



*The World's Largest Open Access Agricultural & Applied Economics Digital Library*

**This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.**

**Help ensure our sustainability.**

Give to AgEcon Search

AgEcon Search

<http://ageconsearch.umn.edu>

[aesearch@umn.edu](mailto:aesearch@umn.edu)

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

*No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.*

# Up and Down the Hill



*This Spring the American Bankers Association and the Independent Bankers Association of America issued the following proposal, "The Rural Economic Development Partnership." It is the intention of both the ABA and the IBAA to persuade Congress to examine the proposal with the intention of creating legislation that would create a new funding source for commercial banks that serve rural Americans. What follows is a description of the proposal.*

Rural banks are currently hampered in their ability to meet the long-term credit needs of their communities because of the mismatch between the characteristics of their deposit base and the types of credit needed in the market. Rural banks hold primarily short-term deposits while meaningful rural economic development requires substantial quantities of long-term capital.

In the housing arena, the Federal Home Loan Bank System has successfully addressed this mismatch by facilitating financial institution access to the agency markets. We propose to replicate the success of the Federal Home Loan Bank System in the rural and agricultural development sphere using a redirected and re-focused Farm Credit System. Under this proposal, Farm Credit Banks will act as conduits between the agency markets and commercial banks so that those institutions can more readily provide long-term funds for rural and agricultural development as well as other competitively priced rural credit needs.

In order to ensure the System maintains its agricultural and rural focus, commercial bank participation will be limited to those institutions holding at least 10% of their assets in agricultural and rural development loans. Additionally, Farm Credit System Associations would remain structured exactly as they are today and could still access funds through the Farm Credit Banks.

## **New Roles for Rural Lenders**

The proposal envisions new roles for the current players in the rural credit delivery system.

- Farm Credit Banks will become limited purpose, wholesale lenders for commercial banks and FCS associations and will retain no retail lending ability.



- FCS associations will remain limited purpose lenders unless they choose to exit the System in the manner stipulated by current law.

- Commercial bank members will remain autonomous institutions, regulated by their current regulators, and will not be subject to regulation by the Farm Credit Administration.

### **Advantages of Membership**

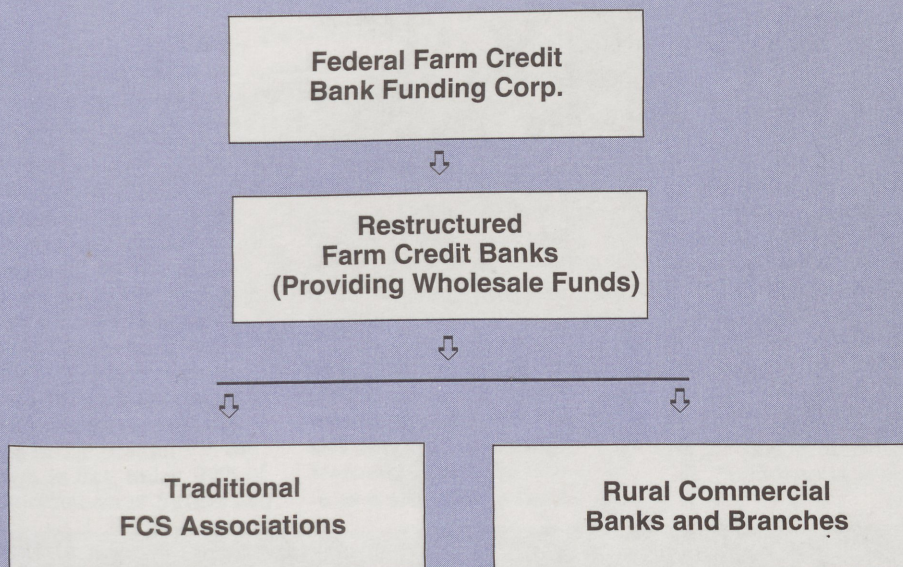
Access to the agency markets will allow the Farm Credit Banks to obtain funds at near Treasury rates and to pass those funding advantages on to their commercial bank and association members through advances for such loans each institution is permitted to make. Also, Farm Credit Banks will facilitate member asset/liability management by providing funds that match the maturity of member agricultural and rural development loans. Finally, access to Farm Credit Bank advances will provide greater liquidity, where needed, to member institutions, further facilitating the provision of rural credit.

### **Capitalization of Farm Credit Banks**

As in the Home Loan Bank System, new commercial bank participants will be required to capitalize their local Farm Credit Bank by purchasing stock from that Bank. At a minimum, banks will be required to purchase stock in an amount equal to .1% of their aggregate unpaid loan principal, but not less than \$1,000. For purposes of a mandatory stock purchase calculation, "aggregate loan principal" will include the principal of the institution's rural loans for agricultural or aquatic purposes, rural housing loans in rural areas with communities not in excess of 2,500 inhabitants, loans for farm-related services, and loans for rural economic development.

Also, as in the Federal Home Loan Bank System, a commercial bank drawing down advances from a Farm Credit Bank will be further required to maintain a capital investment in the Farm Credit Bank in an amount equal to at least 5% of outstanding advances. Capital stock purchased for purposes of the minimum stock subscription noted above will qualify as

## **FLOW OF FUNDS FROM CAPITAL MARKETS TO RURAL DELIVERY NETWORK**





capital eligible to meet the 5% of outstanding advances rule. Though Farm Credit Bank liabilities will be the joint and several responsibility of all of the Farm Credit Banks, member institutions will have only their Farm Credit Bank stock investment at risk.

It should be noted that stockholder institutions will be eligible to receive dividends on all stock purchased from the Farm Credit Banks.

### **Types of Capital Allowed as Collateral**

As in the Federal Home Loan Bank System, member commercial banks will obtain advances from the Farm Credit Banks by pledging eligible assets as collateral for those advances. Those assets will reflect the continued rural focus of the Farm Credit System. Eligible collateral will include whole first mortgages on agricultural real estate, Fannie Mae, Freddie Mac, Ginnie Mae and Farmer Mac securities, deposits of a Farm Credit Bank, loans to agricultural producers, harvesters of aquatic products, rural housing loans, economic development loans or securities representing a whole interest in such loans as well as, on a limited basis, other related collateral acceptable to the Farm Credit Banks.

### **Farm Credit Bank Governance**

Each Farm Credit Bank will be governed by a 12 member board of directors, eight

of whom will be elected by the members of the Bank. At least one board member of each Farm Credit Bank, either elected or appointed, will be a representative of a state or nationally chartered bank.


To ensure that the Banks remain true to their public mission of encouraging access to credit for rural development, at least four directors will be appointed by the Farm Credit Administration. Appointed directors will be barred, during their term of office, from serving as an officer of any Farm Credit Bank or as director or officer of any member of a Bank or holding shares, or any other financial interest in, any member of a Bank.

Elected board members will serve for two year terms for a maximum of three terms while appointed directors shall serve for four year terms. Board members shall be compensated for their time as determined by the board and approved by the Farm Credit Administration.

### **Exiting the System**

Commercial bank members wishing to exit the system will receive payment for their shares from their Farm Credit Bank in an amount equal to the par or book value of those shares, whichever is less. Members choosing to leave the System will not be allowed to reenter the system for 5 years. ▲





**"How does a risk-avoiding ag lender like me  
lend money to a risk-taking farmer? Very carefully."**

Steve Hatz, Ag lender  
First Tier Bank  
Omaha, Nebraska

"When we look at equity and assets, we always want to know what's your marketing plan and do you use futures? I know a farmer has to be a risk taker. So we look very closely at how he's managing his risk. We'll advance more to our customers who have strong hedge positions in the market. In fact, today, 90% of our customers use futures and

options. Not just to be sophisticated...but because part of the whole process today is to use the tools you need to grow."

Steve Hatz, and many like him, believe in limiting risk by using the price management tools of the '90s—futures and options. The Chicago Mercantile Exchange lists futures and options on live

cattle, feeder cattle, pork bellies, hogs and broiler chickens. For a risk manager's tool kit that includes information on futures and options and the latest contract specifications, call 1-800-331-3332.



**CHICAGO MERCANTILE EXCHANGE®**  
The Exchange of Ideas®