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Bert Ely's

# FARM CREDIT WATCH

(May 2001)

## Treasury to FCA: Withdraw National Charters

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On May 2, 2001, the Treasury Department commented to Mike Reyna, chairman of the Farm Credit Administration (FCA), on the FCA's National Charters proposal.

Treasury's comment letter was starkly clear – don't authorize National Charters. Harking back to concerns about National Charters that Treasury expressed in written testimony it submitted to the House Banking Committee last October, Donald Hammond, acting undersecretary of the Treasury for Domestic Finance, stated that "we continue to have those concerns and recommend that the FCA withdraw this proposal." The FCA has not yet responded to Treasury's very pointed letter. Treasury outlined three reasons for opposing National Charters. Those reasons are worth summarizing because they strongly echo *FCW*'s criticisms of the proposal.

First, Treasury questioned "whether allowing national charters

would improve safety and soundness" in the FCS. It correctly noted that "in a cooperative network of lending associations that are jointly and severally liable for each other's debts, encouraging intra-System competition might be counterproductive to safety and soundness. ...

Consequently, price competition among associations for the same borrower can only lead to a reduction in margins, which will tend to decrease, not increase, safety and soundness." As *FCW* has noted many times, FCS associations are not shy about cutting rates to grab the best ag loans. There is no reason to believe that the empire builders within the FCS will shy from stealing loans from each other.

The Treasury letter blew away the FCA's argument that National Charters will increase risk diversification within the FCS, noting that "intra-System competition does not add to the diversification of risk at the System level. ... and, by operat-

ing outside of the area in which it is familiar, national charters could increase the operational risk of some associations.”

Second, Hammond questioned “whether national charters would provide benefits to all System borrowers because national charters could threaten the System’s cooperative underpinnings. Member-owners of an association may no longer look upon each other as equal participants in the success of their lending cooperative” An FCS association “could pursue the most profitable borrowers, regardless of location, without the same sense of obligation to serve each eligible member.” Amen. “In this way, national charters may indeed be beneficial to the largest, most financially sound System members – and may be a boon to the most aggressive and expansion-minded associations” while disenfranchising other borrowers served by the FCS today. “Indeed, it is telling that FCA finds it necessary to require (as part of its proposed national charters regulation) that associations with a national charter serve their local area when the System’s structure for its entire history has been designed to ensure that outcome.” *FCW* could not have said it better.

Noting that the FCS has undergone substantial consolidation during the last 15 years, Treasury’s comment letter stated that “there may well be System members that feel that consolidation has already disenfranchised them to some degree.” The letter rejected the contention that National Charters represent the best way to enable farmers to deal with the nearest FCS office even if the farmer is located outside the office’s service area: “Surely a more simple mechanism could be devised to give eligible borrowers an option to borrow from an association geographically closer to the borrower’s place of business.”

Third, Treasury questioned “whether national charters are an appropriate response by the FCA to increase competition faced by System institutions.” Rejecting the notion that using the Internet as a credit delivery mechanism justifies National Charters, the letter

stated that "it is clear that such technological advances may give System borrowers credit options unavailable before, including options to borrow from non-System institutions. It is less clear, however, whether national charters are an appropriate response." As a GSE, "the System should exist to overcome a market failure in credit availability to agriculture. One might view the competition to System associations created by these new technologies as evidence that such market failures no longer exist." That statement gets to the heart of the issue. Is Congress listening?

Leaving the best to last, the letter concluded: "We do not find the arguments in favor of a national charter convincing. ... we believe there are strong arguments against this policy." It gets better: "As we have considered the issue in recent months, we have concluded that the arguments in favor of national charters are, in fact, arguments that the 80-year-old System is outdated and in need of reevaluation. ... Given the System's unique role as a GSE in agricultural credit markets, at its core, the national charter issue raises questions about the System's future

role in agricultural credit markets. These are critical questions, but questions that should not be answered by the FCA alone."

### ***CoBank Plans to Issue \$300 Million of Preferred Stock***

The last issue of *FCW* reported that the FCA Board authorized the AgFirst Farm Credit Bank, which serves the Southeast, to issue non-voting cumulative preferred stock to "sophisticated investors in blocks of \$100,000 or more." Not to be outdone, CoBank, the largest institution within the FCS, obtained approval from the FCA this month to issue \$300 million of nonvoting, cumulative preferred stock in two classes — term stock maturing after 15 years and perpetual stock. "Using its discretion, [the FCA] also waived clearance of the associated disclosure document, because purchasers of the securities will be large, sophisticated investors." That may be true, but it is unclear how these stock sales comport with the FCS's basic mission or with the Treasury Department's questioning of the FCS's future role in agricultural finance.

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