FCS's Lack of Financial Transparency is a Serious Problem

by Bert Ely

One of the missions of *Bert Ely's Farm Credit Watch (FCW)* is to improve the financial transparency of the Farm Credit System (FCS). This is important for two reasons. First, only through improved transparency can anyone be assured that FCS lending units are not pricing unfairly. As ag lenders know, there have been a growing number of incidents where FCS units have engaged in some fairly aggressive loan pricing; improved FCS transparency will help to more clearly identify the aggressive lenders. Second, improved transparency is essential to ensuring that the FCS does not again become a reckless lender to rural America. Nearly everyone – farmers and ranchers, rural residents, suppliers to the ag sector, taxpayers, bankers and Americans generally – will be harmed if FCS falls off the wagon again.

Call Report Data

Key to improved financial transparency of the FCS is close scrutiny of the financial data for the 155 or so FCS lending units. Much to my surprise, the Farm Credit Administration (FCA), FCS's regulator, does not regularly publish any data on the FCS lending units, such as a listing of them by asset size, capital ratios, levels of non-performing loans, etc. Instead, it passively sells copies of call reports on individual institutions and provides call report data on diskette for all of the FCS institutions. I am planning to purchase a diskette so that I can undertake an institution-by-institution analysis of the individual FCS lending units. I will report on this analysis in a future issue of *FCW*.

Public Disclosure of CAMELS Ratings

I also approached the transparency issue from another tack, by making a Freedom of Information Act request for the CAMELS ratings on each FCS lending institution. FCS institutions are examined by the FCA in much the same manner that commercial banks are subject to periodic examinations. FCA also has adopted substantially the same CAMELS rating system for FCS lenders which bank regulators apply to commercial banks. Like the banking regulators, the FCA does not publish the ratings of individual institutions. However, in its 1997 annual report, the FCA noted that one of its institutions was 4-rated (i.e., fairly seriously troubled) and 4.2 percent of its institutions were 3-rated. At the end of 1996, there were no 4-rated FCS institutions, so someone slipped into trouble during 1997.

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It is logical not to publish the CAMELS ratings of banks and thrift institutions because it is not in the public interest to scare depositors in institutions with weak CAMELS ratings. That rationale, however, does not apply to FCS lenders because they are not supposed to accept deposits from the public. I have been told by FCA personnel that CAMELS ratings are disclosed only to the directors of the institution in question. This means that CAMELS ratings are not disclosed to the stockholders of individual institutions, to other FCS institutions, to Congress, or to the debt market, which supplies most of the FCS funding.

A key congressional belief is that taxpayer risk from federally insured or guaranteed institutions should be minimized through sufficient public disclosure so that there is adequate market discipline over these institutions. That is the intent of the $100,000 deposit insurance limit as well as disclosure of a bank's financial condition to its depositors, debt holders and stockholders so that they can exercise the desired market discipline. The question regarding the FCS is simply this: Where are the sources of the necessary market discipline for the FCS, given that it is a government-sponsored enterprise and therefore not subject to the stockholder discipline to which all commercial banks are subject? This is not an academic question given the 1987 congressional rescue of the FCS in the aftermath of FCA's failure as a regulator.

One could argue that the financial information on the entire FCS published periodically by the FCA and the Federal Farm Credit Banks Funding Corporation provides sufficient disclosure. But I challenge such an assertion because the FCS is composed of more than 150 relatively autonomous lending units that directly or indirectly are jointly liable for each other's indebtedness. In effect, public release of CAMELS ratings on each FCS institution will provide the basis for greater market discipline within the FCS by the management and stockholders of FCS institutions. I suspect that pressure from within the FCS on 3-rated and 4-rated institutions to improve their operations will increase enormously once CAMELS ratings are publicly disclosed.

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Aggressive FCS Loan Pricing

I am continuing to receive data on instances where FCS lending units have been pricing loans well below market rates and the FCS's own lending costs. Keep sending me examples of aggressive FCS loan pricing so that we can demonstrate that the FCS is in fact engaged in broad-scale predatory loan pricing. jal