February 22, 2001

The Honorable Richard Lugar, Chairman
Agricultural, Nutrition and Forestry Committee
306 Hart Senate Office Building
Washington, DC 20510

Dear Senator Lugar:

We understand that the Senate Agriculture Committee will hold a hearing on Farm Credit System (FCS) issues in the coming weeks. As an elected board member of Farm Credit of Maine, ACA, I am writing to provide an update on FCS issues.

I am the owner and operator of Daniel Corey Farms and Nu-Seed Corporation in Aroostook County. I do business with potato farmers both in Maine and down the eastern seaboard. Farm Credit of Maine, ACA is a cooperative, owned and governed by the farmers and producers like me. Farm Credit of Maine, ACA is part of the Farm Credit System. Farm Credit of Maine, ACA provides loans and related services to producers in our local area.

Recently, the Farm Credit Administration proposed regulations that would provide farmers with the ability to choose from a wide range of FCS lenders like mine. The proposed regulation would allow FCS lenders to apply for a national charter to better serve agricultural producers.

As a producer and as a board member of Farm Credit of Maine, ACA, I strongly support vigorous competition among farm lenders. I believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in Farm Credit System institutions.

The FCA's regulatory proposal would result in farmers gaining the flexibility to seek financing from the Farm Credit lender that best suits their individual needs. As a result it will increase the competition for farm loans.

The regulation also would allow our institution to diversify its agricultural portfolio. By lending across a broader geographic area, we will be able to diversify some of our risk, while maintaining farmer control over our lending cooperative. This diversification will make our institution stronger and better able to serve our customers in good times and bad. And while geographic diversification is important, as a farmer-elected board member, I will ensure that producers in our local area, including young, beginning and small producers, continue to receive the primary focus of our institution's lending effort.

I hope you support this important initiative for farmers.

Sincerely,

Daniel J. Corey
Director

Valley Federal Land Bank Association, FLCA
Valley Production Credit Association

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(559) 627-5050, FAX: (559) 627-4728

Valley AgCredit

February 22, 2001

The Honorable Richard G. Lugar
United States Senate
Washington, DC 20510

Dear Senator Lugar:

I understand that the Senate Agriculture Committee will hold a hearing on Farm Credit System (FCS) issues in the coming weeks. On behalf of Valley AgCredit, I am writing to provide input on a selected FCS issue.

Valley AgCredit provides $850 million in loans to over 2000 farmers and ranchers within its local service area, primarily in the California counties of Tulare, Kings and Kern. Our institution is a cooperative, owned and governed by the farmers and ranchers we serve, and is part of the Farm Credit System.

Recently, the independent federal regulatory agency with oversight responsibility for FCS institutions issued regulations that would provide farmers with the ability to choose among a wide range of FCS lenders like Valley AgCredit. That agency, the Farm Credit Administration, is proposing to allow FCS lenders to apply for a national charter to serve agricultural producers throughout the nation. Up until now, every Farm Credit lender was chartered to serve a particular territory. The Farm Credit Administration's regulatory proposal, when implemented, would remove artificial geographic barriers and allow farmers to seek financing from the Farm Credit lender that best suits their individual needs.

The proposed regulation would allow our institution to diversify its agricultural portfolio. As a single sector lender, we are exposed to concentrated risk. By lending across a broader geographic area, we will be able to diversify some of that risk. This diversification will make our institution stronger and better able to serve our customers in good times and bad. In addition, it would allow us to follow our customers to places outside of the local service area when they change or expand their operations.

We strongly support providing farmers with more options for financing. We believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in Farm Credit System institutions. At the same time, it will ensure that we continue to focus primarily on serving the farmers and ranchers of our local service area.

I hope you support this important initiative. It is in the best interest of farmers, ranchers and rural America. I would be pleased to discuss this issue in more depth at your convenience.

Sincerely,

J. Allen Akkerman, President

cc:	Jesse Helms	Craig Thomas	Patrick Leahy	Zell Miller
	Thad Cochran	Wayne Allard	Kent Conrad	Debbie Stabenow
	Mitch McConnell	Tim Hutchinson	Thomas Daschle	Ben Nelson
	Pat Roberts	Mike Crapo	Max Baucus	Mark Dayton
	Peter Fitzgerald	Tom Harkin	Blanche Lincoln	

Farm Credit of Maine, ACA

Aroostook Region
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FAX: 207/784-0195

February 22, 2001

The Honorable Richard Lugar, Chairman
Agricultural, Nutrition and Forestry Committee
United States Senate
306 Hart Senate Office Building
Washington, DC 20510

Dear Senator Lugar:

We understand that the Senate Agriculture Committee will hold a hearing on Farm Credit System (FCS) issues in the coming weeks. As an elected board member of Farm Credit of Maine, ACA, I am writing to provide an update on FCS issues.

I am the owner of McPherson Timberlands, Inc., a forest products company that conducts business throughout the State of Maine. I maintain contact with forestry businesses throughout the United States. Farm Credit of Maine, ACA is a cooperative, owned and governed by the farmers and producers like me. Farm Credit of Maine, ACA is part of the Farm Credit System. Farm Credit of Maine, ACA provides loans and related services to producers in our local area.

Recently, the Farm Credit Administration proposed regulations that would provide farmers with the ability to choose from a wide range of FCS lenders like mine. The proposed regulation would allow FCS lenders to apply for a national charter to better serve agricultural producers.

As a producer and as a board member of Farm Credit of Maine, ACA, I strongly support vigorous competition among farm lenders. I believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in Farm Credit System institutions.

The FCA's regulatory proposal would result in farmers gaining the flexibility to seek financing from the Farm Credit lender that best suits their individual needs. As a result it will increase the competition for farm loans.

The regulation also would allow our institution to diversify its agricultural portfolio. By lending across a broader geographic area, we will be able to diversify some of our risk, while maintaining farmer control over our lending cooperative. This diversification will make our institution stronger and better able to serve our customers in good times and bad. And while geographic diversification is important, as a farmer-elected board member, I will ensure that producers in our local area, including young, beginning and small producers, continue to receive the primary focus of our institution's lending effort.

I hope you support this important initiative for farmers.

Sincerely,

Henry E. McPherson

Henry E. McPherson
Director

Lending to Maine's Agricultural, Aquatic and Forest Products Industries
Part of the Farm Credit System

Idaho Agricultural Credit Association

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Toll Free: 1-800-686-8910
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February 21, 2001

Senate Agriculture, Nutrition, and Forestry Committee
Washington, D.C. 20510

Richard Luger, IN. Chairman	Tom Harkin, IA. Ranking Member
Mike Crapo, ID.	Patrick Leahy, VT.
Jesse Helms, NC.	Kent Conrad, ND.
Thad Cochran, MS.	Thomas Daschle, SD.
Mitch McConnell, KY.	Max Baucus, MT.
Pat Roberts, KS.	Blanche Lincoln, AR.
Peter Fitzgerald, IL	Zell Miller, GA.
Craig Thomas, WY.	Debbie Stabenow, MI.
Wayne Allard, CO.	Ben Nelson, NE.
Tim Hutchinson, AR.	Mark Dayton, MN.

Honorable Senators:

Our Association is a chartered entity, Idaho Agricultural Credit Association (IACA), in the Farm Credit System and covers 24 counties in Idaho and 2 counties in Wyoming. We wish to express our concerns regarding the Farm Credit System issue of "National Charters".

The Board of Directors of IACA has been opposed to the National Charter concept for Farm Credit System institutions since the idea was conceived in 1998.

Our primary concerns and reasons for opposition are outlined as follows:

1. The overall Farm Credit System is in the best shape financially that it has been in, in its entire history and it gained that status without National Charters.
2. A drastic move to National Charters has the potential to cause disruption in the System, being detrimental to some institutions and their borrowers.
3. The National Charter issue appears to be a "forced merger mandate" without regard to individual institution stockholders, the result of which will favor the "large", whether institution or individual borrowers at the expense of the "small", whether institution or individual borrowers.

We appreciate the opportunity to express our views and apologize for the lateness of our input.

Respectfully Submitted
Idaho Agricultural Credit Association

Raymond Parks
Chairman of the Board of Directors

RP:as

First South
Agricultural Credit Association

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Ridgeland, Mississippi 39158-6008
(601) 977-8381 Fax (601) 977-8388

February 22, 2001

The Honorable Richard Lugar
Chairman
Senate Committee on Agriculture, Nutrition and Forestry
SR 328A
Washington, D.C. 20510

Dear Mr. Chairman:

We are writing in anticipation of the Senate Ag Committee hearing scheduled for February 26, 2001 on the Farm Credit Administration's ("FCA's") national charter initiative. We appreciate your and the Senate Ag Committee taking time to review the Farm Credit Administration's efforts to bring the benefits of competition to the Farm Credit System. We understand that the Farm Credit Council is organizing a letter writing campaign in favor of the national charters initiative. We believe that it is important for Congress to understand how the Farm Credit Administration's efforts impact farmers and ranchers in the states of Alabama, Louisiana and Mississippi, which our association serves. We request that this letter be made part of the record of the committee's hearing.

Currently, the Farm Credit System consists of associations with differing lending authorities both as to the type of loans that can be made and the territory in which such loans can be made. Some of these associations are tax-exempt and receive the full benefits of Government Sponsored Enterprise ("GSE") status; others are taxable and do not receive the full benefits of GSE status. There are often overlaps between lending authorities and overlaps in territory. Where competition exists within the system often the playing field is not level because taxable associations are competing against tax-exempt associations or because one association's greater lending authority gives it an unfair advantage over another association. Associations that benefit from this situation want to keep the status quo. Associations that are being discriminated against, and farmers and ranchers who would benefit from fair competition, want change. In short, it is a mess and there is no consensus on how to fix it.

Our association is chartered to provide loans with terms up to 10 years in Alabama, Louisiana and Mississippi. Tax-exempt Federal Land Credit Associations ("FLCAs") located in Alabama, Louisiana and Mississippi and associated with the Texas Farm Credit Bank have the power to make loans with terms of 5 years and above. Since they are tax-exempt entities, they have the full benefits of GSE status, and they have broader lending authority, the Texas Farm Credit bank and its FLCAs have an unfair competitive advantage, especially in loans with terms of 5 to10 years. The Texas Farm Credit Bank has fought all attempts to bring the benefits of fair competition from our association and from associations in other parts of the country to these three states.

In July 1998 FCA adopted a Philosophy Statement that proposed the elimination of territorial restrictions on lending and also proposed giving all Farm Credit System associations the same lending authorities. We believe competition is beneficial and, thus, we supported FCA's Philosophy Statement provided that it was implemented uniformly in all states and in a manner that created a level playing field

February 22, 2001
The Honorable Richard Lugar
Page Two

among competing associations. FCA's first attempt to implement the Philosophy Statement was the adoption of a Participation Regulation that permitted system associations to participate in agricultural loans made by commercial banks anywhere in the country. Under the Participation Regulation our association could work with commercial banks in Alabama, Louisiana and Mississippi to provide a competitive alternative for borrowers in these states on loans with terms over 10 years. The Texas Farm Credit Bank and its FLCAs have attacked the Participation Regulation in federal court, and it may be several months before the case is decided.

The national charters initiative is FCA's second attempt to implement the Philosophy Statement. This time FCA attempts to avoid conflict with the Texas Farm Credit Bank by making the national charters regulation not apply in Alabama, Louisiana and Mississippi.[1] If the attack on the Participation Regulation is unsuccessful, then there will still be some means available to bring the benefits of competition to these states. On the other hand, if the Texas Farm Credit Bank's attack on the Participation Regulation is successful and if FCA presses forward with the national charters initiative in its present form, the Texas Farm Credit Bank and its affiliated FLCAs will have a monopoly on tax-exempt, GSE agricultural lending in Alabama, Louisiana and Mississippi. As a result, states with a high percentage of young, beginning and minority farmers who would benefit most from a choice of tax-exempt, GSE agricultural lenders will be deprived of this opportunity. We believe that an independent economic impact study would confirm the need for a choice of tax-exempt, GSE lenders in these states, but it is our understanding that no economic impact study has been conducted. We believe that such a study should be conducted.

Because the outcome of the Participation Regulation is closely tied to the impact the national charters initiative will have on Alabama, Louisiana and Mississippi, we believe that FCA should delay implementation until this litigation is decided or find another way to address this situation that does not discriminate against farmers in these states.

Sincerely,

FIRST SOUTH ACA BOARD OF DIRECTORS

R. K. Laird
Chairman

James F. Martin, Jr.
Vice Chairman

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[1]FCA bases the exclusion on certain provisions of the 1992 amendments to the Farm Credit Act. Even assuming that the 1992 amendments present some legal issues, FCA has other alternatives available for implementing the Philosophy Statement that do not discriminate against farmers in these three states.

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February 21, 2001

The Honorable Richard Lugar
United States Senate
Washington, DC 20510

Dear Senator Lugar:

With the Senate Agricultural Committee holding a hearing on Farm Credit System (FCS) issues this next week or in the near future, I want to express my position on the proposed National Charters Booklet. I am employed by AgCountry Farm Credit Services, and believe approval of the proposed regulation enabling National Charters for Farm Credit Services associations is in the best interest of the 5600 farmer owners of AgCountry Farm Credit Services. AgCountry is a farmer owned credit cooperative providing over $900 million in operating, term, and real estate loans plus numerous financial services.

On May 3, 2000 the Farm Credit Administration issued a booklet entitled National Charters that would provide Farm Credit Services Associations the ability to apply for and receive National Charters. This proposal will provide farmers with the right to choose which Farm Credit institution they do business with. Currently, associations are limited to serving a specific geographic territory. Agriculture has changed dramatically in recent years with many farmers and agricultural businesses operating over wide geographic areas. The Farm Credit Administration's proposal to allow FCS lenders to apply for national charters will remove artificial geographic boundaries, and allow farmers to seek financing from the Farm Credit lender that best suits their individual needs. **Farmers have always had the right to do business with any other financial services provider regardless of where it is located and should have the same right to choose between Farm Credit institutions.**

The proposals that are established in the National Charters booklet would also allow associations to diversify lending risk over a wider geographic area. As a single sector lender (agriculture), Farm Credit associations are exposed to concentration risk geographically, and by type of enterprise. By having the right to diversify over a larger geographic area, associations can better mitigate both geographic and enterprise type risk. This clearly provides benefits for our farmer-owners by enabling a stronger institution to serve them. Without implementation of the National Charters booklet, many associations may be forced to consider merging to help reduce concentration risk.

Implementation of National Charters should increase options for farmers, improve efficiency through competition, and strengthen the safety and soundness of our institution. At the same time, the Farm Credit Administration proposal ensures that we focus on providing a full-range of financial services to farmers in our local service area.

We hope you share our support for this important initiative. We always appreciate your willingness to listen and support our farmers and their Farm Credit associations.

Sincerely,

Jeremy Oliver
Sr VP-Corporate Finance & Information Services

Farm Credit of Maine, ACA

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February 22, 2001

The Honorable Richard Lugar, Chairman
Agricultural, Nutrition and Forestry Committee
United States Senate
306 Hart Senate Office Building
Washington, DC 20510

Dear Senator Lugar:

We understand that the Senate Agriculture Committee will hold a hearing on Farm Credit System (FCS) issues in the coming weeks. On behalf of Farm Credit of Maine, ACA, I am writing to provide an update on FCS issues.

Our cooperative has over $300 million in commitments to Maine agriculture, forestry and commercial fishing enterprises. Our institution is a cooperative owned and governed by family businesses that we serve. We are part of the national Farm Credit System.

Recently, the independent federal regulatory agency with oversight responsibility for FCS institutions issued regulations that would provide farmers with the ability to choose among a wide range of FCS lenders like mine. That agency, the Farm Credit Administration, is proposing to allow FCS lenders to apply for a national charter to serve agricultural producers throughout the nation. Up until now, every Farm Credit lender was chartered to serve a particular territory. For us, that territory is the State of Maine. The Farm Credit Administration's regulatory proposal, when implemented, would remove artificial geographic barriers and allow farmers to seek financing from the Farm Credit lender that best suits their individual needs. The regulation will result in increased competition for farm loans.

The proposed regulation would allow our institution to utilize our expertise in the forest products lending and to follow our customers as they expand their businesses outside of our chartered territory. In addition, by lending across a broader geographic area in close cooperation with other Farm Credit lenders, we will be able to diversify the risk in our portfolio. This diversification will make our institution stronger and better able to serve our customers in good times and bad.

We believe the Farm Credit Administration regulation could increase efficiency throughout the Farm Credit System.

We hope you share our support for this important initiative. We would be pleased to discuss this issue in more depth at your convenience.

Sincerely,

Raymond J. Nowak
President and CEO

Farm Credit of Maine, ACA

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February 22, 2001

The Honorable Richard Lugar, Chairman
Agricultural, Nutrition and Forestry Committee
United States Senate
306 Hart Senate Office Building
Washington, DC 20510

Dear Senator Lugar:

We understand that the Senate Agriculture Committee will hold a hearing on Farm Credit System (FCS) issues in the coming weeks. As Chairman of the Board of Directors of Farm Credit of Maine, ACA, I am writing to provide an update on FCS issues.

I am the owner of three stern trawlers that harvest shrimp and groundfish. Farm Credit of Maine, ACA is a cooperative, owned and governed by the farmers and producers like me. Farm Credit of Maine, ACA is part of the Farm Credit System. Farm Credit of Maine, ACA provides loans and related services to producers in our local area.

Recently, the Farm Credit Administration proposed regulations that would provide farmers with the ability to choose from a wide range of FCS lenders like mine. The proposed regulation would allow FCS lenders to apply for a national charter to better serve agricultural producers.

As a producer and as a board member of Farm Credit of Maine, ACA, I strongly support vigorous competition among farm lenders. I believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in Farm Credit System institutions.

The FCA's regulatory proposal would result in farmers gaining the flexibility to seek financing from the Farm Credit lender that best suits their individual needs. As a result it will increase the competition for farm loans.

The regulation also would allow our institution to diversify its agricultural portfolio. By lending across a broader geographic area, we will be able to diversify some of our risk, while maintaining farmer control over our lending cooperative. This diversification will make our institution stronger and better able to serve our customers in good times and bad. And while geographic diversification is important, as a farmer-elected board member, I will ensure that producers in our local area, including young, beginning and small producers, continue to receive the primary focus of our institution's lending effort.

I hope you support this important initiative for farmers.

Sincerely,

Robert M. Tetrault

Robert M. Tetrault
Chairman of the Board of Directors

Farm Credit Services

February 15, 2001

Senator Richard Lugar
306 Hart Senate Office Building
Washington, D. C. 20510

Dear Senator Lugar:

I am writing on behalf of Farm Credit Services of Mid-America and the more than 60,000 farmers and rural residents in Ohio, Indiana, Kentucky and Tennessee that we serve to express support for Farm Credit Administration's proposed regulation on National Charters. Our association supports National Charters. We believe that National Charters would remove unneeded and counter productive regulatory restrictions on our operations.

Lobbyists for the commercial bankers are complaining about this proposal. These same bankers have vigorously sought and received massive deregulation by acts of Congress and their own regulators. Underlying the bankers' complaints about National Charters is fear of competition. But this increased competition will be to the benefit of farmers and rural America.

FCS borrowers should be able to choose their System lender. This regulation would help American farmers do so while at the same time updating and making more efficient their credit cooperative. Our associations and others throughout the nation are in full support of the National Charters initiative. We ask that you support this initiative as well.

We understand the Senate Agriculture Committee will be holding a hearing on National Charters. We hope that you will keep in mind that National Charters would provide substantial benefits to Indiana farmers by removing outdated and unnecessary restrictions on the operations of their credit provider.

Please feel free to contact me if you would like additional information on this subject.

Thank you for your consideration.

Yours sincerely,

Donnie Winters
President and CEO

DW/dmo

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February 22, 2001

Senator Richard Lugar
306 Hart Senate Office Building
Washington, DC 20510

Dear Senator Lugar:

I am writing on behalf of Farm Credit Services of Western Missouri to express support for the Farm Credit Administration's (FCA) proposed regulation on National Charters. Our association supports National Charters. We believe that National Charters would remove unneeded and counter-productive regulatory restrictions on our operations.

As one might expect, lobbyists for commercial bankers are complaining about this proposal to remove a regulatory burden on Farm Credit. In recent years, these same bankers vigorously sought and received massive deregulation by acts of Congress and their own regulators. Underlying the bankers complaints about National Charters is fear of competition. But who pays if these restrictions on Farm Credit remain? The answer is the 600,000 farmers, ranchers and other borrowers who now depend upon Farm Credit for financial services.

Farm Credit System borrowers should be able to choose their System lender. This regulation would help American farmers do so while at the same time updating and making more efficient their credit owned cooperative. Our associations and others throughout the nation are in full support of the National Charters initiative. We ask that you support this initiative as well.

We understand the Senate Agriculture Committee will be holding a hearing on National Charters. If so, we hope that you, as a member of the Senate Agriculture Committee, will keep in mind that National Charters would provide substantial benefits to American farmers by removing outdated and unnecessary restrictions on the operations of their credit provider.

Please feel free to contact me if you would like additional information on this subject.

Thank you for your consideration.

Sincerely,

Daryl Oldvader

Daryl Oldvader
Chief Executive Officer

February 19, 2001

agstar.com

February 19, 2001

Richard Lugar
306 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Lugar,

This letter serves to express my support for the Farm Credit Administration's proposed regulation to grant National Charters for System institutions. I am an employee of AgStar Financial Services, headquartered in Mankato, Minnesota. We firmly believe that National Charters are in the best interests of farmers across the United States as they strive to remain competitive in the global marketplace.

Not surprisingly, lobbyists for commercial banks oppose the proposed regulation. The concerns they have expressed thinly mask their fears of increased competition and do not address the right that all farmers should have to choose which Farm Credit institution they work with. If National Charters are not issued, this could cause System institutions to contract and inhibit their ability to serve the marketplace as agriculture continues to evolve at a rapid pace. Finally, confining System institutions to specific geographic areas exposes them to additional risk. Years ago, commercial banks lobbied to have their own geographic restrictions lifted. Evidently, what's good for the goose isn't what's good for the gander when it comes to open markets and free enterprise?

In summary, FCA's proposed regulation is solid public policy that our clients support. We urge you to support this regulation change when it comes before your committee. Please don't hesitate to contact me if you'd like to discuss National Charters for the Farm Credit System.

Thanks in advance for your consideration and support.

Best regards,

Jim McKissick
Vice President of Brand Marketing & Communications
AgStar Financial Services, ACA

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February 20, 2001

The Honorable Richard Lugar
Chairman, Senate Agriculture, Nutrition, and Forestry Committee
United States Senate
Washington, DC 20510

Dear Senator Lugar:

It has come to my attention that the Senate Agricultural Committee will hold a hearing on Farm Credit System (FCS) issues this next week or in the near future. On behalf of the 5600 farmer-owners of AgCountry Farm Credit Services I am writing to provide input on some of the current issues.

AgCountry is a farmer-owned credit cooperative and is the largest provider of agricultural credit in the area we currently serve (west central Minnesota and southeast North Dakota) providing over $900 million in operating, term, and real estate loans plus numerous financial services.

Recently, the Farm Credit Administration issued regulations that would provide farmers with the right to choose which farm credit institution they do business with. Currently, associations are limited to serving a specific geographic territory. Agriculture has changed dramatically in recent years with many farmers' operations and involvement in joint ventures reaching over a wide geographic area. The Farm Credit Administration's proposal to allow FCS lenders to apply for national charters would remove artificial geographic boundaries and allow farmers to seek financing from the Farm Credit lender that best suits their individual needs. **Farmers have always had the right to do business with the commercial bank of their choice regardless of where the bank is located. It is time that they had the same right to choose between farm credit institutions.**

The proposed regulation would also allow our association to diversify our risk. As a single sector lender (agriculture), we are exposed to concentration risk. By having the right to diversify over a larger geographic area, we can mitigate that risk providing our farmer-owners with a stronger institution better able to serve them during good times and bad. Without this regulation, many associations may be forced to consider merging with others to form multi-state associations to reduce risk. This regulation would allow them to stay independent and maintain local control if they chose to by expanding their geographic reach to reduce risk.

We strongly support providing farmers with more financing options, not less. We believe the Farm Credit Administration regulation will increase efficiency and strengthen safety and soundness in our institution. At the same time, the regulation ensures that we continue to focus primarily on farmers in our local service area.

We hope you share our support for this important initiative. I would be pleased to discuss this issue with you or one of your staff at your convenience.

Sincerely,

Don E. Wenell

Don E. Wenell , CEO