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**GSE Status, OFIs, The ABA/IBAA Proposal, Eligibility Regulations, FCS Powers, and The FHLB
Legislative Proposal**

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**Proceedings of a Seminar sponsored by
North Central Regional Project NC-207
“Regulatory, Efficiency and Management Issues Affecting Rural Financial Markets”
New York, NY
September 8-9, 1996**

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June 1997

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GSE Status, OFIs, The ABA/IBAA Proposal, Eligibility Regulations, FCS Powers, and The FHLB Legislative Proposal

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This panel discussion is entitled GSE³ status. However, it is virtually impossible to isolate that topic from a range of issues which interact with each other and are likely to be considered simultaneously in policy development.

I have thus included several other topics in an umbrella title. But I have assembled in this set of notes only materials related to GSE and OFI⁴ issues, for your reference. I will overview some of this material orally, though you may want to raise discussion issues on the other related topics.

I understand my assignment is to cover FCA views. However, I hereby disclaim the idea that these comments are necessarily "FCA views". The views are mine. To start, I need to clarify for you the context in which FCA or I establish our "views".

I. THE ROLE OF FCA

Farm Credit Administration (FCA) is a financial regulator, an independent agency of the Federal government. Our role is much like that of our sister Federal regulators, including the Office of Comptroller of Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the supervisory side of the Federal Reserve. As is the case with other financial regulators, our entire budget is collected by assessments made against Farm Credit institutions, with not a single tax dollar coming to FCA.

FCA is headed by a 3 person, full time Farm Credit Administration Board, whose members are appointed by the President of the United States and confirmed by the US Senate. We are an independent agency, not part of a Cabinet department. This lets us keep a sharp focus on the safety and soundness of the institutions of the Farm Credit System and on whether they are accomplishing their assigned mission of serving agriculture and rural America.

We do our job by creating regulations and policies to implement the law, by examination and evaluation of the performance of the FCS, and by enforcing corrective actions, when they are necessary. We do not become involved in broader financial or agricultural policy, except as it affects our assigned mission.

¹ George Irwin is a Senior Economist at the Farm Credit Administration.

² The opinions expressed in these notes are my own, and do not necessarily reflect the views of the Farm Credit Administration Board or management. The ideas are presented to encourage professional discussion.

³ GSE refers to Government Sponsored Enterprise, and describes a group of Federally chartered financial institutions serving housing, education, and agricultural markets, including the Farm Credit System. They are designed to channel funds to these specific sectors as a matter of public policy.

⁴ OFI is Other Financial Institution, a term used to describe institutions other than farm credit associations with access to funding from Farm Credit System banks.

FCA expects to speak knowledgeably *about* the Farm Credit System, but *not for* the System. We represent the broader public interest, including investors, taxpayers, and borrowers.

II. THE GSE ISSUE

Nature Of The Farm Credit System Charter

The Farm Credit System institutions are Federally chartered, the same as are national commercial banks, Federal savings and loans, and Federal credit unions.

Unlike these other institutions with Federal charters, however, the FCS lacks authority to take deposits. Instead, it generates most of its funds by selling securities to investors in national and international financial markets. This taps the money center funds and bring the financial flows back to rural areas. The *costs of funds themselves* are often *higher than* the cost of *deposits* to a rural commercial bank or thrift. *But* the FCS sale of securities is a *very low cost way of gathering funds*. Adding together the higher cost of funds themselves with the lower costs of funds gathering enables the FCS to be competitive with commercial banks, which often have higher costs in gathering deposits but lower costs for funds themselves.

The FCS institutions also have a relatively narrow charter of lending authority, confined to farmers, farmer cooperatives, and certain other residents of rural areas. Further, they are limited to a narrow range of financial services which they may offer to their customers. FCA has recently proposed to modify and modernize eligibility regulations for the FCS, and has generated some controversy, as you may have heard. I will say more about that in a moment.

The Federal charter grants a number of attributes to the FCS. Together these are known as GSE status, even though the specific package of attributes differs among GSEs. Among other things, GSE status assists the FCS in its access to financial markets. Before we review these attributes, it is useful to investigate the stand-alone strength of the FCS.

Potential Strength of the FCS As A Private Issuer

The FCS has regained its financial health, and has become a far stronger system than before the carnage following the land price collapse of the 1980s. The reasons go well beyond the efficiencies gained from restructuring. Yet a question remains about how capable the FCS is of standing alone as a private issuer.

Capital has been rebuilt, to a level of \$10.2 billion on June 30, 1996, about 13.6% of assets. The mix of this capital has shifted away from borrower stock and toward earnings retained in the institutions. This makes FCS capital strength less vulnerable to borrower flight than was true in the 1980s. This capital growth has come from retaining a portion of record-strong earnings, despite a lack of lending growth from 1985 through the first half of 1995.

The system is stronger in some additional ways, from the viewpoint of investors in the securities. This internal strength helps keep down the cost of funds. Five levels of strength are now in place to protect investors:

1. FCA regulatory powers were strengthened in 1987. Before, we had only the power of persuasion to get problems corrected. Now we have the same enforcement authorities as the other financial regulators. Examination and other evaluations and monitoring are conducted continually, and policies and regulations have a proactive and preventive cast.
2. Each FCS bank is primarily liable for repayment of the portion of FCS securities which were used to fund its operation. This means that the earnings of each bank and its capital protect investors. FCA requires that each institution operate under a business plan which price its loans at high enough interest rate to assure adequate earnings and capital. They must also provide regular financial reports to stockholders and investors, who provide a market discipline that supports the FCA regulatory discipline.
3. The Farm Credit System Insurance Fund was created in 1987. Until the balances built up to an adequate level, each bank is assessed an annual fee based on the amount of loans outstanding and the quality of the loan portfolio. The fund is available to assure repayment of investors, should one of the banks be unable to do so. The fund now has a balance of nearly \$1.1 billion.
4. If both the individual bank reserves and the Insurance Fund are inadequate, all the rest of the FCS banks are jointly and severally liable to repay investors. This offers the earnings capability and capital of all of the banks as additional assurance.

These four also help assure everyone that the US Treasury has greater protection against the risk of the FCS needing loan assistance at any time in the future.

5. The fifth protection is implicit. The law and each issue of FCS securities state that the US Government is not liable for repayment of FCS securities. That was also true in 1987, when the government did, in fact, offer financial assistance. So there is likely some investor expectation that at least an implied guarantee exists -- a sort of "too big to fail".

But there is also an attitude of "never again" on financial assistance, both in government and throughout the FCS. This attitude in government is referred to as "curbing GSE status".

Terminate GSE Status?

With all this strength, how would the FCS fare without GSE status? Two dimensions are key to the FCS capacity: what would be the penalty in cost of money and how much funds could be raised:

- **Rates.** The Treasury Department, as of April 1991, asked Standard and Poor's Corporation to rate GSE securities as if they had no GSE attributes⁵. S & P came up with a BB rating for the FCS, at the top of speculative ratings and just below investment grade. The reasons were "the monoline character of its business, coupled with weak capitalization and earnings power, and continued low asset quality". Three of the four characteristics have been turned around, but the monoline business remains. We can only speculate what the S & P rating grade would be now. But we do know the interest cost would be higher --- even an AAA investment grade is priced higher than current FCS securities --- and the institutions would likely need more capital.
- **Amounts.** The more serious question is what amounts and the kinds of securities could be issued. At June 30, nearly \$63 billion in securities were outstanding, with a large portion in short maturities requiring rollover financing. During the first 6 months of 1996, \$139 billion in securities were issued. A great variety of funding vehicles are used, based on market conditions, to produce lower funds costs for borrowers. This affords great liquidity and flexibility in funding, and it also makes the supply of funds very elastic. What would happen, as a non-GSE issuer, to these funding attributes is a matter of considerable conjecture. Studies of 15 years ago concluded that the quantity constraint would be severe, cutback in the FCS lending would require massive expansion by other lenders, and it could significantly decrease rural credit availability. Since that time, liquidity and flexibility have become more important considerations.

A broader issue is the proper role of GSEs in the scheme of US financial system. In the current good economic times, both the US Treasury and institutions that compete with the FCS have argued that GSEs may not be needed any longer, or should be restricted in the ways that they compete, or should be stripped of GSE attributes (privatized). This rationale tends to treat GSEs as public and commercial banks as private.

Let me point out, however, that the GSE argument is not a simple black-and-white issue, as some proponents would assert. In truth, there are more similarities than differences when one compares depository institutions with GSEs. Federal charters are not the rule in the US -- most corporate charters are issued by states. But Federal charters are fairly common for financial

⁵ See Report of the Secretary of the Treasury on Government-Sponsored Enterprises. April 1991. Pg. A-5.

institutions and certain other areas of great public significance⁶ (Tennessee Valley Authority, for example).

Like the FCS, many commercial banks and thrifts have Federal charters, special tax provisions, access to monetary mechanisms, and implied Federal support in raising funds. (See Exhibits I and II and Attachment A for specific comparisons). And both they and the FCS have private shareholders. In one case shareholders are investors in commercial bank stock. In the other, shareholders are farmer-users of the FCS. In many ways, national banks are really just another form of GSE, with a broader charter. Because they compete with the FCS, it is sometimes hard to distinguish when the argument over GSEs is about public policy and when it is about competitive advantage.

The Present And Future Role Of The FCS

Is the FCS needed for the future? My judgment is yes. I believe that it provides high value to the agricultural sector at almost no direct cost to the government, through two routes:

1. Assuring adequate credit flows to agriculture, in both good and bad economic times. We cannot allow ourselves to forget that the FCS is partly a policy bulwark against disproportionate impacts on agriculture in bad times. Though most of the past decade has been on the upside, there is also a downside. Historically, market shares have fluctuated countercyclically, to the benefit of rural areas.
2. Assuring competitive financial markets for agriculture and rural America. This market policing is a fundamental justification for continuing the FCS, even if commercial bankers or others were able to handle the whole volume ag sector lending. I believe that assuring competitive market results must be a continuing emphasis in this era where financial institutions are consolidating and concentrating at a rapid pace⁷.

There is also a certain genius in this mixed system, with some institutions owned cooperatively and others by investor shareholders. Cooperatives are intended to operate directly in the interest of users, to minimize costs of customer borrowing and to be innovative in providing customer-adapted services. The effect of their presence is to encourage competitive market behavior by investor-owned banks, which might otherwise have greater opportunity to exercise local market power to the disadvantage of borrowers. Conversely, the banks impose

⁶ For a general discussion of the evolution to the concept, from the English Crown Charters (e.g. the Hudson Bay Company) to the modern Federally-chartered corporation with public purposes (including GSEs), see Thomas H. Stanton. "Nonquantifiable Risks and Financial Institutions: The Mercantilist Legal Framework of Banks, Thrifts, and Government Sponsored Enterprises" in Charles Stone and Anne Zissu, eds., *Global Risk-Based Capital Regulations*, Vol. 1. Homewood, IL: Irwin Professional. 1994.

⁷ See Robert Collender. "Can Federal Action Improve Efficiency in the Market for Farm Loans?" USDA Agriculture Information Bulletin No. 724-01. March 1996. Using a Department of Justice criterion, he estimated that 2,111 of the 2,293 rural banking markets (92%) are noncompetitive. The classification uses number and size of banks. Collender concludes (pg. 3). "The persistent lack of competition in local agricultural and rural lending markets provides adequate justification for Federal interest in fostering such competition."

discipline on the FCS institutions which might otherwise get complacent and let operating costs balloon. Even granting that there can be agency problems in both systems, the mix has salutary potential for market efficiency.

I have been surprised by the misperceptions that some competitors to the FCS and some in policy positions have expressed about these FCS roles. Several areas of confusion came out in comment letters FCA received on our proposal to modernize the regulations on eligibility to borrow from the FCS, including some of the letters forwarded by members of Congress:

- One misperception was that the FCS was intended to serve only if other lenders have been shown to fail the market. Not so -- the function in the law is to be a presence at all times, thereby helping assure adequate funds and competitive behavior. It is to be there to prevent market failure, not to jump in after one occurs. The USDA Farm Service Agency, not the FCS, is a lender of last resort.
- A second misperception was that the FCS was intended to serve just smaller family farmers, or even just low income farmers. In fact, it is to serve all of agriculture, and if it is to do the job well, then the exact eligibility rules have to change over time as ag changes. And the non-creditworthy farmers are the province of the USDA Farm Services Agency, not the FCS.
- A third misperception was that the regulations opened up a whole range of new customers. People seemed to be unaware that the FCS already is authorized to lend for nonfarm needs of farmers and for farm related business. They also seemed unaware that the current regulations are a narrower definition of authorities than allowed under current law.
- A fourth assertion has been that the FCS is abandoning agriculture or just "cherry picking" the largest and best loans. To the contrary, the FCS is overwhelmingly a farm lender, and growth since September 1995 suggests the farm share will be increasing. Further, the loan portfolio contains all sizes and types of customers. The lending authorities include some other groups in rural areas----moderate priced rural housing, processing and marketing facilities, certain farm related businesses, and aquatic purposes.

At midyear, June 30, 1996, when seasonal lending is near its peak, the FCS farm loan portfolio held 604,638 loans for a total of \$43.4 billion outstanding. Volume of farm lending had been nearly flat over the prior decade. But since mid-1995, loan numbers were up by nearly 7,000 (1%) and volume was up by \$3 billion (7%), as exports shot up and grain prices strengthened. Commercial banks also are at their tightest liquidity position in a decade, after taking market share from the FCS for all of the prior decade.

- Over 91% of the number of farm loans were for ag real estate or operating purposes; 7.2 % were rural housing; just 1.3% of loan numbers went to farm related businesses , aquatic, processing and marketing and other purposes.
- The dollar volume is even more dominated by farm loans: almost 93% is in farm real estate or non real estate purposes, compared to 3.6% rural housing and 3.7% all other purposes.
- The FCS is also a lender to all sizes of farm business, both small and large. The average size of loan balance outstanding last June 30 was \$71,793. The average on real estate mortgages was a little higher, and on operating/intermediate a little lower; \$92,154 and \$50,858, respectively. About 18% of the number of loans and 13% of the amount outstanding were to primary borrowers who are young, beginning, or small. Just about half (49.5%) the farm real estate mortgages had outstanding balances of \$50,000 or less.

Finally, CBO, Treasury, GAO, and OFHEO have just completed inconclusive studies of whether Fannie Mae and Freddie Mac should be "privatized". The question is of the same character as I have already outlined for the FCS: whether to focus on implicit Federal subsidy to homebuyers or on public policy of maintaining GSEs as instruments for making financial markets more efficient and effective. It is progress to get the debate focused onto the market efficiency issue, and subordinate the competitive advantage issue.

Once the market efficiency focus is established, it is possible to assess whether some adjustments are needed in either type of Federal charter (FCS or commercial bank) to keep both types of institutions healthy. Assuring healthy competitors in order to have competitive financial markets in rural areas is the goal.

III. THE OFI ISSUE

Institutions other than farm credit associations (OFIs) have had a long and troubled funding relationship with the Farm Credit Banks. These institutions include commercial banks and their subsidiaries as well as affiliates of private businesses and agricultural cooperatives who lend for agricultural purposes.

The OFI relationship was last adjusted in the 1981 Amendments to the Farm Credit Act, which sought to establish a clearer definition of eligibility. Use of the OFI arrangement has always fluctuated inversely with the liquidity of commercial banks lending to agriculture. In 1995, two national commercial bankers associations⁸ proposed a major change in the Act, which would have opened OFI access greatly. The legislative proposal has not been acted upon. This section provides, in brief outline form, some background material and current status information on OFIs:

⁸ American Bankers Association and Independent Bankers Association of America.

- Authority established in 1923, preceding PCAs by 10 years. Started as wholesale GSE. Original purpose was to increase access of small rural banks to loanable funds. Congress deemed inadequate in 1933, added retail lending via PCAs--which is now most of volume.
- Authority is limited to short and intermediate term lending - no long term mortgage. (See Attachment 2-1, Sec. 1.7(b)(1)(B)). Both a wholesale (Joint Stock Land bank) and retail (FLB) mortgage program existed from 1916 until 1940s.

Question: Why have both wholesale GSEs failed, and both retail GSEs succeeded in agriculture? In housing and education, we have only wholesale GSEs.

- Both commercial banks and affiliates of nonbank businesses have formed OFIs.
- Run by FCBs, which are owned by the PCAs, direct competitors to commercial banks. This has created concern about equitable treatment.
- Volume fluctuated greatly, inversely with commercial bank liquidity (Attachment 2-4). Question of who pays overhead⁹.
- 1981 legislation clarified who is eligible and allowed a maintenance fee to be charged. (See Attachment 2-1, Sec. 1.7 (b)(4) and FCA implementing regulations, Attachment 2-2).
- Volume has been very low recently (a period of low loan to deposit ratios), but rising last year. By mid 1995, just 23 OFIs (16 affiliated with commercial banks) and \$208 million outstanding. June 1981 184 OFIs (154 affiliated with commercial banks) and \$914 million.
- In 1995, the two commercial bankers associations proposed great expansion of OFI authority and joint ownership of FCS. Authority to lend to OFIs would have been broader than to FCS Associations. At the same time, the FCS had sought expanded authorities of its own.

⁹ In another paper in this report, Peter Barry recalls that banker's own efforts to deal with cyclical liquidity problems have suffered the same fate as the OFI mechanism. In the early 1980s, the MidAmerica Agricultural Services Company (MABSCO, through a subsidiary called Mid America Services, Inc {MASI}) was chartered by bankers associations in 13 midwestern states to sell loans to Rabobank. But it failed to achieve significant volume because restoration of banking liquidity eliminated the supply of product. The same cyclic problem appears to have doomed the 1916 and 1923 FCS legislation, which created direct short and long term FCS discounting mechanisms for commercial banks. It could also be argued that the unfulfilled high hopes for Farmer Mac are closely related to cyclic nature of the supply of the kinds of financial instruments it is designed to securitize. All these examples appear to teach the lesson that it is difficult to build a financial institution whose input supply is dependent on a steady supply of overlines in other institutions.

- In 1996, FCA invited comment on what kinds of changes in the OFI regulations might be appropriate for the future (Attachment 2-3). The comment period closed August 30, 1996. Staff will be summarizing and analyzing comments in the coming months.

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EXHIBIT 1. ARE NATIONAL COMMERCIAL BANKS ESSENTIALLY GSEs?

HYPOTHESIS: The FCS is no more and no less a "governmentally created institution" and it is no more and no less a "private institution" than are national banks. Each has public and private attributes:

- Both have *federal charters and federally supported access to funds*. Only the funds source and the type of support is different. (Deposit sources with FDIC insurance, public deposits, and FED discount facilities vs. financial market source with FCSIC insurance, GSE status, and favorable treatment of investment securities).
- Both get larger *amounts of funds as well as lower interest rates* than they would without the perceived public support.
- Both have, in the past, had that *public support demonstrated* through direct Federal assistance. (the 1987 Act and the commercial bank bailouts on too-big-to-fail.)
- Both have *restrictions in their charters* which limit the range of customers and services they may offer, although the scope of authority is quite different. Both also find technology and customer change are creating *continuing pressures to change* these charters, or else lose markets to less regulated competitors.
- Both have features which reflect the *perception that rural areas need to have better access to credit* over adverse periods in the interest rate cycle. This is a central aspect of the FCS justification, but rural commercial banks are also provided significant separate treatments in banking regulation.
- Both are subject to *Federal regulation* for safety and soundness, as well as for some aspects of program (YBS borrowers, CRA).
- Both have *special tax laws and exemptions as well as unique accounting* treatment, as compared to other businesses, that take into consideration their functions and their nature as financial institutions.
- Both have *public functions* -- in one case maintenance of a currency function and vehicle for monetary policy and in the other assurance of credit availability in a traditionally credit-disadvantaged sector.
- Both also have *private ownership* through shareholders -- in one case the private owners are bank investors and in the other they are FCS users."

EXHIBIT II. SOME UNIQUE "SUBSIDIES" TO COMMERCIAL BANK CHARTERS

1. Access to low cost funds, due to:

- a) Federal Deposit Insurance program greatly reduces capital requirement for banks to attract deposits. Once 20-30% capital was needed.
 - b) Authority to offer no-interest demand deposits for transaction purposes.
 - c) Access to Federal Reserve discount window
2. Limits on competition, through branching restrictions and threshold requirements for charters. Also limits on nonbank competitors.
 3. Small bank statutory exceptions on authority to act as insurance agents, and exceptions to costly bank regulations for them.
 4. Access to Fedwire funds transfer, the international SMART transfer system, the FED check clearing systems.
 5. Ability to serve as depositories for public funds.
 6. Various Federal programs are focused through banks.
 7. Authority to amortize agricultural loan losses and losses on acquired properties, 1983-1992.
 8. Tax treatment favorable for gaining business in financing municipalities and housing.
 9. Creation of GSEs has improved the liquidity of bank assets. The most recent example is expansion of the Federal Home Loan Bank authorities to provide advances to commercial banks. The proposal to expand OFI access to the Farm Credit System is pending.

ATTACHMENT I -- BACKGROUND ON GOVERNMENT SPONSORED ENTERPRISES

1. Excerpt from 1982 USDA Study. Comparison of federal charters of Farm Credit System, credit unions, savings & loans, and national banks.
2. Excerpt from 1991 CBO Study. Comparison of attributes among GSEs.

Attachment I-1. Comparison of GSE and Other Federal Financial Charters

This page and the immediately following 7 pages were taken from an unpublished report on GSE's drafted in 1982, as indicated on this title page. Although the details of the comparisons do not represent current statutes and regulatory rules accurately in all details, the report provides one of the few comparisons available between the Farm Credit System and other Federally chartered financial institutions.

A STUDY OF THE FARM CREDIT SYSTEM

A Report to the Secretary of Agriculture

Economic Research Service

U.S. Department of Agriculture

Washington, D.C., 20250

July 1982

Table 9. Summary of Selected Operational Differences Among Federally Chartered Lending Institutions

Federally Chartered Financial Institutions				
	<u>Farm Credit System Banks & Associations</u>	<u>Federal Credit Unions</u>	<u>Federal Savings & Loan Associations</u>	<u>National Banks</u>
1. Can accept deposits and provide checking services	No	Yes	Yes	Yes
2. Deposits eligible for Insurance against default by government sponsored agency	Not applicable	Yes (NCUA)	Yes (FSLIC)	Yes (FDIC)
3. Methods of acquiring loanable funds	<u>Major.</u> Sale of bonds and discount notes in financial markets <u>Minor.</u> Borrowing from commercial banks	<u>Major.</u> Deposits of members <u>Minor.</u> Sale of certificates of indebtedness. Borrowing through Corporate Central System Borrowing through NCUA who obtain funds through the Federal Financing Bank.	<u>Major.</u> Deposits Borrowing from Federal Home Loan Bank Sale of loans and participations to government sponsored agencies <u>Minor.</u> Borrowing from other than FHLB Debentures	<u>Major.</u> Deposits Federal funds Bankers acceptances Correspondent overline loans Borrowing from the Federal Reserve <u>Minor.</u> Sale of commercial paper Discounting with FICBs Sale of guaranteed loans Eurodollars
4.. Interest on financial market issuances exempt from and local tones	Farm Credit System Bonds and discount notes (Yes)	Not applicable	FHLB Securities (Yes) FNMA Securities (No) GNMA Securities (No)	Commercial paper (No) Bankers Acceptances (No) Certificates of Deposit (No)
5. Eligibility of financial market issuances and other financial investments for Federal Reserve use in open market operations	Farm Credit System Bonds(Yes) Discount notes (Yes)	Not applicable	FHLB Securities (Yes) FNMA Securities (Yes) GNMA Securities (Yes)	Bankers acceptances (Yes) Commercial paper (No) Certificates of Deposit (No)

	<u>Farm Credit System Banks & Associations</u>	<u>Federal Credit Unions</u>	<u>Federal Savings & Loan Associations</u>	<u>National Banks</u>
6.	Legal limitations on investments in financial market securities	Investments made only as temporary actions in liquidity management. Within these guidelines, investments in Federal government or agency securities, bankers acceptances or negotiable CD's are possible	Securities which qualify as liquid investments (government and agencies) must have a maturity of less than 5 years. Commercial paper must have one of 2 highest ratings, corporate bonds must have one of 4 highest ratings. Total of commercial paper, corporate bonds, and assumed loans cannot equal or exceed 20% of association assets.	Investments in corporate and municipal bonds limited to "investment quality". Investment of one issuer restricted to 10% of bank unpaid capital and surplus with exceptions for state and Federal obligations and Federal agency obligations.
7.	Legal lending limitations per borrower	PCA's 50% of capital & surplus in the Association. FLB's 20% of capital and surplus of the District Land Bank. BC's Seasonal loans: 35% of BC capital & surplus Term Loans: 25% of B.C. capital & surplus All loans: 50% of B.C. capital plus surplus	Lesser of 100% of the Associations net worth or 10% of its withdrawable capital	Approximate Lending Limits Per Customer: 10% (Capital + Surplus + undivided profits + 1/2 Reserves for Losses)
8.	Do investors regard financial market securities as guaranteed by the Federal government	Bonds and discount notes not guaranteed by the government, but many believe there is an implicit guarantee	GNMA securities are backed by the Federal government FNMA and FHLMB issues are not guaranteed by the government, but there is a strong belief that the government would not allow a default on these securities	Bankers acceptances, certificates of deposit, and commercial paper are not guaranteed by the government. Past government actions suggest that only stockholder equity is at risk

	<u>Farm Credit System Banks & Associations</u>	<u>Federal Credit Unions</u>	<u>Federal Savings & Loan Associations</u>	<u>National Banks</u>
9. Must securities be cleared by SEC?	Farm credit system bonds and discount notes (No)	Not applicable	FNMA, GNMA and FHLB securities (No)	Bankers Acceptances, certificates of deposit, and
10. Are the securities rated by rating agencies?	No, but likely could be if requested and paid for by FCS	Not applicable	FNMA, GNMA, and FHLB Securities (No) Mortgage-backed bonds and pass-through certificates (Yes, upon request of the issuer)	Bankers acceptances and commercial paper (No) Obligations of banks and bond holding companies (Yes, upon request of issuer)
11. Are financial market securities eligible for rediscounting at the Fed?	Bonds and discount Notes (Yes)	Not applicable	FNMA Securities (Yes) GNMA Securities (Yes)	Commercial paper and bankers acceptances FHLB Securities (Yes) (Yes, if less than 90 days to maturity. Also pays a higher discount rate)
12. Are securities eligible for collateralization of U.S. Government deposits?	Yes	Not applicable	Yes	No
13. Geographic limits (and legal structure)	Nationally-federated structure organized by exclusive districts and associations	No geographic limits	State-wide branching	Varies among states (state-wide branching, unit banking, holding company authorizations): corporate structure)
14. Regulatory Agency	Farm Credit Administrations	National Credit Union Administration	Federal Home Loan Bank Board. Savings and Loan Insurance Corporation	U.S. Comptroller Currency (also Federal Reserve System and Federal Deposit Insurance Corporation)
15. Interest Rate Controls	None on major sources	"Regulation Q"--being phased out	"Regulation Q"--being phased out	"Regulation Q"--being phased out

	<u>Farm Credit System Banks & Associations</u>	<u>Federal Credit Unions</u>	<u>Federal Savings & Loan Associations</u>	<u>National Banks</u>
16. Interest Rate Controls on uses of funds	No legal limits	State usury laws	State usury laws	State usury laws
17. Reserve and Capital requirements	No legal reserve re- quirements; statutory guidelines on capital	Federal and state reserve require- ments on "depos- its"; statutory guidelines on capital	Federal and state reserve requirements on "deposits" statutory guidelines on capital	Federal and state reserve requirements on "deposits" statutory guidelines on capital
18. Equity Capital and legal organization	Cooperatives with corporate organization; equity from owner stock purchases and retained earnings	Reserves accumu- lated from net earnings	Mutual (primarily) or stock associations; reserve accumulated from	Corporate organization; equity from public issues and retained earnings
19. Taxation	Production Credit Associations and Banks for Cooperatives subject to income taxation; Federal Land Banks, Federal Land Bank Associations, and Federal Intermediate Credit Banks exempt	Exempt	Taxed as corporations	Taxed as corporations
20. Restrictions on members or depositors and lending	Specified eligibility conditions primarily farm and farm-related lending	Common bond; primarily con- sumer loans	Specified authorizations; primarily mortgage loans	Specified authorizations; broad range

a/ Varies significantly by size of Bank

Table 11. Alleged competitive advantages of the-Farm Credit System.

-
- Interest income derived from FCS systemwide bonds and discounted notes are exempt from State, municipal, and local taxation but are subject to Federal taxes.
 - Income of Federal land banks, Federal Land Bank Associations and Federal Intermediate Credit Banks are exempt from payment of Federal, State and local income taxes,
 - Limitations that banks cannot invest more than 10 percent of their capital stock and surplus fund in the securities of one obligator do not apply to farm credit securities.
 - National banks and State member banks of the Federal Reserve System may invest in farm credit bank obligations without being subject to the statutory limitations and restrictions generally applicable in dealing with investment securities from their own account.
 - FCS securities are in the exclusive "unrestricted" category of eligible investment for national banks (shared only by Treasury debt issues, Federal agency debt issues, and certain loans fully guaranteed by the U.S. Government).
 - FCS securities are exempt from SEC regulations and registration but are subject to regulation by the Farm Credit Administration.
 - The quasi-governmental status of FCS agencies enables them to finance their operation at a cost close to that at which the U.S. treasury borrows and significantly below the cost of capital market funds for high-grade private corporation borrowers.
 - The "Market" (investors, underwriters, traders, et. al.) assumes with good reason that the Federal Government would not and could not permit the FCS institutions to fail. Despite the absence of any explicit statutory or contractual Federal guarantee, the presumption of both implicit guarantee and total moral responsibility is universal and unequivocal.
 - FCS security Issues are exempt from application of standards of financial soundness commonly applied by bond rating services and investment analysts to corporate issues.
 - Farm Credit System securities are eligible for Federal Reserve Bank investment in the open market portfolio.
 - FCS banks are eligible for rediscount at the Federal Reserve's discount window.
 - FCS securities are eligible for collateralization of public deposits such as tax and loan accounts.
 - FCS securities are eligible-for credit union investments, unlike corporate securities.
 - FCS securities are eligible for savings and loan investment of liquidity reserve (maturities of 5 years or less only).

Table 12. Proposed actions to alter certain features of the Farm Credit System.

- Put restrictions on amount of FCS securities held by commercial national banks and State FRB members.
- Remove any FRB discounting privileges above those offered to private financial institutions.
- Remove any inequities between FCS and the private sector regarding FRB investment securities (these are securities in which the FRB invests).
- Remove eligibility of FCS securities to serve as collateral for public deposits (deposits held by the Federal Government including tax and loan accounts).
- Disallow credit union investment in FCS securities.
- Disallow savings and loans association investment in FCS securities.
- Remove tax exempt status of land banks and associations and FICBs.
- Remove tax exemption on income derived from FCS securities.
- Require the FCS to change the name of Federal Land Banks and Associations and FICBs.
- Subject FCS banks to SEC regulations.
- Subject FCS to same State banking regulations as commercial national banks.

Concluding Comments

Proposals to modify the operating characteristics of the Farm Credit System should be judged in the context of the overall competitive balance of financial institutions and in the context of the impact on financial markets, farmers, and consumers. It is apparent from the discussion in Parts II and III that all forms of lending institutions have both competitive advantages and disadvantages over other lending institutions. The competitive advantages of one institution should not be viewed in isolation, but should be part of a balanced look at the entire structure of our financial system.

A number of the proposals to eliminate the alleged competitive advantages of the Farm Credit System would, if enacted, also harm competitors. Thus, proposed changes should also be viewed in terms of the efficiency of the entire financial system and what impact such changes may have on competitive balance.

Many of the proposed changes identified in Part III would raise the cost of issuing FCS securities thereby increasing the cost of funds to the agricultural sector.

Attachment I-2. Comparison of GSE Attributes

The following table compares the various Government Sponsored Enterprises (GSEs). It is from:

U.S. Congressional Budget Office. Controlling the Risks of Government-Sponsored Enterprises. April 1991.

TABLE 2. LEGAL BENEFITS ENJOYED BY GOVERNMENT-SPONSORED ENTERPRISES

Benefit	Farm Credit System			Freddie Mac	FHLBs	Sallie Mae
	Farm Credit Banks	Farmer Mac	Fannie Mae			
Treasury Lending Authorized (Billions of dollars)	None	1.510	2.25	2.25	4.0	1.0
Eligible for Federal Reserve Open-market Purchase	Yes	c	Yes	Yes	Yes	Yes
Use of Federal Reserve Fiscal Agent	Yes	Yes	Yes	Yes	Yes	Yes
Eligible to Collateralize Public Deposits (All federal; most state/local)	Yes	Yes	Yes	Yes	Yes	Yes
Exempt from Registering with the Securities and Exchange Commission (1933 Act)	Yes	No	Yes	Yes	Yes	Yes
Government Securities for Purposes of the Securities Exchange Act of 1934	Yes	No	Yes	Yes	Yes	Yes
Eligible for Unlimited Investment by National Banks and State Bank Members of the Federal Reserve	Yes	Yes	Yes	Yes	Yes	Yes
Eligible for Unlimited Investment by Federally Insured Thrifts	Yes	Yes	Yes	Yes	Yes	Yes
Exemption of Corporate Earnings from Federal Income Tax	Yes	No	No	No	Yes	No
Exemption of Corporate Earnings from State and Local Income Tax	Yes	No	Yes	Yes	Yes	Yes
Exemption of Interest Paid From State Income Tax	Yes	No	No	No	Yes	Yes

SOURCE: Adapted from Department of the Treasury. *Report of the Secretary of the Treasury on Government Sponsored Enterprises*. (May 1990), p.4.

NOTE: Farmer Mac = Federal Agricultural Mortgage Corporation; Fannie Mae = Federal National Mortgage Association; Freddie Mac = Federal Home Loan Mortgage Corporation; FHLBs = Federal Home Loan Banks; and Sallie Mae = Student Loan Marketing Association.

a. Treasury is authorized to guarantee up to \$4 billion of Financial Assistance Corporation bonds.

b. Upon required certification from the Federal Agricultural Mortgage Corporation, borrowing from the Treasury is authorized to make payments under Farmer Mac guarantees.

c. Not applicable; entity newly created.

ATTACHMENT II -- BACKGROUND INFORMATION ON OFIs (OTHER FINANCIAL INSTITUTIONS) AS USERS OF THE FARM CREDIT BANKS.

1. Section 1.7 from Farm Credit Act, defining scope of OFI lending authority and the requirements to be eligible to be an OFI.
2. Excerpt from FCA regulations, Section 614, Subpart P, implementing the lending authorities and eligibility requirements.
3. Copy of Advanced Notice of Proposed Rulemaking, which invites comment on whether and how these regulations might be modified.
4. Table and chart showing volume of FCS lending through OFIs, 1923 through 1994.

Portions of text have been boxed for easy reference.

Attachment II-1. OFI Lending Authorities

This is a portion of the Farm Credit Act of 1971, as amended in 1980 with respect to OFI lending. A portion of text has been boxed, to highlight basic information.

Statute: 1971 ACT AS AMENDED
Title: Title I Farm Credit Banks
Part:
Subtitle:
Chapter:

U.S. Code Citation: 12 U.S.C. 2015

12 U.S.C. 2015

SEC. 1.7. LENDING AUTHORITY.

(a) REAL ESTATE LOANS AND RELATED ASSISTANCE.

- (1) **REAL ESTATE LOANS.** The Farm Credit Banks may make or participate with other lenders in long-term real estate mortgage loans in rural areas, as defined by the Farm Credit Administration, or to producers or harvesters of aquatic products, and make continuing commitments to make such loans under specified circumstances, for a term of not less than 5 nor more than 40 years.
- (2) **FINANCIAL ASSISTANCE.** The Farm Credit Banks may provide and extend financial assistance to, and discount for, or purchase from, a Federal land bank association any note, draft, or other obligation with the endorsement or guarantee of the association, the proceeds of which have been advanced to persons eligible and for purposes of financing by the association, as authorized under section 7.6 (a).

(b) INTERMEDIATE CREDIT.

- (1) **IN GENERAL.** The Farm Credit Banks are authorized to make loans and extend other similar financial assistance to and to discount for or purchase from

(A) any production credit association, or

(B) any national bank, State bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings institution, credit union, or any association of agricultural producers engaged in the making of loans to farmers and ranchers, and any corporation engaged in the making of loans to producers or harvesters of aquatic products, any note, draft, or other obligation with the institutions endorsement or guarantee, the proceeds of which note, draft, or other obligation have been advanced to persons and for purposes eligible for financing by production credit associations as authorized by this Act.

- (2) **PARTICIPATION WITH OTHER ENTITIES.** The Farm Credit Banks may participate with one or more production credit associations or other Farm Credit Banks in the making of loans to eligible borrowers and may participate with one or more other Farm Credit System institutions in loans made under this title or other titles of this Act on the basis prescribed in section 4.18 of this Act.

- (3) **LIMITATIONS ON EXTENSION OF FINANCIAL SERVICES.**

(A) **GENERAL RULE.** No paper shall be purchased from or discounted for, and no loans shall be made or other similar financial assistance extended by a Farm Credit Bank to any entity identified in paragraph (1)(B) of this subsection if the amount of such paper added to the aggregate liabilities of such entity, whether direct or contingent (other than bona fide deposit liabilities), exceeds ten times the paid-in and unimpaired capital and surplus of such entity or the amount of such liabilities permitted under the laws of the jurisdiction creating such institution, whichever is the lesser.

(B) **LIMITATION ON NATIONAL BANK.** It shall be unlawful for any national bank which is indebted to any Farm Credit Bank, on paper discounted or purchased under paragraph (1), to incur any additional indebtedness, if by virtue of such additional indebtedness its aggregate liabilities direct or contingent, will exceed the limitation described in subparagraph (A).

- (4) **FCA REGULATIONS.**

- (A) **IN GENERAL.** All of the loans, financial assistance, discounts and purchases authorized by this subsection shall be subject to regulations of the Farm Credit Administration and shall be secured by collateral, if any, as may be required in such regulations.
- (B) **REQUIREMENT OF REGULATIONS.** The regulations shall assure that such loans, financial assistance, discounts, and purchases are available on a reasonable basis to any financing institution authorized to receive such services under paragraph (1)(B) of this subsection, and that
- (i) is significantly involved in lending for agricultural or aquatic purposes;
 - (ii) demonstrates a continuing need for supplementary sources of funds to meet the credit requirements of its agricultural or aquatic borrowers;
 - (iii) has limited access to national or regional capital markets; and
 - (iv) does not use such services to expand its financing activities to persons and for purposes other than those authorized under title II.
- (C) **FEES.** The regulations may authorize a Farm Credit Bank to charge reasonable fees for any commitment to extend service under this section to such a financing institution.
- (D) **SUBSIDIARIES AND AFFILIATES.** For purposes of this subsection, a financing institution together with the subsidiaries and affiliates of such may be considered as one, but such determination to consider such institution together with the subsidiaries and affiliates of such as one shall be made in the first instance by the bank and in the event of a denial by the bank of its services to a financial institution, then by the Farm Credit Administration on a case-by-case basis with due regard to the total relationship of the financing institution, its subsidiaries, and affiliates.
- (5) **EFFECTIVE DATE.** Nothing in this section shall require termination of discount relationships in existence on the effective date of the Farm Credit Act Amendments of 1980.

Attachment II-2. FCA Regulations on OFIs

This is the part of FCA regulations which implement the OFI authorities contained in the Farm Credit Act.

PART 614 - LOAN POLICIES AND OPERATIONS

Subpart P - Farm Credit Bank and Agricultural Credit Bank Financing of Other Financing Institutions

§ 614.4540 Definitions.

When used in this subpart:

(a) The term person means an individual, corporation, partnership, association, joint stock company, trust, fund, or any organized group of individuals or entities whether incorporated or unincorporated.

(b) The term affiliate of another person means a person that directly, or indirectly through one or more intermediaries,

(1) Owns, controls, or has the power to vote shares of any class of voting securities of such person; or

(2) Controls in any manner the election of a majority of directors of such person; or

(3) Exercises or has the power to exercise a controlling influence over the management of such person.

(c) The term subsidiary of another person means any person 10 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by such other person.

(d) The term depository institution means any national bank, state bank, trust company, savings institution, or credit union.

(e) The term other financing institution (OFI) means any person enumerated in section 1.7(b)(1)(B) of the Act, except to the extent that depository institutions, as defined herein, are specifically excluded from the term.

(f) The term national money markets means those money markets serviced by the largest banks in the United States which operate on a national level and conduct international operations as well.

(g) The term regional money markets means those money markets generally served by intermediate size banks which do not ordinarily operate on a national level but which may trade funds among themselves and provide services to community banks.

(h) The term bank(s) refers collectively to Farm Credit Banks, as defined in section 1.3 of the Act, and agricultural credit bank(s) as defined in part 619.

(i) The term association(s) refers collectively to production credit associations, and agricultural credit associations.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4545 General.

(a) The banks have a responsibility to make loans and extend other financial assistance to, and discount for or purchase from, any OFI which meets the criteria set forth in § 614.4550 and complies with the various other requirements of this subpart.

(b) An OFI meeting the basic eligibility criteria in § 614.4550 of this subpart shall have its request for access evaluated on the basis of its ability to make and service a sound loan portfolio and its managerial and financial strength. The presence of two or more OFIs serving the same territory or the failure of an OFI to enter into loan participations with production credit associations or agricultural credit associations shall not be considered in evaluating the request for access. Financial assistance may be provided through a direct loan to the OFI, or by purchasing or discounting individual loans made by the OFI.

(c) A bank shall determine, in considering a request to establish an access relationship, whether the OFI should be considered by itself, or together with its affiliates or subsidiaries as a combined entity, for the purpose of determining eligibility in applying the criteria set forth in § 614.4550 of this subpart. A determination to consider an OFI together with its affiliates as a combined entity shall require the consistent application of each of the eligibility criteria to the combined entity on a consolidated basis. In making its determination, the bank shall give due regard to the total relationship between the various parties, including but not necessarily limited to the following factors:

- (1) Ownership of voting stock;
- (2) Common management and employees;
- (3) Common directors;
- (4) Contractual and correspondent relationships;
- (5) Prior business dealings; and
- (6) Liability interrelationships, including but not limited to fund flows.

(d) Where a bank makes a determination to consider an OFI together with its affiliates as a combined entity, the OFI must demonstrate that the larger organization of which it is considered a part will continue to use the same proportion of its resources for agricultural or aquatic lending. The OFI must also demonstrate that all resources available to the consolidated entity are being used to alleviate the shortage of funds for agriculture.

(e) In dealing with an OFI affiliated with a cooperative, the bank shall consider the possible effects of such relationship on the operations and credit policies of the cooperative. Such OFI which is an otherwise eligible entity may discount or borrow on the security of notes of farmers, ranchers, or producers or harvesters of aquatic products (as distinguished from notes of cooperatives), evidencing loans to finance the cost of supplies, equipment, or services obtained from such affiliated cooperative, if the bank board finds that an additional source of credit is needed to facilitate financing of such transactions and the primary benefits of such credit will inure to the borrowing farmers, ranchers, or producers or harvesters of aquatic products.

[46 FR 51886, Oct. 22, 1981; 46 FR 54726, Nov. 4, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4550 Basic eligibility criteria.

(a) An OFI shall be afforded access on a reasonable basis to a bank as a source of funds if it meets all of the eligibility criteria set forth below:

(1) The OFI is duly organized and qualified to make loans under the laws of each jurisdiction in which it operates. The OFI shall be a person primarily engaged in the business of extending short- and intermediate-term credit to farmers, ranchers, and/or producers or harvesters of aquatic products. A person engaged in other business activities shall not be eligible to obtain credit from a bank merely because it has the power to make loans to farmers, ranchers, and/or producers or harvesters of aquatic products. The fact that an OFI has powers not related to such credit activities or receives income from other sources shall not in and of itself render it ineligible. A person whose primary function is to finance the sale of products by its affiliates shall not be eligible for access.

(2) The OFI is significantly involved in lending for agricultural or aquatic purposes. The OFI has at least 15 percent of its loan volume at the seasonal peak in agricultural and/or aquatic loans. The bank shall consider requests with a lesser percent if the OFI demonstrates that it is making a special and sustained effort to serve agricultural or aquatic producers and the 15 percent will be attained in a reasonably short period. Only obligations under section 2.15(a)(1), (2), and (3) of the Farm Credit Act of 1971, as amended, as well as eligible agricultural or aquatic real estate loans to eligible borrowers and leasing obligations to eligible borrowers originated through the OFI's own leasing program, shall be considered in determining that this 15-percent requirement has been met.

(3) Where the OFI seeking access is a depository institution, or where the OFI is affiliated with one or more depository institutions and considered a combined entity in accordance with § 614.4545(c) of this subpart, the OFI must demonstrate a continuing need for supplementary sources of funds to meet the credit requirements of its agricultural or aquatic borrowers. The OFI's gross loan-to-deposit ratio shall be not less than 60 percent at the seasonal peak for the last 3 consecutive years. Where failure to meet this criterion in one of the last 3 consecutive years is the result of a general

decrease in borrowings caused by an economic decline, the bank may make an exception in applying this criterion to a request for access where the OFI has otherwise maintained ratios equivalent to depository institutions of comparable size in the district. For purposes of this paragraph, gross loans shall include all direct credit extended by the OFI in its trade area. Such items as loans purchased from or participated in with other OFI's shall be excluded.

(4) The OFI has limited access to national or regional money markets as an alternate source of funds and is fully utilizing locally generated funds to finance local needs. Evidence of money market access shall be determined by the extent to which the OFI, or persons of similar size and circumstances, have the ability to utilize, on a regular basis, bankers acceptances, commercial paper, or negotiable certificates of deposit, or other similar liability instruments as a source of funds.

(5) The OFI would continue to use at least the same proportion of its resources for agricultural or aquatic lending.

(b) An OFI eligible under previous regulations which cannot meet the basic eligibility requirements of these regulations and is discounting with a bank on the effective date of these revisions shall not become ineligible provided it does not make material changes in operations or ownership.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4555 Review of denial of access based on eligibility.

A bank which proposes to reject a request by an OFI for access to the bank as a source of funds on the basis of eligibility as set forth in § 614.4550 of this subpart shall promptly notify the Farm Credit Administration of such decision and the reasons therefor. The Farm Credit Administration shall review each such negative decision on a case-by-case basis, taking into consideration all relevant factors, and advise the bank of its final determination. Thereafter, the bank shall promptly notify the OFI of the determination as to the request for access and, if rejected, the reasons therefor.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4560 Establishing and maintaining access.

(a) An OFI seeking access to a bank as a supplemental source of funds shall demonstrate that it is able to establish and maintain a sound lending program. Each bank shall develop standards to evaluate an OFI relative to:

- (1) A capital structure adequate to support an economically feasible lending operation;
- (2) The amount of collateral required to be deposited with or invested in the bank to support the extension of credit to the OFI; and
- (3) The ability of the OFI to extend and administer the anticipated loan portfolio on a sound basis.

(b) The standards set forth in paragraph (a) shall be subject to the following limitations:

(1) The amount required to capitalize an OFI shall be determined by an analysis of the economic feasibility of the proposal presented in the request, the credit risk involved, and the servicing cost to the bank. Any uniform minimum capital requirement based on the banks administrative costs shall be supported by documented costs which clearly demonstrate the need for the minimum requirement.

(2) The initial capital required to be invested in the bank by an OFI shall be no greater than the actual average investment required of associations in the district. OFIs with established access relationships may be assessed for additional capital if the contract is renegotiated to permit a larger volume of loans or when a general capital equalization or assessment is made. Capital invested in the bank by an OFI shall be retired in accordance with bank policy.

(3) No obligation shall be purchased from or discounted for, and no loans shall be made or other similar financial assistance extended by a bank to an OFI if the amount of such obligation added to the aggregate liabilities of such OFI, whether direct or contingent (other than bona fide deposit liabilities), exceeds 10 times the paid-in and unimpaired capital and surplus of such OFI or the amount of such liabilities permitted under the laws of the jurisdiction creating such OFI, whichever is less. It shall be unlawful for any national bank which is indebted to any bank upon obligation discounted or

purchased to incur any additional indebtedness, if by virtue of such additional indebtedness its aggregate liabilities, direct or contingent, will exceed the limitation contained herein. A debt-to-capital ratio less than that permitted by statute may be imposed to assure that the OFI maintains its eligibility to borrow and provides adequate capital from a credit standpoint. Any lesser ratio imposed initially shall not be less than one ratio point below the district average for associations. Once the OFI has established and maintained a satisfactory access relationship with a bank, the debt-to-capital standard shall be the same as that used in evaluating associations.

(4) General collateral securing the entire credit line from a bank may be required in accordance with § 614.4570 of this subpart. The amount to be required shall be based on the credit risk presented by the OFI and shall not be proportionally greater than is required of an association under similar circumstances.

(5) Credit lines with a bank shall be established based solely on the management ability, financial condition, and needs of the OFI. The line shall be renegotiated based on these same criteria when the needs of the OFI increase. A credit line shall be established for at least a 2-year term in support of the OFIs continuing need for access. The OFI shall provide the bank a 2-year projected average daily loan balance. Failure to maintain an annual average daily balance of loans discounted to at least 70 percent of the projected average daily balance shall subject the OFI to payment of an annual loan commitment fee. The fee shall be equal to 1 percent of the difference between the projected and approved average daily balance and the actual average daily balance of loans outstanding or discounted. The bank must make exceptions when failure to comply with this requirement is caused by a general decrease in agricultural borrowings caused by an economic decline, but no exception shall be made when failure to comply with this requirement is due to borrowings obtained from other sources or repurchase of loans by an affiliate. Repeated failure to utilize the line of credit at an acceptable level may result in loss of access. No fee shall be assessed if the relationship is terminated by the bank for reasons other than those stated in this section. OFIs with inactive access relationships on the effective date of these regulations shall be notified and given a reasonable opportunity to activate or cancel the relationship.

[46 FR 51886, Oct. 22, 1981, as amended at 46 FR 59960, Dec. 8, 1981; 55 FR 24886, June 19, 1990]

§ 614.4565 Lending limit.

An OFI having access to a bank shall not accept liability on any loan or other obligation, or obtain any endorsement or guarantee from a borrower where the aggregate of such liabilities or indebtedness to the OFI would exceed 50 percent of its capital and surplus or such lesser amount as may be established by other State or Federal statute. OFIs which have loans in excess of this limitation shall have 2 years from the effective date of these regulations to reduce individual risk exposure to within this limitation.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4570 General collateral requirements.

As a condition precedent to establishing a credit line with a bank, OFIs (except depository institutions) shall pledge as collateral for any and all obligations to the bank, cash, or readily marketable securities of high rating, in an amount to be determined by the bank. At the discretion of the bank, depository institutions may be required (unless prohibited by law or by supervisory authority) to deposit acceptable collateral. Securities and obligations pledged with the bank shall be deposited under a collateral pledge agreement pursuant to which all securities and obligations so pledged, including all substitutions and additions and the proceeds of any such collateral, including all income derived, shall be available to secure any and all obligations to the bank, whether direct or contingent, present or future.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4580 Use of funds.

Funds obtained from the bank may not be used by an OFI to expand lending activity in loans which would be ineligible for discount.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4590 General financing agreement.

An OFI desiring to access a bank shall execute a general financing agreement. The agreement shall state the general terms and conditions under which loans will be discounted or made or credit otherwise extended and shall provide for the OFI to periodically furnish the bank acceptable financial reports and any data necessary to assure that the OFI remains in compliance with these regulations. The agreement shall further provide that the OFI, other than a State bank, trust company, or saving association, agrees to examination by the Farm Credit Administration if such examination is requested by the Chairman. With respect to an OFI which is a State bank, trust company, or savings association, the agreement shall provide that such OFI, at the request of the Chairman, consents that reports of its examination by constituted State authorities may be furnished by such authorities to the Farm Credit Administration.

[51 FR 41947, Nov. 20, 1986, as amended at 55 FR 24886, June 19, 1990]

§ 614.4600 Methods of financing.

(a) A bank may provide funds to OFIs by discounting or purchasing individual loans or by direct loan to the OFI, all subject to the following:

(1) Direct discount or purchase is normally made at full face value of the individual loan of acceptable quality. At the option of the bank, a loan of less than acceptable quality may be discounted or purchased at less than the full amount of such loans. In such transactions, the OFI shall be required to apply all repayments toward repayment of the amount of the less than acceptable loan discounted or purchased by the bank.

(2) A bank is authorized to make loans and advances to OFIs secured by notes or other such obligations of eligible borrowers defined in part 613 of these regulations; however, such loans or advances may be made to enable the OFI to make or carry loans to such bona fide farmers and ranchers or to producers or harvesters of aquatic products.

(b) The following classes of obligations are authorized for discount or purchase or as collateral for direct loans and advances to OFIs, subject to approval of the bank to which such securities are to be pledged:

(1) Obligations of eligible borrowers defined in part 613 of these regulations arising from direct credit extension by the OFI.

(2) Loan participations purchased.

(3) Obligations set forth in § 615.5140(a) which have been approved by the Farm Credit Administration for investment by institutions of the Farm Credit System.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4610 Obligations eligible for discount or purchase.

Any obligation the proceeds of which could have been advanced to an eligible borrower by an association in the district shall be eligible for discount by or purchase from an OFI, as set forth in part 613 of these regulations and the limitations contained therein, including § 613.3040(d)(2). Loan participations purchased by an OFI shall be eligible for discount by or purchase from an OFI. The bank is authorized to take corrective measures if this authority is being used to circumvent the intent of these regulations. The banks shall be responsible for providing OFIs with any additional lending and borrower eligibility guidelines which may be provided to associations.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4620 Multiple ownership.

Where two or more entities combine resources to form an OFI to apply for access to a bank, the request for access shall be evaluated according to the criteria set forth in §§ 614.4545 and 614.4550 of this subpart. The bank shall in no event be required to discount for, purchase from, or extend credit to such an OFI with respect to any obligation originated by one of its affiliates which is itself ineligible under the criteria set forth in § 614.4550 of this subpart.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4630 Insolvency of an other financing institution.

(a) If an OFI having access to a bank becomes insolvent or is in process of liquidation, or if it fails to service its loans properly, and where supervision or orderly liquidation will be facilitated by direct handling of the obligations of the note makers, the bank may, with the consent of the Farm Credit Administration, take over such obligations for orderly liquidation. Obligations pledged with the bank by an OFI, either as collateral for a direct loan or as additional security for any and all indebtedness of the institution to the bank, also may be taken over and handled directly with the makers after a title has been acquired in accordance with the provisions of applicable laws and the terms of the pledge agreements executed by the OFI involved. The bank's authority to handle obligations directly includes the authority to make additional advances, to grant renewals and extensions, and to take such other actions as may be necessary to collect the loans. Direct liquidation of obligations carried for an OFI should be resorted to only in cases where other measures have failed, and it is apparent that direct liquidation is the only practicable means available to the bank for protection of its interest.

(b) Obligations handled for an insolvent OFI as provided in this section shall not be assigned as collateral for bonds without the approval of the Farm Credit Administration.

(c) As to obligations which a bank has taken over from a defaulting OFI for liquidation, interest shall be collected according to the terms. Renewals of such obligations, when directly payable to the bank, shall bear interest at a rate not to exceed the maximum rate that may be charged by OFIs on obligations eligible for discount by the banks at the time of renewal.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4640 Rates and fees.

Interest on loans to OFIs shall be charged and collected at the same rate and on the same basis as to associations. Except as provided in § 614.4560(b) of this subpart, a bank may charge servicing fees in connection with credit extended to financing institutions provided comparable fees are charged to associations.

[56 FR 2674, Jan. 24, 1991]

§ 614.4650 Basis for revocation of access.

(a) A bank may revoke or suspend the credit line of an OFI for cause. The following may be cause for revocation.

(1) Failure to comply with this subpart or the terms of the agreement between the bank and the OFI.

(2) Failure to correct violation of State or Federal statutes brought to the attention of the OFI, where the nature of the violation calls into question the safety of the loan or discount relationship or the integrity of the OFI's management.

(3) Failure to maintain management, credit practices, or credit quality satisfactory to the bank.

(4) Failure to use the established credit line to the extent contemplated in § 614.4560(b)(5) of this subpart.

(5) Changes in the operation of the institution which render it ineligible under § 614.4550 of this subpart.

(b) During any period of suspension the bank shall not be required to purchase from or discount for the OFI any new obligations and no further advances shall be required pending correction of a default. The bank may make advances to cover commitments on obligations held by the bank or to preserve the security and protect the interest of the bank in obligations held by it. Before making additional advances to an OFI whose right to borrow or discount has been suspended because the ratio of its total liabilities to unimpaired capital and surplus equals or exceeds the maximum permitted under law, the bank shall satisfy itself that the OFI will not violate any applicable law by assuming liability for such additional advances.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

§ 614.4660 Place of discount.

When an OFI has loans outstanding to borrowers in more than one Farm Credit district, it shall establish its eligibility with the bank in whose territory the OFI has its principal place of business. However, if more than 50 percent of the OFI's loans outstanding to borrowers are located in a single Farm Credit district other than that in which the OFI is headquartered, it shall establish its eligibility and discount relationship with the bank in whose territory the loan volume is concentrated. No OFI having access to a bank on the effective date of these regulations shall be required to change its relationship to another bank unless the OFI changes its headquarters location or its lending territory.

[46 FR 51886, Oct. 22, 1981, as amended at 55 FR 24886, June 19, 1990]

Attachment II-3. FCA ANPR on OFI Regulations

This is a copy of the Federal Register notice inviting suggestions for modification of the OFI regulations. The comment period cited was extended to August 30, 1996 by FCA notice in the Federal Register of 7/17/96.

ADVANCE NOTICE OF PROPOSED RULEMAKING

Published: 61 FR 24907. May 17. 1996

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 614

RIN 3052-AB67

Loan Policies and Operations: Other

Financing Institutions

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Farm Credit Administration(FCA) requests public comment through an Advance Notice of Proposed Rulemaking (ANPRM) concerning potential revisions to the regulations in subpart P of part 614 that govern the funding and discount relationship between Farm Credit System (Farm Credit, FCS. or System) banks that operate under Title I of the Farm Credit Act of 1971, as amended (Act), and non System other financing institutions(OFIs). Farm Credit Banks (FCBs) and agricultural credit banks (ACBs) are authorized to fund and discount certain short- and intermediate-term loans for non-System lenders, such as commercial banks, savings associations, credit unions, trust companies, agricultural credit corporations, and other agricultural and aquatic lenders as part of their mission to finance agriculture, aquaculture, and other specified rural credit needs. External developments, such as the consolidation of the commercial banking industry, the advent of interstate banking and branching, the gradual reduction of Federal assistance to agriculture and rural communities, and the increased interest of non-System financial institutions in additional sources of funding and liquidity may necessitate revisions to the regulations in subpart P of part 614 so that System banks can fulfill their obligation to meet demands in rural communities for short-and intermediate-term credit. The purpose of any future rulemaking would be to ensure that eligible and creditworthy farmers, ranchers, aquatic producers and harvesters, processing and marketing operators, farm-related businesses, and rural homeowners will continue to have access to affordable, dependable, and stable short- and intermediate-term credit through both System and non-System lenders. Specifically, this ANPRM seeks comments regarding the FCA's OFI regulations and how they may be revised to better implement the statutory provisions.

DATES: Written comments should be received on or before July 16, 1996.

ADDRESSES: Comments may be mailed or delivered to Patricia W. DiMuzio. Associate Director, Regulation Development. Office of Examination. Farm Credit Administration. 1501 Farm Credit Drive. McLean, Virginia 22102-5090 or sent by facsimile transmission to the FAX number at (703) 734-5784. Copies of all communications received will be available for review by interested parties in the Office of Examination. Farm Credit Administration.

FOR FURTHER INFORMATION CONTACT:

Eric Howard. Policy Analyst. Regulation Development. Office of Examination. Farm Credit Administration. McLean, VA 22102-5090. (703) 883-4498.

or

Richard A. Katz. Senior Attorney. Regulatory Enforcement Division. Office of General Counsel. Farm Credit Administration. McLean, VA 22102-5090. (703) 883-4020. TDD (703) 883-4444.

SUPPLEMENTARY INFORMATION: The Agricultural Credit Act of 1923¹⁰ created 12 Federal intermediate credit banks (FICBs) to discount agricultural production loans for national and State banks, trust companies, savings associations, credit unions, agricultural credit corporations, incorporated livestock loan companies, and other specified lenders. In 1930, Congress authorized the former FICBs to make secured loans and advances directly to such institutions (hereinafter OFIs)¹¹ As a result, OFIs could borrow from and discount production agricultural loans with System banks before the Farm Credit Act of 1933¹² created production credit associations (PCAs) as an alternative source of financing the operating needs of farmers and ranchers.

The legislative history to the Act reveals that Congress originally granted OFIs discount privileges at System banks in order to redress the scarcity of operating credit for farmers and ranchers¹³. During the past 73 years, Congress has responded to the changing demands of agricultural producers and other rural residents for affordable short- and intermediate-term credit by updating the statutory authorities of the FICBs and their successor FCBs and ACBs to provide funding and financial assistance to both System and non-System lenders. Currently, section 1.7(b) of the Act authorizes OFIs to obtain funding from FCBs or ACBs¹⁴ for any loan that a PCA could make under section 2.4 of the Act to eligible farmers, ranchers, aquatic producers and harvesters, processing and marketing operators, farm-related businesses, and rural homeowners.

Section 1.7(b)(4) of the Act requires the FCA to enact regulations that assure that funding from Farm Credit banks operating under title I of the Act will be "available on a reasonable basis" to any national bank, State bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings association, credit union, association of agricultural producers engaged in making loans to farmers and ranchers, or corporation engaged in making loans to producers or harvesters of aquatic products that: (1) Is significantly involved in lending for agricultural or aquatic purposes; (2) demonstrates a continuing need for supplementary sources of funds to meet the credit requirements of its agricultural or aquatic borrowers; (3) has limited access to national or regional capital markets; and (4) does not use the services of System banks to extend credit to persons and for purposes that cannot be financed by a PCA under title II of the Act. According to the legislative history to section 1.7(b)(4) of the Act,¹⁵ Congress intended that Farm Credit banks act as a primary funding and liquidity source for small, local OFIs so they

¹⁰ Pub. L. No. 503, 42 Stat. 1454. (Mar. 4, 1923)

¹¹ Pub. L. No. 439, 46 Stat. 816 (June 26, 1930)

¹² Pub.L. No. 75-73D. title 11. 48 Stat. 257. 259. (June 16, 1933)

¹³ See H. R. Rep. No. 1712. 67th Cong., 1st Sess. (Feb. 25, 1923). P 17.

¹⁴ Section 410 of the Agricultural Credit Act of 1987 (1987 Act) created the FCBs through the mandatory merger of the Federal Land Bank and the FICB in each Farm Credit district. See Pub. L. No. 100-233, S 410. 101 Stat. 1568, 1637. Jan. 6. 1988). Section 7.0 of the Act allows a FCB to merge with a bank for cooperatives in order to form an ACB. Section 7.0 of the Act derives from section 416 of the 1987 Act. Section 7 0 was further amended by section 408(b) of the Agricultural Credit Technical Corrections Act of 1988. See Pub.L. No. 100-233. S 416. 101 Stat. 1568,1645. (Jan. 6, 1988) Pub. L. No. 100-399. S 408(b). 102 Stat.989, 1001. (Aug. 17. 1988).

¹⁵ Current section 1.7(b)(4) derives from section 203 of the Farm Credit Act Amendments of 1980 (1980 Act). See Pub. L. No. 96-592. S 203. 94 Stat. 3437. 3441. (Dec. 24, 1980) Section 203 of the 1980 Act substantially revised former section 2.3 of the Act, which set forth the lending authorities of the FICBs. The new OFI eligibility criteria in section 203 of the 1980 Act were incorporated into former section 2.3(d) of the Act. Section 401 of the 1987 Act, which set forth the powers and obligations of the FCBs, recodified the requirements in former section 2.3(d) as section 1.7(b)(4) of the Act. See Pub. L. No. 100-233. S. 401. 101 Stat. 1568. 1625 (Jan 6. 1988).

in turn could meet certain short- and intermediate term credit needs in their rural communities.¹⁶ However, the legislative history to section 1.7(b)(4) of the Act also indicates that Congress did not intend to exclude other agricultural creditors from funding or discounting loans with System banks¹⁷, so long as they have a need for supplementary funds that cannot be met through access to national or regional capital markets.

Section 1.7(b) of the Act requires FCBs and ACBs to extend credit to qualified OFIs (within the confines of safety and soundness) as part of their mission to finance agriculture, aquaculture, and other specified rural credit needs. While many OFIs often compete directly with PCAs and agricultural credit associations (ACAs) that own voting stock in the FCB or ACB, the Act requires Farm Credit banks to extend funding on a safe and sound lending basis to any qualified OFI so that farmers, ranchers, aquatic producers and harvesters, farm-related businesses and rural homeowners have access to affordable and dependable credit.

The number of OFIs that fund or discount loans with System banks has declined from a peak of 327 in 1982 to 22 on December 31, 1995. Furthermore, the amount of credit that System banks have extended to OFIs has decreased from almost \$914 million in 1981 to \$230.8 million as of December 31, 1995. The farm crisis of the 1980s caused a decline in overall agricultural debt, which in turn, substantially reduced the number of OFIs and their demand for System financing. The FCS also experienced significant financial stress between 1984 and 1989, and many OFIs terminated their discounting relationship with System banks because: (1) They sought to reduce their exposure to loss by retiring their investments in FCS banks; (2) the FCS no longer offered competitive rates; or (3) several OFIs ceased operations as a result of merger or closure. Many rural commercial banks, including some OFIs, merged with regional banks or bank holding company networks that did not qualify for OFI status because they were no longer significantly engaged in agricultural lending.

The financial strength of Farm Credit banks has significantly improved in the past several years. As a result, FCBs and ACBs are better positioned to help increase the availability of reasonably priced and dependable credit in many of America's rural communities. Efforts by Federal and State governments to balance their budgets may reduce direct assistance to agriculture and rural development in future years. As rural areas require greater private sector investment to sustain their economic viability, local financial institutions are seeking alternative means to provide affordable credit to their communities on a sustainable basis. Rural lenders also face liquidity problems from time-to-time. Loan-to-deposit ratios at rural depository institutions are now at historically high levels¹⁸. As the commercial banking industry continues to consolidate into large national and regional networks it is unclear how the credit needs in rural communities will be affected.

Today, several non-System financial institutions are once again expressing interest in obtaining FCS funding for their short- and intermediate-term loans to agricultural and other rural borrowers. However, many of these non-System institutions perceive barriers that impede their access to System funding. Although a variety of factors may have contributed to the historical decline in the OFI lending program, the FCA wants to eliminate any regulatory restrictions that are not required by the Act and its legislative history or do not promote safety and soundness of the FCS.

The FCA wants to ensure that the relationship between Farm Credit banks and OFIs provides another means for meeting the short- and intermediate-term credit needs of agricultural producers and other rural borrowers, as Congress intended. The existing regulations were enacted in 1981, after Congress amended the OFI provisions in the Act. See 46 FR 51886 (Oct. 22, 1981). As a result of external developments over the past 15 years, the FCA believes that it is now time to review these regulations in subpart P of part 614 to determine whether they are appropriately addressing the credit needs of non-System institutions that lend to agriculture and rural communities. An ANPRM will give all interested parties an opportunity to provide the FCA with information to assist it in

¹⁶ See H.R.96-1287, 96th Cong., 2d. Sess., (1980), 21, 32-34. See also 126 Cong. Rec. H. 10960-64 (daily ed. Nov. 19, 1980).

¹⁷ Id.

¹⁸ A recent study indicates that loan-to-deposit ratios at commercial banks of all sizes that substantially engage in rural lending have risen from 53.6 percent in 1987 to 86.2 percent as of June 30, 1995. See Economic Research Service, U.S. Dept of Agriculture, (AIS-60), Agricultural Income and Finance Situation and Outlook Report 11, 53, (Feb. 1996).

developing proposed regulations that will be responsive to the credit needs of OFIs and their borrowers¹⁹. Furthermore, the FCA seeks guidance about how new regulations can best promote equitable treatment of OFIs and System associations by FCBs and ACBs. Comments from non-System lenders are encouraged so that the FCA can consider the needs and concerns of eligible financial institutions that the Agency does not examine or regulate.

The Act establishes certain requirements that OFIs must meet in order to initiate and maintain a relationship with the FCS. For example, section 1.10(b) of the Act authorizes FCBs and ACBs to extend credit to OFIs so they can make short- and intermediate-term loans to persons who would be eligible to obtain credit from PCAs.²⁰ Additionally, each OFI is required by section 4.3A©(1)(D)(iii) of the Act to purchase non-voting equity in its funding FCB or ACB. Finally, the same borrower rights that PCAs must provide also apply to OFI loans that are funded by a Farm Credit bank.

Safety and soundness issues will also be addressed when the FCA proposes new OFI regulations. OFIs may pose different safety and soundness considerations for the FCA than direct lender associations. For example, OFIs may merit a different regulatory treatment than System associations for questions relating to collateral and lien perfection because, in contrast to System associations, OFIs can borrow from other lenders without the permission of their System funding banks. In contrast to the authorities vis-a-vis FCS institutions, the FCA lacks broad authority to: (1) Appoint a conservator receiver for insolvent OFIs²¹ or (2) determine the priority of claims against OFIs in liquidation.²²

The FCA requests comments and information that address the following questions:

I. Eligibility for OFI Status

A. Significant Involvement in Agricultural or Aquatic Lending

1. What criteria (such as assets, income, composition, of the loan portfolio, or other factors) best determine whether an OFI is significantly involved in agricultural or aquatic lending as required by section 1.7(b)(4)(B)(1) of the Act and what specific threshold, if any, should new regulations use? Please explain your recommendation.
2. How should the FCA define an agricultural-cultural lender? Would the profiles of agricultural lenders established by other Federal agencies be useful? Please explain your recommendation.

B. An OFI's Need for Supplemental Sources of Funds

What criteria should be used to determine whether depository and non-depository OFIs demonstrate a continuing need for supplementary sources of funds to meet the credit requirements of their agricultural or aquatic borrowers, as required in section 1.7(b)(4)(B)(ii) of the Act? Please explain your recommendations.

C. OFI Access to National or Regional Capital Markets

¹⁹ The FCA is aware that Congress is considering proposals that would provide non-System financial institutions greater access to funding and discount relationships with System banks. These legislative proposals go substantially beyond what the existing statute allows. Should any of these proposals be enacted, the FCA would review the regulations in light of the new statutory provisions.

²⁰ Section 1.10(b) of the Act allows FCBs and ACBs to extend financial services to PCAs, ACAs, and OFIs so they can make: (1) Aquatic loans that mature within 15 years, and (2) loans to farmers, ranchers, farm-related businesses, and non-farm rural homeowners that mature within 7 years, unless the bank's board, under the regulations of the FCA, approve loans that are repayable within 10 years.

²¹ Section 4.12(b) of the Act grants the FCA 'exclusive power and jurisdiction to appoint a conservator or receiver' for FCS banks and associations

²² For the past 65 years, the Federal courts have interpreted various Farm Credit Acts as authorizing FCA to determine the priority of claims for System institutions in liquidation. See *Wheeler v. Greene*. 280 US 49 (1929); *Knox National Farm Loan Association v. Phillips*. 300 US 194 (1937); *Little v. First South Production Credit Association*. CA No. J890021(W)(S.D.Miss. May 16. 1990)

1. Has the existing regulatory definition of 'national or regional capital markets' in S 614.4540 become outmoded? If so, what factors in today's financial environment demonstrate that an OFI has limited access to 'national or regional capital markets'?
2. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 will enable bank holding companies and their commercial bank affiliates to expand, over time, their interstate banking and branching networks. How will this law affect the concept of limited access to 'national or regional capital markets' in section 1.7(b)(4)(B)(w) of the Act?

D. Mergers, Consolidations and Acquisitions of OFIs

When an OFI merges, consolidates, or is acquired by another financial institution, the eligibility of the successor entity to borrow from an FCB or an ACB must be established anew. Under what conditions, if any, should a successor to an existing OFI be entitled to 'grandfather' rights?

E. Parent and Affiliate Relationships

1. What factors should determine whether an OFI applicant is considered together with its parents and affiliates as a single entity?
2. Section 1.7(b)(4)(D) of the Act establishes specific criteria for FCA review of OFI application denials based on the OFI's subsidiary or affiliate relationships. Under SS 614.4550 and 614.4555, the FCA creates a review procedure when an FCB or ACB rejects an OFI's request for financing for any reason. In the interest of eliminating unnecessary prior approvals and case-by-case reviews, the FCA requests comments on whether there is a compelling need for the regulations to continue to require an FCA review of all OFI applications that have been denied. Please explain your recommendation.

F. Eligibility of Major Financial Institutions

The statute and the legislative history indicate that agricultural lenders that do not meet the criteria of sections 1.7(b)(4)(B)(ii) and (iii) of the Act could still fund or discount certain loans with System banks. What restrictions, if any, should the regulations impose on System funding to these types of institutions?

II. Place of Discount

1. Should new regulations continue the territorial restrictions in existing S 614.4660 which require that an OFI must obtain financing from the FCB or ACB (designated System bank) in whose territory: (1) The OFI maintains its headquarters; or (2) more than 50 percent of the OFI's borrowers is concentrated? If not, what criteria should determine which Farm Credit bank should finance an OFI? Please explain your recommendation.
2. Under what circumstances, if any, should new regulations allow an FCB or ACB to extend financing to an OFI that does not operate in its chartered territory if the designated System bank does not approve the OFI's application?
3. Are there any aspects of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 that the FCA should consider as it develops new regulatory provisions that determine the place of discount for commercial banks and nonbank affiliates of bank holding companies whose networks operate in the chartered territories of more than one Farm Credit bank? Please explain your recommendation.

III. Safety and Soundness

A. Supplemental Collateral

Under what circumstances, if any, should OFIs be required by the new regulations to pledge cash and readily marketable securities or other assets as additional collateral for their loans from System banks?

B. OFI Lending Limit

Current regulations at S 614.4565 impose a lending limit on OFIs. Is this limit appropriate? If not, what alternatives do you suggest and why? How should concentration risk be addressed in a general financing agreement between an OFI and a Farm Credit bank?

C. Insolvency of an OFI

How should new regulations safeguard the interests of an FCB or ACB when an OFI is liquidated?

IV. Fair Treatment Between OFIs and Direct Lender Associations

1. Do current regulations adequately and appropriately ensure that FCBs and ACBs accord impartial and equitable treatment to both FCS associations and OFIs? If not, what changes should be made and why?
2. The regulations currently require, with certain limited exceptions, that OFIs must be treated in a manner that is comparable to direct lender associations. To the extent feasible, the FCA seeks to ensure that OFIs and FCS associations are treated equitably by their funding banks. What circumstances, if any, justify different standards concerning equity investment in the funding bank, interest rate charges, and servicing fees?

V. Other Issues

Are there other regulatory changes, not addressed above, that would improve an FCS bank's ability to serve an OFI and its agricultural customers? Please explain your recommendations

Dated: May 13, 1996.

Floyd Fithian.

Secretary.

Farm Credit Administration Board.

Attachment II-5. Volume of FCS Lending Through OFIs.

The data in the following table are from FCA records.

APPENDIX 5

FCS Lending to OFIs, 1923-1994 \$ million

1923	\$0.4	1941	\$42.9	1959	\$103.1	1977	\$376.0
1924	\$48.0	1942	\$48.0	1960	\$104.5	1978	\$510.9
1925	\$58.4	1943	\$41.0	1961	\$105.9	1979	\$666.4
1926	\$76.5	1944	\$35.9	1962	\$114.6	1980	\$810.7
1927	\$65.1	1945	\$30.7	1963	\$126.6	1981	\$913.8
1928	\$68.6	1946	\$34.7	1964	\$133.8	1982	\$872.0
1929	\$68.1	1947	\$40.8	1965	\$141.3	1983	\$850.0
1930	\$91.7	1948	\$59.1	1966	\$168.5	1984	\$875.2
1931	\$136.7	1949	\$63.6	1967	\$185.0	1985	\$536.9
1932	\$116.1	1950	\$58.8	1968	\$205.4	1986	\$275.0
1933	\$82.1	1951	\$91.4	1969	\$221.4	1987	\$202.0
1934	\$159.2	1952	\$98.5	1970	\$250.7	1988	\$111.6
1935	\$88.5	1953	\$86.6	1971	\$253.5	1989	n.a.
1936	\$54.3	1954	\$67.9	1972	\$261.3	1990	n.a.
1937	\$48.0	1955	\$75.4	1973	\$271.4	1991	\$83.3
1938	\$42.9	1956	\$74.7	1974	\$280.1	1992	\$84.3
1939	\$40.2	1957	\$71.7	1975	\$319.1	1993	\$162.5
1940	\$40.9	1958	\$86.0	1976	\$349.4	1994	\$210.2

Source: FCA Annual Reports and Funding Corporation Reports

1923-1970: 1969-1970 FCA Annual Report, p. 105

1971-1978: 1977-1978 FCA Annual Report p. 83

1979- present: FCA Call Reports and Funding Corporation Reports

1923 through 1972: Fiscal Years ending June 30.

1973 to the present: Fiscal Years ending December 31.