August 15, 2008

Mr. Gary K. Van Meter
Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Re: Rural Community Investments Proposed Rule

Dear Mr. Van Meter:

We are sending this letter on behalf of the Independent Community Bankers of America (ICBA) and our 5,000 community bank members[1] in response to the proposed rule by the Farm Credit Administration that would expand the eligibility and scope of financing for <u>all</u> FCS lenders to engage in so-called "rural community investments."

<u>Summary of ICBA Position</u>

ICBA appreciates the opportunity to comment. ICBA strongly opposes the proposal, and urges the Farm Credit Administration (FCA) to withdraw it. ICBA strongly urges FCA to be guided by the immense weight of evidence *against* this proposal as presented in our letter and thousands of letters in opposition from community banks. We are greatly concerned about the proposal's immense scope and the lack of public information about the specific details of the investment pilot program (which the FCA relies on a great deal to justify the proposed regulation), and the broad reach of financing by Farm Credit System Institutions (FCSIs) into general credit markets that the proposal would facilitate. The proposal would allow <u>all</u> FCS lenders to become generalized credit providers, competing directly against community banks while retaining their status as government-sponsored-enterprises (GSEs).

FCA's proposal would usher in a vast new realm of financing by FCS institutions that has never been debated or considered by Congress. Clearly Congress has never given FCA the broad-based interpretive and policy making authority that FCA is claiming for itself.

As detailed more fully below, our opposition is principally based on the following:

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry.

- FCSIs are limited purpose GSEs chartered to provide credit to agriculture producers. It is improper for the FCA to transform the FCSIs into general purpose providers of credit.

- There is no statutory basis for the proposed regulation. The FCA's reliance on the preamble to the Farm Credit Act (Act) is improper as it forms no part of the enacted statute. The FCA has historically interpreted the investment authority of FCSIs only to be used to meet liquidity requirements and to manage surplus funds and risks. It is impermissible for the FCA to reinterpret the investment authority in the way proposed because the interpretation conflicts with the overall structure of the Act. The investment provisions must be interpreted in light of the entire statutory scheme of the Act, including in particular, the lending restrictions. The more specific lending restrictions take precedence over the general investment authority. The lending restrictions would not permit the financing anticipated by the regulation. The proposal would permit FCSIs to "invest" in debt securities of a broad array of enterprises. A debt security is a form of debt financing and credit. The particular form of a debt security does not make it something other than loan.

- Contrary to the emphasis placed on financing public work projects in the explanation to the proposed regulation, the proposed regulation would permit a broad array of commercial lending unrelated to agriculture.

- The proposal would shift the FCS away from farmers and farmer-owned agribusiness to all businesses, and put the current FCS borrowers' capital at risk. However, the new customers financed under the proposal would not be required to contribute to the capital of the System, diminishing further the cooperative nature of the FCS.

- The provision in the proposed regulation allowing the FCA to approve investments on a case-by-case basis is completely open-ended. The public would have no way of determining when a new activity had been approved and no way to assess the appropriateness of the activity.

- The FCA has refused to supply adequate information on the pilot program that the FCA relies on to justify the current proposal. The refusal makes it difficult for commenters to evaluate the FCA's reliance on the pilot program.

- After Hurricane Katrina, the FCA lobbied Congress to enact legislation to permit FCSIs to finance housing in declared disaster areas. Congress rejected the proposal. By making the request of Congress, the FCA acknowledged that the investment authority on which it now relies does not permit FCSIs to participate generally in "revitalization" efforts that do not fit within the parameters of their lending authority.

- The disaster related proposal has vague standards and would result in the financing of businesses and other entities that are unaffected by disasters.

- The FCA has no authority to define "rural" as it relates to the activities of FCSIs. Moreover, the proposed definition of "rural" does not comport with the definitions used by the Census Bureaus, and would include cities.

- The proposal would allow FCSIs to make these new "investments" in an amount equal to 150 percent of surplus. Allowing FCSIs to launch into these new activities at this level creates safety and soundness concerns and puts taxpayers at great risk.

- By allowing FCSIs to invest in venture capital funds in addition to investments in Rural Business Investment Corporations, the FCA circumvents the investment restrictions set forth in the RBIC statute.

- Contrary to established federal policy, the proposal would permit a mixing of banking and commerce.

- In pursuing broad commercial financing authority in connection with the Farm Bill of 2008, System advocates admitted that the Act does not permit many of the activities that would be authorized by the proposed regulation.

Proposal Is Inappropriate for a GSE Created to Have a Limited Charter

The FCS is a government sponsored enterprise (GSE) granted special privileges by Congress in exchange for serving a very narrow market niche (agriculture producers) that was deemed underserved approximately 100 years ago. Times have changed and the agricultural credit markets are no longer underserved. As even the FCA has stated, "it is not as clear as it once was that agriculture and rural America face a credit crunch on a widespread basis. Rather, where credit availability gaps do exist and occur, they tend to be in more specific and localized market areas."[2]

It is improper for the FCA to allow the FCS to transform itself from a farm credit provider to a general purpose provider of credit, as envisioned in the proposal. As past FCA leadership has acknowledged: "Government-sponsored enterprises, like the Farm Credit System, are established to serve a specific public purpose, rather than a general public purpose. For example, Fannie Mae and Freddie Mac were established to facilitate the flow of funds to housing; whereas, the System was established to do the same for agriculture. Commercial and community banks, in contrast, are chartered to serve a more general public purpose."[3]

The Department of the Treasury has also pointed out that the FCS has explicit federal subsidies. In its May 2, 2001 letter commenting on the FCA's proposed "National Charters" proposal Treasury noted: "But the existence of such (private sector) competitors again suggests that the market failures that have existed in the past in providing agricultural credit may no longer exist. We question whether enabling a GSE-subsidized competitor to better compete in this market advances a public purpose … the System is a GSE, operating with a federal charter, a federal mission and federal subsidies." (Emphasis added)

---

[2] FCA Chairman Michael Reyna, Opening Remarks, Public Meeting on Scope and Eligibility, McLean, Virginia, June 26, 2003.

[3] Ibid.

The FCA cannot discount the advantages that this special government status gives FCSIs over private sector credit providers. The proposed regulations would inappropriately tilt the competitive scales further against community banks and other private sector lenders.

Impact from a Policy Perspective

If allowed, the FCA's proposal will permit FCS lenders to extend practically *any* credit they desire in virtually *any* rural community they desire to be active in. The authority would include making general business loans by negotiating the credits as private bonds.

By claiming these credits are "investments" instead of "loans," FCA intends to allow FCS lenders to thumb their noses at the lending constraints in the Farm Credit Act (Act). After all, FCA contends, these are not loans that are subject to the Act, but rather investments subject to regulation by FCA. According to the regulator, "The authority for the proposed rule is derived from the Farm Credit Act of 1971, as amended, which allows System institutions to hold investments that FCA approves." Thus, previously illegal FCS loans would now simply be labeled "investments."

The FCA is splitting hairs in calling privately negotiated bonds with non-farm businesses "debt securities" instead of loans. FCS lenders themselves have referred to these "investment bonds" as "loans." By allowing FCS investments for purposes that would be considered illegal if made as loans, FCA is rendering the constraints Congress placed on FCS lending in the Farm Credit Act meaningless. ICBA strongly disagrees with this egregious attempt to sidestep the law's plain meaning and statutory boundaries simply to achieve the System's lobbying agenda of expanded lending authorities and expanded customer options.

Adoption of the proposed rule would turn the Act completely on its head in that it would ignore policy limitations set by Congress and make FCA, not Congress, the policy setting body for FCSIs. The proposal would make policy direction given by Congress – whether in the past or in the future – virtually meaningless since FCA could simply sidestep any constraint by calling an illegal activity an "investment."

Proposal Lacks Accurate and Thorough Explanation of Overall Scope

Since 2005 the FCA has granted FCS lenders leeway to conduct a series of 37 pilot programs, which FCA now proposes to formalize into a national program. These pilot programs have been allowed even though the Act does not authorize these pilot programs. There appears to be a wide chasm between the proposal's stated purposes and the on-the-ground projects being financed under the pilot programs. FCA states, for example, that the proposal allows FCSIs to "invest" in "health care services, infrastructure, quality-of-life projects" and "other economic opportunities."[4]

FCA is suggesting that the primary purpose of the proposal is for financing community-wide projects and only in infrequent instances for business lending, a sphere of activity that Congress

---

[4] FCA Press Release, NR-08-06 (05-08-08); *FCA Adopts a Proposed Rule to Authorize FCS Institutions to Make Rural Community Investments,* page 1.

firmly rejected during deliberations over the 2008 Farm Bill. Although, the FCA's proposed rule makes brief references to addressing needs of "rural development projects," "other economic development initiatives," "start-up businesses," and "rural entrepreneurs," FCA is not clearly revealing to the public and to Congress that the proposal allows extensive financing of both small and large businesses.

While there are only scant details about the activities of the pilot programs from the FCA itself either on its website or in the explanation of the proposed rule, several FCSIs have publicized their activities to their members and new customers the FCSIs would like to solicit. Examples of activities financed by various FCSIs include:

> **AgStar** advertises "AgStar Rural Finance" as "working for rural communities and businesses." This FCSI advertises financing for "*businesses including light manufacturing and non-agriculture businesses*" and for "housing, including multi-family, low-to-moderate income, apartment complexes, cooperative or senior housing." (Emphasis added)
>
> **Greenstone FCS** explains that it is "now able to provide financing for rural community businesses and organizations through its Agriculture & Rural Community (ARC) Bond Program." Greenstone adds, "The ARC Bond Program offers flexible terms and conditions structured *to meet your business / organizational needs* **. . .** *Financing under this program can be provided for either public or private businesses.*" Greenstone concludes that it will extend credit to "entrepreneurs to help finance the businesses of today and tomorrow."
>
> **Farm Credit Services of Mid-America** uses its advertisements to make the following statement: "You may not be actively involved in farming, but farm or land ownership *entitles you* to borrow from FCS for many purposes." Mid-America advertises that these purposes include: *restaurants, inns, manufacturing facilities, commercial buildings, vet clinics, and road graders/contractors.* (Emphasis added)

The FCA's explanation of the proposal does not reveal that these types of business activities could be financed under the proposal.

FCA's internal Informational Memorandum (Investments in Rural America—Pilot Investment Programs, 01/11/2005) states that the purposes for the Rural Community Investments would include "agricultural enterprises, agribusinesses, and rural communities." However, the proposed regulation would allow not only "agribusinesses" to be financed, an expansion Congress rejected as part of the Farm Bill, but would also allow non-farm businesses to be financed by FCSIs. In fact, non-agricultural business financing appears to be a key aspect of both the pilot program and the current proposal. However, the impression FCA seeks to present in the proposed rule is that the proposal primarily targets community investments (schools, facilities, roads, etc.). The focus on business financing is largely glossed over and appears to be an attempt by FCA to hide the broad reach of the proposed rule from the public and from Congress.

Additionally, it should be noted that the proposal does not require that the businesses financed be agriculturally oriented. Clearly, a main component of the proposal is non-agricultural business financing, and the FCA attempts to justify this aspect of the proposal through indirect benefits accruing to farmers – a small percentage of millions of other residents in rural communities – is a gambit to enlarge FCSI financing activities.[5]

No Statutory Basis for the Rural Community Investments Proposal

FCA's proposal claims, "The preamble and investment provisions of the Act form a broad statutory framework that confers considerable discretion on the FCA to decide the purposes, conditions, and limits for all investment activities at System institutions." ICBA disagrees with this premise for many reasons. The proposed regulation is without any statutory basis and runs counter to the lending restrictions in the Act that establish eligibility for FCSI financing. In reality, the proposed regulation would circumvent lending restrictions through a novel and unauthorized reinterpretation of FCSIs' investment authority.

The purpose of FCA's investment authorities is to allow FCSIs to manage their day-to-day need for liquidity and cash reserves in order to allow FCSIs to make loans consistent with the policies and objectives of the Act. The FCA, however, has proposed a regulation that, for the first time in the history of the FCS, would allow FCSIs to "invest" in long-term debt securities to finance non-farm projects and non-farm activities in any community outside of an "urbanized area," as defined by the U.S. Census, a definition that could change without any regard to policy considerations.

Preamble is Not Law and Cannot Override Specific Provisions of the Law Itself

The FCA's reliance on the preamble to the Act is legally inappropriate. The preamble cited appears before the enacting clause of the Act and is not part of the law. It cannot be used to override the specific lending restrictions or the Congressional declaration of policy and objectives found in Section 1.1 of the Act (12 USC 2001). The policy is to *provide sound, adequate, and constructive credit to American farmers and ranchers and their cooperatives,*

---

[5] ICBA also questions the FCA's inconsistent actions and statements in providing details on its pilot programs. In fact, FCA has demoted any public mention of its pilot program approvals to the footnotes of press releases as part of the board's "notational votes" or actions taken between FCA board meetings. Typical of such announcements are these statements from the FCA's June 8, 2006 and August 10, 2006 press releases: "On May 17, the Board authorized AgCountry Farm Credit Services, ACA to make investments in agriculture and rural community bonds under a pilot investment program"; " on May 19, the Board authorized AgStar Financial Services, ACA to invest in agriculture and rural community bonds under a pilot investment program"; "since July 13, the Board approved AgriBank, FCB, and its affiliated associations to invest in agriculture and rural community bonds through a pilot investment program"; and since July 13, the Board approved U.S. AgBank, FCB, to purchase investment grade agriculture and rural infrastructure bonds under a pilot investment program."

FCA's 2007 annual report gave only summary information on the investments program suggesting that programs had been approved "for economic development," "revitalization and stabilization projects" necessary to maintain "strong rural communities." While indicating other pilot projects were approved to purchase and hold rural housing mortgage securities and equity investments, there were no significant details presented.

In addition, FCA essentially denied ICBA's Freedom of Information Act (FOIA) request and subsequent appeal for further information on AgriBank's program. The documents provided to ICBA had large portions of text deleted, making them useless for understanding the broad reach and scope of the AgriBank pilot program and its utilization by several dozen FCSIs associated with AgriBank.

and to selected farm-related businesses. The declared policy does not include providing financing to a vast array of non-farm enterprises in communities of up to 50,000 people.

FCA undoubtedly is aware that a preamble to a statute "is not an operative part of the statute and it does not enlarge or confer powers on administrative agencies or officers" and that "(w)here the enacting or operative parts of a statute are unambiguous, the meaning of the statute cannot be controlled by language in the preamble."[6] Clearly, the FCA needs to look at the Act's actual meaning, rather than create vast new financing regimes based on fanciful, yet inaccurate, interpretations.

The policies and objectives specifically set forth in the Act provide that the purpose of the FCS is to promote a "farmer-owned cooperative system" and to "participate in a system of credit for agricultural producers" and that credit is to be offered to "eligible" borrowers. Clearly, the System is not intended to be a general purpose provider of credit to rural America, which would be the result of the FCA's proposal. The Act plainly states that the FCA board shall only approve regulations that are not inconsistent with the Act (12 U.S.C. 2243 ; SEC. 5.9 of the Act . Powers of the Board), and this regulation is indeed inconsistent with the Act's financing and eligibility provisions.

FCA also states it has broad authorities to go beyond the statute's scope if financing is labeled as "investments" because FCSIs can make "other investments as may be authorized under regulations issued by the Farm Credit Administration." However, Section 5.17 (9) of the Act plainly constrains FCA's regulations to those "necessary and appropriate" to carry out the Act. This proposal is not necessary and appropriate because the proposal is inconsistent with many parts of the Act, particularly the lending policies, objectives and restrictions.

Plain Meaning of Investment Authority Must Be Assessed in Light of the Whole Statutory Structure

The FCA bases the proposal in part on sections 1.5(15) and 3.1 (13) (A) of the Farm Credit Act (Act). These sections authorize buying and selling obligations of, or insured by, the United Sates or agencies thereof, or securities backed by the full faith and credit of any such agency, and making other investments as may be authorized under regulations issued by the FCA. The grant of investment authority in sections 1.5(15) and 3.1 (13) (A) of the Act needs to be assessed in the context of the whole Act and needs to be construed in a manner that is compatible with the rest of the law.[7] These two provisions are a minor part of the general corporate powers of the FCSIs.[8]

---

[6] Association of American Railroads, et al. v. Costle, 562 F.2d 1310, 1316 (D.C. Cir. 1977).

[7] *United Savings Ass'n v. Timbers of Inwood Forest Associates*, 484 U.S. 365, 371 (1988).

[8] It is instructive to visit the FCA's current interpretation of investment authority which are extremely limited and specific. Current regulation 12 CFR 615.5140 sets forth the types of permissible investments, credit criteria applicable to investments, limits on the terms of investments and limits on the amount of investments that may be made. In contrast to the "investments" envisioned by the proposal, the investments currently authorized by 615.5140, are high-quality, readily marketable, have relatively short maturity dates, and cannot be convertible to equity. Specifically, the maturity of any such investment can be no longer than five years, and must meet one of the two highest NRSRO credit ratings. The proposal would allow FCSIs to negotiate highly illiquid "investments" (called bonds) that will never be sold into a secondary market. The long-term commercial mortgage-like investments envisioned by the proposal are not currently authorized. (footnote continued on next page)

The Act's lending sections[9] *not the general corporate powers*, are where Congress specifically addresses the purposes for which FCS should extend credit and the scope of how broad or narrow such lending should be.

Specific terms of statutes generally take precedence and override more general terms of a statute.[10] In this situation, to permit the general investment authority to supersede the Act's lending restrictions would turn the Act's entire statutory structure on its head. For example, although shopping malls are ineligible for FCS loans, shopping malls could be considered an essential community facility or an economic development project under FCA's proposal and could be financed by any FCSI because the developer issues a "debt security."

Lending Restrictions

The investment authority must be construed in light of the very extensive lending restrictions that are applicable to FCSIs. The Act permits loans to non-farmers and non-farmer-owned businesses in only two instances.[11] First, the Act gives express permission to finance single-family mortgages of non-farmers in communities of less than 2500 population. 12 USC §§ 2017 (3), 2019 (b) and 2075 (b). In addition, the Act permits loans to businesses that provide farm-related services directly related to the on-farm operating needs of farmers and ranchers. 12 USC §§ 2017 (2), 2019 (c) and 2075 (a).

The proposed rule would permit FCSIs to purchase debt securities in "rural" communities without any requirement that the issuer be a farmer or rancher, or a citizen in a community of less than 2,500 people. Nor would there be a limit to financing only single-family rural residences. Nor would these "investments" be limited to businesses that provide farm-related services directly related to the on-farm operating needs of farmers and ranchers.

In fact, Congress explicitly placed into the Act avenues for disputing adoption of regulations by FCA relating to the scope and eligibility of FCS financing authorities. These provisions require the FCA to work with the Board of Governors of the Federal Reserve System and to make Congress aware of any unresolved differences between the FCA and the Federal Reserve in regards to any regulations implementing the Act's lending/finance sections, which FCA also

---

(footnote continued from previous page) The FCA has until now interpreted these investment provisions to permit investments for purposes of meeting liquidity reserve requirements, managing surplus funds and managing interest rate risks, consistent with congressional intent. 12 CFR 615.5132. Current regulations permit neither these long-term investments in non-farmer debt financing instruments as proposed nor the investments in venture capital funds.

Although an agency is permitted to change its position on an issue, the change cannot be sustained, when, as here, the new interpretation is contrary to the plain meaning and overall structure of the Act, and when, as here, the change has no factual basis for support. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Life Ins. Co.*, 463 U.S. 29 (1983).

[9] The Act's lending sections are at Policy and Objectives (Sec. 1.1); Lending Authority (Sec 1.7); Eligibility (Sec. 1.9); Purposes for Extensions of Credit' (Sec. 1.11); Lending Power (CoBank, Sec. 3.7); and 'Eligibility' (CoBank Sec. 3.8).

[10] *Fourco Glass Co v. Transmirra Products Corp.*, 353 U.S. 222, 228 (1957).

[11] CoBank has additional authority under Title III of the Act to lend to cooperative utilities, rural telephone companies and certain water/sewer projects of small municipalities.

references in this proposed rule. 12 U.S.C. 2252. The fact that Congress did not include investment authorities along with references to financing and eligibility sections clearly reveals that Congress never intended that FCA construe the general corporate powers as a gateway to creating a vast new financing scheme.

Bonds Versus Loans

To permit FCSIs to purchase "debt securities" in the fashion proposed would allow FCSIs to circumvent current lending restrictions. Although the proposed regulation states that debt securities exclude commercial loans, the proposal does not define "commercial loan" or distinguish a commercial loan from a debt security. In fact, debt security is a form of debt financing and credit. The particular form of the contract does not make a "debt security" something other than a loan. In fact, a promissory note is just as much a debt security as other forms of commercial debt.[12]

Bonds are essentially loans, as various sources state. For example: "*A bond is essentially a loan* (emphasis added) that the issuing organization takes from the investor who becomes the creditor of the issuing organization. In other words it is a debt, which the investor buys from the issuing organization and consequently becomes its creditor.[13]

Another source explains that a bond is a "Written and signed *promise to pay* a certain sum of money on a certain date, or on fulfillment of a specified condition. *All documented contracts and loan agreements are bonds.*"[14] This source adds that a loan agreement is "a formal document that evidences a loan." Yet another source defines a bond as "An instrument (of the nature of the ordinary legal bond) made by a government or corporation *for purpose of borrowing money*" (emphasis added).[15]

Similarly, a loan is: "A transaction whereby an owner of property (lender) grants another party (borrower) to use the property for a specified length of time. The borrower promises to return the property and to pay a fee (interest) for its use. When the property is cash, the borrower signs *a promissory note*." (Emphasis added) Likewise, securities are: "Financing or investment instruments such as bonds, debentures, and notes. Debentures are a "Charge, claim, or lien on asset or property, usually as *a result of a loan*. Financing instruments are defined as: "A document such as a share certificate, *promissory note*, *or bond*, used as means to acquire . . . *loan capital*" (emphasis added).[16]

A bond is "A written promise to pay money . . . if a certain time elapses. The fact that an instrument is called a 'bond'' is not conclusive as to its character. It is necessary to disregard nomenclature and look to the substance of the bond itself. The distinguishing feature of a bond is that it is an obligation to pay a fixed sum of money, at a definite time, with a stated interest,

---

[12] Dictionary of Finance and Investment Term, 7th Ed., (2006), p.164.

[13] See http://finance.mapsofworld.com/bond.

[14] See www.businessdictionary.com/definition/bond.html.

[15] See http://ardictionary.com/Bond/6144.

[16] www.businessdictionary.com/definition/debenture.html; www.businessdictionary.com/definition/loan-capital.html.

and it makes no difference whether a bond is designated by that name or by some other. There is no distinction between bonds and certificates of indebtedness which conform to all the characteristics of bonds."[17] A certificate of indebtedness is essentially a commitment by a borrower to repay a loan.

Clearly, FCA's contention that "Proposed § 615.5176(b) expressly excludes commercial loans and instruments or transactions that are more similar to commercial loans than to traditional investment instruments in order to clarify the statutory distinction between loans and investments" is disingenuous and self-serving. Bonds are essentially loans. By allowing these "bonds" and other debt instruments that are in effect loans, while stating the proposal prohibits loans, FCA is splitting hairs and playing name games. The "investments" that FCSIs would make under this authority will displace commercial bank loans.

The only actual investment authority that Congress has authorized for the FCS that FCA could cite for purposes beyond cash management and managing interest rate risks, etc. would be the RBIC authority initially enacted as part of the 2002 Farm Bill. Yet, even in this authority, the Secretary is required to "ensure that the rural business investment company is designed primarily to meet equity capital needs of the businesses in which the rural business investment company invests and <u>not to compete with traditional small business financing by commercial lenders</u>" (emphasis added).[18]

That FCA's proposal would allow FCSIs' bonds to compete directly with a wide variety of financing by commercial banks is further evidenced by the following statement: "While FCS cannot lend directly for community facility type projects, Farm Credit can purchase bonds and provide credit enhancement for such projects."[19]

As stated by the Chairman and Ranking members of the House Financial Services Committee, joined by the Chairman and Ranking Member of the House Subcommittee on Financial Institutions and Consumer Credit, "<u>While the proposed rule states that debt securities do not include commercial loans, from the perspective of providing financing it is difficult to see how they would differ in effect.</u>" (Emphasis added)

<u>Chevron Not Applicable</u>

FCA's proposal would not be entitled to deference under the principles outlined in *Chevron,*[20] the Supreme Court opinion explaining the circumstances in which some administrative actions are entitled to deference by federal courts.

In *Chevron*, the Supreme Court specifically addressed a situation where administrative rulemaking was appropriate to "fill a gap" left by Congress or to make a policy determination

---

[17] Black's Law Dictionary, 7th Edition, Pg 169.

[18] Cornell University Law School, Legal Information Institute, US CODE: Title 7, 2009cc–8. Rural business Investment Companies.

[19] Morgan Keegan presentation on Rural America Capital Group, page 6.

[20] *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc*., 467 U.S. 837 (1984).

when two conflicting interpretations regarding a statutory term were possible. In this case, there is no gap to fill. The lending restrictions are clear. The FCA's proposal claims authority to greatly expand the powers of FCSIs based only on a preamble to a statute and on general "investment provisions" that are restricted by the limitations within the Act. Such a dramatic enlargement of FCSIs powers as envisioned in FCA's current proposal would *not* be entitled to *Chevron* deference.

The U.S. Court of Appeals for the District of Columbia Circuit on July 11, 2008, struck down a federal agency's regulation in part because, as in this instance, the regulation exceeded the scope of the agency's statutory mission.[21] Much like the FCA's overreaching effort to claim that virtually unlimited investments in infrastructure projects of rural communities is "compatible with the System's statutory mandate," the Environmental Protection Agency ("EPA") had adopted a regimen for compliance with a portion of the federal Clean Air Act that went beyond the explicit language of the federal law. The Court of Appeals noted that "an agency may not 'trespass beyond the bounds of its statutory authority by taking other factors into account' than those to which Congress limited it, nor 'substitute new goals in place of the statutory objectives without explaining how [doing so comports with] the statute'."[22]

The Court of Appeals rejected an argument that the EPA's solution was legitimized by broad rulemaking authority "to prescribe such regulations as are necessary to carry out [its] functions" under the Clean Air Act. The Court noted that the EPA lacked "(c)arte blanche authority to promulgate any rules, on any matter relating to the Clean Air Act, in any manner that the [EPA] wishes" and that an administrative agency is "a creature of statute" that has "only those authorities conferred upon it by Congress."[23]

Finally, the Court pointed out that when an administrative agency lacks explicit authority, the agency's public policy goals are irrelevant and the ends will not justify the means. The Court stated that "(a)ll the policy reasons in the world cannot justify reading a substantive provision out of a statute" and that a regulation inconsistent with or in excess of statutory authority was invalid despite the fact that the agency's regulatory "instinct may be laudatory."[24] FCA suggests (without any real economic studies by the agency supporting their proposals) that rural communities are in need of assistance that FCSIs are willing and able to offer. This justification for the proposal is irrelevant because Congress has never given the FCA authority to address rural development concerns.

<u>Open-Ended 'Catch-All' Investment Authority Expands Scope Even Further</u>

Moreover, the proposed rule would allow the FCA to approve any other investment or type of investment not outlined in the proposal on a case-by-case basis. FCA would have unfettered authority to authorize all kinds of debt financing contrary to the lending restrictions. The

---

[21] *State of North Carolina v. Environmental Protection Agency*, (D.C. Cir. July 11, 2008).

[22] Opinion of the Court of Appeals in *State of North Carolina* at page 39, quoting *Independent U.S. Tanker Owners Comm. v. Dole*, 809 F.2d 847, 854 (D.C. Cir. 1987).

[23] Opinion of the Court of Appeals in *State of North Carolina* at Page 44.

[24] Opinion of the Court of Appeals in *State of North Carolina* at Pages 21 and 42.

"miscellaneous" investment authority in Section 615.5176(d) could be used to grant FCSIs enormous authorities ad infinitum.

Such sweeping authorities are inappropriate for a GSE as GSEs by their nature are intended to have targeted financial activities to ensure their government-derived privileges are not leveraged in such a way as to crowd out private sector financial institutions. Such authorities would be solely dependent upon the interpretive whims of the FCA ,which could overlook statutory constraints.

The public would be unable to determine when a new activity would be proposed and would be unable to comment on these sweeping proposals. Interested individuals and the public would have no way of assessing whether such proposals are appropriate, reasonable, or legal.
The FCA has shown a propensity to take any action it can, no matter how questionable, to expand the FCS's powers. Under 615.5176(d), such actions, veiled from the public's view and from a public comment process, would be undeterminable, unobservable, and unknown
In addition to being open-ended and unpredictable, such an authority is incompatible with FCA's explanation in the summary of the proposed rule which states that FCS institutions will make investments "only for specific purposes (*Federal Register, June 16, Pg 33931*)." Indeed, this regulatory provision has absolutely no specificity, contrary to FCA's claim. While FCA suggests it now approves investments on a case-by-case basis under existing regulation 615.5140(e), this authority applies to a significantly more limited range of financing activities than what proposed 615.5176(d) would be applied to under the proposed rule.

This "miscellaneous" investment authority provision would cover a much more sweeping and expansive finance regime than has ever before been contemplated by either the current FCA or Congress. This "catchall" provision should be dropped.

FCS Disaster Related Financing Already Rejected by Congress

ICBA finds it troubling that the FCA asserts that it has authority to permit FCSIs to invest in "revitalization projects" in rural areas recovering from declared disasters. After Hurricane Katrina, the FCA lobbied Congress to enact legislation to permit FCSIs to finance housing projects in any community of 50,000 located in a declared disaster area. Congress rejected the proposal. By making the request of Congress, the FCA acknowledged that the investment authority on which it now relies did not permit FCSIs to participate generally in disaster relief efforts that do not fit within the parameters of their lending authority. This provision lacks legislative authority, does not target financing to disaster victims, lacks meaningful eligibility standards, allows financing for 40 years based on an initial disaster designation, is unenforceable, and seeks FCS expansions based on the misfortune and suffering of others.

The language that FCA lobbied Congress to enact, but which Congress refused to enact, reads as follows:

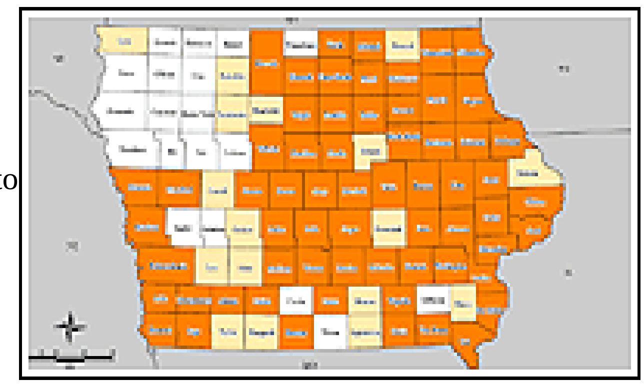
2005 FCA Proposed Waiver Language:

In the event of a natural disaster that has been declared as such by the President of the United States, the Farm Credit Administration Board, as it considers appropriate, may *waive the application of the population requirements of sections 1.11(b)(3), 2.4(b)(3) and 3.7(f) of the Farm Credit Act of 1971, as amended, 12 U.S.C. §§ 2019(b)(3), 2075(b)(3) and 2128(f), for the rural areas affected by the disaster, and increase such requirements to not in excess of 50,000 inhabitants.*

In addition to the lack of statutory authority to permit such investment, ICBA finds this provision to be problematic for a number of other reasons. First, the proposal's standards for gauging eligibility under the provision are broad and vague. The proposal does not define revitalization project. So, the FCSIs would be free to classify any project or loan in a disaster area as a revitalization project. Without clear standards, it would be impractical for the FCA to ensure that projects financed under this provision actually benefited victims of disasters.

Secondly, because many state as well as federal statutes authorize the declaration of disasters, the scope of the provision is quite broad, and is not confined to generalized disasters like hurricanes. For instance, weather-related disasters may be declared to provide relief to farmers for weather-caused crop failures. Under the proposal every business within a crop disaster area would be eligible for financing, whether or not the businesses were affected by the "crop disaster."

Example of the broad reach of FCA's weather related proposal based on FEMA declared disaster counties in the state of Iowa in 2008.



It also should be noted that the proposal allows 20 to 40-year terms for this financing. The length of the term suggests something other than disaster recovery financing.

<u>Proposal's Other Debt Financing Provisions Illegal</u>

In addition to the illegality of the disaster financing provision, ICBA strongly believes the other provisions authorizing broad non-farm debt financing activities are also illegal. FCA proposes that FCSIs would finance a broad swath of the nation's economy, extending its financing activities to 98 percent of the geographical area of the United States. These purposes include but are not limited to: transportation infrastructure (roads, bridges, public transportation systems, airports); essential community facilities (fire stations, schools, hospitals, health care facilities); rural economic development projects and programs of governmental agencies; and private businesses including dental facilities, etc.

These purposes as stated previously are clearly outside the bounds of the Act's scope and eligibility and lending authorities. Congress did not authorize broad financing of public and essential community facilities. In fact, Congress limited the Bank for Cooperative's ability to finance community facilities by authorizing limited authorities such as for water and waste disposal facilities in rural areas via Sec. 3.7 (f) and, contrary to FCA's proposal, limited the population size of such communities where these facilities can be financed to towns of 20,000.

Definition of "Rural" Undermines Proposal's Rationale

FCA Has No Authority to Define Rural

The Act does not give free rein to the FCA to define "rural" anytime the FCA chooses. Congress has clearly placed restrictions on FCS lending activities unless individuals are bona fide farmers. These restrictions include the population limit of 2,500 for single family residential mortgages and the population limit of 20,000 for CoBank's water and waste disposal facilities financing. While the Rural Business Investment Company (RBIC) population is larger, it applies only to the RBIC statute contained in the 2002 Farm Bill.

FCA misleadingly states that "whenever Congress has expressly authorized FCS institutions to lend or invest in rural development projects, it has allowed these activities in communities with populations of 50,000 or fewer residents." This false claim suggests that Congress typically authorizes FCSIs to finance activities in cities up to 50,000 people. Yet, the citation, mentioned above, includes the statutory limit of 20,000 population for waste and waste disposal facilities, not the 50,000 limit FCA is suggesting. Further, the only instance of Congress authorizing a higher population limit was in regards to the RBIC investment program, a program with very explicit and detailed eligibility and operational requirements lacking in FCA's current proposal for venture capital financing.

Proposed Definition of "Rural" is Inconsistent with Census Bureau Definitions

The FCA uses a very broad definition of "rural" to determine eligibility for financing under the proposal. FCA's proposal simply states that "rural" means the financing activity "must be outside an urbanized area as determined by the latest decennial census of the United States." The FCA's proposed definition of "rural" is not consistent with current Census Bureau definition of "rural." The FCA's proposed definition, in fact under current Census Bureau definitions, would include "urban" areas, with populations between 2,500 and 49,999. It also should be noted that the Census Bureau can change the definition of "urbanized area" in the future for reasons wholly unrelated to rural development policy.

The most direct definition of rural would be towns of 2,500 population. The U.S. Census defines four terms including urban, urbanized area, urban cluster, and rural areas:[25]

- **Urban:** Territory, population, housing units within urbanized areas and urban clusters.
- **Urbanized Areas:** Densely-settled areas with a population of at least 50,000 and typically having more than 500 people per square mile and consisting of all or part of one or more incorporated places, such as towns.
- **Urban Clusters:** Densely settled areas with a census population of 2,500 to 49,999.
- **Rural:** Territory, population and housing units located outside of urbanized areas or urban clusters. Rural areas have fewer than 2,500 people or areas where people live in open country.

[25] The University of Montana Rural Institute, RTC, The Census Bureau Place Definitions; U.S. Census Bureau, *Census 2000 Urban and Rural Classification*, www.census.gov/geo/www/ua/ua_2k.html.

The Census Bureau definition also states: "**Urban areas.** Urban areas consist of urbanized areas and other urban entities. An urbanized area consists of densely settled territory with a population of 50,000 or more inhabitants. Other urban areas have from 2,500 to 49,999 population."[26]

USDA's Economic Research Bureau (ERS) adds this explanation: "Urban areas are of two types—**urbanized areas** and **urban clusters**—identical in the criteria used to delineate them but different in size . . . . The same computerized procedures and population density criteria are used to identify urban clusters of at least 2,500 but less than 50,000 persons.

This delineation of built-up territory around small towns and cities is new for the 2000 census. In 2000, 11 percent of the U.S. population lived in 3,158 urban clusters. "According to this system, rural areas consist of all territory located outside of urbanized areas and urban clusters."[27] The U.S. rural population was 59 million (21 percent) in 2000. This system for defining rural America by place therefore evidences that FCA's definition is a clear over-reach of authority.

It appears that the agency's goal is not to serve rural agricultural communities, but rather to allow FCSIs to get as close as possible to large cities and finance activities in large suburbs. The FCA's goal is not to serve struggling rural communities as evidenced by the lack of any criteria targeting low-income communities, businesses, or individuals. If the agency wanted to achieve a rural policy of assisting rural communities it would have chosen two courses of action: 1) Seek authorizing legislation from Congress allowing FCSIs to finance a broad array of rural development projects; and 2) define rural based on the Census Bureau's definition of "all areas outside urban areas."[28] This definition would have included over 59 million people, 21 percent of the U.S. population and 97% of the U.S. land area. FCA's conscious choice to ignore this definition is a conscious choice to ignore a key Census Bureau definition of rural.

While the FCA states "Many rural communities are struggling to retain economic viability and vitality," the proposal also states, "FCA seeks to include those areas with sufficient population densities to support health care and other essential facilities serving rural residents while prohibiting investments in urbanized areas." Again, contrary to the proposal's stated goal, FCA seeks to allow FCSIs to lend in as close proximity as possible to major cities. If FCA's goal were to match the goal stated in the proposal, it would have limited the definition of rural to communities of up to 2,500, consistent with the Act's limits on rural residential mortgages.[29]

---

[26] U.S. Census Bureau, Introduction to Census 2000 Data Products, June 2001.

[27] ERS Briefing Room, *Measuring Rurality: What is Rural?*

[28] ERS Data Sets, Rural Definition-State Level Maps, Virginia, Page 11.

[29] In fact, the Census Bureau has nine definitions of rural. While OMB has utilized a definition whereby metro areas were once considered as those counties with a core urban area of 50,000 or more inhabitants and the remaining counties as nonmetro, this definition proved to be problematic. As the Federal Reserve Bank of Kansas City noted, "The nonmetro designation has supported the myth of rural homogeneity repeatedly belied by research" (The Main Street Economist, *Defining "Rural" America*, July 2004, emphasis added).

This article explains that OMB added a "micropolitan" classification that features a core city of 10,000 to 50,000 inhabitants and includes a central county that contains core cities along with any counties that have substantial commuting flows to the central county. The article notes the new (footnote continued on next page)

To the extent that there are "remote rural locations typically having higher costs with greater risks, which deter investors" as the proposal states, they would much more likely be remote rural communities with small populations, not larger, more highly populated communities near major cities. These communities' remoteness and smaller populations would be a fundamental reason they may have trouble attracting venture capital and "investments." Yet, FCA's proposal undermines its own foundation by stating that larger population densities are necessary to support health care and other essential facilities. In other words, the truly "remote rural locations" will not be those served by FCSIs as they will not have the "willingness" to extend financing for rural development projects that would not otherwise receive financing from the private sector. The FCA has absolutely no evidence to support that contention. Community banks, for example, were looking at financing the St. James hospital that FCA suggested would not have been financed without FCSI financing under the FCA's pilot program.

(footnote continued from previous page) classification system became necessary because many counties with small cities perform a widening variety of functions for their more rural neighbors. Better roads and cars have let people in outlying counties work and shop in micropolitan areas." (emphasis added)

The article insightfully adds commentary that dispels much of the underlying basis for FCA's proposed regulation. In particular FCA offers a number of misleading arguments that:

- "Rural communities often have difficulty attracting financing at affordable rates;";
- The proposal would "help strengthen the economic viability of rural communities;"
- "Rural areas often lag behind those in metropolitan areas;" and
- "This . . . limits the ability of rural communities to attract and retain businesses that provide employment and economic opportunities."

Federal Register/vol.73, No. 116, June 16, 2008, page 33933.

Contrary to FCA's claims and their rationale for using a very expansive definition of rural, the article referenced above makes a number of pertinent observations:

> "The new classification system should also dispel another stubborn myth about rural America – that rural places lack new job opportunities. <u>Nonmetro areas in general – and micropolitan areas in particular – have in fact been remarkably vibrant.</u> <u>Rural labor markets recovered more quickly</u> in the two recent 'jobless recoveries' of 1991 and 2001. In March 1993, two years after the end of the 1991 recession, <u>nonmetro job levels had risen 2 percent compared to 1.2 percent in metro areas.</u> Using the latest available data from March 2002 through March 2004, <u>nonmetro employment growth was again slightly higher than metro employment growth.</u>
>
> "The finer detail afforded by the micropolitan classification suggests that these regions were, in fact, the principal drivers of rural job growth. In the first two years of the current recovery, micropolitan counties have paced national employment growth, rising 1.85 percent, compared to 1.69 percent in metro counties and 1.53 percent in town counties.
>
> "The new classification system <u>invites analysts to reconsider a variety of rural myths</u>. <u>Traditional misconceptions such as those regarding employment and population, can handicap rural areas as they seek new paths to economic growth.</u> This new tool, however, should help shed a brighter light on what's actually happening in rural America."[29]

Not only is the FCA seeking to perpetuate the "traditional myths" cited by the Federal Reserve Bank of Kansas City, the agency is taking a shotgun approach by indiscriminately allowing FCSIs to finance any community it considers "rural" based on the inflated inclusion of "urban clusters" (which represent 'urban', not 'rural' areas).

While FCA claims that "Many rural communities are struggling to retain economic viability and vitality,"[30] FCA's proposal does not target communities that are shown to be truly "struggling" nor does it target struggling customers nor does the proposal contain any standards by which FCSIs would target underserved or struggling communities, or businesses. In fact, a key FCS criteria for extending financing is that customers must be 'credit worthy.' FCA's proposal therefore would allow FCSIs to utilize their tax and funding advantages as a government sponsored enterprise to cherry pick the best customers and loans away from community banks. Little to no new financing would be provided that the private sector is not already providing.

Unfair Competition, Not Cooperation

FCA has suggested that FCSIs will work with community banks to finance rural development projects under the proposal. Yet, the proposal does not prevent FCSIs' investments from displacing bank loans. Simply calling the financing of the same customers "investments" rather than loans, does not prevent the FCSIs' financing from displacing private sector financing.

The FCA has never contacted either of the national bank trade associations to discuss how FCSIs would work with the banking industry. Furthermore, FCA had not released the 2007 Annual Report of Rural Community Investment pilot projects even though this report was supposedly completed months ago.

The proposal does not require FCSIs to engage in participation loans with the banking sector, thus allowing FCSIs to finance many business loans and other activities on their own with no involvement of private sector lenders.

Similarly, FCA's proposal claims that "many rural community banks are willing to provide short-term funding, but find it difficult to provide additional long-term capital investment needed for facilities in rural areas … no single investor is willing and able to supply all of the capital necessary for such projects …" These statements are unfounded. When community banks need to finance a large project they typically engage in loan participations, meaning FCA's suggestion that "no single investor" is capable of financing all of the capital necessary is irrelevant since there is often more than a single community bank involved.

Proposal Shifts FCS Away From Farmers and Places Farmer Capital at Risk

FCA's proposal represents a dramatic shift away from the FCS's historic mission of serving agriculture and would facilitate huge amounts of non-farm financing. These activities are not "mission-related" as FCS contends as they shift the FCS away from directly serving its core constituency. FCA's claims that FCS financing of large corporations, small businesses, and various rural development projects will indirectly benefit farmers and ranchers are disingenuous.

[30] FCA, *Fact Sheet on Rural Community Investment Proposed Rule*, June 8, 2008.

In recent years FCA's expansions have allowed FCS to solicit more agribusiness lending to the point where "producers" today comprise only 67 percent of FCS borrowings. The allowance of an additional $36 billion for non-farm purposes represents over one-third of funds now borrowed by farmers. Over time, according to FCA documents, the portfolio limits could potentially cause loans to farmers, ranchers and cooperatives to constitute less than 50 percent of associations' total assets.

According to the definition of rural that FCA intends to utilize, FCSIs could finance activities in areas comprising nearly 90 million people and 31 percent of the U.S. population. According to USDA statistics, in 2007 there were approximately 2 million farms in the U.S. It is not credible for FCA to essentially argue that financing the activities of areas where 90 million people live primarily benefits those who represent only two percent of that population base. Obviously, many of the cities where FCSIs would engage in financing would have few if any farmers and there are no requirements in FCA's proposal that farmers represent a majority or even a significant percentage of the beneficiaries of the projects financed.

It is very concerning that FCA proposes to utilize 150 percent of FCSIs' total surplus. Since farmers and ranchers supposedly own the System, this provision would put a huge amount of their ownership in the System at risk. Over eighty percent of System surplus is comprised of capital. Incredibly, FCA is proposing that the System move from a GSE intended to serve farmers and ranchers to a generalized credit provider, effectively taking the "farm" out of "Farm Credit System."

Almost the entire amount of financing under the proposal would be for non-farm purposes. This would mark a historic shift of the FCS *away* from serving the actual needs of farmers and ranchers. Given the ongoing desire of the System to reinvent itself as a general purpose lender, it is easy to foresee a time in the near future when the System would be primarily a nonfarm lender. This direction is clearly inconsistent with the Act and legislative history.

The proposal moves the FCS further away from a cooperative financing organization. Not only does the FCA proposal allow FCSIs to risk their current members' capital, the proposal does not require the new set of proposed customers to contribute any capital to the System. The hallmark of a cooperative finance system is shared risk. The new set of borrowers will have no capital at risk.

Proposal Threatens Safety and Soundness of the System

The safety and soundness risks in the proposal are extensive. The proposal concedes that the 150 percent of surplus level for the portfolio limit would amount to $225 million for an FCSI with assets of $1 billion. This amount represents almost a quarter of the institution's total assets – an alarmingly high percentage that represents serious safety and soundness issues. The 150 percent of total surplus figure is arbitrary with the only explanation for it being that it is "an amount that offers meaningful assistance to rural communities." FCA also argues the figure is based on the "significant needs of rural communities" but does not (and cannot) quantify what those specific needs are in terms of needed financing. Furthermore, more than one farm credit association can join together to provide financing over a multi-state region, (i.e. Rural America Capital Group). This suggests that 150 percent of surplus number is completely superfluous.

FCA also wants the public to believe that the pilot projects have given the System considerable expertise in venturing into new financing areas. But FCS lenders state otherwise: "We've taken the lead (in using this authority) and are further ahead than the rest … Most of the other lenders in the system are just dipping their toes now."[31]

Unlike the FCA's proposal, commercial banks do have investment authorities to invest in public welfare projects. However, this authority applies only to national and state banks, but not thrifts. Congress codified this authority in 1992 but banks are limited to 15 percent of a bank's capital and surplus. For the FCS to allow FCSIs to make investments at 150 percent of surplus is both dangerous and unreasonable. The FCA's interpretation of the investment authority has no bounds, subject only to the limitations of the FCA's changing view of its mission. Although the proposal sets these new investment limits at 150 percent of surplus, nothing prevents the FCA from establishing a much higher limit in the future. Under this interpretation, FCA would have unchecked authority to expose taxpayers to risky investments, which are not even within the scope of the FCS mission.

In addition, the proposal would permit FCSIs to undertake activities that are not permissible for commercial banks. (See, e.g., the discussion on mixing banking and commerce below.)

ICBA also questions the legality of authorizing FCS service organizations to conduct the same financing activities as FCS lending organizations. FCS service organizations, as the proposal notes, are prohibited by the Act from extending credit (Section 4.25). As explained elsewhere, the financing that would be extended under this proposal would be the equivalent of loans.

Proposal Conflicts with RBIC Statute

For the first time, the proposal allows FCSIs to make major equity investments in venture capital funds other than strictly limited investments to Rural Business Investment Corporations (RBICs) authorized in the 2002 Farm Bill. Although the 2002 Farm Bill authorized RBICs and participation in them by banks, savings associations and FCS lenders, this proposal goes much further than Congress authorized.

If FCSIs hold more than 25 percent (increased in the 2008 Farm Bill from 15 percent) of the equity shares of a RBIC, then the RBIC can only assist businesses that are eligible to receive financing from the System. If the general investment authority of FCSIs included authority to make equity investments for a broad array of purposes inconsistent with the lending authorities in the Act, Congress would not have needed to authorize FCSI investments in RBICs.

FCA is clearly seeking to evade the requirements Congress set in place for FCSI to make equity investments through RBICs. FCA accomplishes this evasion by allowing FCSIs to utilize a misguided alternative system to invest in "other" venture capital funds. RBICs have strict risk management and operating guidelines, which apparently FCSIs desire not to comply with.

[31] Fran Howard, Twin Cities Business, *Can AgStar Save Rural Minnesota*, February 2008.

The proposal allows FCSIs to invest up to 5 percent of their total surplus in "other" venture capital funds, or using FCA's example of a $1 billion FCSI, $50 million. This amount is at least five times the amount needed to establish a RBIC. FCA unmistakably appears to be opting for an alternative to the RBIC program in an effort to allow FCSIs to engage in broad non-farm financing activities.

The proposed regulation allows each FCSI to invest 2 percent of their surplus capital in a single venture capital fund. This would allow, contrary to the RBIC statute, the approximately100 FCS institutions to jointly own 100 percent of five different venture capital funds – four times the ownership amount allowed for RBICs to remain within the parameters of the Act's lending constraints. There is no statutory basis for this proposal which is wholly inconsistent with the RBIC statute.

Proposal Allows the Mixing of Banking and Commerce by a GSE

This broad departure from statute would also establish the FCS as uniquely privileged and distinct from any other federally chartered bank or thrift and most state banks and thrifts. . The general policy of federal law and most state law is to prohibit the mixing of banking and commerce and to control the instances when financial institutions may take an equity stake in non-financial firms. (See, e.g., Title IV of Gramm-Leach-Bliley Act, which prohibited new affiliations between non-financial companies and thrifts.) To our knowledge, Congress has authorized FCSIs to make equity investments in businesses in only one instance, as noted above in Section 6029 of the Farm Security Rural Investment Act of 2002. The program authorizes the Secretary of Agriculture to make grants and guarantee debenture of rural business investment companies that provided capital to small businesses in rural areas. RBICs are required to have a certain minimum of private equity capital and RBIC financing must not compete with loans made by commercial banks.

Congress has been very specific about financial institution investments in non-financial firms. It would be contrary to this general Congressional policy to believe that the FCSIs' general investment authority granted broad based authority to make equity investments generally in rural areas and highly populated areas, and in both small and large corporations. Allowing the mixing of banking and commerce by a GSE not only contradicts the historical prohibition by Congress but creates the opportunity for serious conflicts of interest and anti-competitive behavior.

FCSIs could, for example, invest in and finance corporate customers over cooperative customers in the same area or region. FCSIs could be both equity owners and financiers of various business interests. In addition, FCSIs could then direct and influence such customers in a wholly inappropriate manner.

The Act's policies and objectives make clear that "It is declared to be the policy of Congress that the credit needs of farmers, ranchers, and their cooperatives are best served if the institutions of the Farm Credit System provide equitable and competitive interest rates to eligible borrowers."

<u>Proposal Allows General Business Financing Greater Than What Congress Already Rejected</u>

The FCS proposed to finance a variety of businesses in a legislative proposal submitted to Congress in March of 2007 in preparation for the 2007/2008 Farm Bill deliberations. Although the FCS made many attempts to gain acceptance of the loosely worded proposal, Congress declined FCS's overtures. However, in the course of pursuing these legislative goals, System advocates argued that the Act did not permit many of the credit transactions that would be permitted under the current proposal; hence their desire for new statutory authority. These arguments are an admission by System stakeholders that the Act does not authorize the current proposal.[32]

The FCA's proposal to allow broad-based housing finance in cities up to 50,000 is also curious given the former FCA Chairman's comments on these issues in which he stated: "Not only is there not a mortgage credit shortage in this population range, but authorizing the System to lend in communities larger than 2,500 will distract it from financing moderately priced <u>rural</u> housing where it is most needed."[33]

Congress rejected the idea of expanding FCS powers. This firm decision by Congress to reject expanding the FCS's powers communicates a strong message to the FCS's regulator as well: <u>do not expand FCS powers</u>.

The Farm Bill already contains a robust rural development title and a strong credit title. If Congress desired to expand the FCS's powers broadly, as FCA proposes, such powers could and would have been given in the bill's rural development or credit titles. Congress chose only modest expansion of the rural development title's Rural Business Investment Companies (RBIC) provisions in relation to the FCS and chose no expansion of the FCS in the Farm Bill's credit title. The fact that Congress chose generally, in terms of the overall Farm Bill, and specifically, in terms of the bill's rural development and credit titles, *not* to broadly expand FCS powers is further evidence that the FCA's proposal is inconsistent with congressional objectives.

---

[32] The System's proposals included new authority for business financing and housing loans. Specifically, versions of the System's proposals would allow FCS to finance "small agribusiness" entitles that are designated as small businesses by the SBA. Another version had eligible businesses engage in any one of 30 or more activities. Other FCS proposals targeted the financing of "biofuels." Regarding housing loans, FCS sought higher population limits on financing eligible rural home mortgages. These requests ranged from population sizes of 50,000 to 10,000 to 6,000 to 7,500.

System lobbyists believed they did not have the legal authority to engage in financing business and housing finance authorities that the FCA is now proposing. FCS specifically told Congress it did not have the authority to go beyond 2,500 for housing finance and that such financing was limited to single-family, residential housing. In addition, the FCS's Horizons project, on which the FCA's proposal is directly based, stated that it would need legislative authority to engage in multi-family housing finance and to redefine the term "rural."

[33] Michael Reyna, former Chairman & CEO, FCA, Letter to House Members, July 2007.

If the FCA believes that rural communities need assistance and that FCSIs are positioned to provide such assistance, those beliefs are immaterial since Congress has not specifically delegated rulemaking authority to the FCA for broad rural development financing.

Congress chose not to adopt the System's business lending proposals, yet the FCA is proposing to allow business financing in this proposal. Congress also did not broadly expand rural development programs on behalf of FCS, yet FCA proposes to do just that in this proposal immediately after the Farm Bill's completion. Congress could have objectively considered FCA's proposal in terms of the Farm Bill's overall rural development title had FCA communicated its proposal to Congress. The FCA chose not to do so. Only Congress can authorize the current proposal. Congress should have been afforded an opportunity to consider the implications of this proposal's significant and harmful impact on rural America as part of the Farm Bill's deliberations.

Conclusion

ICBA appreciates the opportunity to comment. However, ICBA strongly objects to this proposal for the reasons outlined above. It is clear that FCA lacks a legitimate legal foundation for this proposal. The proposal unmistakably marks a dramatic shift in the FCS's mission which moves away from farmers and ranchers and their farmer-owned enterprises, inconsistent with the purposes of the Act and the intent of Congress reflected in legislative history.
The proposal places at risk an enormous amount of the System's capital owned by farmers and ranchers by allowing FCS to engage in a number of risky ventures.

The FCA has not provided meaningful disclosure of background information related to the pilot projects. The policy arguments put forward by the FCA lack solid evidence. FCA's proposal would allow broad financing authorities based on arbitrary and unmeasureable criteria. The proposal is vast in terms of its current proposed scope and would be unlimited in its future scope, with programs being approved with no public review or accountability.

The proposal does not target proven needs or underserved communities or individuals. The proposal assumes that all communities under 50,000 lack access to financing and are "struggling," an insupportable theory. It allows FCSIs to engage in non-farm activities and non-farm business financing of huge proportions, provide business financing to some of America's largest corporations, and allows FCSIs to conduct these activities as close as geographically possible to large U.S. cities and far away from truly remote, rural towns and villages.

This proposal is little more than an effort to allow FCSIs to make loans that would otherwise be ineligible and illegal under the statute.

The proposal includes authorities even beyond those requested by FCS during the Farm Bill debate, but which Congress explicitly rejected. The proposed authorities go far beyond even what FCS itself believes is authorized under the Act. The proposal includes disaster recovery authorities even beyond what FCA sought in legislation in 2005 and which Congress rejected.

1615 L Street NW, Suite 900, Washington, DC 20036 ▪ (800)422•8439 ▪ FAX: (202)659•3604 ▪ Email: info@icba.org ▪ www.icba.org

The proposal includes authorities that go far beyond permissible authorities afforded to the banking industry. This includes allowing the mixing of banking and commerce. Congress has historically prohibited the broad-based mixing of banking and commerce envisioned by the proposal. The proposal's equity and investment authorities go far beyond those allowable to the banking industry without required firewalls and other safeguards imposed on commercial banks.

The FCS is a government sponsored enterprise with privileged tax and funding advantages unavailable to the private sector. Congress granted these privileges to the FCS in exchange for limiting the mission and charter of the FCS. FCA's proposal goes far beyond its statutory mission. While claiming FCSIs will also develop partnerships and their activities will foster cooperation, the proposal circumvents the lending of community banks.

Congress also rejected business financing authorities for the FCS during the Farm Bill debate. FCA's provisions go even beyond those discussed during Farm Bill deliberations. Such business-related financing under the banner of "rural development" is not the historical mission of the FCS and these financing activities are not "mission-related." Nor did the FCA enter into discussions with Congress on rural development policies during the Farm Bill's consideration to address the policy issues it now suggests exist. The proposal represents poor public policy for many reasons. The FCA's proposal is arbitrary and capricious and lacks a substantive legal foundation. It is misguided, inappropriate and unwarranted.

ICBA has raised a number of specific points regarding faults with the proposal. We do not believe it can be fixed and be compatible with the limitations of the Act. The proposal should be withdrawn. To discuss this letter, please contact Mark Scanlan or Ike Jones of ICBA's staff at 202-659-8111. Thank you for considering our views.

Sincerely,

/s/

Camden R. Fine
President and CEO

1615 L Street NW, Suite 900, Washington, DC 20036 ▪ (800)422·8439 ▪ FAX: (202)659·3604 ▪ Email: info@icba.org ▪ www.icba.org