Farm Credit System Lending to Young, Beginning, and Small Farmers and Ranchers

Statement of

Dale E. Pohlmann
President and Chief Executive Officer
Ravenna Bank
Ravenna, Nebraska

On Behalf of the

American Bankers Association

At a Public Meeting of the

Farm Credit Administration

Held at

Kansas City, Missouri
November 13, 2002

Chairman Reyna, Ms. Jorgenson, and Mr. Flory, my name is Dale Pohlmann. I am the president and chief executive officer of the Ravenna Bank in Ravenna, Nebraska. The Ravenna Bank has approximately $53 million in assets and $43 million in outstanding loans and loan commitments, 75 percent of which are to farmers, ranchers, and agribusinesses. I appear before you today as a representative of the American Bankers Association ("ABA").

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country. We appreciate this opportunity to express our views on lending by the Farm Credit System ("FCS" or "System") to Young, Beginning, and Small ("YBS") farmers and ranchers.

Mission of the Farm Credit System

The FCS was established as a tax-advantaged government-sponsored enterprise ("GSE") in 1916 to serve the special credit needs of America's farmers and ranchers at a time when national banks and many state-chartered banks were generally prohibited from lending money on real estate. In 1933, at the height of the Great Depression and at a time when credit was difficult for farmers and ranchers to obtain, the charter of the System was expanded to include short- and intermediate-term operating loans. Since its creation, the System has had a special, limited mission to deliver specific services to a particular segment of the economy. In exchange, the System enjoys significant freedom from taxation and the implied full faith and credit of the United States government in borrowing lendable funds.

In 1980, Congress further defined the mission of the FCS by requiring most System institutions to develop a "program for furnishing sound and constructive credit and related services to young, beginning, and small farmers and ranchers."[1] In 1998, the Farm Credit Administration ("FCA" or "Administration") adopted a policy statement that again recognized the special mission of the System. This policy statement provided definitions of young farmers and ranchers (35 years of age or younger), beginning farmers and ranchers (10 years or fewer farming or ranching, and small farmers and ranchers (generating less than $250,000 in annual gross sales).[2] Finally, during its meeting on October 11, 2001, the FCA board of directors rejected a proposal to grant national charters to System institutions and directed FCA staff to develop a policy statement related to the mission of the System.

Despite occasional expansion of the System's charter, its status as a GSE has not changed, nor has its special mission. The ABA applauds the recognition by FCA of the need to better define the mission of a System that continues to use its GSE, tax-advantaged status to undermine the spirit of the Farm Credit Act by increasingly lending not to young farmers and ranchers, but to older farmers and ranchers; not to beginning farmers and ranchers, but to well-established farmers and ranchers; and not to small farmers and ranchers, but to large farmers and ranchers. Furthermore, the System is increasingly financing non-farm rural estates, golf courses and other recreational facilities, development projects, and other functions not closely related to production agriculture.

[1] 12 U.S.C.A §2207(a)
[2] FCA-PS-75, adopted December 10, 1998

On a number of occasions, the ABA has highlighted an agricultural credit market that is well served by many private sector lenders willing and able to provide affordable credit to a broad cross-section of farmers and ranchers. It is in this environment that the FCS, the only lender with a federal mandate to lend to YBS farmers and ranchers, seeks out the very best credits and seemingly ignores those it is obligated to serve.

Current YBS Lending Practices: A Chronic Problem Exists

The System continues to fall short of its special mission of lending to YBS farmers and ranchers. This is due, in part, to the FCA's lack of clear and concise goals for System institutions and an apparent reluctance on the part of the FCA to follow through on all YBS lending aspects of examinations. However, it is clearly the fault of the FCS that YBS farmers and ranchers remain an underserved component of the System loan portfolio as it pursues older, more established, and wealthier farmers and ranchers.

System institutions are rapidly consolidating into fewer and larger institutions that are more efficient and better positioned to serve larger and wealthier customers from a distance. As a result of this practice, the FCS has closed smaller, more remote offices. Banks and other commercial lenders are better positioned to serve smaller farmers and ranchers since they have maintained more offices in remote rural areas. According to the System's Annual Information Statement for 2001, just 2.8 percent of the System's loans then outstanding—all over $500,000 in size—accounted for 51.3 percent of total FCS lending."[3] This situation is highlighted in a survey released by the USDA Economic Research Service, a report by the General Accounting Office, and surveys released by the American Bankers Association and the Nebraska Bankers Association.

US Department of Agriculture, Economic Research Service, Agriculture Economics and Land Ownership Survey

In August 2001, the US Department of Agriculture Economic Research Service ("ERS") released its most recent Agriculture Economics and Land Ownership Survey ("AELOS"). The survey is based upon information supplied by farmers and ranchers to the USDA Census of Agriculture. The AELOS data revealed that only 8 percent of the System's portfolio was loans to young farmers and ranchers while 54 percent of the portfolio was dedicated to those farmers and ranchers over 50 years of age. The AELOS data revealed that System institutions on average loan to significantly larger operations than do banks. The average size operation served by bank financing was 600 acres. The average size operation served by FCS lending was 935 acres, 56 percent larger than bank-financed operations. The AELOS data also revealed that the average market value of production on bank-financed operations was $156,000 while the average market value of production on FCS-financed operations was $311,000, fully double that of bank-financed operations.

General Accounting Office Report on YBS Lending

On March 8, 2002, the General Accounting Office ("GAO"), the investigative arm of Congress, issued a report entitled *Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to Be Improved.* As stated in the GAO report:

---

[3] Farm Credit System *Annual Information Statement 2001.* Chart on 36

> A broad regulation, such as the current FCA regulation on YBS, is open to broad interpretation. FCA's expectations for YBS program elements and performance are unclear in the current language of the regulation. Alternatively, regulation that provides specific guidance or standards for YBS programs would afford FCA and System institutions greater certainty about what is appropriate and adequate for YBS programs.[4]

Essentially, overly broad guidelines and unclear expectations have led to System institutions being uncertain or indifferent regarding YBS lending obligations. For the report, GAO reviewed a sample of 30 System institution examination reports and found that "the characteristics of YBS programs at institutions in the System varied significantly."[5] GAO found that nearly half (14) of the System institutions in the sample had no specific YBS program in place, over two-thirds (21) of the institutions had no numerical goal for YBS service, and half (15) had no marketing and outreach effort in place.

In addition to reviewing the sampling of examination reports, GAO also reviewed the special missions of other GSEs and in each case how those missions were accomplished and how the regulator in each case measured performance. GAO found that every regulator except FCA had issued regulations with specific standards describing what constituted an acceptable program and/or setting quantifiable goals. Furthermore, GAO found that FCA is the only regulator that does not publicly disclose performance information.

GAO concluded that, "FCA's efforts to guide System institutions in establishing and implementing meaningful, result-oriented YBS programs, and clarify its expectations for System performance would be strengthened by setting clear, qualitative standards in regulation."[6] Furthermore, GAO "found weaknesses due to incomplete execution of examination of procedures and incomplete documentation to support examination findings."[7]

Banking Industry Surveys

Surveys of the banking industry have consistently found that System institutions fall short of their responsibility to serve YBS farmers and ranchers while actively pursuing older, more established, and wealthier farmers and ranchers. The most recent ABA Farm Credit Survey Report outlines four characteristics of the FCS regarding which the survey asked bankers to respond on a scale of 1 to 5, with 1 being "strongly agree" and 5 being "strongly disagree." On the first characteristic, "targets larger, wealthier farm customers," the average banker opinion was 4.22. On the second characteristic, "is interested in lending to smaller borrowers," the average banker response was 2.28. On the third characteristic, "offers below-market interest rates to attract new business," the average bankers response was 4.26. On the fourth characteristic, "offers services at below market rates to attract customers," the average banker response was 3.62.

---

[4] *Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to Be Improved.* General Accounting Office, March 2002 at 9.
[5] *Id* at 16.
[6] *Id* at 26.
[7] *Id.*

In the Nebraska Bankers Association's ("NBA") 2001 Ag Credit Survey, a series of questions were asked of bankers regarding their perception of the agricultural credit market. In response to a question pertaining only to the FCS, bankers were asked how much lower System rates were than their own and roughly two-thirds of the respondents indicated the rates were 2 to 3 points lower. Finally, when asked whether the FCS loaned to individuals across the financial spectrum, nearly 60 percent of respondents said no. System institutions are using GSE tax and funding advantages to provide below market loans to large and wealthy farmers and ranchers, not the YBS farmers and ranchers for whom the advantage is intended.

Specific Recommendations to Improve System Lending to YBS Farmers and Ranchers

Instead of a "renewed commitment," general guidance from FCA, and completion of yet another questionnaire by reluctant FCS institutions, we recommend that FCA develop a "hard target" system for FCS institutions to follow when making, monitoring, processing, and reporting loans to YBS borrowers. We define "hard target" as a specific assignment of loans to be made on an annual basis to qualifying YBS farmers and ranchers. FCA can utilize USDA data to determine the population of qualifying YBS farmers and ranchers in an association's service area.

For example, if an association is located in a region that has a high percentage of farmers and ranchers that qualify as YBS borrowers, it is reasonable for FCA to require that association to have a high percentage of their total loans to qualifying YBS borrowers. A "hard target" system would require strictly defined performance guidelines such as numbers of borrowers served, require clear reporting of performance to FCA and the public, and impose penalties when FCS institutions fail to perform. GAO clearly pointed out that a "soft target" system, which is now in use by the FCS and FCA, is not effective, not taken seriously by FCS institutions, and not enforced by FCA examiners.

To put a "hard target" system in place, we recommend FCA take the following actions:

- **Develop a meaningful definition of a small farm or ranch.** We understand that FCA currently uses the $250,000 annual sales figure to determine "small" because USDA adopted this definition. USDA was responding to tremendous political pressure to be as inclusive as possible when they adopted their definition. We see no particular basis for this definition since over 90 percent of the farms and ranches in the United States qualify as small under this definition. Furthermore, we can see no justification for the use of 10 years of operation being the definition of a beginning farmer or rancher. FCA used to use 5 years, and we believe that the 10-year definition was adopted solely in an attempt to make it appear that FCS institutions were doing more to help beginning farmers and ranchers.

- **Develop other criteria that FCA and the public can use to evaluate the performance of a specific FCS institution.** For example, many FCS institutions take great pride in announcing their patronage refund programs. Under these schemes, existing borrowers get a certain amount of the profit of the association back as a patronage dividend. We recommend that FCS institutions, before they distribute a profit dividend to their existing borrowers, use some of their profits to fund special low interest programs for YBS borrowers. The insidious system that is currently in place rewards insiders while actively discriminating against new entrants to the system.

- **Develop a "Scorecard" for System performance.** A scorecard will allow FCA, policy makers, and the public the opportunity to compare one FCS institution against another. FCA will be able to determine which System institutions are making a good faith effort, and which institutions are not engaged in meeting YBS lending goals. With this information, FCA will be able to take meaningful steps to supervise and correct institutions that continue to flaunt the will of Congress. With a scorecard, FCA could intervene in patronage dividend schemes to enforce FCA's goals for YBS lending. Those institutions that fail to meet objectives established for YBS lending would be prohibited from distributing a patronage refund to their existing borrowers. By making sure that the lending scorecard be disclosed to the public, especially the owner/borrowers of the FCS institutions, they will be able to determine how their borrower owned cooperative compares to other borrower owned institutions within the system. The disclosure will encourage stockholder activism, and management will have to respond to their owner borrowers and to the public in general.

- **Create an Affordable Farming Program modeled after the Affordable Housing Program ("AHP") implemented by the Federal Home Loan Bank System ("FHLBS").** The AHP is funded by a charge of 10 percent of the net profit of each of the 12 banks in the FHLBS and is administered by the Federal Housing Finance Board ("FHFB"), the regulator of the FHLBS. Member financial institutions of each of the 12 FHLBS banks submit applications for AHP grants or interest rate subsidies to its respective FHLBS bank. Applications are then reviewed and scored against established criteria. Applications are either denied or granted based upon this scoring system. Such a model could be used to ensure that adequate resources are devoted to YBS lending by the FCS.

  If FCA considers a 10 percent charge to profits too harsh for FCS institutions, we recommend FCA take a close look at System taxation levels. In 2001, the FCS paid no federal income taxes. Further, rapid adoption of the Agricultural Credit Association ("ACA") model by FCS institutions has reduced the effective federal tax rate for the System from 12 percent of profits to 6 percent of profits. Tax lawyers employed by FCS institutions should be congratulated for their skillful manipulation of the federal tax codes but Congress did not create the FCS with the intention that it would work so aggressively to increase tax sheltered revenues. FCA, as the regulator, certainly has the moral authority to step in to demand that some of the System's tax savings be dedicated to YBS lending programs. If FCS managers are offended by this requirement, let them go to Congress and argue that they should be allowed to keep more profits at the expense of YBS farmers and ranchers.

- **FCA should work aggressively to improve the reporting of loan information.** The current YBS reporting system is badly flawed. Multiple loans to a single farmer or rancher are not aggregated, and many young and beginning farmers are also small farmers. Hence, these farmers are being double- and triple-counted in the FCS reporting system—as young AND beginning AND small farmers. For example, a borrower who has four separate FCS loans and loan commitments outstanding is counted four times, not once. Another example would be a farmer with sales under $250,000 who is under 36 and who has been farming or ranching for 10 years or less. In this example, the farmer gets counted three times—once under each of the three categories. The result is that FCS data seriously overstate the System's volume of YBS lending. We believe that FCS reporting data is so flawed that no one, including FCS owner/borrowers, FCA examiners, members of Congress and the Congressional committees that oversee the

System, or the public has a clear idea about the YBS lending activities of the System. Clearly FCA has a role in reforming how System institutions report lending activities. It is unacceptable that an institution that receives the generous subsidies that the FCS receives is able to get away with such a flawed reporting system. As the safety, soundness, and mission regulator of the FCS, FCA must act aggressively and expeditiously to correct these glaring flaws.

Conclusion

We appreciate the opportunity to share our thoughts with you about how the FCS can improve its service to YBS farmers and ranchers. In return for various taxpayer-provided benefits, the FCS has special responsibilities. Chief among these responsibilities is ensuring that YBS farmers and ranchers receive their fair share of consideration by the System for credit to start, maintain, and grow their operations. Unfortunately, the System's performance in this area leaves much to be desired. Over the years, some System institutions have shirked their responsibility to YBS farmers and ranchers and have concentrated on making large loans to wealthy farm and ranch operators, or on making loans to wealthy professionals for their weekend retreats and their exclusive golf courses. As the regulator, FCA bears a great responsibility for establishing measurable goals for the System, for monitoring the System's performance, for enforcing federal law, and for reporting to the owner/borrowers of the System and the public.

FCA has an opportunity to act decisively. FCA has the support of American agriculture, many within the FCS, and the membership of the American Bankers Association. If FCA fail to act in a decisive manner, the System will continue to turn away from YBS farmers and ranchers and public trust in the System will evaporate. As the safety, soundness, and mission regulator of the System, FCA has the authority to mandate fundamental change and influence the direction of the System. The stakes are high. If FCA follows the status quo, then only a fortunate few will receive the generous subsidies inherent in FCS credit. If FCA acts boldly, it could influence the survival of America's small farmers and ranchers and extend a lifeline to young and beginning farmers and ranchers. We urge bold action.

I will answer any questions you may have.