THE FINANCIAL SERVICES ROUNDTABLE

Impacting Policy. Impacting People.

1001 PENNSYLVANIA AVE., NW
SUITE 500 SOUTH
WASHINGTON, DC 20004
TEL 202-289-4322
FAX 202-628-2507

E-Mail rich@fsround.org
www.fsround.org

RICHARD M. WHITING
EXECUTIVE DIRECTOR
AND GENERAL COUNSEL

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: Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Mission-Related Investments, Rural Community Investments

Dear Mr. Van Meter:

The Financial Services Roundtable[1] (“Roundtable”) appreciates this opportunity to share with the Farm Credit Administration ("FCA") its position with regard to the FCA's proposed regulation to expand the ability of Farm Credit System ("FCS") institutions to invest in projects throughout the country in areas not classified as urban.

While the proposed regulation presumably would increase capital investments in rural communities, the Roundtable contends that the proposed regulation greatly exceeds the FCS’s mission as chartered by Congress. Furthermore, the proposed regulation would grant investment authorities to FCS institutions far beyond that express purpose, distort the competitive marketplace, and expose the FCS to significant risk. Therefore, the Roundtable believes the proposed regulation should be withdrawn as its scope and intent far exceeds the original scope of *the Farm Credit Act of 1971* ("Act"), as amended.

The Proposed Regulation Exceeds Congressional Intent.

Congress chartered the FCS to meet well-defined public-policy objectives, namely to provide credit to farmers, ranchers, and aquatic producers and harvesters who could not otherwise obtain credit, to provide credit for farm-related businesses, and to finance moderately priced rural homes that serve as the primary residence of their owners. In order to fulfill this defined mission, Congress granted the FCS extensive tax and other benefits unavailable to the FCS's private-sector competitors, including the FCS’s ability,

[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $66.1 trillion in managed assets, $1.1 trillion in revenue, and 2.5 million jobs.

as a GSE, to borrow funds at extremely favorable rates. Because of the FCS's special taxpayer-subsidized mission, Congress quite deliberately has not given the FCS broad lending powers or more specifically, the ability to provide financing through both debt and equity investments.

The proposed regulation, however, goes far beyond the mission Congress established for the FCS. Specifically, the proposed regulation would expand the FCS investment authority in several ways, including:

1) permitting investments that "involve projects or programs that benefit the public in rural communities"[2];
2) broadening the definition of "rural" (for purposes of this regulation) to include all areas not considered urbanized according to the United States Census Bureau;
3) allowing equity investments beyond what is permitted through rural business investment companies; and
4) allowing investments beyond the proposed regulation, if approved by the FCA.

The proposed regulation seeks to broaden the FCS's authority to invest in rural communities and businesses based on previous regulatory actions by the FCA that are more closely related to the FCS mission, such as permitting the purchase of mortgage-backed securities issued or guaranteed by the Federal Agriculture Mortgage Corporation (Farmer Mac), or investment in securities backed by agriculture equipment.

The proposed regulation also attempts to rationalize an expansion of FCS investment powers based on pilot programs implemented by the FCA, which allowed FCS institutions to fund economic growth and development projects in rural America. In fact, these pilot programs have far exceeded the scope of the FCA's mission, as established by Congress.

These justifications, as discussed, clearly exceed the FCA's statutory authority and therefore, cannot be used as the basis of broadening the FCS's investment authority.

The proposed regulation also justifies FCS investments in venture capital funds, based on Congressional support of rural business investment companies ("RBICs") under the *Farm Security and Rural Investment Act of 2002* (P.L. 107-171). The Roundtable disagrees. At the time of enactment of that statute, Congress only permitted FCS investments through RBICs and even made restrictions on these RBIC investments, requiring that if FCS institutions held over 15 percent of an RBIC's shares, the RBIC could only invest in entities eligible for FCS financing.[3] With passage of *the Food Conservation and Energy Act of 2008* ("2008 Farm Bill"), Congress again continued to maintain restrictions on such investments[4]. If Congress had intended to permit FCS institutions to invest in

[2] Federal Register Vol. 73 No. 116 Monday, June 16, 2008 p. 33932
[3] P.L. 107-171
[4] Albeit, the 15 percent threshold was increased to 25 percent.

venture capital funds, it would have explicitly authorized these institutions to do so at both points of time.

Furthermore, broader limitations on the FCS lending authority were recently reconfirmed in the 110th Congress. During consideration of the 2008 Farm Bill, an amendment supported in the House of Representatives removed provisions that would have expanded the FCS's lending authority. In fact, during floor consideration a Member of Congress speaking in support of the limited FCS expansion provisions in the underlying bill discussed the Agricultures Committees' actions to narrow what was requested by the FCS.

> The FCS "in the HORIZONS project wanted to expand rural housing from 2,500 to 50,000. They wanted to expand on agriculture lending to agriculture related businesses, a great diversion from where they are limited right now. And we thought [Agriculture Committee] that was too far . . ."[5]

In many respects the current proposal would go further by permitting financing through debt and equity investments.

Although the Roundtable strongly supports investment in rural America, we believe the proposed regulation far exceeds the FCA's statutory authority and Congressional intent with respect to the FCS's mission.

The Proposed Regulations Are Unduly Expansive, Anticompetitive, and would Expose FCS Institutions to Undue Risk.

Not only does the proposed regulation on its face exceed the FCS mission, in practice the proposed regulation also goes well beyond its intended purpose. The proposed regulation would allow FCS institutions to invest in areas already well served by financial institutions and to compete against private, taxpaying capital. In addition, the proposed regulation would expose FCS institutions to undue risk.

As part of the proposed regulation the FCA would expand the areas where FCS institutions could invest. This would expand the FCS's ability to finance non-farm/agriculture related projects outside of rural communities. Congress limited mortgage lending (a non-agriculture related lending permitted by Congress) to "rural" communities, defined statutorily as communities with populations of less than 2,500.[6] The proposed regulation would redefine "rural" as any area not defined as "urbanized" according to the U.S. Census Bureau. Using this measure would allow FCS institutions to finance investments in areas that are considered the suburbs of major metropolitan areas. For example, based on this criterion, FCS institutions could make investments of

[5] House Report 110-261 Congressional Record, H8728, Comments made by Representative Tim Holden (D-PA).
[6] 12 U.S.C. 2019(b)(3)

the type envisioned by the proposed regulation in areas immediately outside the Capital Beltway.[7]

This would similarly be the case within other major metropolitan areas. In addition, given that this expanded investment authority would be based on areas determined by a decennial census; FCS institutions potentially could invest in some of the fastest growing areas surrounding major metropolitan areas where there traditionally has been no lack of financing. This only would serve to displace private financing. FCS financing of projects in some of these non-urbanized areas actually could run counter to the FCS mission of serving agriculture, by promoting the urbanization of less populated areas.

Section 615.5176(d) of the proposed regulation would allow FCS institutions to expand beyond the proposed limitations on investments under this regulation so long as approved by the FCA. We are concerned that this would only take FCS institutions further afield from their congressionally mandated mission of serving farmers, ranchers, aquatic producers, harvesters and rural homeowners.

The potential for FCS institutions to be exposed to increased risk through their investments in rural America is very real. Although the proposed regulation would place some limits on both debt and equity investments, it would allow FCS institutions to risk up to 150 percent of their surplus in investments, which runs counter to the FCS's mission. The analysis accompanying the proposed regulation categorizes these investments as "less liquid," and indicates they would "have to be held to maturity," which in some instances could be up to 40 years.[8] This would appear to have the potential to put FCS institutions at substantial risk in several regards. First, these investments, and especially venture-capital investments, could suffer a loss of principal comparable to a loan loss. Second, if an FCS institution was experiencing liquidity strains, the institution might be forced to sell an investment at a substantial loss due to its inherently illiquid nature. Third, fair-value accounting requirements, specifically FAS 157, might force a FCS institution to mark down the carrying value of investments of the type authorized by the regulation, thereby reducing the institution's capital and its capacity to lend to farmers and ranchers, the very enterprises Congress chartered the FCS to serve.

<u>Conclusion</u>

The Roundtable urges the FCA to withdraw the proposed regulation as it far exceeds the FCS's mission as chartered by Congress. The proposed regulation would greatly relax the constraints Congress has placed on the FCS and would expose the FSC to unnecessary risk, at the expense of the American taxpayer and the FCS mission in serve to farmers, ranchers, aquatic producers, harvesters and rural homeowners.

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[7] See the attached map that highlights urbanized areas in the Washington Metropolitan Area.
[8] <u>Federal Register</u> Vol. 73 No. 116 Monday, June 16, 2008 p. 33938

If you have any questions concerning this letter, please feel free to contact me or Paul Begey at 202-289-4322.

Sincerely,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel

Attachment

Attachment 1   Source: U.S. Census Bureau American FactFinder website: http://factfinder.census.gov/home/saff/main.html?_lang=en