

HEARING TO REVIEW THE FARM CREDIT SYSTEM

HEARING BEFORE THE COMMITTEE ON AGRICULTURE HOUSE OF REPRESENTATIVES ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

DECEMBER 2, 2015

Serial No. 114-35



Printed for the use of the Committee on Agriculture
agriculture.house.gov

U.S. GOVERNMENT PUBLISHING OFFICE

98-358 PDF

WASHINGTON : 2016

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

COMMITTEE ON AGRICULTURE

K. MICHAEL CONAWAY, Texas, *Chairman*

RANDY NEUGEBAUER, Texas, <i>Vice Chairman</i>	COLLIN C. PETERSON, Minnesota, <i>Ranking Minority Member</i>
BOB GOODLATTE, Virginia	DAVID SCOTT, Georgia
FRANK D. LUCAS, Oklahoma	JIM COSTA, California
STEVE KING, Iowa	TIMOTHY J. WALZ, Minnesota
MIKE ROGERS, Alabama	MARCIA L. FUDGE, Ohio
GLENN THOMPSON, Pennsylvania	JAMES P. McGOVERN, Massachusetts
BOB GIBBS, Ohio	SUZAN K. DELBENE, Washington
AUSTIN SCOTT, Georgia	FILEMON VELA, Texas
ERIC A. "RICK" CRAWFORD, Arkansas	MICHELLE LUJAN GRISHAM, New Mexico
SCOTT DESJARLAIS, Tennessee	ANN M. KUSTER, New Hampshire
CHRISTOPHER P. GIBSON, New York	RICHARD M. NOLAN, Minnesota
VICKY HARTZLER, Missouri	CHERI BUSTOS, Illinois
DAN BENISHEK, Michigan	SEAN PATRICK MALONEY, New York
JEFF DENHAM, California	ANN KIRKPATRICK, Arizona
DOUG LAMALFA, California	PETE AGUILAR, California
RODNEY DAVIS, Illinois	STACEY E. PLASKETT, Virgin Islands
TED S. YOHO, Florida	ALMA S. ADAMS, North Carolina
JACKIE WALORSKI, Indiana	GWEN GRAHAM, Florida
RICK W. ALLEN, Georgia	BRAD ASHFORD, Nebraska
MIKE BOST, Illinois	
DAVID ROUZER, North Carolina	
RALPH LEE ABRAHAM, Louisiana	
JOHN R. MOOLENAAR, Michigan	
DAN NEWHOUSE, Washington	
TRENT KELLY, Mississippi	

SCOTT C. GRAVES, *Staff Director*
ROBERT L. LAREW, *Minority Staff Director*

CONTENTS

	Page
Conaway, Hon. K. Michael, a Representative in Congress from Texas, opening statement	1
Prepared statement	3
Peterson, Hon. Collin C., a Representative in Congress from Minnesota, opening statement	3
Scott, Hon. Austin, a Representative in Congress from Georgia, submitted letter	49
Scott, Hon. David, a Representative in Congress from Georgia, submitted letter	49
WITNESS	
Spearman, Hon. Kenneth A., Chairman of the Board and Chief Executive Officer, Farm Credit Administration, McLean, VA; accompanied by S. Robert Coleman, Director, Office of Examination, FCA; Hon. Charles R. Rawls, J.D., General Counsel, FCA	4
Prepared statement	5
Submitted questions	57
SUBMITTED MATERIAL	
Auer, Kenneth E., President and Chief Executive Officer, Farm Credit Council, submitted letter	49
Independent Community Bankers of America, submitted statement	55

HEARING TO REVIEW THE FARM CREDIT SYSTEM

WEDNESDAY, DECEMBER 2, 2015

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Committee met, pursuant to call, at 10:00 a.m., in Room 1300, Longworth House Office Building, Hon. K. Michael Conaway [Chairman of the Committee] presiding.

Members present: Representatives Conaway, Goodlatte, Lucas, King, Thompson, Gibbs, Austin Scott of Georgia, Crawford, DesJarlais, Hartzler, Benishek, LaMalfa, Davis, Yoho, Walorski, Bost, Rouzer, Abraham, Moolenaar, Newhouse, Kelly, Peterson, David Scott of Georgia, Costa, Walz, Fudge, McGovern, DelBene, Vela, Lujan Grisham, Kuster, Nolan, Kirkpatrick, Aguilar, Plaskett, Adams, Graham, and Ashford.

Staff present: Caleb Crosswhite, Jessica Carter, Josh Maxwell, Matt Schertz, Scott C. Graves, Stephanie Addison, John Konya, Anne Simmons, Lisa Shelton, Liz Friedlander, Matthew Mackenzie, Robert L. Larew, Nicole Scott, and Carly Reedholm.

OPENING STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE IN CONGRESS FROM TEXAS

The CHAIRMAN. Good morning, everyone. We will call the hearing to order. I will ask Rick Crawford to open us with a prayer.

Rick?

Mr. CRAWFORD. Thank you, Mr. Chairman.

Father, I bow humbly before you, thankful for every blessing of life, Lord, and thankful for this country that You have blessed us with. Father, I would just ask that You be with each Member here and be with our nation. And I would ask that You give each Member a spirit of discernment today, Lord, that all that we say and do will be pleasing to You.

I ask it in Jesus' name. Amen.

The CHAIRMAN. Thank you, Rick. Well, good morning. This hearing of the Committee on Agriculture to review the Farm Credit System, will come to order.

Providing credit to America's farmers and ranchers is a necessary and serious challenge for many lenders in the United States. After a recent period of record highs, crop prices have declined due to record plantings and strong production. Input costs have risen. And some of our biggest foreign competitors are sharply increasing their subsidies, tariffs, and non-tariff barriers to trade.

Meanwhile, farmland values are on a downward trend. And while livestock producers are rebounding on the balance sheet with lower feed costs, our western producers are still struggling with consecutive years of drought.

Unfortunately, the U.S. Government has added to the challenges faced by America's farmers and ranchers. The EPA continues to push for new and costly regulations. And then there are those issues standing in the way of critical tax relief, ranging from a permanent section 179 and bonus depreciation to repeal of the death tax. It is times like these that our farmers and ranchers are most in need of reliable sources of credit at competitive rates. I am thankful we have a network of commercial and community banks, USDA loan programs, and a Farm Credit System, that each plays a critical role in providing that access.

The importance of the Farm Credit System is largely unknown to those outside the agricultural community, often leaving it prone to political attacks. So I am thankful that we have an opportunity today to highlight the System and its century-long mission of providing credit to agriculture and rural America during the good times and the bad, as well as the Farm Credit Administration in ensuring the soundness of the System and its lending practices.

While Congress has generally outlined the authority by which the Farm Credit System may fulfill its ultimate mission of ensuring a dependable source of credit for agricultural and rural America, I realize that authority is not necessarily delineated with bright line rules. Therefore, we largely rely on FCA as the regulator to ensure that the System banks are doing their part to stay within the bounds of the Farm Credit Act. In that vein, there has been much scrutiny of System bank financing deals with major telecommunication networks that I am sure a number of our colleagues will be eager to discuss again today. I look forward to a healthy discussion of similar-entity lending authority that provides greater clarity for all involved.

On the whole, I believe that the Farm Credit System is fundamentally safe and sound and in a position to weather the challenges that it is likely to face in the times ahead. Together with commercial banks, community banks, and the Farm Service Agency, the Farm Credit System will continue to play a crucial role in maintaining the success of the American agriculture.

Today, we will hear from the Farm Credit Administration, the regulator of the Farm Credit System. Before we begin, I would like to thank our witness, Ken Spearman, for being here today. Mr. Spearman has had a recent medical procedure. And that is the reason why he is wearing his *chapeau* this morning. He is not being disrespectful but saving us from whatever is going on under there. So we will get that off the table right now. We are happy to hear he is recovering well.

And I appreciate you making the time to be here this morning. And is it Maria? Your wife is also here backing him up. So I appreciate that.

[The prepared statement of Mr. Conaway follows:]

PREPARED STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE IN
CONGRESS FROM TEXAS

Good morning, and welcome to today's hearing.

Providing credit to America's farmers and ranchers is a necessary and serious challenge for many lenders in the United States. After a recent period of historic highs, crop prices have declined due to record plantings and strong production, input costs have risen, and some of our biggest foreign competitors are sharply increasing their subsidies, tariffs, and non-tariff barriers to trade.

Meanwhile, farmland values are on a downward trend, and while livestock producers are rebounding on the balance sheet with lower feed costs, our western producers are struggling with consecutive years of drought.

Unfortunately, the U.S. Government has added to the challenges faced by America's farmers and ranchers. The EPA continues to push for new and costly regulations, and then there are those standing in the way of critical tax relief, ranging from a permanent section 179 and bonus depreciation to repeal of the death tax.

It is in trying times like these that our farmers and ranchers are most in need of reliable sources of credit at competitive rates. Thankfully we have a network of commercial and community banks, USDA loan programs, and the Farm Credit System that each play a crucial role in providing that access.

The importance of the Farm Credit System is largely unknown to those outside the agricultural community, often leaving it prone to political attacks. So I am thankful that we have an opportunity today to highlight the System and its century-long mission of providing credit to agriculture and rural America during the good times and the bad, as well the role of the Farm Credit Administration in ensuring the soundness of the System and its lending practices.

While Congress has generally outlined the authority by which the Farm Credit System may fulfill its ultimate mission of ensuring a dependable source of credit for agriculture and rural America, I realize that authority is not necessarily delineated with bright line rules. Therefore we largely rely on FCA as the regulator to ensure that System banks are doing their part to stay within the bounds of the Farm Credit Act.

In that vein, there has been much scrutiny of System bank financing deals with major telecommunications networks. I am sure a number of my colleagues will be eager to discuss that topic again today, and I look forward to a healthy discussion of "similar-entity lending authority" that provides greater clarity for all involved.

On the whole, I believe that the Farm Credit System is fundamentally safe and sound and in a position to weather the challenges that it is likely to face in the times ahead. Together with the commercial banks, community banks, and the Farm Service Agency, the Farm Credit System will continue to play a crucial role in maintaining the success story of American agriculture.

The CHAIRMAN. With that, I will turn to our Ranking Member for any comments that he would like to make.

**OPENING STATEMENT OF HON. COLLIN C. PETERSON, A
REPRESENTATIVE IN CONGRESS FROM MINNESOTA**

Mr. PETERSON. Thank you, Mr. Chairman.

And good morning, everybody.

I would like to welcome today's witness, as well as, Mr. Coleman and Mr. Rawls.

The topic of today's hearing is very timely given what is happening across the countryside right now. Commodity prices have fallen and will likely continue to fall. And land values, for some reason, continue to increase. This has a lot of farmers asking if they will have access to the financing they need for the next planting season. Access to credit is one of the most important tools that we can provide to our farmers and ranchers. And the farm bill's commodity programs work hand in hand with crop insurance to provide a safety net to ensure continued access to credit. Having a crop insurance policy in place gives lenders the certainty to know that farmers will make good on their commitment and pay back

their loans even during difficult times. So I appreciate the opportunity to have this hearing today.

And I yield back the balance of my time.

The CHAIRMAN. Thank you, Collin.

The chair would request that other Members submit their opening statements for the record so that our witness may begin his testimony to ensure there is ample time for questions. I would like to welcome to our witness table today, Mr. Ken Spearman, Chairman of the Board and CEO of the Farm Credit Administration, from McLean, Virginia. He is joined this morning by Robert Coleman, who is the Director of the Office of Examination, Farm Credit Administration, and Mr. Charles Rawls, the General Counsel for the Farm Credit Administration. And his other two Commissioners are in the audience as well. And I have it on good authority they are not in violation of any kind of Open Meetings Act by having all of them in one room.

This is not the first time the FCA has been here. We have had conversations with them at the Committee at least every term since I have been here. And it is good to have the Chairman here to talk to us directly about a variety of things.

So, Mr. Spearman, the 5 minutes is yours. And then we will get to our questions.

STATEMENT OF HON. KENNETH A. SPEARMAN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION, McLEAN, VA; ACCOMPANIED BY S. ROBERT COLEMAN, DIRECTOR, OFFICE OF EXAMINATION, FCA; HON. CHARLES R. RAWLS, J.D., GENERAL COUNSEL, FCA

Mr. SPEARMAN. Thank you, Mr. Chairman and Ranking Member Peterson.

Chairman Conaway, Ranking Member Peterson, and Members of the Committee, it is a privilege to appear before you to report on the mission of the Farm Credit Administration. I have a written statement to submit for the record.

President Obama appointed me to the FCA Board on October 13, 2009. On March 13 of this year, the President designated me FCA Chairman and CEO. I have the pleasure of serving on the board with two distinguished colleagues, Dallas Tonsager and Jeff Hall, who are here today.

FCA is an independent Federal agency that regulates and examines the banks, associations, and related entities of the Farm Credit System, including the Federal Agriculture Mortgage Corporation or Farmer Mac. Our responsibility is to ensure that the System meets its Congressional mission to provide a dependable source of credit for agriculture and rural America.

FCA was created by an Executive Order of President Franklin Roosevelt in 1933. During the agriculture credit crisis of the 1980s, this Committee restructured the FCA, giving it regulatory and enforcement powers similar to those of other Federal financial regulators. FCA is not an appropriated agency. We are funded primarily through assessments paid by System institutions.

The Farm Credit System, which was established in 1916, is the nation's oldest government-sponsored enterprise. It is a nationwide

network of borrower-owned cooperative financial institutions and affiliated service organizations. Currently, the System includes four banks and 75 direct-lending associations. The banks provide loan funds to the associations, which in turn provide operating loans and long-term real estate loans to farmers, ranchers, and other eligible borrowers. One of the System banks also has authority to lend to agriculture cooperatives and to rural utilities.

Farm Credit banks and associations cannot take deposits. The System obtains loan funds by selling securities on the national and international money markets. The securities are not guaranteed by the Federal Government. The System is the only GSE that makes loans at the retail level. It was established to provide a dependable source of competitive credit to farmers, ranchers, and farm cooperatives. The System was not established to be the lender of last resort. Its mission is to serve American agriculture in good times and bad. By providing competitive credit, the System has helped our farmers provide abundant, affordable food and fiber to people at home and around the world. I am pleased to report that the System's banks and associations are fundamentally safe and sound. They are well capitalized, with solid earnings and strong credit quality. Farmer Mac, and the System, is well-positioned to meet this challenge.

And FCA is taking steps to make sure the System remains safe and sound. We are updating capital rules, emphasizing internal controls, and monitoring emerging risks. We are also emphasizing mission fundamentals. The System must serve all eligible credit-worthy potential borrowers regardless of race or gender, and regardless of the size of the producer's operations or the commodities they produce. In addition to serving large production operations, we want to make sure the System institutions serve small operations that produce organic and value-added foods for local markets.

As you know, the farm economy is cyclical. That is why Congress long ago created a safety net to help farmers survive downturns in the agricultural economy. In a recent hearing, Chairman Conaway noted that agriculture is the backbone of the economy. He said: "America has been able to not only survive but thrive because our agricultural safety net helps farmers weather the bad times." I cannot agree more. And the Farm Credit System is an important part of that safety net.

Thank you, and I would be happy to answer your questions.

[The prepared statement of Mr. Spearman follows.]

PREPARED STATEMENT OF HON. KENNETH A. SPEARMAN, CHAIRMAN OF THE BOARD
AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION, MCLEAN, VA

Introduction

Chairman Conaway, Ranking Member Peterson, and Members of the Committee, I am Kenneth A. Spearman, Farm Credit Administration (FCA) Board Chairman and Chief Executive Officer. On behalf of my colleagues on the FCA Board, Dallas P. Tonsager of South Dakota, Jeffery S. Hall of Kentucky, and all the dedicated men and women of the agency, it is a privilege to appear before you today.

FCA is an independent agency responsible for examining and regulating the banks, associations, and related entities of the Farm Credit System (FCS or System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). The banks and associations of the FCS form a nationwide network of borrower-owned financial institutions that provide competitive credit to all creditworthy farmers, ranchers, and other eligible borrowers.

FCA Mission

As directed by Congress, FCA's mission is to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. We accomplish this mission in two important ways.

First, we protect the safety and soundness of the FCS by examining and supervising all FCS institutions, including Farmer Mac, and we ensure that they comply with applicable laws and regulations. Our examinations and oversight strategies focus on an institution's financial condition and any material existing or potential risk, as well as on the ability of its board and management to direct its operations. We also evaluate each institution's compliance with laws and regulations to ensure that it serves all eligible borrowers, including young, beginning, and small farmers and ranchers. If a System institution violates a law or regulation or operates in an unsafe or unsound manner, we use our supervisory and enforcement authorities to take appropriate corrective action.

Second, we develop policies and regulations that govern how System institutions conduct their business and interact with customers. Our policies and regulations protect System safety and soundness; implement the Farm Credit Act; provide minimum requirements for lending, related services, investments, capital, and mission; and ensure adequate financial disclosure and governance. We approve the corporate charter changes of System institutions, System debt issuance, and other financial and operational matters.

Through the oversight and leadership of the House and Senate Agriculture Committees, many important reforms were made to the Farm Credit Administration and the FCS as a result of the agricultural credit crisis of the 1980s. This included restructuring FCA as an independent arm's-length regulator with formal enforcement powers, providing borrower rights to System borrowers with distressed loans, and establishing the Farm Credit System Insurance Fund (Insurance Fund) to protect System investors.

Since then, the Farm Credit System has restored its financial health and the public trust. Using our authority as an arm's-length regulator, we have contributed to the System's success by ensuring that System institutions adhered to safety and soundness standards. The Insurance Fund also helped by restoring investor confidence.

Both the System and FCA learned much during the crisis of the 1980s, and those lessons helped build a much stronger Farm Credit System, as well as a stronger regulator. We will continue to focus on ensuring that the System remains safe and sound by promulgating regulations, providing appropriate guidance, and maintaining strong and proactive examination and supervisory programs. With the dynamics and risks in the agricultural and financial sectors today, we recognize that FCS institutions must have the appropriate culture, governance, policies, procedures, and management controls to effectively identify and manage risks. Today the System is a dependable provider of credit to agriculture and rural America as intended by Congress.

Farm Credit System Mission

The FCS is a government-sponsored enterprise (GSE) created by Congress in 1916 to provide American agriculture with a dependable source of credit. The System's banks and associations form a nationwide network of cooperatively organized lending institutions that are owned and controlled by their borrowers, serving all 50 states and the Commonwealth of Puerto Rico.

The System provides credit and other services to agricultural producers, aquatic producers or harvesters and farmer-owned agricultural and aquatic cooperatives. It also makes loans for agricultural processing and marketing activities, rural housing, farm-related businesses, rural utilities, and foreign and domestic companies involved in international agricultural trade. In addition, the System provides funding and discounting services to certain "other financing institutions" and forms partnerships with commercial banks to provide credit to agriculture and rural America through participations and syndications.

As required by law, System borrowers own stock or participation certificates in System institutions. The FCS had nearly one million loans and approximately 500,000 stockholders in 2014. Approximately 85 percent of the stockholders were farmers or cooperatives with voting stock. The remaining 15 percent were nonvoting stockholders, including rural homeowners and other financing institutions that borrow from the System. The U.S. Department of Agriculture's latest data show that the System's market share of farm debt was 39 percent, compared with 41 percent held by commercial banks.

One of FCA's oversight roles is to ensure that the System, with its mission devoted to agriculture and rural America, maintains its presence in the agricultural

marketplace to provide competitive and dependable credit for all eligible and credit-worthy farmers, ranchers, aquatic producers or harvesters and agricultural cooperatives. In fact, the System has maintained its mission service during the difficult markets of the past years to help producers and rural America. When commodity prices soared in early 2008, System institutions stepped forward to meet the critical financing needs of the grain elevator industry. They met increased demands for financing machinery and higher input costs for producers. The FCS also helped Midwest borrowers affected by floods and worked with livestock producers, especially dairy and hog producers, as they made difficult decisions during stressful market conditions. Overall the System continued to have access to funds and was able to increase its lending to agriculture and rural America during a financial crisis and severe recession.

Condition of the FCS

The FCS remains fundamentally safe and sound and is well positioned to withstand the challenges facing U.S. agriculture during the current cyclical downturn. The depth and duration of market weakness is unknown, which will continue to present challenges for the System until markets rebound.

The U.S. Department of Agriculture is forecasting lower net cash income in 2015 for the second consecutive year as receipts for crops and livestock decline in tandem. Continued weak farm prices stem primarily from large U.S. and global crop supplies and expanding livestock production. Average prices received by farmers for corn and soybean have dropped sharply from records posted in 2012 and remain near or below levels last received in 2007.

As a consequence of lower prices, margins for many crop producers in 2015 remain low or negative for the third consecutive year. For livestock producers, lower crop prices translate into lower feed costs, but profitability has been adversely affected by lower protein product prices, particularly for the hog, dairy, and broiler sectors. Lower grain prices have also resulted in softening in some farmland markets, specifically in the Midwest.

While the current credit stress level in the System's loan portfolio is well within its risk-bearing capacity, asset quality is expected to decline modestly in 2016 from relatively strong levels in 2015. Supporting the overall condition of the FCS is moderate loan growth, adequate capital, and reliable access to debt capital markets.

The System continues to grow at a moderate pace. As of September 30, 2015, gross loans totaled \$226.8 billion, up \$18.8 billion or 9.0 percent from September 30, 2014. Real estate mortgage lending was up \$7.0 billion, or 7.2 percent, as demand for cropland continued in 2015. Overall, real estate mortgage loans represent 45.7 percent of the System's loan portfolio. Production and intermediate-term lending increased by \$2.9 billion or 6.4 percent from the year before, and agribusiness lending increased by \$4.2 billion or 13.9 percent.

The System also continues to enhance its capital base, which strengthens its financial position as low or negative farm returns increase financial stress on borrowers. As of September 30, 2015, System total capital equaled \$48.9 billion, up from \$45.8 billion the year before. The System's total capital-to-assets ratio was 16.8 percent as compared with 16.9 percent a year earlier. Moreover, more than 82 percent of total capital is in the form of earned surplus.

The increase in total capital is due in large part to the System's strong earnings performance. For the first 9 months of calendar year 2015, the System reported net income of \$3.5 billion compared with \$3.6 billion for the same period of the previous year. The small decline results from slightly higher non-interest expenses and provisions for loan losses, which offset an increase in net interest income. The increase in net interest income stems from a higher level of average earning assets despite an eight-basis-point decline in net interest margin to 2.56 percent. Compression of net interest spread is expected to continue as interest rates change and borrowers prepay or reprice loans.

Credit quality in the System's loan portfolio continues to be strong. In each calendar year since 2010, the amount of non-performing loans has declined, and capital has increased. In the most recent period, as of September 30, 2015, non-performing loans totaled \$1.7 billion, or 0.76 percent of gross loans, as compared with \$1.8 billion, or 0.85 percent, for the same quarter a year ago. Relative to total capital, non-performing loans represented 3.5 percent at quarter-end. For historical comparison, at year-end 2010, non-performing loans as a percentage of capital was more than ten percent.

Lenders expect an uptick in loan delinquencies and other indicators of loan repayment problems as they move into 2016, but a large increase in problematic loans is unforeseen at this point. With weak margins, more farmers are expected to change their operating structures to reduce production costs or rebalance their farm

balance sheets by, for example, lengthening loan terms or selling unproductive assets.

The System continues to have reliable access to the debt capital markets. Investor demand for all System debt products has been positive, allowing the System to continue to issue debt on a wide maturity spectrum at very competitive rates. Risk spreads and pricing on System debt securities remained favorable relative to corresponding U.S. Treasuries. Further strengthening the System's financial condition is the Insurance Fund, which holds just under \$4.0 billion. Administered by the Farm Credit System Insurance Corporation, this fund protects investors in System-wide consolidated debt obligations.

System banks also maintain liquidity reserves to ensure they can withstand market disruptions. As of September 30, 2015, the System's liquidity position equaled 183 days, significantly above the 90 day regulatory minimum required for each FCS bank.

A Changing Risk Profile in Agriculture

U.S. farmers and ranchers are in the midst of serious belt-tightening. Commodity prices have declined sharply while input costs have been slow to adjust downward. Both the crop sector and livestock sector are operating generally in price environments that are either squeezing margins or pushing them into negative territory for many producers.

An extended downturn in the farm sector would be a major challenge for U.S. agriculture. In the past 2 years, many farmers have been coping with a declining market by using working capital generated during the previous period of strong earnings. As a result, the System has recorded relatively low loan losses and maintains a strong financial position to date. However, if commodity price weakness extends for another year or 2, we expect significant financial stress on borrowers as working capital erodes further and as farmers make additional cuts to capital expenditures, household spending, and operating costs.

Weakness in commodity prices is due to both supply and demand factors. Globally, good weather in major producing regions has resulted in large supplies of grain and oilseeds. Expanding stocks have insulated many markets from significant price volatility, and in the absence of major weather shocks, commodity prices could remain subdued.

In 2015, export demand for U.S. agricultural products has been slowed by the higher value of the dollar, which reduces U.S. price competitiveness in foreign markets. Also, while long-run trends are positive, modest economic growth tempers demand in major U.S. export markets, including China. Exports of high-value commodities, including meat, dairy, fruit, tree nuts, and vegetables, are particularly vulnerable to changes in income that drive export growth. Further strengthening of the U.S. dollar or a downturn in global economic growth would represent additional risk to U.S. farm receipts and loan repayment capacity.

After rising rapidly in recent years, farmland values have leveled off generally, with markets either slightly higher or lower, depending on the type of acreage and region of the country. In fall 2015 relative to the year earlier, according to surveys conducted by several Federal Reserve Banks, the value of irrigated acreage declined in several producing areas, as did farmland in Illinois and Iowa. Farmland registered modest gains in the upper Midwest and West, as did ranchland in most regions. A positive sign for producers who cash-rent land is USDA data indicating a decline in cropland rents in the Midwest for the first time in 20 years.

During the next year, many observers expect farmland values to weaken given the outlook for commodity markets. However, any downward movement could be limited by investors stepping into the market. Impacts of declining land values on the Farm Credit System would be mitigated by the System's underwriting procedures, which have been prudent during the recent run-up in land values.

Anticipation for higher interest rates remains part of the economic landscape. Nevertheless, rates are expected to remain relatively low and increase very slowly over the next couple of years to maintain economic stability. Higher interest costs could put additional pressure on producers, especially those with liquidity problems, and any substantial rise in long-term rates would have negative effects on land values.

Farm program payments for major crops will assist many grain and oilseed producers through at least next year. Farm financial health also benefits from the typical lender practice that requires borrowers to obtain crop insurance and use other risk-mitigating strategies for marketing. Over time, though, if market prices remain relatively weak, farm program payments will provide less assistance to corn, soybean, and other producers who selected Agriculture Risk Coverage as revenue guarantees begin to adjust downward.

Examination Programs for FCS Banks and Associations

FCA is responsible for regulating and supervising the banks, associations, and related entities that compose the Farm Credit System. Our examination and oversight programs provide strategic, proactive risk supervision of the System. In conducting our institution-specific, risk-based oversight and examination activities, we assign highest priority to institutions that present the greatest risk.

We also perform nationally focused examinations that target specific issues and operational areas to monitor the condition and operations of the System as a whole. We actively monitor risks that may affect groups of System institutions or the entire System, including risks from the agricultural, financial, and economic environment.

Through our oversight, we require System institutions to have the programs, policies, procedures, and controls to effectively identify and manage risks. Our oversight program also requires compliance with laws and regulations. When institutions are either unable or unwilling to address unsafe and unsound practices or to comply with laws and regulations, we take appropriate supervisory or enforcement action. We use a comprehensive regulatory and supervisory framework to ensure the System's safety and soundness. FCS institutions, on their own and in response to our efforts, continue to improve their risk management systems.

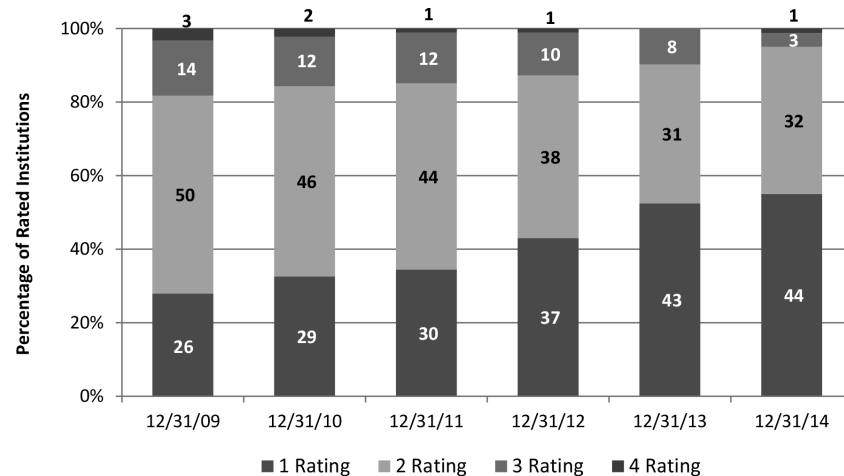
FCA uses the Financial Institution Rating System (FIRS) to assess the safety and soundness threats to each System institution. Similar to the systems used by other Federal financial regulators, the FIRS is a CAMELS-based system, with component ratings for capital, assets, management, earnings, liquidity, and sensitivity, all factoring into an overall composite rating. System institutions are assigned component and composite ratings based on FCA's evaluation of quantitative and qualitative factors. FIRS ratings range from 1 for a sound institution to 5 for an institution that is likely to fail.

Although the System's financial condition remains sound, a small number of individual institutions display some weaknesses. These weaknesses stem from several factors that have adversely affected some System borrowers.

As the System's regulator, we have increased supervisory oversight and dedicated additional resources to institutions experiencing stress. As of December 31, 2014, four System institutions had a composite FIRS rating of 3 or higher. While these institutions represent less than one percent of System assets and do not meaningfully affect the System's consolidated performance, they require significantly more resources to oversee.

The chart below includes the System banks and their affiliated associations. The figures in the bars reflect the number of institutions by FIRS rating.

Farm Credit System FIRS Composite Ratings



Source: FCA's FIRS Ratings Database.

Regulatory Activities

Congress has given the FCA Board statutory authority to establish policy, prescribe regulations, and issue other guidance to ensure that System institutions com-

ply with the law and operate in a safe and sound manner. We are committed to developing balanced, flexible, and legally sound regulations.

Over the past few years, we have revised our regulations to accomplish the following objectives:

- To require each System institution's business plan to include strategies and actions to serve all creditworthy and eligible persons in the institution's territory. In addition, the regulation encourages institutions to serve nontraditional customers, such as women and minorities, who often operate within local food systems by producing organic or specialty crops on small farms. The regulation also seeks to achieve diversity and inclusion in the workforce of System institutions.
- To ensure that System funding and liquidity requirements are appropriate and to ensure that the discounts applied to investments reflect their marketability.
- To ensure that prudent practices are in place for the safe and sound management of System investment portfolios.
- To establish a regulatory framework for the reporting of System accounts and exposures to FCA. The revisions reaffirm our authority to collect data on System institution accounts and exposures, including data on shared assets.
- To establish standards for Farmer Mac's capital planning process. The revised process emphasizes the quality and level of capital and annual stress testing.
- To increase the level and quality of assets held in Farmer Mac's liquidity reserve.
- To implement the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act by imposing margin requirements on non-cleared derivatives transactions and removing references to credit ratings.
- To implement Title III of the Terrorism Risk Insurance Program Reauthorization Act of 2015 that grants exceptions from the margin requirements of the final rule for non-cleared swaps.
- To implement the provisions of the Biggert-Waters Flood Insurance Reform Act of 2012, as well as the additional provisions of the Homeowner Flood Insurance Affordability Act of 2014.
- To revise regulatory requirements for mergers or consolidations of banks and associations.
- To seek public input on FCA regulations that may duplicate other requirements, are not effective in achieving the stated objectives, are not based on law, or impose burdens that are greater than the benefits received.

Currently, we are working on regulatory projects to accomplish these additional objectives:

- To enhance our risk-based capital adequacy framework to more closely align it with that of other Federal banking agencies and the Basel Accord. We published a notice of proposed rulemaking to solicit comments on amending our regulations to replace the current core and total surplus capital standards with a Tier 1/Tier 2 capital framework.
- To clarify and strengthen the standards-of-conduct requirements for System directors, employees, and agents.
- To strengthen the safety and soundness of the investment activities of System banks by more accurately reflecting the risk in particular investments, and to comply with a provision of the Dodd-Frank Act by replacing credit rating requirements with other standards of creditworthiness.
- To clarify or change the loan amortization limits for agricultural credit associations and production credit associations.
- To amend FCA regulations applicable to System lending to conform with the private flood insurance provisions of the Biggert-Waters Flood Insurance Reform Act of 2012.
- To ensure appropriate and effective risk governance and board oversight at Farmer Mac, and to clarify standards-of-conduct and conflict-of-interest requirements.
- To remove reliance on credit ratings from investment eligibility regulations pertaining to Farmer Mac and to maintain the quality and availability of Farmer Mac's liquid investments.

Corporate Activities

The number of FCS institutions has declined over the years as a result of bank and association mergers. Generally, System institution mergers result in larger, more cost-efficient and better-capitalized institutions with broad, diversified asset bases, both by geography and commodity.

However, these mergers also increase the complexity of the continuing institutions. The increased complexity places greater demands on both FCA staff resources, as well as the level of expertise required of staff, particularly in areas of regulation, policy, examination, and legal interpretation. As of November 1, 2015, the System consisted of the following:

- Seventy-five direct-lender associations.
- Three Farm Credit Banks and one Agricultural Credit Bank.
- Five service corporations that provide support, technology, leasing, human capital, and other services.
- A funding entity that markets the securities—chiefly bonds and discount notes—that the banks sell in the capital markets to raise loan funds.
- A GSE with the mission of providing a secondary market for agricultural real estate and rural housing mortgage loans.

Federal Agricultural Mortgage Corporation

Congress established Farmer Mac in 1988 to provide a secondary market for agricultural mortgage and rural home loans to improve the availability of cost-effective long-term credit and liquidity to America's farmers, ranchers, and rural communities. Farmer Mac creates and guarantees securities and other secondary market products that are backed by mortgages on farms and rural homes, including certain USDA guaranteed loans. Loan originators that participate in Farmer Mac's secondary market programs include community banks, Farm Credit System institutions, mortgage companies, commercial banks, insurance companies, and credit unions. The 2008 Farm Bill expanded Farmer Mac's program authorities by allowing it to purchase and guarantee securities backed by eligible rural utility loans made by cooperative lenders.

Through a separate office required by statute (the Office of Secondary Market Oversight), FCA examines, regulates, and oversees Farmer Mac's operations and its safety and soundness. As the secondary market GSE devoted to agriculture and rural America, Farmer Mac has the statutory authority to, in extraordinary circumstances, issue obligations to the U.S. Treasury Department, not to exceed \$1.5 billion, to fulfill the guarantee obligations of its guaranteed securities. The Insurance Fund does not back Farmer Mac's securities, and the System is not liable for any Farmer Mac obligations.

Farmer Mac continues to grow its business through an increasing network of rural lenders and to strengthen operations to advance its statutory mission. Farmer Mac's outstanding business volume reached \$15.6 billion as of September 30, 2015, on a compound annual growth rate of 12 percent from 1999 to 2014. The number of institutions participating in Farmer Mac programs grew 47 percent, from 367 to 542, over the past 4 years. Farmer Mac recently reported that small farm loans contributed 38 percent of the loans related to its Farm & Ranch program. Despite the decreasing number of small farms, Farmer Mac has seen an overall increase in the dollar volume and number of small farm loans in its programs.

Over the past several quarters, Farmer Mac has improved the quality of its capital base and risk-bearing capacity through healthy core earnings and capital restructuring. As of September 30, 2015, Farmer Mac's core capital totaled \$558.2 million, \$115.4 million above the minimum capital level required by Farmer Mac's statutory charter. As of September Farmer Mac's core capital level was \$766.3 million, which was \$345.0 million above the minimum requirement. The decrease in capital in excess of the statutory minimum capital level was due primarily to the redemption of \$250.0 million of Farmer Mac II LLC preferred stock on March 30, 2015. Farmer Mac also issued an aggregate of \$150.0 million of non-cumulative preferred stock during the first half of 2014.

Lower-quality capital was replaced with higher-quality capital as part of Farmer Mac's capital restructuring initiative and new regulatory requirements. In accordance with FCA's capital planning rule, Farmer Mac has adopted a policy for maintaining a sufficient level of Tier 1 capital (consisting of retained earnings, paid—in capital, common stock, qualifying preferred stock and accumulated other comprehensive income allocated to investments not included in its four business lines). The preferred stock issued in 2014 qualifies as Tier 1 capital whereas the Farmer Mac II LLC preferred stock that was redeemed did not qualify as Tier 1 capital.

At September 30, 2015, Farmer Mac reported a Tier 1 capital ratio of 11.5 percent. Farmer Mac is also required to conduct stress tests to evaluate its ability to maintain sufficient capital under adverse economic conditions and develop possible strategies to address potential risks to capital in accordance with FCA regulations.

Farmer Mac's credit quality metrics remain favorable. As of September 30, 2015, Farmer Mac's 90 day delinquencies increased over the 12 month period but remained low at \$36.7 million, or 0.67 percent of Farm & Ranch volume, compared with \$24.7 million, or 0.46 percent, as of September 30, 2014. The increase in delinquencies was related to an idiosyncratic borrower situation rather than an increasing trend related to a specific commodity or geographic region. Real estate owned as of September 30, 2015, was \$1.4 million, up from \$1.2 million a year earlier. Farmer Mac reported no delinquencies in its pools of rural utility cooperative loans. On September 30, 2015, Farmer Mac's allowance for losses totaled \$10.3 million, compared with \$10.6 million on September 30, 2014.

Farmer Mac continues to enjoy reliable access to the debt capital markets to support its mission of providing financing and liquidity to agriculture and rural markets. To improve its financial flexibility in the event of a financial or market disruption, Farmer Mac has taken significant measures to increase the quality of its \$2.0 billion liquidity investment portfolio.

Serving Young, Beginning, and Small Farmers and Ranchers

As part of their mission to serve *all* eligible, creditworthy borrowers, System institutions are required to develop programs and make special efforts to serve young, beginning, and small (YBS) farmers and ranchers. In 2014, the System continued to show gains in loan dollars outstanding and loan numbers outstanding to YBS producers. From 2013 to 2014, the number of new loans made to young and beginning farmers increased approximately two percent. However, the number of new loans made to small farmers declined 1.4 percent.

For this past year, the total outstanding YBS loans by both number and dollar volume increased as a percentage of the System's total farm loans. These results are encouraging given the high costs of starting a farm, the declining number of people entering agriculture, and the rising average age of farmers.

FCA issued a booklet in August 2007 to encourage institutions to seek ways to better serve YBS borrowers. The booklet provides institutions with more flexibility to lend to YBS borrowers and encourages them to use credit enhancements to allow more YBS borrowers to qualify for credit. Credit enhancements for YBS borrowers may include

- lower rates or fees for YBS borrowers,
- differential underwriting standards, and
- USDA loan guarantees.

In response to this guidance, a higher percentage of institutions are committing capital to assist in their YBS lending and are using advisory committees to update YBS policies and procedures. In addition, many institutions have stepped up their YBS outreach efforts and their coordination with outside parties or organizations to serve YBS producers.

In addition to providing credit to YBS borrowers, FCS institutions offer other financial services to YBS borrowers, and many institutions provide special training and educational programs for them.

Our efforts to encourage System institutions to emphasize diversity and inclusion and to serve producers of local and regional foods also benefit YBS producers. In 2012, to ensure the System fulfills its Congressional mission to serve all eligible, creditworthy borrowers, we issued a regulation requiring institutions to develop human capital and marketing plans that promote diversity and inclusion. Because many small and beginning farmers belong to underrepresented groups, this regulation helps strengthen service to YBS borrowers. Likewise, a booklet we issued in 2012 to provide guidance regarding service to local and regional foods producers also benefits YBS borrowers because many of these producers would be classified as young, beginning, or small.

Working with Financially Stressed Borrowers

Risk is an inherent part of agriculture, and the causes of risk are many:

- Adverse weather.
- Changes in government programs.
- International trade issues.
- Fluctuations in commodity prices.

- Crop and livestock diseases.
- General increase in interest rate environment.

These risks can sometimes make it difficult for borrowers to repay loans. The Farm Credit Act provides System borrowers certain rights when they apply for loans and when they have trouble repaying loans. For example, the act requires FCS institutions to notify borrowers of the right to seek restructuring of loans before the institutions begin foreclosure. It also provides borrowers an opportunity to seek review of certain credit and restructuring decisions. When a System institution acquires agricultural property through liquidation, the Farm Credit Act also provides borrowers the opportunity to buy or lease back their former properties.

FCA enforces the borrower rights provisions of the Farm Credit Act and examines institutions to make sure they are complying with these provisions. We also receive and review complaints from borrowers who believe their rights have been denied. Through these efforts, we ensure compliance with the law and help FCS institutions continue to provide sound and constructive credit and related services to eligible farmers and ranchers.

Conclusion

We at FCA remain vigilant in our efforts to ensure that the Farm Credit System and Farmer Mac remain financially sound and focused on serving agriculture and rural America. While we are proud of our record and accomplishments, we remain committed to excellence, effectiveness, and cost efficiency, and we will remain focused on our mission of ensuring a safe, sound, and dependable source of credit for agriculture and rural America. This concludes my statement. On behalf of my colleagues on the FCA Board and at the agency, I thank you for the opportunity to share this information.

The CHAIRMAN. The chair will remind Members that they will be recognized for questioning in order of seniority for the Members who were here at the start of the hearing. After that, Members will be recognized in the order of arrival. I appreciate Members' understanding.

And I recognize myself for 5 minutes. Again, Mr. Spearman, thank you for coming this morning. Can you look into your crystal ball and talk to us about next year and the year after that? I am concerned, given the stresses on the agriculture economy and the new regulations that are coming on the commercial banking side as well as across the System—will farmers next year be able to have access to the credit they need, given the hard results they are going to get this year? Will they have the access to that credit that they are going to need to get next year's crop in? What is your view on that?

Mr. SPEARMAN. Thank you, Mr. Chairman. That is a very good question. And with the looming cloud over agriculture as predicted by the USDA estimate of a 36 percent decline in farm income in the subsequent year, the System is fundamentally sound, well-positioned to be able to provide credit for America's farmers and ranchers and aquatic producers.

The System is, again, in my opinion, only one part of being able to provide credit to the market. It needs to work with the other organizations that provide credit, such as the community bankers, other lenders, in order to be able to provide that credit. The good thing about the System is that it is a GSE, and it has a mission component that the System has to be there in bad times. And we, as the regulator, need to make sure that the System remains safe and sound so that it can be there.

The CHAIRMAN. We have a lot of friends in the room. There are bankers in the room and Farm Credit Service folks in the room. Most of us on this panel have friends on both sides of every issue.

And most of us try to stick with our friends. But your agency has the mission to make sure that the System stays within its lanes of authority. Can you talk to us a little bit about the similar-entity lending authority that has been used in some of the higher profile loans of late and how that mechanically works? And you may need to refer to one of the other witnesses to flesh that out. But if you could walk us through that.

Mr. SPEARMAN. Well, I will start and then I will turn it over to our General Counsel, who will be able to kind of explain some of the specifications of the Act and how they relate to similar entities. Similar entities were started as a risk-mitigation tool, if you will. Because the System is a monoline lender, their market is fairly limited. This risk-diversification tool is necessary to be able to help them get involved with entities that they may not necessarily have been able to do without this particular rule. One of the key factors of that rule, and I am sure our General Counsel will get into that, is that these loans cannot normally be eligible loans that they can participate in. So I will turn it over to Charlie and let him get into some of the specifics of the similar-entity rule.

Mr. RAWLS. Okay. Thank you, Mr. Chairman.

And Chairman Spearman covered a lot of the most important points about the similar-entity authority. It did come into the Act first in 1992 as a risk-diversification tool. It is not a direct lending authority of System institutions. So it is a participation authority, which means that someone else, usually a commercial bank, would lead a transaction. It would typically be a multilender transaction. Some of these transactions are quite large. And System institutions have authority then to, in plain English, buy part of that credit, to participate in that credit, but only up to 50 percent of the credit. So there is that limitation.

There are other portfolio limitations. For example, Farm Credit System institutions can only hold up to 15 percent of their portfolio in these types of credits. They are nowhere near that. I think the last time we looked at the numbers, they might be about six or seven percent System-wide. But that is one of the other limitations. So some of this, as we say, is not intuitive except from the very basic standpoint that this is a risk-diversification tool. This is not a mission-directed type of authority. There is no particular rural requirement on it or that kind of thing.

The first requirement, as we say, of similar-entity lending is that it is a credit that is not eligible under the Farm Credit Act. And the second basic requirement is that it has to be an entity that is functionally similar to someone that is eligible. And so looking at that functional similarity is where our examiners and the legal staff would get involved in looking at these credits after they are made. We don't have any prior approval authority. I think that is the basics and I would be happy to follow up with questions.

The CHAIRMAN. Well, other Members will maybe ask some follow-ups. My time has expired.

I will turn to the Ranking Member for 5 minutes.

Mr. PETERSON. Thank you, Mr. Chairman. And I wanted to also focus in a little bit on the mission, Mr. Chairman, as we discussed. One of the main things that you are there to accomplish is to make

sure that the System is safe and sound, and there is oversight over the System.

But as the Chairman said, we keep getting complaints from constituents. For example, the Minnesota bankers sent me a letter last year that said that, "the FCS engages in various activities that are well beyond the scope of its lending mission." And so there is a lot of confusion about what the mission is. So if you could just respond to that question or statement, and also talk about how you make sure that the System is staying within the parameters of its mission.

Mr. SPEARMAN. Thank you, Ranking Member Peterson, for that question. I am aware that there are issues about what we are about and how we relate to the Farm Credit System. I want to assure you that we are the regulator of the System. Our task is to make sure that the System remains safe and sound, is there in good times and bad times. There are issues that may come up within the Act, such as the similar-entity, which Charlie has kind of gone over, that may be somewhat controversial. We, as an agency, our folks do a great job of trying to read the mission and understand that the Farm Credit System is a GSE and that it has that mission component; that it must be there in good times and bad. I don't want to get into any specific areas. What I want to do is kind of turn it over to our chief examiner. And he can give you an idea of how an examiner pretty much goes in the field and makes that determination if something controversial comes up and how we handle that as an agency.

Mr. COLEMAN. Thank you, Chairman Spearman. Our examination program looks at each institution to the safety and soundness and if they are operating within the parameters of the statute and the regulations. We look primarily to the risk-control systems of the institution. We come up with a financial institution rating system, 1 through 5, for each institution. That also includes looking at their asset portfolio as well as looking at if those loans are within the statutory and regulatory requirements in regards to mission and scope of financing, *et cetera*. The Farm Credit System also has some limited investment authority. So there are certain investments that Farm Credit System institutions work with USDA and other commercial banks in regards to certain aspects and local communities in that area. But the primary mission, as Chairman Spearman discussed, is providing credit to creditworthy borrowers, farmers and ranchers and rural residents within specific authorities.

Mr. PETERSON. Thank you. One of the other missions that you are charged with under the statute is young, beginning, and small farmers. And could you talk about what you are doing to promote and comply with that mission.

Mr. SPEARMAN. Thank you, Congressman.

Yes. The YBS or the young, beginning, and small farmer facet of the Act has to do with mission component, if you will. American agriculture, all its statistics is showing that American farmers today are advancing in age. And the YBS Program, my understanding, was begun to help fill that pipeline of young farmers to come in and to be able to have a capital structure to become full-fledged farmers. As an agency, since it is a requirement that the

System deal with the YBS program, our agency collects statistics. We require that certain things be done to make sure there is a strategic program.

What I am going to do at this point is refer to Robert again there because he can kind of explain to you somewhat what our examiners do in the field.

The CHAIRMAN. In order to give every Member a chance to ask a question, we are going to follow the 5 minute clock. So we will take that question for the record, or your answer for the record, or we will come around a second time.

Mr. Lucas, for 5 minutes.

Mr. LUCAS. Thank you, Mr. Chairman.

And coming from, being a good farmer from an old farm family, a multi-generation of debtors, we are always interested in our credit providers from every source. So I would like to continue down the vein of the discussion just a moment ago. I sit on Financial Services, as well as Agriculture, of course. And under Dodd-Frank, that amazing piece of legislation that affects the rest of the banking industry, banks are required to do stress testing. Can you explain, as we continue down this line of focus on the examinations, can you explain how the Farm Credit Administration does stress testing of the Farm Credit System? Because that is more than just, are you loaning it to eligible participants; you are staying within the guidelines of how those loans are structured. Stress gets down to the viability of the loans themselves.

Mr. Chairman?

Mr. SPEARMAN. Thank you, Congressman Lucas.

Yes, stress testing is a risk-mitigation tool that the System utilizes to put certain pressures on an operation to try and determine if A happens, what happens with B. The agency requires that the System do stress testing. And we did that in the form of an Information Memorandum. We require every year that they, at a minimum, that they put certain stresses on their operations.

Mr. LUCAS. So an annual basis. And could you explain, or one of your folks there, explain how the stress test that you apply or your agency applies compares with what, say, the commercial bankers are going through?

Mr. SPEARMAN. I am going to defer to Robert—

Mr. LUCAS. Please.

Mr. SPEARMAN.—on the stress testing.

Mr. COLEMAN. In 2010, we put out, as Chairman Spearman mentioned, an Informational Memorandum that laid out our expectations for each and every Farm Credit System institution. And what we expect on an annual basis is the Farm Credit System institutions to stress test every significant portion of their balance sheet. With Farm Credit System institutions, obviously, the huge majority of that component is around loan assets. So what we ask institutions to do, we give lots of different parameters, but the institutions have some flexibility in looking at what they want to do.

Over the last several years, obviously, there has been a lot of focus on land values, real estate values, and stress testing around significant drops if they were to occur in real estate values, most especially in the Midwest. We also look at other components around interest rates, around softening of commodity prices, *et*

cetera. But those expectations were laid out. And we require the institutions to do that annually.

Mr. LUCAS. Mr. Coleman, if I could ask, in your last round of stress tests, did you have any surprises or any regions or particular commodity groups, any areas where the red flags went up?

Mr. COLEMAN. I wouldn't say red flags, but areas of caution or concern, most especially in the Midwest, as recognized by other bankers and academics, starting to see flattening or softening of real estate in the Midwest, certainly with USDA projections for a 36 percent decline in net farm income. A lot of that is impacted in regards to grains. The Farm Credit System has about 18 percent of the total portfolio concentrated in grains. So those institutions in the Midwest are heavily concentrated in corn, soybeans, and wheat. We certainly have paid more attention to what they are doing and how, as Chairman Spearman mentioned, they have well positioned themselves over the last several years to deal with the borrowers and deal with the stress anticipated.

Mr. LUCAS. Chairman Spearman, one last question. In Oklahoma, we have a law that says that banks cannot hold real estate for more than 5 years. The logic is that banks should be collectors of capital, arbitrages of capital, make loans, they should not be in the long-term asset-holding business. But my understanding is that some of the Farm Credit institutions have some rather substantial mineral holdings around the country perhaps that generate substantial revenue. From an Oklahoma perspective, that would seem to me to be contrary at least to the spirit of the way we have always done things in our state. Is this correct? And if that is the case, do you know how long these assets have been on the books, mineral rights?

Mr. SPEARMAN. Yes, Congressman. Mineral rights are being held by some institutions in the System. Primarily, I believe, it is AgriBank that holds most of them. But this happened years ago. And, currently, System entities are no longer eligible to acquire mineral rights.

Mr. LUCAS. But we have not dispersed those old assets yet?

Mr. SPEARMAN. No. We have not.

Mr. LUCAS. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

Mr. Scott, for 5 minutes.

Mr. DAVID SCOTT of Georgia. Thank you, Mr. Chairman.

Welcome, Chairman Spearman. First of all, let me say that what an outstanding job you are doing, Mr. Chairman. You are doing a great job. And I wanted to call attention to you and the Farm Credit System under your leadership. First of all, what I would like to do, Mr. Chairman, I would like to submit this letter for the record. It is an important letter. It is from Fort Valley State University. As you know, Mr. Chairman, you and I have worked hard to address the issue of the 1890s, which are your African American colleges and universities. We had an outstanding hearing. It was remarkable. Farm Credit played an exciting role in that.

But, Mr. Chairman, I would like to submit this letter for the record. Let me just state one little sentence out of here where it says: "Over the past years, Farm Credit has not only provided financial support through internships and scholarships for FVSU

students, but has also been actively involved in providing educational programs such as the AgAware program to our farmers in order to successfully prepare them for future endeavors.”

The CHAIRMAN. Without objection.

[The document referred to is located on p. 49.]

Mr. DAVID SCOTT of Georgia. Thank you, Mr. Chairman.

For beginning farmers and addressing this issue is paramount to us, and particularly with the age of our farmers now averaging about 60 years of age. Many of us realize it is not only an agriculture issue; it is a national security issue because we need to make sure we protect our food supply in our own hands. So our efforts on that are very, very important. And your support of the 1890s, our African American students, to get more African Americans into farming and into agriculture is very critical.

Now, I want to go to one question, let me follow up here for a moment. I want to ask, Chairman Lucas, former Chairman Lucas brought up the stress testing. Let me just follow up with that for a moment. How would you compare your stress testing with commercial banks? Is it on an equal footing?

Mr. SPEARMAN. Again, stress testing, Congressman, is a risk-mitigation tool that is utilized. We have asked—I don't want to say ask. We expect, through this memorandum, for the System to perform certain stress testing on their institution financials at a minimum of once a year.

I am not aware of any comparison that is done with commercial bankers. We are, our folks are aware of what areas that are more vulnerable than not. And the stress testing that is done on those areas, as Robert mentioned, such as interest rates—

Mr. DAVID SCOTT of Georgia. All right.

Mr. SPEARMAN.—they try to ensure that that stress testing is performed on those areas.

Mr. DAVID SCOTT of Georgia. Okay, Mr. Chairman. Let me ask you this question: The FCA has responsibility for ensuring the safety and soundness of the Farm Credit System institutions. Tell me, how many examiners do you currently employ to get this job done, and how frequently are FCA employees in the System institutions reviewing what they are doing?

Mr. SPEARMAN. Congressman, we currently employ roughly 300 individuals. Since we are primarily a regulator, more than ½ of those folks are examiners.

Mr. DAVID SCOTT of Georgia. Yes.

Mr. SPEARMAN. And according to the Act, each institution must be examined at least once every 18 months.

Mr. DAVID SCOTT of Georgia. Yes.

Mr. SPEARMAN. We have one institution that, by our choice, we examine once a year.

Mr. DAVID SCOTT of Georgia. All right. Now, finally, Mr. Chairman, the Chairman opened up and he made a very profound statement that we have friends in the banking community and the Farm Credit community, and we love our friends. So I wanted to ask just briefly, because 42 percent of this market is handled by Farm Credit and 42 percent of this is handled by the banks. So it is important for us to communicate and harmonize here. So, finally,

Mr. Chairman, can you give us an example of opportunities where both Farm Credit and the banks work together and harmonize?

Mr. SPEARMAN. One example I can think of off the top of my head that was brought up by our General Counsel here, the Farm Credit System does participate in investments in rural communities. I had an opportunity to go out and visit one project where there was a joint working between community bankers and the Farm Credit System. It was a hospital in Minnesota. And those folks were just thrilled to be able to have the capacity with this joint venture to be able to have that facility.

Mr. DAVID SCOTT of Georgia. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. King, 5 minutes.

Mr. KING. Thank you, Mr. Chairman. And especially I want to thank you for holding this hearing here today and giving us an opportunity to have this discussion and take a look at Farm Credit. I think if we don't have this hearing publicly and do so annually, we will just simply not do the examination that is necessary, the oversight that we have. So I appreciate having it today.

And, Mr. Chairman, I appreciate your visit and the opportunity to hear your testimony here. I just looked back on the past hearing, and it is not clear to me the exact mission statement, that, to me, there are a number of different pieces along on this. But is there a compact, printed, published mission statement that we can look at that anchors us to the mission of Farm Credit? And could you deliver that to me please?

Mr. SPEARMAN. Our annual report, of course, annually publishes the mission of the Farm Credit Administration. And the Farm Credit System publishes a mission statement also in their annual report. And the mission statement primarily states that the Farm Credit System is to provide sound and dependable credit to America's farmers and ranchers, producers, and harvesters of aquatic products, their cooperatives, and limited types of farm-related businesses.

Mr. KING. Okay. Thank you. That actually is the one I am working with. I wanted to make sure we read the mission statement into the record. And then I wanted to expand a little further on some of the inquiry we have heard from the other Members with regard to is it your belief that Farm Credit has gone outside the boundaries of that mission statement you have just read?

Mr. SPEARMAN. No. It is not. My General Counsel says I shouldn't start out with a negative like that. But as a regulator, our primary function is to look at areas that have possibly gone outside of the mission.

Mr. KING. Thank you. And I did hear that answer earlier in one of your responses. And so I would ask you then, who is responsible for staying within the, let's say, the fences of the mission statement? Who is responsible to ensure that Farm Credit lenders stay within the boundaries of the mission statement?

Mr. SPEARMAN. The Farm Credit Administration.

Mr. KING. The Administration—that would be Article II, the Obama Administration?

Mr. SPEARMAN. The Farm Credit Administration, FCA.

Mr. KING. Okay. The Farm Credit Administration then does have the responsibility. And Congress has the responsibility of oversight.

Mr. SPEARMAN. That is correct.

Mr. KING. Could we imagine, if we backed up, say, 20 years and let's go back to the 1980s when we really did have a farm crisis, and could we imagine then that we would be having this conversation now about Verizon and other telecommunications companies and hundreds of millions of dollars that have gone into those particular endeavors? Let's just say if some Members of this Committee have a sense of mission creep, is that totally explainable? And I want to understand this. Is there a limit within the Administration, the Farm Credit Administration, that would say we are going outside our boundaries, and is that boundary in the definition of the *mission*, or is it in the concern that Congress will look in and look at that definition of the *mission*?

Mr. SPEARMAN. Well, we have the mission, Congressman, and we also have the Act that we have to follow. So we have legal guidance whenever we look at any product that the System kind of brings before us. And what we do is we follow the guidance of what we believe that the—

Mr. KING. But we agree that we would not have imagined this mission statement to encompass, say, back during the farm crisis years, we would never imagine this mission statement to encompass some of the lending that has taken place, especially with regard to telecommunications. And I would add to that acquiring private-sector businesses, such as crop insurance companies that look like they are being used as leaders, that opens up the doors to direct that into Farm Credit. And I brought this up the last hearing we had—I bring it up at this hearing too—is that the language in the mission statement seems to me to confine Farm Credit to a narrower set of boundaries than those that you have adhered to. And I like what Farm Credit has done. I look around my neighborhood, and I have neighbors I wouldn't have if it weren't for Farm Credit. But it behooves us all to stay within those boundaries. I think the mission statement is fine. But you have overstretched it. So I appreciate your testimony and the hearing.

And I yield back the balance of my time.

The CHAIRMAN. The gentleman yields back.

Mr. Walz, 5 minutes.

Mr. WALZ. Thank you, Mr. Chairman.

And thank you, Chairman Spearman, for being here.

As you are constantly looking at risk in lending to farmers and ranchers, this might be more for our colleagues who aren't here, could you explain to me how important crop insurance is to lenders as they make decisions?

Mr. SPEARMAN. Thank you, Congressman, for that question. Crop insurance, again, is a risk-mitigator. There are two issues that come to mind about the availability of crop insurance. One would be that, without crop insurance, would a potential borrower be able to get a loan? And the other issue would be, would they be able to repay the loan? So crop insurance is very important.

Mr. WALZ. Well, I ask this question. I think it is important. I would like to thank Chairman Conaway, Ranking Member Peterson, and all the Members of this Committee, along with Speaker Ryan, have ensured crop insurance will remain strong. The prom-

ise that we made will be kept. And hopefully that makes our lending work for people.

One more question from me. In speaking of this mission, and you heard a concern that comes from a lot of our folks of trying to stay within that mission, my concern is, do you have the tools necessary—you heard a little bit from Mr. Scott dealing with this—but do you have all the tools necessary to make those loans to small, beginning farmers and ranchers? This is something that we have taken an interest in, we passed legislation in the last farm bill to do that. Do you have the tools to make that happen?

Mr. SPEARMAN. Congressman, yes, we believe that we have the tools to make that happen. Could they be better? Yes. And we are open to working with the staff of the Committee to help to improve some of those areas. But for me personally, the YBS program is an excellent program. And there are areas that we could improve upon.

Mr. WALZ. I think we will take you up on that because we all know that barriers to credit are what stops people from getting in this. It is not their desire. They have to be able to, as you heard the Ranking Member say, land prices continue to go up as crop prices go down. But we have people out there who want to take advantage of this. We want to get them educated. We want to make sure we are making good loans and they are well thought out and we have the tools necessary. So I appreciate that. And I thank you for your testimony.

I yield back.

The CHAIRMAN. The gentleman yields back.

Mr. Gibbs, 5 minutes.

Mr. GIBBS. Thank you for holding this hearing.

And thank you for being here. As a previous borrower of Farm Credit—my first loan was in the 1970s—and also managing a local—on the board, working at a co-op bank, was a good experience, very supportive of the organization. I want to follow up a little bit more on the mission. And it is clear by my colleague from Iowa's questions. But here in the second quarter of 2015, we saw that Farm Credit Service increased their risk exposure level to \$1.5 billion. That is double the limit it was 2 years ago. What precipitated that change? And how many farmers and ranchers need a \$1.5 billion loan?

Mr. SPEARMAN. Thank you, Congressman, for that question. I am going to defer to Robert, who is our chief examiner, to be able to talk specifically about the particular size of loans.

Mr. COLEMAN. Thank you, Congressman. The Farm Credit System has almost 17 percent capital today, significantly larger than it was 20 or 30 years ago. And those increased limits are reflective of the risk-bearing capacity of the Farm Credit System and the institutions. Primarily those larger loans are going to be farmer co-ops, processing co-ops, and rural utilities, all authorized under different titles of the Farm Credit Act.

Mr. GIBBS. In my past life borrowing experience, when I went in and talked about a loan, we kind of had to put out what the line of credit, kind of what the purpose was or if it was buying property or building a facility, it was pretty well spelled out. And one issue, first of all, I guess I have to ask the question: It has been reported

to me that the Farm Credit System made a \$700+ million loan to Verizon. Is that true?

Mr. COLEMAN. Last year, that is correct.

Mr. GIBBS. Okay. And it also has been brought to my attention that that was really to buy the final stake in a European cell phone company, Vodafone. Is that correct?

Mr. COLEMAN. I am not aware of the details. I believe that is correct.

Mr. GIBBS. So that is where we really get back to the mission. I am sure anybody would make the argument that we want to expand broadband and get fiber optic out there and those kinds of loans. But how could the regulators sign off on a deal like that that really has nothing to do with the mission? I am really struggling with that. And this is almost \$¾ billion. How does that help my farmers in Ohio?

Mr. COLEMAN. If I may, our General Counsel mentioned earlier today, the similar-entity authority was provided for risk-mitigation. Since Farm Credit System institutions are limited to agriculture, there was a provision added in the Act about 20 years ago that allowed Farm Credit System institutions to participate in loans that were originated, led by others, commercial banks primarily, so they have to be invited in, and their participation in those loans is for risk mitigation. One of the first requirements in the Act for similar-entity participation is that it is an ineligible loan. We would all recognize, up front, that those are ineligible loans, but they are authorized in the Act by the similar lending authority.

As our General Counsel mentioned earlier, two other requirements are that either the assets of the company or the income generated by the company have to be functionally similar to an entity that the Farm Credit System could make an eligible loan for.

Mr. GIBBS. Okay. I will follow up a little bit more on the loans made to—just certain conditions to make loans to build houses in rural areas, 5 acres or whatever. Because I am running out of time here, I want to mention my concern to make sure that they keep in the light the mission. We have to be careful because they have access to money that the private-sector doesn't have. And they have a competitive advantage. In the spirit of the mission, the regulators have to keep that in mind. And I kind of agree with the previous comments that the spirit of the mission and what is actually happening is a concern and the effect it has on the other part of the banking sector, especially my community banks, the competitive advantages or disadvantages. And that needs to be addressed.

And I appreciate the Chairman for the oversight hearing. I think this is something we need to delve into to make sure that you, as the regulators, are making sure that the spirit of the mission is complied with and not kind of mission creep. And that is my concern.

And I yield back.

The CHAIRMAN. The gentleman yields back.

Ms. Adams, 5 minutes.

Ms. ADAMS. Thank you, Mr. Chairman.

And thank you, Chairman Spearman, for being here. As a member of the Farm Credit System, Ag Credit North Carolina is using its corporate mission fund to provide grants to scholarships that

support beginning farmers and connect local producers to food retailers, including in the 12th District that I represent. Ag Credit North Carolina is also providing scholarships to poor students from my alma mater, North Carolina A&T, which is also one of the schools that the Ranking Member spoke about. The services provided by the Farm Credit System are very important for residents to receive rural housing and farming loans. Some credit options, such as guaranteed loans, reduce lender risk and make lending possible to beginning farmers who might otherwise have difficulty accessing credit. When utilizing such a lending program for beginning farmers, what kind of education and support do you provide to beginning farmers that increases their chance of successful loan repayment?

Mr. SPEARMAN. Thank you, Congresswoman, for that question. As I mentioned previously, the YBS program is a special interest of mine because when I came to the FCA, I noted that there was a lack of information about what the Farm Credit System was all about. I was hearing things that we were part of USDA; we were the lenders of last resort in the USDA. A lot of my job, the way I see it, is to go out, when I do have an opportunity to give a speech, is to sort of educate people about what the Farm Credit System is about and how FCA relates to that System. We are the regulators of the System. There are, within the statute, rules that the System has to follow regarding YBS programs. They have to have a plan within their strategic operation on how they are going to implement the YBS program. And our examiners evaluate that plan. We do not set specific rules. It is up to the particular institutions to come up with what their marketing plan is going to be for their YBS program. We just evaluate it to make sure that they do have a plan and that plan is being executed.

Ms. ADAMS. Thank you. In the 12th District, there is a significant level of interest in developing regional food systems to provide more fresh food options for constituents that live in food deserts. And you may know that in North Carolina, in my district, we are actually ranking very high as it relates to food insecurity. And so that is a concern. How is the Farm Credit Administration shaping its policies and regulations to encourage more lending to young farmers and small farmers that serve a regional food system?

Mr. SPEARMAN. Congresswoman, a big interest of mine since I came to the FCA is urban agriculture and being able to make sure that, as you mentioned, that food deserts don't exist. The System has capacity to be able to get involved with programs at the urban level. That is sort of a mission of mine to be able to come up with a plan, to see if we can, as an agency, help them to be able to help mitigate some of the deficiencies in under-served areas.

Ms. ADAMS. Okay. Thank you, Chairman Spearman. And I would certainly like to have my staff follow up with you at some point in time to work on this very serious issue in North Carolina, particularly in the 12th District. So thank you very much for your testimony.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentlelady yields back.

Mr. Austin Scott, 5 minutes.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman. And I, too, had questions about the young, beginning, and small farmers. They have been answered. And I also have a letter to submit on behalf of Fort Valley State as my colleague, Congressman Scott from Georgia.

The CHAIRMAN. Without objection.

[The document referred to is located on p. 49.]

Mr. AUSTIN SCOTT of Georgia. Gentlemen, Mr. Spearman especially, thank you for being here today.

And virtually every Member of this Committee has mentioned the concerns about certain banks, I would suggest, in the System or a certain bank in the System getting outside of the scope of what Farm Credit is supposed to be about.

And I would just read from your annual statement: "The Farm Credit System is a network of borrower-owned, cooperative, financial institutions and service organizations servicing all 50 states and the Commonwealth of Puerto Rico created by Congress in 1916 to provide American agriculture with a dependable source of credit. The FCS is the oldest government-sponsored enterprise."

When you look through your annual report, cows, chickens, everything in your annual report is farm-oriented. There is not a picture of a Verizon shop in there. I want to be maybe a little more blunt than some of my other colleagues have. You are the regulator. I think the Farm Credit System is extremely important to the parts of the country that I represent. Certain people getting outside of the parameters of what the Farm Credit System was set up for, I believe, are putting the whole System at risk. As the regulator, I do think when you have an organization who is putting the System at risk, you do have the ability then to step in and stop that.

And while what they are doing might be technically legal, it is certainly, in my opinion and apparently in the opinion of the majority of the Members of this Committee, who are your greatest advocates in Congress, that it is outside the scope and the intent of the Farm Credit System. I will just be honest with you. I don't think CoBank is going to stop until someone stops them. And I hope that you, as regulators, will work to get them back into what the scope of the Farm Credit System was set up for.

Mr. Rawls, you have been with the Farm Credit System for a long time. Is that correct?

Mr. RAWLS. I have been with FCA a little over 12 years.

Mr. AUSTIN SCOTT of Georgia. And you are one of the ethics officers?

Mr. RAWLS. There is a Chief Ethics Official that is within my office. And I function as essentially an alternate or Deputy Ethics Official.

Mr. AUSTIN SCOTT of Georgia. Are you aware of one of your institutions accessing confidential and proprietary information from a password-protected extranet of its competitor?

Mr. RAWLS. I am aware a number of years ago of probably the incident that you are referring to, yes.

Mr. AUSTIN SCOTT of Georgia. If that happened to a private-sector institution, what do you think the consequences for the executives of that institution would be?

Mr. RAWLS. I really couldn't say. It depends so much on the facts and circumstances of any particular incident like that.

I would say the agency in this case did follow up with our supervisory activities that we found appropriate at that time.

Mr. AUSTIN SCOTT of Georgia. I think that bank would probably be shut down in the private-sector. What was the monetary payment for that conduct?

Mr. RAWLS. I would have to get the details on that and get back with you. I just don't recall.

Mr. AUSTIN SCOTT of Georgia. I would appreciate it very much if you could get back to me with the details of the whole event and whether or not the people, the individuals whose information was accessed, were notified properly that their information had effectively been taken without authorization.

And, again, the Farm Credit System is extremely important. I think that, I hope that you guys, as regulators—and I mean this with all sincerity—can keep within the scope of the original intent of the Act that was written. If not, I worry that the System may not exist in the future. And it is important to me and my community that it does exist and that it function as it was originally intended to.

With that, I yield the remainder of my time.

The CHAIRMAN. The gentleman yields back.

Mr. Costa, for 5 minutes.

Mr. COSTA. Thank you, Mr. Chairman.

The credit lending and agriculture throughout the country has changed over the decades, as we all know, American agriculture has changed. The note that you made, Mr. Chairman, in your opening statement about President Roosevelt's Executive Order, there used to be more than a thousand, several thousand institutions around the country. And, today, there are around 80 if my numbers are correct. A lot of that has resulted in the changing of the lending practices that have taken place over the decades for agriculture communities. But, also, consolidation has been a part of that effort.

In California, we have perhaps one of the largest portfolios in terms of farm credit, with over \$20 billion in lending activity that takes place. Consolidation, and mergers, as I have met and spoken with my local institutions, have been a part of that change. Do you foresee additional mergers taking place, Mr. Chairman? And do you think by and large the approval of those, as the Board looks at each one on an individual basis, is done in a way that protects the fiscal integrity of the institutions?

Mr. SPEARMAN. Thank you, Congressman, for that question. Mergers come up from the System. Our role primarily is to evaluate the merits of it. As you mentioned, there is the impact on safety and soundness of the System. There is, as an agency, we do what is called a preliminary review in our Office of Regulatory Policy. And our General Counsel office reviews each application as it comes in very thoroughly. We give what might be called provisional approval. Then it goes back to the banks. And the banks end up, the stockholders actually vote on whether the merger ought to take place or not.

Mr. COSTA. How long does that process, since you have been Chairman in 2009, typically take, the mergers that you have supervised?

Mr. SPEARMAN. My experience since I have been there has varied. It depends upon the complication. We had two banks that merged. It took a substantial amount of time.

Mr. COSTA. So it is not simply a process where a couple of institutions get together in an area or within two different states or whatever and say, "we are going to do this," and then there is a thorough review that has to happen?

Mr. SPEARMAN. It is a very thorough review. And to your point, if the two institutions are not contiguous that is even a factor that is considered.

Mr. COSTA. Okay. I want to get some clarity because a number of the questions, of course, that many of us have thought about have already been raised. But I wanted to get some clarity.

When you and I spoke, we talked about the issue of—that has been termed *mission creep* and the constraints upon the System on a 15 percent of nontraditional loans, as it is put. But now that 15 percent cap, as I understand it, is both per institution and System-wide. And now there is also a distinction between lending activity and participatory loans as well. And I want to be clear or let you clarify the distinctions within that constraint.

Mr. SPEARMAN. That is a statutory question, and I am going to refer to Charlie to be able to respond.

Mr. RAWLS. Thank you, Mr. Spearman. The 15 percent referenced is a portfolio limitation System-wide on the similar-entity participations that we talked about. And that is right from the statutory language.

Mr. COSTA. So that is participatory? It doesn't include lending activity?

Mr. RAWLS. As we have talked about this, that is not what we call a direct lending authority. Those are our participations, yes.

Mr. COSTA. And that is locally and System-wide?

Mr. RAWLS. The System-wide would be 15 percent on the participations through a similar-entity. To further confuse things, but the System engages in other participations that would be outside of that, much more cooperating with commercial banks and more traditional loan makings.

Mr. COSTA. So that would be outside of the 15 percent?

Mr. RAWLS. Yes, yes.

Mr. COSTA. So a local institution could have more than 15 percent?

Mr. RAWLS. In participations, it could. I would have to ask Robert if he has any numbers. But it could, yes.

Mr. COSTA. All right.

Mr. Chairman, I would like them to respond back to the Committee.

The CHAIRMAN. And we will get a clarification of that. It is confusing. If the System went to 15, how would you then scale it back in any one individual entity? So I will ask you for a written response on that issue.

Mr. Crawford.

Mr. COSTA. Thank you, Mr. Chairman.

Mr. CRAWFORD. Thank you, Mr. Chairman.

I want to thank the gentlemen for appearing today.

I really hate to beat a dead horse here, but I have to go down this road and take a little bit of a different turn here. We have addressed at some length in detail the issue with CoBank and the acquisition or the help in Verizon acquiring Vodafone. Two things here. Number one, I would like if you can identify any ancillary benefits to our rural communities here in the United States, I would love to give you the opportunity to do that right now and then let me follow up with another question that relates to that.

Do you see any ancillary benefit to that, to our rural constituencies across the United States?

Mr. SPEARMAN. Congressman, are you referring to the similar-entity program, ancillary program?

Mr. CRAWFORD. I am referring to the CoBank participation in the Verizon-Vodafone activity.

Mr. SPEARMAN. I am going to refer to Robert on that.

Mr. COLEMAN. Thank you, Mr. Spearman.

As we had mentioned, there is a 15 percent limit on similar-entity lending. The System has about five or six percent of its total loan volume out. So the other 95 percent are either—

Mr. CRAWFORD. Okay. And let me stop you there because I know that was the answer basically that was given earlier. But you are threading a needle there.

What I am trying to get to is: That is good for CoBank, but how is this good for rural constituencies? And this leads to my second question.

And a quick background, I started my business literally under the roof of Farm Credit. I rented space from them. I have a long-standing relationship with the Farm Credit lenders in my district. These are not just my constituents; they are my friends. Also, the bankers are my friends because I borrowed money from them to start my business. So I have a pretty vested interest in both of those, in the soundness of those in ag lending. But what has happened here with CoBank, they have done considerable damage to the Farm Credit brand. And I am wondering what can be done, what you are doing actively to repair that damage because risk reputation is what has transpired as a result of that. And I am hearing this—the day after this became public, I went into my Farm Credit office in my hometown, and they stood there with their hands up, with no explanation. And the damage that that has done in my community to the Farm Credit brand is something that I don't see being resolved or addressed at this level.

Can you comment on that?

Mr. COLEMAN. Two points, if I may. How does it benefit?

With a monoline lender, diversification of an income stream is important, just like when we were talking earlier about corn producers, if they also have other income, that other component of income is helpful in diversifying the risk-management component. I think that was the original intent. It continues to be the intent today in regards to similar-entity participation authority.

In regard to the issue over how that transaction was dealt with, we had conversations with the institution that purchased a portion

of that similar-entity loan, and that no longer exists in that institution today.

There are three of the four other banks, as well as a handful of other Farm Credit System institutions, that do the majority of the similar-entity lending in the Farm Credit System. And we have looked at more closely over the last several years those types of transactions and actually worked with the System on guidance around some of the very issues that you are visiting with us today on. And we have found instances in the past where we have required Farm Credit System institutions to actually divest of some of those similar-entity participations where we thought that there was some reputational risk or other areas where they shouldn't be doing.

Unfortunately, we just see the Verizon account a little bit differently in regards to compliance with the law.

Mr. CRAWFORD. Okay. Let me interject something right there. The optics of this, the fact that we are spending so much time on this and the amount of energy that is being devoted to defending it probably means that it is one of those kinds of things that has done some severe damage to the brand.

Let me suggest this in the time that I have remaining, that if CoBank wants to help Farm Credit restore the damage that they did to the Farm Credit brand, they might want to be very forthright and proactive in helping to engage rural utilities to deliver rural broadband across this country. So we actually could see the tangible benefits accrue to rural constituents to the extent that they did help Verizon and Vodafone.

Thank you. I yield back.

The CHAIRMAN. The gentleman's time has expired.

Mr. Aguilar, for 5 minutes.

Mr. AGUILAR. Thank you, Mr. Chairman.

Mr. Spearman, thank you for being here today and for your update on Farm Credit Administration.

CRS has forecasted that the agricultural industry net income would decline over 52 percent from 2013. You talked a little bit earlier from urban farming, and I represent an area that is more urban, and it has taken off as a grassroots movement, as you discussed.

What is the Administration doing to kind of forecast or project urban farming demands? And where might you be able to offer help? Where do you envision this market in the next few years? And could this be an opportunity for growth within the Administration?

Mr. SPEARMAN. Thank you, Congressman, for that question.

We just recently had a strategic planning session as an agency. And expanding the pie is one of the issues that we are discussing, during those sessions. Urban agriculture is a personal interest of mine, as I mentioned, because of the fact that this is one way to expand the pie.

My staff and I, we had an opportunity to go and visit a small operation in Austin, Texas. This young fellow started his agricultural farm, in his backyard, on very small plot. And he took his crop and he sold it at a farmers' market. Today, as a result of YBS

and the Farm Credit System, today he has over 200 acres of agriculture that he is growing, and he has developed a CSA program.

This is something that if I can do as Chairman of the Farm Credit Administration, I can go out and see these things and promote them and share that with other institutions, I see that as a growth area.

Mr. AGUILAR. What tools did that individual use? What areas in your discussions with them and when you and your staff visited, what areas did you walk away thinking this was working or this could be expanded? Could you expand on that a little bit more?

Mr. SPEARMAN. Well, one of the tools that this young fellow was using there was through a YBS program. And he worked with his institution because he didn't have—this was not a legacy farm. He was able to, through that program, get some mitigation of an underwriting standard to allow him to be able to get a loan that he normally would not have been able to get through some other area. So it was the change in the underwriting standard that helped him.

Mr. AGUILAR. What other programs do you think would help more urban borrowers?

Mr. SPEARMAN. Programs like the YBS program.

Mr. AGUILAR. Do you think that they are aware of the YBS program sufficiently? Or do you think that efforts can be expanded to raise that to their awareness?

Mr. SPEARMAN. I think both. I think raising it to their awareness and expanding the program would be great for the farming community.

Mr. AGUILAR. Thank you.

I will yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

Mr. DesJarlais, for 5 minutes.

Mr. DESJARLAIS. Thank you, Mr. Chairman.

Gentlemen, thank you so much for appearing before us today.

I share with my colleagues, when they say that they are supportive of the work that the Farm Credit System does. Tennessee is very appreciative and benefits greatly from the services you provide. However, it is always concerning when you hear stories of a quasi-government entity potentially expanding beyond what appears to be its statutory authority.

I had the privilege yesterday of sitting down with some of our Tennessee bankers, Mr. Tim Amos, the Executive Vice President of Tennessee Bankers Association, and also Mr. John Barker, a community banker from my district. And as important as you all are, our small town community banks are also very important.

We have heard some examples of Verizon and Vodafone and you talked about the risk-mitigation clause, if you will.

I was getting more and more concerned as we heard the questions and answers this morning about the expansion beyond your charter, if you will. They are going outside the fence. Because what they brought to me was a list of e-mails from all over the State of Tennessee from small town community banks. And I won't burden you with the 20 or so different examples I was given. But let me share a few: One was a loan for a car wash in a small town in Tennessee. Another was funding a vacation home on the Gulf Coast for

a local farmer. There was funding to acquire a property for an exotic animal hobby farm. And there was even funding for a local restaurant chain. So I guess I would ask if you could elaborate on how these lending practices support farmers in their rural communities.

Mr. SPEARMAN. Thank you, Congressman, for that question.

If you earn 100 percent of your income from farming, there are broad authorities under the Farm Credit Act. The car wash and the items that you have mentioned, I am not aware of any. I know that our examiners examine for loans when they are reviewing loan portfolios at the institutions. And if anything comes to our attention there, we immediately indicate that they need to divest of it. We do have those authorities and the powers to do that. And if you are aware of any specific ones, please let me know.

Mr. DESJARLAIS. Yes, because I was going to say, there is probably no justification for those types of loans if they are at face value of what I shared today. You would be concerned about that and think that probably goes beyond your scope, assuming that what I am telling you is accurate, that these loans were made.

Mr. SPEARMAN. Assuming that is accurate and it is outside of the scope of lending.

Mr. DESJARLAIS. Okay. And you agree that is probably not what Congress envisioned when it passed the Farm Credit Act?

Mr. SPEARMAN. Well, you are asking me to make a personal assumption here.

Mr. DESJARLAIS. I get that. But what I would like to do is get some specifics to you. Again, a hearing is a tough place to give you specific examples. But if, indeed, what I read through is correct, it would be very concerning to you and certainly is not fair to the small community bankers.

They are as willing to accept healthy competition as anyone else. But if the playing field is that unlevel, it threatens the small town community banks. And we want to see the Farm Credit System do what it is intended to do. But if it is hurting small community banks because of these types of loans, then that is certainly something that y'all would want to look into. Would you agree?

Mr. SPEARMAN. I would agree.

Mr. DESJARLAIS. Okay. So let me do this, let me get some specific examples that are in writing and then we can correspond further.

I yield back.

Mr. SPEARMAN. Great. Thank you.

The CHAIRMAN. The gentleman yields back.

Mr. Ashford, for 5 minutes.

Mr. ASHFORD. Thank you.

I think the issues involving mission and loans outside of the mission have been covered. I would second your answers to questions about the markets in urban areas. I think that is significant. It is very significant in Omaha, where I live. In some low-income areas, we are making significant progress and the Farm Credit is a partner in that.

I just have a hypothetical, and it may be very simplistic. But in Nebraska, we are trying to develop our dairy industry. I mean, we are not in the top 20 or so in dairy. Just how would the Farm Credit approach that? I mean, we have producers who would like to expand their operations. We just don't have anybody to sell the milk

to. And we are losing that capacity. Even what we did have, we have lost up in the northeast Nebraska area.

Could you just generally answer that? What can we do in Nebraska? What can you do to help us expand already existing operations on the dairy side?

Mr. Spearman.

Mr. SPEARMAN. Thank you for that question, Congressman.

I spent some time in visiting Farm Credit Services of America there. They have a very dynamic institution.

One suggestion I would have is that some of those folks probably need to be talked to about, they are going to be very knowledgeable about what System can lend to.

I can't think off the top of my head of anything that I could suggest to you right at this point of what dairy farmers can do in Nebraska. I will turn to one of my colleagues to see if they have any comments.

Mr. ASHFORD. Yes.

Mr. SPEARMAN. Robert?

Mr. COLEMAN. Thank you, Chairman Spearman.

As Mr. Spearman mentioned, FCS of America, which operates out of Omaha, a large institution, a lot of different borrowing. And I would agree with him in regards to looking for ideas there for additional programs or additional lending capacity that may help in that expansion either in dairy or in any other areas where it will help further diversification.

In addition to that, USDA is obviously a contact point as well as others in regards to other Farm Credit System institutions. I know that in the upper tier in the United States, a couple Farm Credit System institutions up there that have been very active in the dairy industry and the expansion of dairy not only there but also down in California. So it is quite a bit of a knowledge base in several different Farm Credit System institutions that could be helpful.

Mr. ASHFORD. Let me just ask one other follow-on.

It would seem to me that in the area of expanding an existing product line—dairy, for example—in a state like Nebraska that has a rich agriculture tradition, that is an area where collaboration between the private-sector banks and the Farm Credit could make a significant difference. Would that be your thought as well?

Mr. COLEMAN. I would absolutely agree, yes.

Mr. ASHFORD. Good. That is all I have. I yield back.

The CHAIRMAN. The gentleman yields back.

Mr. Abraham, for 5 minutes.

Mr. ABRAHAM. Thank you, Mr. Chairman.

And I thank the witness for being here.

Everybody in this room wants the young and beginning business man or woman to succeed. So I guess my first question is, what percentage of those applications that fall on that YBS heading are actually approved? Do we have that number?

Mr. SPEARMAN. Congressman, I don't have that number in front of me here.

Mr. ABRAHAM. And if you could get it, I would be interested.

So I will follow up with that. Of your total loan portfolio, what percentage falls under the YBS heading?

Mr. SPEARMAN. Robert, do you have that number?

Mr. COLEMAN. Yes, sir. We require institutions to report to us in each category. In the young category, beginning, and small. And for the number of loans outstanding in the Farm Credit System, about one in six go to young farmers; about one in four go to beginning farmers; and almost $\frac{1}{2}$ are in the category of small farmers.

Mr. ABRAHAM. I am doing the math. So maybe under that whole heading, 28, 29 percent.

Mr. COLEMAN. I apologize. I didn't hear you.

Mr. ABRAHAM. I said, under the whole YBS heading then, I am guessing 28 to 30 percent.

Mr. COLEMAN. We don't add those numbers together. When we look at what we believe is best recorded in our annual report to Congress, we try to keep each one of those categories separate.

Mr. ABRAHAM. I will echo my colleagues' statements on the CoBank.

I live in rural—my district is rural Louisiana. And I certainly have many areas where I can't get cell phone service, certainly not Internet. And we know that without these instruments today, you can't have a business. You literally cannot. And I appreciate the transparency of the Farm Credit System that allows us to talk about these issues, about the car wash and the condos and the CoBank. So to that aspect, kudos to you guys for having your system in place that allow those areas to come up for discussion and for us to talk.

My final question. I read your testimony. And since 2010, your non-performing loans have been decreasing steadily. Now we are done to \$1.7 billion in non-performance loans.

Give me both the region and the sectors that are still your hot spots for those non-performing loans.

Mr. COLEMAN. Mr. Spearman, if I may?

Mr. SPEARMAN. Yes, go ahead.

Mr. COLEMAN. I mentioned earlier California, a significant state for agricultural production as well as loan volume in the Farm Credit System.

Mr. ABRAHAM. But they are still one of your top non-performers?

Mr. COLEMAN. Correct. So the non-performing would basically track where the loan volume is; California and Texas being the largest ones. There is no other particular geographic concentration or commodity concentration.

Mr. ABRAHAM. I looked at the pie chart where most of your loans come from, ag production, ag business, real estate, and it looked like that is a good 60 percent of the whole pie.

Are those two states that are non-performing more, is that basically due to climate, drought? Why?

Mr. COLEMAN. In those two states, the non-performing, the numbers would just be higher just because that is where the larger portion of the volume is within the Farm Credit System. They are the largest states.

Mr. ABRAHAM. Okay.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman yields back.

Ms. Lujan Grisham, for 5 minutes.

Ms. LUJAN GRISHAM. Thank you, Mr. Chairman. I appreciate your holding this hearing. And thanks to the panelists.

As we try to strike the balance between looking at your mission and making sure that we are not competing inappropriately with independent banks and community banks that have their lending portfolio priorities; and making sure that we protect small and young farmers and rural access, we want to make sure that they have access to capital, which I appreciate that you will include in your oversight and administration efforts, that they do outreach.

I am also clear that in the context of your evaluating—it seems to me that based on this hearing, I am clear—that your mission does not include doing outreach or requiring that outreach is an effective component for access to capital by disadvantaged or minority farmers. Is that correct?

Mr. SPEARMAN. Thank you, Congresswoman, for that question.

Since I have been on the Board at FCA there, I have noticed that there are areas that the System could do better. Traditionally, my observation has been that loan officers would sit in their office and wait for people to come to them.

One of the issues that is important to me is that the System live up to its mission. That its credit is available to all creditworthy borrowers, no matter what the size or what have you, even though I am putting more emphasis on the smaller urban and rural areas for me personally.

Ms. LUJAN GRISHAM. Well, that is terrific because it seems to me that has been separated in terms of who does what. And I would agree with you that arguably if we are not reaching out to those disadvantaged farmers, it is another layer of discrimination, given the way in which we are not focusing on making sure they have access to capital. And, in fact, discrimination for this subset of farmers is well documented in USDA by themselves internally. Externally, I would tell you, given the number of settlements—although we are not anywhere close to getting that, Mr. Chairman, addressed by USDA—that it is clear that we are still having those issues. And in a minority-majority state with real issues with small and young and disadvantaged minority farmers, if we are not clear about a pathway, a significant pathway investment, which includes outreach and real access to capital—recognizing that it is not a universal issue, right? Not everyone is going to be eligible. But if they never get in the door, I can tell you this, that my state, which relies significantly—and so, therefore, the rest of the country—on our agricultural investments, will cease to be able to make them if we don't figure out a way to be clear that everyone should be addressing outreach and access to capital in the appropriate lending institutions for not just the small and rural farmers, but also those disadvantaged and minority farmers.

How can we help you to make sure that that occurs?

Mr. SPEARMAN. Well, as an agency, we are always willing to work with the Committee to help us to strengthen the areas within the Act. Our examiners are in the field daily, and they are seeing what is actually happening on the firing line. So we would be a wealth source to help the Committee come up with some future improvement in the Act to help that area.

Ms. LUJAN GRISHAM. I really appreciate that.

And, Mr. Chairman, maybe we can get that in writing and ask for a couple of things, given that you appropriately—I am not sure if it was teasing or chastising me. I am okay with either. But let's get the data from this group to show who has access and who doesn't; get it separated by those minority and disadvantaged farmers, as well as the young and small farmers. And then let's come up with some ideas from the Committee that is a bipartisan effort to make sure that we are reaching, universally, the folks who were intended to have access to this capital.

The CHAIRMAN. Well, certainly, we will put that question before the witnesses so they can give us that information.

But as we have said earlier in the hearing, it is about 40 percent of the lending commercial banks; 40 percent. FSA is in the fight. So there is a broad spectrum of lenders that need to be a part of that solution.

Ms. LUJAN GRISHAM. I am in.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentlelady yields back.

Mr. Newhouse, for 5 minutes.

Mr. NEWHOUSE. Thank you, Mr. Chairman.

Gentlemen, thank you for being with us this morning. As a farmer, I certainly appreciate the credit being made available to agriculture around the country. Currently my loan balance is zero, but that is due to change here dramatically shortly.

Someone said "at the risk of beating a dead horse," maybe there is a little life left in that horse.

I wanted to ask one more question about mission. You have talked quite a bit about that this morning. There is quite a bit of interest, obviously, on the Committee about that subject. And you have talked about some of the regulatory measures in place to ensure that financing falls within the lines of the mission.

So let me ask your opinion. Do you see any additional mechanisms that would help FCA or FCS preserve that mission? Is there something else that you could use to help alleviate some of the concerns and make sure we stay on track and, as one of my colleagues said, preserve the ability of Farm Credit to have financial credit available in the future?

Mr. SPEARMAN. Thank you, Congressman, for that question. There are probably always things that can be improved upon. The Act, as it is stated now, has provisions. We do have authority, as an agency, to put regulations out. We also have the authority to put various memorandums out to the System that may not have the authority of a regulation. We believe at this point that we have the authorities to be able to keep the System safe and sound. Again, I would offer that if there is something that the Committee has in mind that they would like for us to assist them in, we would be more than glad to do that.

Mr. NEWHOUSE. So you have everything you need? All the tools in place?

Mr. SPEARMAN. I don't want to say we have everything we need but we have adequate kinds of authorities to be able to make sure the System remains safe and sound.

Mr. NEWHOUSE. Okay. Another question in opening comments talked about the downturn in the ag economy, and certainly that places a lot of stress on farmers but also on lending institutions.

Could you talk a little bit about the impact that has had so far across the System and the ability for people to pay back their loans? Is there enough capital within the System to protect against losses? And also, as kind of a follow-up to that, what is in place to work with farmers who may have difficulty in making payments? I am not sure who to direct that to, Mr. Chairman.

Mr. SPEARMAN. Well, to answer your first question, there is record low, as was mentioned previously, about non-performing loans in the System right now. Some of this could be due to the good times that ag has experienced in previous years, but we all are reading the tea leaves now that there are some clouds on the horizon.

The System is well postured, I believe, right now—and not just me, the staff also—to weather some downturn in the economy. But we are vigilant, and our examiners are constantly making us aware of some of the clouds that may be on the horizon. And we are taking action.

Mr. NEWHOUSE. So there are things in place to help farmers who may be having difficulty making those payments?

Mr. SPEARMAN. There are some. There are some. But we have borrower rights that are part of the mission component there to be able to work with—and that is another mission component of the Farm Credit System there—to work with institutions there to make sure that they get the right of first refusal, restructuring some of the tools that are available under the borrowers' rights provisions.

Mr. NEWHOUSE. Right. Okay. I see my time is up. I appreciate very much your responses. Thank you.

The CHAIRMAN. The gentleman yields back.

Mr. Kelly, for 5 minutes.

Mr. KELLY. Thank you, Mr. Chairman.

And I thank the witnesses for being here and all our other people who came here that are interested in this.

I want to go back to the 15 percent. The individual entity, are they bound by the 15 percent of their loans rule, the individual entity, not as a System but as each bank held by that?

Mr. SPEARMAN. Charlie?

Mr. RAWLS. The 15 percent that we have talked about, is also by implication, a System-wide limitation on the similar-entity participations. So at the individual institution level, overall for participations, I am not sure that there is a limit.

Mr. KELLY. All right. I am a pretty simple guy. But, I mean, it is a simple question. Is the individual entity held to the 15 percent? Because we have had this question asked several times. And I want to know, is each bank or each lending institution held to the 15 percent limit in that institution?

Mr. RAWLS. The answer is no for all types of participants. Yes, for similar-entity only.

There is a separate ten percent limit on how much of that institution's capital can be devoted to similar-entity. I am sorry if we

have not been clear. The 15 percent would apply to the institution level.

Mr. KELLY. And I, like everyone else—and the Chairman started out right. We have friends on both sides of this. And I am talking about really good friends.

Self-regulation is very, very important. It is very, very important. And we all are parents or we deal with soldiers or deal with employees and those kinds of things. And when we fail to do those things ourselves, okay—sometimes they are right. Sometimes they are legal and lawful. I am a lawyer too, so I understand that sometimes they are legal and lawful, but they are still not right. Okay? They are not morally, or they are not the honorable, or integrity, or trustworthy thing to do.

I would just ask our banker friends, your banker friends, our banker friends if they like all the regulations that came with Dodd-Frank. Okay? And most of those guys did not, as individuals, do anything wrong that caused those regulations to come down on them. They were a part of the System.

I see you guys as a System. Just remember, if you don't regulate those things which may be lawful, that you ask for an outside entity to do that. And I would just add extreme caution that maybe if 15 percent does apply across the System, then maybe it should apply to each individual entity so that they are not able to use that or certain ones, certain bad actors, because 95 percent of the people that you represent are doing the right things for the right reasons. I would ask, what can we do to make sure that those five percent don't disparage the other 95 percent?

Mr. SPEARMAN. Well, Congressman, one thing that we are doing is that, there has been an Informational Memorandum that went out to the particular institution that I believe you are addressing, where some of these issues are arising. The memorandums centered around getting the Board directly involved because, as an agency, we don't have prior approval for a lot of these. So we are seeing them—the way the Act works—we are seeing them afterwards. As an agency, we have to turn them down and ask them to divest after the fact. We have asked the Board to review these items.

As an individual, I am concerned about reputational risk for the System, and I don't think that I am the only one. I think the System's funding corporation—because they have to go out to the market in order to sell the paper for the System. The market may be concerned about that, exactly what you are saying. So we are trying to do the things that we can do as an agency.

Again, we would be willing to work with you if there is anything you see that might be able to assist us.

Mr. KELLY. Thank you. And I appreciate that. And like I said, I am a huge friend. But I am just telling you, the best person to regulate you is you.

The final point I would just like to make—and I don't have time really to ask a question.

Young, beginning, small farmers, if it is a priority—Congress obviously said, “We want you to lend money to these folks,” okay. And I would suggest, if you are not tracking that, it cannot be a priority or it cannot be something you are focused on if you are not

tracking what you are doing with that. And I would just suggest that maybe you look at or you put that as a data point that you look at to make sure that you are carrying out what Congress intended the right percentages.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields back his time.

G.T., for 5 minutes.

Mr. THOMPSON. Mr. Chairman, thank you.

Gentlemen, thank you for being here.

I have a number of questions. Let me jump right into them.

How do you measure creditworthiness risk in terms of the regulatory pressure on agriculture? Because agriculture is somewhat unique with the pressures. And, specifically, I mean, there is a long list I could give you.

But like *Waters of the U.S.*: Where someone is applying for a loan, if *Waters of the U.S.* is in place, what is their number one asset, their soil, all of a sudden becomes off-limits unless you get EPA permitting.

Do you measure that in terms of your consideration or creditworthiness risk?

Mr. SPEARMAN. Thank you, Congressman, for that question. I am going to defer to Robert to give some of the specific CAMELS and FIRS ratings type of processes that our examiners follow and measure and rate.

Robert?

Mr. COLEMAN. Thank you, Mr. Spearman.

We require each Farm Credit System institution to have loan policies and procedures that guide their underwriting standards.

Mr. THOMPSON. I understand that. I want to zero in because I have a couple questions.

Robert, I am really looking for the question of: Do you at this point take into consideration pending, looming regulatory pressures that fall on the backs of the agriculture industry, our farmers, when it comes to—does that play a role in determining creditworthiness, those potential risks?

Mr. COLEMAN. The short answer is, yes, absolutely. And uncertainties around any of those areas, crop margin, compression pressures, *et cetera*.

Mr. THOMPSON. Okay. Great. And I appreciate that because that should be given as some of the advantages that Farm Credit has, that is one of those things that makes sense to be part of the mission, trying to mitigate some of those undue pressures and appropriate pressures as well, however you want to describe them.

With that said then, with your exposure of the differences in terms of between 1980s and today, I mean congratulations. Your portfolio looks like—the number I read, \$217 billion in 2013 in terms of loans that are out there or were out there at that point. But, also, if there is a potential decline in the agriculture economy—and just for the record, the Chairman and the rest of us are doing our best to make sure that does not occur with the good work that we are trying to do—but also the regulatory threats that are there, is FCS prepared to handle possible loan defaults, given the size of your portfolio? Where are your reserves, and how is FCS better prepared than in the 1980s to deal with that situation?

Mr. SPEARMAN. Robert?

Mr. COLEMAN. Thank you, Mr. Spearman.

As I mentioned earlier, Congressman, the System overall has about almost 17 percent capital, as compared to total assets. If you go back to the 1980s, that is almost twice of what it was. If you look at the System earnings overall, about \$4.5 billion generated last year, on track probably to exceed \$4 billion this year.

Another very important component, most especially after the 2008 financial crisis, is liquidity. We came up with new rules that require the banks to hold at least 90 days of liquidity. They have more than twice that now, as an average. So there are very good levels of liquidity in regards to that.

Credit quality, as you mentioned, over 96 percent of the loans outstanding in the Farm Credit System are currently classified as acceptable. And just over $\frac{3}{4}$ of 1 percent on total non-performing. So the System is very well positioned to handle adversity or areas where we anticipate some stress over the next several years.

Mr. Spearman also mentioned the Farm Credit Act added in the late 1980s the borrower rights. So if there are difficulties with borrowers, Farm Credit System institutions are required to look at restructuring plans and the ability to keep the farmers on the ranch and keep them in production agriculture, if at all possible.

Mr. THOMPSON. Great. One suggestion, I guess, and then a quick question.

I think we are all looking for outcomes when it comes to mission. So doing that in a transparent way—maybe a dashboard or something where we can look at the percentage of young, beginning farmers—anything that can provide greater transparency to us is helpful since there is a specific mission.

And then my other question—and I am not going to have time for a verbal response, but I would appreciate one for the record—what safeguards do you have in place to prevent mission creep? Because mission creep in government is well known and certainly in quasi-government agencies as well. I think it is a human nature tendency. And I would love, for the record, if you could send the Committee a list of, what are the safeguards you have in place to keep you within the lines of what Congress envisioned when this authorizing legislation was passed?

Once again, thank you, gentlemen, for being here.

The CHAIRMAN. The gentleman's time has expired.

Mr. Yoho, for 5 minutes.

Mr. YOHO. Thank you, Mr. Chairman.

Gentlemen, I appreciate your being here.

Mr. Spearman, I appreciate your work with the Florida citrus industry and everything you have done with that. You know the plight we have in Florida with the citrus industry.

In agriculture, when times are good, everybody wants to lend money to the farmers. And we know that is a good thing. But when the economy turns and the ag sector takes a big hit, there are not as many people out there willing to lend. They like to ride that wave of good fortune. And in today's situation, especially in Florida, the way I understand it, just in two regions with the Farm Credit System, there is about \$200 million owed in the citrus industry or lent out.

Would that happen or would that be possible or would you have credit available in a situation like today if there wasn't a Farm Credit System? How difficult would it be to get that money?

Mr. SPEARMAN. The short answer: It would be very difficult.

Mr. YOHO. So I mean, the service that you provide, the ability to borrow the money in times like this is, it is imperative that we have that.

And being a veterinarian for over 30 years, working in the ag sector with food animals, we have so many clients that are members of the Farm Credit System. And I commend you for what you do.

What do you anticipate in the future, say in the next 5 years, if the economy and the ag industry stay a little bit lean? Do you see anything that Congress can do to either help or stay out of your way so that you can perform the job that you need to perform for our farmers?

Mr. SPEARMAN. Congressman, there is nothing I can see directly. Again, I would mention that there are certain authorities that could probably be improved upon that we have. But that is something that, as I mentioned previously, we would be willing to work with the Committee on to shore those up.

I would defer to Robert to see if he has any comments.

Mr. YOHO. Mr. Coleman, anything you want to add to that?

Mr. COLEMAN. I have nothing to add. We stand ready to work with the Committee on any specific areas.

Mr. YOHO. Well, that is good.

Again, when you look at all this stuff and the lending portfolios that you guys deal with and you look at the breakdown of that, it is just nice to know that it is there, it is available for the farmers when they need it—whether it is real estate, whether it is equipment or planting the next crop. And that is the stability that we need. And I commend you for the work that you have done.

Mr. Rawls, do you have anything you want to add, any of the challenges you see coming up in the ag community in the next couple of years?

Mr. RAWLS. Congressman, it has been pretty well covered. We are just very vigilant now about what is going to be happening with commodity prices and the issues that seem to be coming into view now with farmers, going forward. Hopefully this will not be a long downturn.

Mr. YOHO. Yes. We hope that. And I hope that the citrus greening gets taken care of real quick, and I appreciate your work.

Mr. Chairman, I yield back. Thank you.

The CHAIRMAN. The gentleman yields back.

Mr. Benishek, for 5 minutes.

Mr. BENISHEK. Thank you, Mr. Chairman.

I have been listening to all this for quite some time. And one of the things that comes to my mind—I am from Michigan. I represent the northern half of Michigan. And we have a very diverse agricultural economy in Michigan. I am familiar with our local credit agency GreenStone, and there may be, because of that diversity, there is more stability. Of course, in states like Iowa that have a lot of corn, these issues can lead to crisis, I think.

I would like to delve into that a little bit more. I have a couple of questions about this stuff that, we have been hearing all this mission creep stuff, and it is something that comes to my mind. What is this mineral rights issue that Mr. Lucas talked about? I mean, that seems to be a mission creep to me. One of your institutions is holding mineral rights as an asset. Is that correct?

Mr. SPEARMAN. Well, as I mentioned, Congressman, this goes back a ways.

Mr. BENISHEK. Don't you look at that and say, "Well, this is an inappropriate asset to be holding, and you should diversify"?

Mr. COLEMAN, is this one of the things that you would consider as a diversification?

Mr. SPEARMAN. Well, that Act, it was changed so that these mineral rights cannot be held. But I will defer to Robert there because they actually examine those.

Mr. COLEMAN. Thank you, Mr. Spearman.

The Farm Credit System was allowed by statute to hold mineral rights for land that was foreclosed upon because of nonpayment and default. So those mineral rights track back to many, many years ago when those Farm Credit System institutions acted under the statutory authority to acquire those and not transfer them with the surface rights.

Later—in the 1980s I believe it was—there was a requirement that any mineral rights would attach to the surface rights when that acquired property was sold. So some of the Farm Credit System institutions who had mineral rights in their portfolio or on their balance sheet chose to sell those. Other institutions chose to keep those. But since the mid-1980s, no new mineral rights—

Mr. BENISHEK. All right. Let me ask you this: Are there any transactions that you would look at and say, "This is not appropriate from the Farm Credit Administration"? I mean, I understand are you saying there is like a 15 percent cap maybe. But is there any transaction that one of your members would make that you would look at and say, "Well, this is not appropriate"?

Mr. COLEMAN. We have regulatory requirements in regards to eligibility.

Mr. BENISHEK. Could you give me an example of something you would say, "This is not an appropriate transaction"?

Mr. COLEMAN. We have to make sure the loan is extended to an eligible borrower and for an eligible purpose.

Mr. BENISHEK. But, as I understand it, there is no completely eligible purpose as long as it leads to what you call the more stability of the System.

Mr. COLEMAN. I believe you are now talking about the similar-entity transactions. Is that correct?

Mr. BENISHEK. Well, is there any transaction that you would reject when somebody did it because it was inappropriate?

Mr. COLEMAN. Absolutely. I think the point that was—

Mr. BENISHEK. Give me an example of that.

Mr. COLEMAN. If we looked at a loan that a Farm Credit institution extended and we believed that it was outside of the eligibility or outside of the scope of lending, then we would tell that institution, you need to divest of that loan.

Mr. BENISHEK. But I haven't heard anything like that. I mean, everything that I have heard today is that this Verizon loan seems to be outside the scope, except that it is a similar-entity, and there are all kinds of reasons to stabilize the economy or to stabilize the loan portfolio.

You haven't told me of an example that you would reject.

Mr. COLEMAN. Well, there is another example of a similar-entity loan that a Farm Credit System institution entered into where we did not agree that it was authorized, and we required the institution to divest of it, and they divested of that similar-entity transaction. So there are loans that fall outside of that we would look at on a—

Mr. BENISHEK. Could you give me an example of what that would be?

Mr. COLEMAN. There was a loan made to Cracker Barrel by a Farm Credit System institution, and we did not agree with the conclusion by the institution that it was—

Mr. BENISHEK. What percentage of loans does that occur to, that type of thing?

Mr. COLEMAN. It is extremely small from a percentage basis. As we mentioned earlier, there is only about five percent of the loan volume in similar-entity transactions across the Farm Credit System.

Mr. BENISHEK. Thank you. I am out of time.

The CHAIRMAN. Mr. LaMalfa, for 5 minutes.

Mr. LAMALFA. Thank you, Mr. Chairman.

And thank you, Chairman Spearman, for being here with your colleagues today. It is good to see you.

We have much praise for the Farm Credit System in America and in California, again, one of the largest states. And I hope today's hearing doesn't sound too much like a flogging or whatever. But, the same questions keep coming up over and over again, but they are good questions, good points about the mission.

So, as you know, in California, over 1/2 of our state's farms are under 50 acres in size. So we are concerned with the small operations continuing to be viable and that is where Farm Credit comes in and provides alternatives where we haven't necessarily had them in the past, especially going back to the 1980s, when things were going bad with other types of financing. So I guess some of my questions would revolve around—one of the important ones right now, obviously, we are in a huge drought in California and in much of the West. So do you see your focus being able to help directly with drought relief efforts on that? Not just infrastructure or typical farm loans but being able to go directly to alleviate some of the crisis on that?

Mr. SPEARMAN. Thank you, Congressman, for that question.

We receive reports periodically. They are mainly quoted from our economists and also from our examiners, as board members.

Mr. LAMALFA. Pardon me. Let me have the focus be on restructuring existing loans. Pardon my interruption.

Mr. SPEARMAN. Well, that is part of it. If it was ever to get to that point, to where there was potential for some foreclosure on a loan. But there is attention that we, as an agency, pay to risks within the System. The drought in California definitely is a risk

that I am sure you would appreciate also to agriculture and to farmers' abilities to repay their loans. It is something that, as an agency, we definitely are aware of. How can we help you to mitigate that? I don't know off the top of my head what the agency could do, other than mitigation in loans or something of that nature there, if they were to run into financial trouble.

Mr. LAMALFA. Well, restructuring and more patience. I mean, we are all banking on, to use the term, the end of the drought someday.

Mr. SPEARMAN. Yes.

Mr. LAMALFA. If we don't want to bet on the end of the drought, then we are in bigger problems than anything we are talking about here today.

So does Farm Credit have the ability or have the patience, the longer view, to say, "Yes, we have to help these guys and gals through this crisis and maybe bend in a way we haven't bent before on that?"

Mr. SPEARMAN. Well, Congressman, we are getting back to the mission component of the System, where we need to be there. The System needs to be there in bad times.

Mr. LAMALFA. Yes, we do expect that from Farm Credit for the farm sector. And in your statement here on mission, it is to ensure a safe and sound, dependable source of credit for ag and rural America.

Now, do you think that, given the line of questions today, that the rural America portion—due either to restructuring or something that happened in previous legislation 20 years ago or whenever—that there has been a greater emphasis done on the portion called rural America and less from agriculture; the other things that are ancillary to what people typically think of the mission. Is the rural America part becoming too big a part of your portfolio and less from ag? And is it something that legislatively we have caused or you feel pressured to do?

Mr. SPEARMAN. Well, I am not sure if I totally understand your question. But rural America is very important. I think that there is—

Mr. LAMALFA. But if it is not farm-related things so much. If that is the mission creep that keeps coming up, do we need to have kind of a snapback on that to get more focused? Has that been caused by pressure put on by this Committee or by Congress? We have heard other priorities here brought up today, pressuring you guys to do certain things. Is that a result of legislation that we are having a bigger rural America focus and less on ag?

Mr. SPEARMAN. I don't foresee that. I believe that the agency has adequate powers to be able to take care of the System in bad and good times. I don't perceive any pressure from the Committee that we need to do some—

Mr. LAMALFA. Or for other certain types of loans, *et cetera*?

Mr. SPEARMAN. I beg your pardon?

Mr. LAMALFA. Or for other certain types of loans, there is not Congressional pressure to do things that don't make sense to you?

Mr. SPEARMAN. No.

Mr. LAMALFA. I yield back, Mr. Chairman, thank you.

The CHAIRMAN. The gentleman yields back.

Former Chairman Goodlatte, 5 minutes.

Mr. GOODLATTE. Thank you very much, Mr. Chairman. I appreciate you holding this hearing.

Mr. Spearman, you testified that non-performing loans have decreased each year since 2010 and currently total \$1.7 billion. Is the non-performing loan portfolio dominated by any certain sector of the agriculture industry?

Mr. SPEARMAN. I am going to let Robert answer that directly. But in my opinion, it is not because it is more related to the capital asset management of the institution and not necessarily a particular segment. But I will let Robert, as our chief examiner, respond also.

Mr. COLEMAN. Thank you, Mr. Spearman.

The one area that is a bit higher than all the other sectors is horticulture. That area suffers from the continuing housing weaknesses. That is a very, very small portion of the total overall, one or two percent.

Mr. GOODLATTE. Can you explain that? How is horticulture affected by housing weaknesses?

Mr. COLEMAN. Primarily, they would be greenhouses that produce either turf or nursery products and so forth, landscaping, production agriculture of those components.

Mr. GOODLATTE. I have you. Okay. And is there any region of the country that contributes to this non-performing loan total more than others?

Mr. COLEMAN. The regional areas are more focused from a non-performing standpoint in the two largest states where the loans are outstanding, in California and in Texas. So that is just a function of where the loan volume is.

Mr. GOODLATTE. Thank you.

Mr. Spearman, agriculture continues to evolve and change. And, yet, the law that you administer has not really received any major overhaul since the mid-1980s or earlier. Is the current law constraining the Farm Credit System's ability to fulfill its mission?

Mr. SPEARMAN. The short answer, again, would be no, Congressman. I think that the authorities that we have as an agency are adequate for us to be able to ensure the safety and soundness of the System. They can always be improved upon.

Mr. GOODLATTE. I have heard complaints from farmers and from people with Farm Credit that they can lend to farmers but they can't lend to the people who do business with farmers. What would you say about that?

Mr. SPEARMAN. Again, we would have to refer back to the Act and what the Act allows and—

Mr. GOODLATTE. I know what the Act allows. What I would like to know is whether it allows enough.

Mr. SPEARMAN. Again, that question is almost relative, what we would do, that needs to be pondered. Enough? Enough for whom? It is an issue where we, as regulators, focus on pretty much what the Act is right now. To answer your question, is there something that we would personally recommend to add to the Act to be able to improve the lending ability to those who sell to farms.

Mr. GOODLATTE. I am talking about farm implement dealers, other folks who could use financing to be able to maintain the in-

ventory they have on their business lots. Are you able to loan to those folks?

Mr. SPEARMAN. There is a provision in the Act, I believe, where we are to, the System is able to lend to equipment dealers. And I will defer to Robert to—

Mr. GOODLATTE. Because I am running out of time, let me ask you to respond in further detail after you have a chance to more carefully examine what the current practices are and what the law allows. But I am sure you would agree that the Farm Credit System has certain advantages and benefits that small community banks don't have. Alternatively, what advantages do community banks have over the Farm Credit System? That may be one of them. The small community bank can lend to that implement dealer but Farm Credit cannot.

Mr. SPEARMAN. Well, when you talk about, Congressman, when we talk about advantages and disadvantages, both sides have certain advantages and disadvantages. Community banks can't take—they take deposits; the System cannot. When you start weighing the advantages and disadvantages, the way that I look at it personally is that the ag market needs all concerned. It needs the Farm Credit System. It needs community bankers. And it needs those to be able to provide credit for it.

Mr. GOODLATTE. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

Mr. Spearman, you are almost through. Good job this morning.

Let me follow up with some quick nits and nats that are out there. Tax structure for these entities, as I understand it, on the real estate portfolio, the entities do not pay tax but on all the rest of the portfolio, they do pay tax. Is that accurate? Mr. Rawls?

Mr. SPEARMAN. That is, I believe, accurate. Charlie, go ahead.

Mr. RAWLS. Yes, fundamentally.

The CHAIRMAN. All right. Are there any real issues between how the banks apply that rule, and is there anything we need to do there in terms of the allocation of overhead and anything else? Mr. Coleman, are there any issues when you examine the banks on the way they do their taxes?

Mr. COLEMAN. Mr. Chairman, we look at each Farm Credit System institution. And we have a requirement that they have audited financial statements. So we rely heavily on the outside auditors to help address that—

The CHAIRMAN. I got you.

Mr. Rawls, you have a bad actor out there, somebody that is doing something that is against the rules. Could you bring charges against them? Could you do anything to a particular loan officer or anything? What is your authority to go after a bad actor?

Mr. RAWLS. We have very broad enforcement authorities under the Act.

The CHAIRMAN. That is against the bank. What do you have against the individuals who actually do the bad stuff?

Mr. RAWLS. It is limited on individuals. And that would be one area that probably could be improved.

The CHAIRMAN. The way I understand it is once they leave the employment of the bank, you really have no authority, unless you refer it to Justice.

Mr. RAWLS. That is correct.

The CHAIRMAN. In the circumstances where you have referred a case to Justice, what actually happened there?

Mr. RAWLS. That is a mystery. In working with the prosecution, they have to decide that it is something worth their time to take up. And oftentimes, it is not.

The CHAIRMAN. Right. Several times, Mr. Spearman, you mentioned that banks or that your entities don't take deposits. However, it seems that the System has some scheme—that is probably a harsh word—but of holding funds in an account that looks and acts like a checking account. Can you walk us through the mechanics of how that is not a deposit and how you are complying with the rule that they don't take deposits? Mr. Coleman?

Mr. COLEMAN. Yes, sir. Mr. Chairman, Farm Credit System institutions are allowed to hold advanced conditional payment accounts. So if you have a Farm Credit System loan, and let's say it is a real estate loan and you have two payments to make during the year, you can deposit that payment, future payment, and then have it held by the institution until the payment is actually due. Farm Credit System institutions are authorized to have those.

The CHAIRMAN. Can you write checks on that? How does that customer access that advanced payment?

Mr. COLEMAN. They would have to come back to the institution and request that those funds be released.

The CHAIRMAN. Come back. Okay. Do you pay them interest on that, on those deposits? Does the System pay interest?

Mr. COLEMAN. On that advanced conditional payment account, there would be funds paid, correct.

The CHAIRMAN. Okay.

Mr. Rawls, any indication that the similar-entity lending arrangements, the 15 percent, which you say is about five percent, has that come at the expense of all the other lending things that more directly relate to your core businesses? So are there instances where but for a similar-entity loan, the bank would have had the capacity to make other loans to small businesses and small farmers and others? Any sense of that?

Mr. RAWLS. No, sir. Based on everything we have heard, there is no credit rationing or limitations in the System right now.

The CHAIRMAN. Okay. Back in my banker days, 6 years of my life, we had a restriction on what is called a tying act. That may not have been the proper name. But as a banker, I couldn't make a loan to somebody and require them to do something else in exchange for that. Buying credit, buying crop insurance and getting a better rate, is that going on? If it is, is it okay under the regulations to allow credit or Farm Credit System banks to require customers buy the insurance from a particular insurance agency or agent?

Mr. RAWLS. Mr. Chairman, that is not okay. And that is specifically disallowed under our regulations and policies and so on and so forth. And that would be something that examiners would follow up on, any concerns with that.

The CHAIRMAN. I got you.

Ms. Plaskett, you were not here earlier, so 5 minutes.

Ms. PLASKETT. Yes, hi. Thank you very much, Mr. Chairman, Mr. Ranking Member.

Thank you, gentlemen, for being here today. I know that most of my colleagues have probably asked the bulk of the questions. I am thankful that my staff has been keeping me apprised while I was in another hearing.

But I did have a question about the Farm Credit institutions. So your examiners are out looking at Farm Credit institutions and what they are doing every day. Do you see Farm Credit institutions and commercial banks working together to serve rural communities in agriculture? And, more importantly, can you give us specific examples of how that has been effective and how that has worked in some of those communities?

Mr. SPEARMAN. Thank you, Congresswoman, for that question. Yes, I have had an opportunity to go out and visit programs and projects where the two entities have worked together on. And it was primarily through the Investment in Rural America Projects. And I had an opportunity to visit a hospital, a nursing home. And, in my opinion, that really works favorably toward the mission aspect of the Farm Credit System.

Ms. PLASKETT. And how do you feel that it fits within the mission to accomplish that?

Mr. SPEARMAN. It fits within the mission because the Farm Credit System's mission deals with the fact that they need to be there in good times and bad times for America's farmers and ranchers.

Ms. PLASKETT. That is really interesting to me because in the Virgin Islands, we are considered a rural area. And we have, after many, many years not really, at one point actually, about 100 years ago, we were considered the bread basket of the Caribbean. And we have moved completely away from farming, with other industries falling off, our farmers are beginning to once again try and revamp themselves, modernize, become much more technical and business-like in their work.

And one of the things that I wanted to understand was we realize that the Virgin Islands are excluded from seeking credit through FCS. And I just wanted to know if you could explain to me, any of you, why that is and what can be done to rectify that.

Mr. SPEARMAN. My understanding is that the Farm Credit System does lend to the Commonwealth of Puerto Rico. The Virgin Islands, I believe, my understanding is that, it is different from yours, that they could possibly do it. But I will refer to Charlie on that.

Mr. RAWLS. Just quickly if I can, there is authority under the Farm Credit Act for lending activities in the Virgin Islands. But a charter has never been issued or expanded for that area.

Ms. PLASKETT. And who would be responsible for that charter?

Mr. SPEARMAN. The Farm Credit Administration issues charters.

Ms. PLASKETT. So we would need to petition the Farm Credit Administration to issue a charter to support the farmers of the Virgin Islands.

Mr. SPEARMAN. That is correct.

Ms. PLASKETT. And how long does that take? What are the impediments to that happening?

Mr. SPEARMAN. I am not sure personally.

Ms. PLASKETT. More often than not, what happens is that people think that it is in Puerto Rico, so it is covering the Virgin Island. But we are two completely different animals. And when you have a population of three million people and then a separate jurisdiction with 100,000, you know where most of the interest and the resources go. So to encourage Farm Credit banks to do business in the Virgin Islands, then we need to now do the charter. But does there need to be any legislative changes? Or is it strictly a regulatory or an agency matter?

Mr. SPEARMAN. I believe it is just a regulatory matter. I can get back to you on the length of time.

Ms. PLASKETT. I will get with you. You won't have to get back with me. I will be getting back with you. Okay. Well, thank you. That was pretty much the bulk of my questions.

So thank you very much for your responses and for the information, which will be really helpful to us.

And thank you, Mr. Chairman and Ranking Member.

The CHAIRMAN. The gentlelady yields back.

I will turn to David Scott for the closing statement of the ranking Minority Member. And I would like to also recognize that David is also on the Financial Services Committee, which has the other set of friends in the room.

So, David, any remarks?

Mr. DAVID SCOTT of Georgia. Yes, indeed, I am on both of those committees, Mr. Chairman. That is why in conclusion and summary of this hearing, it can be summed up in six words: We have two trains running here. One train is financial, the Farm Credit System. And the other train is our banks. And our task here is you get these two trains on these two tracks; we can't let one train jump over the other track or we have a big wreck coming. And our farming system cannot handle that. And this is why this has been such an extraordinary hearing.

And it will be good, Mr. Chairman, if we just reviewed for a moment why, back in 1994, we, in Congress, added the similar-entity lending language to the Farm Credit Act. It was put in there to provide greater diversity at a very, very serious time for this reason, so that we could add to the portfolio of the Farm Credit Council for risk management. It was very much needed. Now, but we also put in there some very important language, that it could not exceed 15 percent of the Farm Credit entity lending portfolio, and it could not exceed over 50 percent of the total individual loan. And that is why we are here. And we are going to have to modulate that a bit.

We have to make sure we keep both trains running. And it is very interesting that the train for the Farm Credit System has 42 percent of the loans and the train of the community banks and the commercial banks has 40 percent of the loans.

And so that is why this is so important, Mr. Chairman, why this is such an important hearing. And it may do good for us, as we summarize, to see—and from the banking community and from the Farm Credit System—if there is any need for legislation to con-

tinue to smooth it or if, so to speak, we can keep that oil in there on both of these trains so we don't have a train collision.

So this has been a wonderful hearing. Thank you very much, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

I, too, want to thank Mr. Spearman, Mr. Coleman, and Mr. Rawls for this morning. I think all of us operate better with the facts as opposed to misinformation we might have. I have had some things clarified this morning and that has been very helpful. I appreciate your testimony today. This is not the first time the agency has been up for a review, and we will continue to do this.

I had an analogy that I was going to use that I used with the Texas Farm Credit System in Albuquerque earlier this year, but the train issue that my colleague from Georgia just talked about is probably a better one. You are the referee in this deal. And you have great responsibility to make sure that the mission for the Farm Credit System is met and that it is safe and sound and all the tools are available. If we need to relook at those tools, that is fine. But the tools are in place to keep the System safe because if it is safe, it continues to make loans in the bad times. And that is really what this is all about, to keep a program there. It is pretty instructive that about ½ the loans are done by commercial bankers and community bankers, and about ½ are done by the Farm Credit System. And our farmers and ranchers and small, by the way, is there a height and weight limit on a small farmer? At any rate, I guess probably not.

I want to thank our witnesses again. Great job this morning. Thank you for being here.

I appreciate your wife being here and the other Commissioners.

It is hard, sometimes, to get folks to come testify. And it is great that you had your whole team here this morning. And I appreciate that.

Before we close, under the rules of Committee, the record of today's hearing will be open for 10 calendar days to receive additional material and supplementary responses. I think there were a couple of questions that Members had. I got some head nods behind you that they have those ready, that you will get those responses to us.

And this hearing on the Committee of Agriculture is adjourned. Thank you.

[Whereupon, at 12:17 p.m., the Committee was adjourned.]

[Material submitted for inclusion in the record follows:]

SUBMITTED LETTER BY HON. AUSTIN SCOTT AND HON. DAVID SCOTT,
REPRESENTATIVES IN CONGRESS FROM GEORGIA

November 30, 2015

Hon. AUSTIN SCOTT,
Member of Congress,
U.S. House of Representatives,
Washington, D.C.;

Hon. DAVID SCOTT,*
Member of Congress,
U.S. House of Representatives,
Washington, D.C.

Dear Representative Scott:

It is my understanding that a House Agriculture Committee oversight hearing will be taking place on December 2, 2015 on the Farm Credit Administration. In this regard, as Dean of the College of Agriculture, Family Sciences and Technology at Fort Valley State University (FVSU), I would like to ask that my views about the Farm Credit System be added to this hearing record.

As an 1890 land-grant university, FVSU has provided 120 years of service to communities throughout Georgia and beyond. We have a proud tradition of conducting outreach as well as providing a productive environment for cutting-edge academic and practical research in agriculture, animal science, biotechnology, energy, the environment as well as other fields. While we understand that Farm Credit makes loans to young, beginning and small farmers, it's important to also recognize that they do more than just make loans. Over the past years, Farm Credit has not only provided financial support through internships and scholarships to FVSU students, but has also been actively involved in providing educational programs such as the AgAware Program to our farmers in order to successfully prepare them for future endeavors. The AgAware Program is available through AgSouth Farm Credit and is designed to assist young, beginning, small and minority farmers through educational workshops, community projects and more.

We appreciate Farm Credit's partnership with Fort Valley State University and the vital role they play in supporting agriculture in our state. I appreciate the opportunity to submit this letter for the hearing record.

Sincerely,



GOVIND KANNAN, PH.D.,
Dean.

CC:

Hon. DAVID SCOTT.

SUBMITTED LETTER BY KENNETH E. AUER, PRESIDENT AND CHIEF EXECUTIVE
OFFICER, FARM CREDIT COUNCIL

December 11, 2015

Hon. K. MICHAEL CONAWAY,
Chairman,
House Committee on Agriculture,
Washington, D.C.;

Hon. COLLIN C. PETERSON,
Ranking Minority Member,
House Committee on Agriculture,
Washington, D.C.

Dear Chairman Conaway and Ranking Member Peterson:

We appreciate the opportunity to submit this testimony to be made a part of the record of the oversight hearing held on December 2, 2015 on the Farm Credit System.

* **Editor's note:** Identical letter sent to Mr. David Scott. For the purposes of publishing this letter, both Representatives are listed here to avoid duplication.

The Farm Credit System supports rural communities and agriculture with consistent, reliable credit and financial services, today and tomorrow. Farm Credit finances the farmers, ranchers, and agricultural marketing, processing and supply cooperatives, and other agricultural businesses that make American agriculture a pillar of our nation's economy and help feed a growing world. Farm Credit finances the rural infrastructure that is so vital to the quality of life for rural families and the economic lifeblood of agriculture and rural businesses as they create jobs and compete in a global marketplace. Farm Credit also finances rural families who want quality, affordable homes in rural communities. Farm Credit finances the export of U.S. agricultural products to overseas markets; markets that are vital to our nation's farmers and ranchers as well as the growth of the U.S. economy. Most importantly, Farm Credit does all of these things through good times and bad—ensuring a continued supply of affordable credit to many important segments of the rural economy.

Congress gave Farm Credit this specific mission and everything the System does is designed to make sure that mission is fulfilled. Farm Credit's success in fulfilling its mission is demonstrated by the loyalty of its customers and the strong support of groups that advocate for a thriving rural America.

Thank you for calling attention to Farm Credit and its mission during last week's hearing. We are grateful for the continued support of the House Agriculture Committee and fully commit to working with the Committee to address the many issues facing our nation's farmers, ranchers, and rural communities.

Farm Credit Is Financially Strong

We agree completely with the testimony provided by the Chairman of the Farm Credit Administration that the Farm Credit System is fundamentally safe and sound, with strong capital, strong earnings and a moderate pace of loan growth. Farm Credit is very proud of the fact that its financial performance was such that Farm Credit institutions returned in 2014 over \$1 billion in earnings through cooperative dividends back to the farmers, ranchers and cooperatives that own the System.

These are matters of public record with System institutions publicly disclosing their financial results individually and on a combined basis quarterly. These disclosures contain detailed information regarding not only the present position of the System but also include discussions regarding conditions in agriculture and the economy which can impact on the financial safety and soundness of Farm Credit institutions. In addition, the Farm Credit Administration posts summary performance information on their website. They provide a detailed annual report to the Congress that includes a discussion about what Farm Credit is doing to meet its mission. While the numbers speak for the success of the Farm Credit System; the customers and other beneficiaries of the Farm Credit System tell a powerful story of alignment of interests to build and protect an important part of America—rural America.

Farm Credit's Mission—Supporting Rural Communities and Agriculture

The Farm Credit System has a very clear mission—to support rural communities and agriculture with reliable, consistent credit and financial services today and tomorrow. There is no mission creep in either Farm Credit's service to rural communities or agriculture. The Farm Credit Act specifically authorizes what Farm Credit can do to accomplish its mission and System institutions operate within those boundaries. The purpose statement for the Farm Credit Act of 1971, as amended, makes perfectly clear that the mission of the System is not exclusively agriculture. That purpose statement reads as follows, "To further provide for the farmer-owned cooperative system of making credit available to farmers and ranchers and their cooperatives, for rural residences, and to associations and other entities upon which farming operations are dependent, to provide for an adequate and flexible flow of money into rural areas, and to modernize and consolidate existing farm credit law to meet current and future rural credit needs, and for other purposes."

The policy and objectives section of the Farm Credit Act recognizes the "growing credit needs of rural areas" and that the Farm Credit System be, "designed to accomplish the object of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations." It also states that the Act is intended to "modernize and improve the authorizations and means for furnishing . . . credit for housing in rural areas."

But in order to fully understand the breadth of Farm Credit's mission and whom Farm Credit is intended to serve, you need to look beyond the broad introductory

language of the Act to the specific lending authority set out in the law itself. The law makes clear that the System is expressly authorized to lend to everything from rural home buyers to the companies that provide rural areas with electricity, broadband and other telecommunications services, water and waste services, agricultural cooperatives and many other rural businesses.

More recently, Farm Credit was called upon to provide financing to renewable energy which is a growing part of our country's power supply. Our country's rural infrastructure providers have come to rely on Farm Credit as a significant provider of credit as well as an important partner in the development of our rural communities as good places for people to start businesses and raise families. And our rural communities are increasingly looking to Farm Credit to provide credit for community facilities that are essential to a quality of life that rural residents deserve.

Farm Credit institutions are authorized to serve farmers and ranchers both for their farming and non-farming credit needs and to serve farm-related businesses that support agricultural producers. Those that suggest Farm Credit was never intended to serve anything beyond farmers and ranchers ignore over eighty years of history since the Banks for Cooperatives were first authorized in the 1930's as well as the plain language of the Farm Credit Act as it was put in place in 1971. These services are critical to the future of our rural communities.

While the "farm" in Farm Credit remains the focus of the majority of the System's loan volume, it is far from the only focus or the only area in the rural economy that is positively impacted by Farm Credit's activities. Farm Credit has demonstrated itself to be a highly efficient and dependable mechanism for rural America to tap into both domestic and international money markets in order to attract capital for rural America's benefit. When many other sectors of the economy struggled to have access to capital in late 2008 due to the mess made by some financial institutions, the agricultural sector and rural infrastructure providers continued to have access and performed far better than other sectors throughout the resulting recession. Farm Credit was at the front and center of those institutions that could be relied upon, and we are very proud to have helped ensure that capital was available.

Managing Risk Through Participating in Loans With Commercial Banks

There also has been great confusion regarding the concept of the Farm Credit System's participation with commercial banks in loans to what are known as "similar entities", a concept unique to the Farm Credit System. Participating with commercial banks in similar-entity loans helps Farm Credit accomplish its mission of supporting rural communities and agriculture. These partnerships with commercial banks help ensure that credit is available in rural areas in difficult economic times. Back in the 1990's the Congress recognized that with so much of its loan portfolio concentrated in agriculture and rural America, the Farm Credit System was vulnerable to prolonged downturns in the agricultural or rural economy. Congress understood that when times got tough in agriculture, commercial banks reduced their lending to agriculture and pursued other less vulnerable credits. But with part of Farm Credit's mission being to serve agriculture and rural communities during both good times and bad, even when commodity prices won't cover the cost of production or financing a rural infrastructure project is not in vogue, the Farm Credit System is expected to figure out a way to continue to make credit available to those that produce the food and support the rural communities on which our nation and many around the world rely for their quality of life. Producers must have a reliable, timely source of credit available to them to use to purchase the inputs necessary to grow a crop. Rural infrastructure providers need the same dependability and rural communities need an advocate that is there day in and day out.

To help the System have a more diversified portfolio that will help generate income to help cover the operating costs of continuing to serve farmers and ranchers while agriculture weathers tough times, Congress authorized the Farm Credit System to participate with commercial banks in loans to entities that would not otherwise be eligible to directly borrow from the System but which are engaged in activities that are "similar to" what an eligible borrower may engage in.

This same basic principle applies to Farm Credit's rural infrastructure mission. Farm Credit is charged providing financing so rural communities have modern power, telecommunications, and water and wastewater services and facilities. Participating with commercial banks in loans made to the more urban infrastructure services providers, or to those companies that are large enough and have the capacity to provide rural areas with the same quality of services such as high-speed broadband that our urban and suburban residents enjoy, diversifies Farm Credit's risk and helps ensure they can still support rural infrastructure providers through inevitable economic cycles.

Importantly, similar-entity participation authority was not provided as an open-ended authority that would overtake serving the needs of directly eligible customers. Very specific limits restricting the use of this “similar-entity” authority are built right into the law. The most important limitation is that similar-entity participations must be done in partnership with non-Farm Credit commercial lenders. The System is prohibited from holding the majority share of any “similar-entity” loan. Each individual Farm Credit institution may not have more than 15% of its assets dedicated to similar-entity participations and the total amount of similar-entity loans to one borrower made by all institutions in the System may not exceed 10% of total System capital. The use by the System of this diversification authority is not close to reaching any of these limits.

It is critically important that the Committee understand that every similar-entity loan that the System makes, by definition, has to have a commercial bank or banks holding the majority of the credit. In virtually every one of these deals, commercial banks bring the credit to the System asking that Farm Credit participate with them in the credit as a result of our deep knowledge and lending capacity. If banks did not want Farm Credit to be involved in these credits, Farm Credit would not be involved in them. In fact, clearly stated in the legislative history surrounding this authority is the desire to encourage commercial banks and Farm Credit institutions to work together more—and there are many examples of strong partnerships that have been formed between commercial banks and Farm Credit institutions as a result.

We want you to know that we have heard the concerns raised by Committee Members about the use of this authority. Farm Credit is addressing this internally, conducting an assessment of involvement in similar-entity participations by Farm Credit institutions, how they are using this authority, and making sure that its use is closely tied to supporting the System’s mission and being used as Congress intended to diversify risk. While making adjustments may help address the reputational risk issues that surround some of these credits, if Farm Credit has to step back from effectively using this authority this will mean less diversity in the System’s loan portfolio and could result in the need for a more cautious approach in serving agriculture especially in tough economic times.

Serving All Sizes and Types of Agricultural Producers

The Farm Credit Act is very clear that the Farm Credit System exists to serve “. . . all types of agricultural producers having a basis for credit.” (see Sec.1.1 of the Farm Credit Act of 1971, as amended). America’s farming and ranching operations are very diverse in their size, scope and in the types of enterprises they operate. A quick review of USDA’s report “Structure and Finances of U.S. Farms: Family Farm Report, 2014 Edition” published in December, 2014, illustrates throughout its more than 60 pages the diversity that is U.S. agriculture. It highlights how the majority of farmland in the U.S. is owned by small farmers and that those small farmers are highly dependent on off-farm employment and the success of the rural economy to stay on their farms. It also illustrates how 8% of farms are responsible for 60% of the value of all agricultural production in the country. Farm Credit serves all of these differing operations and everyone in between.

Farm Credit is intensely committed to serving the next generation of agricultural producers. Every local Farm Credit association has programs in place specifically targeted at supporting young, beginning and small farmers. Every Farm Credit institution reports the results of their programs annually to the Farm Credit Administration and every year FCA reports the results directly to the Congress.

The facts are plain and we will compare our record of service to young, beginning and small producers to anyone’s. For 2014, over 21% of the new loans made by System institutions went to beginning farmers, about 17% were made to young farmers and over 40% were provided to small farmers. These categories are not additive. Each is considered a separate category and a borrower can fit into multiple categories at the same time. Farm Credit institutions are required by regulation to track and report this data in this manner. No other lenders can report at this level of detail and no other financial regulator outside of the Farm Credit Administration requires this level of specificity in reporting on service to these groups.

The Farm Credit Act specifically makes clear that full time farmers and ranchers can come to Farm Credit to meet their other financing needs. When it comes to working with small farmers for this same purpose however, regulations limit what the System can do to support them as they work to generate sufficient income to cover their family living expenses from off-farm activities.

The System has created specific outreach programs to support young, beginning, small, and minority agricultural producers as well as programs to support small and minority cooperatives, small rural water and wastewater systems, and emerging re-

newable energy projects. As authorized by law, the System invests in Rural Business Investment Companies that make equity financing available to rural businesses, particularly smaller and agriculture related entities. We also actively cooperate, collaborate and partner with others who serve rural communities and agriculture, including community banks, USDA, and other lenders. The System delivers on this mission at no direct cost to the American taxpayer or support from the government, while making an important difference as a socially responsible corporate citizen. We are standalone cooperative institutions that are owned by our customer-members and heavily regulated by the Farm Credit Administration who maintain a strong financial and business profile so the System is resilient and able to serve its mission throughout the inevitable ups and downs of the economic, financial, and agriculture business cycles.

Banks Benefit From Direct Government Backing and GSE Benefits

One of the greatest myths that commercial banks continually put forward is that the Farm Credit System somehow enjoys taxpayer backed access to the financial markets while they have to rely on the private sector. The truth of the matter is quite the opposite. Commercial banks enjoy direct taxpayer backing whereas the Farm Credit System does not.

If you doubt the veracity of this statement, we refer you to a regular study produced by the Federal Reserve Bank of Richmond, not known as an apologist for the Farm Credit System. The Federal Reserve Bank of Richmond publishes on a regular basis a report detailing the taxpayer backstopping of financial institutions and the risk to taxpayers that is created. Their report called the “Bailout Barometer” was last updated in May, 2015. Always on the top of their list for the greatest amount of “explicitly guaranteed liabilities” by U.S. taxpayers are banking and saving firms—to the tune of just over \$6 trillion (see <https://www.richmondfed.org/safetynet/>). In comparison, the number for explicitly guaranteed liabilities of the Farm Credit System is \$0!!! This does not fit the narrative that the bankers put forward in their characterization of the relationship they have with the government *versus* what Farm Credit has. \$6 trillion *versus* \$0 is a rather stark difference and the lack of validity in their claims doesn’t stop there.

Beyond the direct taxpayer guarantee of their liabilities enjoyed by the banks, they also have direct access to GSE funding through Fannie Mae and Freddie Mac to make housing loans, and through Farmer Mac to make agricultural loans. Commercial banks also are the majority stockholders of the Federal Home Loan Bank System through which they have access to advances of GSE funds that can be used to support housing, small business and agricultural loans by banks. They even can gain access to funds to be used for operating loans for farmers by creating a funding relationship with Farm Credit institutions. It is important that Committee Members be reminded of this picture in order to better understand the competitive landscape among various financial institutions.

Direct backing to their liabilities by the U.S. Government and virtually unfettered access to GSE funding for loan making—these are the facts regarding banks. We have never heard of a bank wanting to become a Farm Credit System institution. That alone should tell you something.

Stress Testing Is an Important Part of Understanding Risk

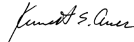
Farm Credit System institutions undertake a variety of stress testing exercises as a critical component of both their annual and ad hoc business and financial planning. The shock variables which are applied to a given entity’s portfolio are designed to identify and stress the particular combinations of credit, market, and economic conditions to which that institution is most vulnerable. The results of these stress tests then form part of the management information provided to each institution’s leadership team and board of directors to help direct business and contingency planning. These exercises supplement scenario analysis and related disclosure elements required and examined by the Farm Credit Administration. All Farm Credit institutions are required to create capital adequacy plans that support their portfolio strategy and engage in regular analysis and stress-testing of their loan portfolios. Each institution is unique based on the part of the country they serve and the composition of their portfolio in terms of the businesses they serve and the risks inherent to those businesses. Farm Credit stress testing, while having many similarities to the CCAR testing completed by banks, would not match specifically that done by banks due to the operating differences between banks and Farm Credit institutions.

In summary, Farm Credit is accomplishing its mission to support rural communities and agriculture, staying within the boundaries Congress set for it and bringing great benefits to agricultural producers, rural infrastructure providers, rural families, and rural communities. The support

Farm Credit has across agriculture and rural America was evidenced earlier this year when over forty farm, commodity and rural organizations wrote to the President of the American Bankers Association (ABA) expressing their opposition to the ABA's stated goal of eliminating the Farm Credit System. A copy of the letter sent by these groups is attached.

Thank you for providing us the opportunity to elaborate on a number of these key issues discussed at the recent hearing. If at any time you, your staff or any Member of the Committee has an issue or concern about the operations of the Farm Credit System, please do not hesitate to reach out and we will be happy to respond.

Sincerely,



KENNETH E. AUER,
President and CEO.

CC: Members of the House Committee on Agriculture

ATTACHMENT

May 1, 2015

FRANK KEATING,
President,
American Bankers Association,
Washington, D.C.

Dear Mr. Keating:

Your radio actuality release dated April 13 calling for the elimination of the Farm Credit System (FCS) has been brought to our attention. As organizations representing farmers, ranchers and rural communities, we want to register our strong objection to your goal to eliminate the FCS.

Credit availability is absolutely critical to our members. The FCS as well as rural and other commercial banks play vital roles in ensuring that farmers, ranchers and other rural Americans have access to constructive, competitive credit on an ongoing basis. The array of credit products offered by both Farm Credit and commercial banks—often in a collaborative, cooperative manner—ensures that agricultural producers and their industry sector partners have access to financial tools that are vital to their success and economic sustainability.

The suggestion that the FCS and/or commercial banks and other lending institutions should be further constrained or even eliminated from the marketplace would be unwelcome and injurious to those who live and work in rural America. Rather than calling for the elimination of the FCS, we believe it would make more sense to find improved ways to work collaboratively with Farm Credit and other credit providers for the benefit of farmers, ranchers and rural communities.

The stakes are simply too high for rural America to have fewer financing options to meet the challenges of advancing rural economic growth. We want you to know that your effort to reduce competition is not supported by those of us whose members live, work and form the economic foundation in rural areas. We would appreciate the opportunity to work constructively with your organization and others, including the Farm Credit System, to improve and expand farmers', ranchers' and rural businesses' access to competitive and stable credit offerings to meet the challenges rural America faces in our still-recovering economy.

Sincerely,

American Agri-Women;	National Council of Farmer Cooperatives;
American Association of Farm Managers and Rural Appraisers;	National Farmers Union;
American Farm Bureau Federation;	National Milk Producers Federation;
American Feed Industry Association;	National Pork Producers Council;
American Honey Producers Association;	National Potato Council;
American Horticulture Industry Association;	National Rural Electric Cooperative Association;
American Mushroom Institute;	National Rural Water Association;
American Soybean Association;	National Sorghum Producers;
American Sugar Alliance;	National Sunflower Association;
Association of Equipment Manufacturers;	NTCA—The Rural Broadband Association;
California Association of Winegrape Growers;	Rural and Agriculture Council of America;
Florida Fruit and Vegetable Association;	Society of American Florists;
National Association of State Departments of Agriculture;	Southern Peanut Farmers Federation;
National Association of Wheat Growers;	United Egg Producers;
National Barley Growers Association;	USA Rice Federation;
	U.S. Apple Association;
	U.S. Canola Association;

National Black Growers Council;
 National Cattlemen's Beef Association;
 National Christmas Tree Association;
 National Corn Growers Association;
 National Cotton Council;

U.S. Cattlemen's Association;
 U.S. Dry Bean Council;
 U.S. Rice Producers Association;
 Western Growers;
 WTA—Advocates for Rural Broadband.

SUBMITTED STATEMENT BY INDEPENDENT COMMUNITY BANKERS OF AMERICA

On behalf of the more than 6,000 community banks represented by the ICBA, thank you for convening today's hearing: "*To Review the Farm Credit System.*" When Chairman Conaway convened the House Agriculture Committee on January 21 of this year he pledged to "focus on aggressive oversight of all policies and programs under the Committee's jurisdiction." On September 15, Chairman Conaway referenced once again his "commitment to hold a top-to-bottom review of a full range of issues and policies within our jurisdiction."

This type of review is especially important in regards to the Farm Credit System (FCS), a government sponsored enterprise (GSE) that has run amuck of the law and its historical mission. ICBA noted in our June, 2014 statement on credit availability in rural America: "we could raise a number of additional issues regarding FCS abuses. We believe these types of issues and questions warrant a series of separate hearings. There are many concerns Congress should explore in their oversight capacity over the FCS." We continue to urge this Committee and its Senate counterpart to conduct a series of in-depth hearings on the FCS's questionable and secretive activities.

Adrift from its Historic Mission

Congress created the FCS to specifically serve *bona fide* farmers and ranchers, farmer cooperatives and a narrow group of businesses that provide on-farm services. However, the FCA in recent years has become a willing accomplice in FCS's efforts to expand into non-farm financing and has derived creative ways to circumvent the law to accommodate FCS's desires. FCS has sought to morph from a GSE with a narrowly targeted mission into a generalized rural lender serving all types of borrowers in rural credit markets and even non-farm borrowers in non-rural areas. In this sense, the FCA, quite frankly, has become a captive regulator, often willing to do the System's bidding at the drop of a hat while claiming to be an independent regulator.

Illegal Investment Schemes: One example of FCA's capitulation to FCS's expansionist agenda to engage in non-farm lending is the agency's tortured effort to implement its 'Investments in Rural America' program. The FCA allowed FCS lenders to create a series of pilot programs which often included non-farm lending projects. FCA also released a major proposed regulation to allow FCS non-farm lending if such lending was characterized as "investments."

FCS lenders could, for example, extend credit for hospitals, commercial offices (doctors, lawyers, and dentists), manufacturing facilities, apartment complexes in cities, hotels and motels, trucking and towing companies, auto dealerships, *etc.*). Any limitations would primarily be based on the FCA/FCS's lack of imagination.

After 5 years, the FCA announced it was withdrawing its proposed rule and ending its allowance of FCS rural investment pilot programs. However, these actions were just a sleight of hand by the regulator. While eliminating the pilot programs, the FCA allowed the financed projects to continue through the term of the financing which in some cases will last for decades. The FCA then briefly published on its website a guidance memo instructing FCS lenders on how to apply and gain approval to engage in investment programs that included financing for non-farm businesses, communities, rural areas and infrastructure projects. In other words, even though the FCS lobbied Congress for years to receive expanded powers—appeals that were mostly rejected by Congress—the FCA has suddenly and quietly decided to just allow FCS lenders to do whatever they want as long as FCA provides their rubber stamp of approval.

ICBA submitted several letters with comprehensive questions to FCA asking for details on FCA's intentions based on the guidance memo. FCA refused to answer the questions. This raises a further question—why is the FCA adamantly against transparency and accountability to the outside world?

FCA finally responded to a few of the questions after pressure from the Senate Agriculture Committee. The gist of FCA's response was that its investment authorities appeared in a separate section of the Farm Credit Act (Act) and therefore financing of FCS investments were virtually unlimited and could go beyond the constraints that Congress put in place in the loan making sections of the Act. ICBA adamantly rejects this preposterous interpretation and notes the complete lack of

legislative history supporting FCA's position. Congress did not intend to limit the purposes of FCS loan making in one section of the Act but then allow unlimited purposes for FCS financing in another section of the Act. ICBA seeks further answers to the questions we have submitted to FCA and we believe the non-farm financing envisioned by the guidance memo should be halted immediately.

\$725 Million Verizon Loan: It appears the FCA was initially unaware that CoBank, the FCS's large lender to cooperatives, had made a \$725 million loan to Verizon to buyout Vodaphone's interest in a joint venture. Verizon and Vodaphone are headquartered in New York City and London and this extremely large loan was not rural in nature nor would it be allowed under the provisions of the Act. However, CoBank and the FCA hid behind a provision referred to as "similar entities" lending, but this provision was never meant to allow CoBank or any FCS lender to make ineligible loans. FCA is again abandoning their regulatory oversight responsibilities in an effort to go to any length necessary to allow FCS lenders to make whatever types of non-farm loans they desire.

During debate on the 2008 Farm Bill, ICBA noted that the FCS's Horizon's Project proposals were loosely worded and would allow FCS lenders to engage in financing large Fortune 500 companies. FCS representatives derided this contention and claimed it was misleading. But what has happened since, even though Congress rejected the misguided Horizons proposal?

CoBank has provided major financing to Verizon, AT&T, U.S. Cellular, Frontier Communications and other very large corporations. In the Verizon example, CoBank's financing did not target a "rural" telecommunications cooperative. Vodafone is a British multinational telecommunications company headquartered in London and ranks as the world's second-largest mobile telecommunications company in terms of revenues and number of subscribers. Verizon Communications, headquartered in New York City, had just reported quarterly profit of over \$2 billion and revenues of over \$30 billion and hardly represented a rural telephone cooperative in need of financing by a government sponsored enterprise.

CoBank's newly found lending activities appear to be an effort to leverage their GSE advantages deeply into the realm of multi-national, non-agricultural, non-rural and non-cooperative corporate financial deals. This is not the purpose for which CoBank and other FCS lenders were created.

Keep in mind that the FCA has recently raised the lending limit for FCS entities to \$1.5 billion and the FCS already has several very large loans in their portfolio. Congress should require a list of these large borrowers and the amounts financed.

\$10 Billion Line of Credit: On September 24, 2013, the Treasury Department, through its Federal Financing Bank, entered into a \$10 billion note purchase agreement with the Farm Credit System Insurance Corporation (FCSIC) to establish a standby line of credit to provide FCS funds at the Treasury's cost of funds. This line of credit, which the FCA sought in secret, raises a number of serious questions. For example, why did the FCA seek a \$10 billion line of credit at a time when FCS lenders were reporting record profits of \$4.64 billion in 2013?

Why did the FCA not seek Congressional approval? When the FCS failed in the 1980s, the farmland values which the FCS utilized as collateral had collapsed. Yet, the \$10 billion line of credit, according to FCA, is "collateralized" meaning the collateral backing this line of credit could be dramatically reduced. If the FCS were to collapse, as it did in the 1980s, American taxpayers would be on the hook once again for a sizeable bailout.

The FCSIC was created to collect premiums from FCS institutions as a backstop in the event of financial deterioration within the System. Why then did the FCA seek and obtain a line of credit from the Treasury's FFB as additional protection? A report to the FCSIC prepared by the Brookings Institution stated: "FCS should be required to approach the Congress and the Administration for legislative help" in seeking a line of credit. Yet, **FCA did not go to Congress** but secretly went to the Treasury to obtain the line of credit. There should have clearly been hearings on a GSE seeking a \$10 billion line of credit. This is another example of FCA/FCS seeking to avoid transparency and accountability.

FCA and FCS Diminishing Ag Credit Markets

When ICBA surveyed bankers about their experiences with the FCS the responses were quite informative. Bankers complained about the FCS cherry-picking activities and stated FCS almost exclusively targets top borrowers, offers these targeted borrowers below market rates and is willing to set those below market rates at longer terms.

By taking top borrowers from community banks, FCS weakens the overall community bank portfolios and leaves the less seasoned/younger borrowers and higher leveraged borrowers with community banks. Similarly, if community banks stretch to

keep top borrowers, community banks must accept less return and assume more interest rate risk by fixing the rate for a longer period which is difficult to do based on the short term nature of their deposits. Bankers typically stated the FCS largely ignores young, beginning and small farmers. As one banker stated, "FCS wants us to get these types of farmers started first and then later attempts to take them away once they become financially stronger."

With Farm Financial Stress on Horizon FCS Needs to Focus on Farm Sector

The USDA has noted farm sector profitability is projected to decline again this year with net cash farm income forecast at \$93 billion, down about 28 percent from 2014 levels. Net farm income is forecast to be about \$56 billion in 2015, down 38 percent from 2014's estimate of \$90 billion. If realized, the 2015 forecast for net farm income would be the lowest since 2002 in both real and nominal terms and a drop of 55 percent from the recent high of \$123 billion in 2013.

With low prices expected to continue next year and potentially greater financial stress over the next year and possibly beyond, this is not the time for the FCS to dilute its emphasis on farmers and ranchers by seeking to finance non-farm borrowers. FCS needs to remain focused on its mission as a GSE intended to serve the narrow niche of production agriculture.

Conclusion

We thank the Committee for conducting this initial review of the FCS by questioning the FCA. The FCA has clearly lost respect for the Act's boundaries established to keep the FCS a narrowly targeted GSE. By thumbing their noses at the Act, the FCA and FCS are also thumbing their noses at Congress and the history and legislative intent of the Act. If FCA believes the Act is so loose as to allow it to grant any type of financing desired by FCS lenders, then the Act needs to be tightened. Congress never intended for FCS to be a general purpose rural lender. If the FCA and FCS do not want to play by the rules, there are many other lenders that would welcome the heavy subsidies enjoyed by the FCS as a government sponsored enterprise with tax and funding advantages.

A series of hearings focused on FCS abuses and FCA's complicity in circumventing the law and intent of Congress would be a welcomed next step. We look forward to discussing these issues in more depth with Congress in coming months. Thank you again for holding this hearing and for the opportunity to submit this statement for the record.

SUBMITTED QUESTIONS

Response from Hon. Kenneth A. Spearman, Chairman of the Board and Chief Executive Officer, Farm Credit Administration

Questions Submitted by Hon. K. Michael Conaway, a Representative in Congress from Texas

Question 1. When was the last audit of the Federal Farm Credit Banks Funding Corporation? Who conducts the audit and is it available to the public?

Answer. Under Farm Credit Administration (FCA) regulations, each Farm Credit System (FCS or System) institution must, at least annually, have its financial statements audited by a qualified public accountant in accordance with generally accepted auditing standards. In addition, FCA examines each FCS institution at least every 18 months. The last examination of the Funding Corporation occurred for the 18 month period ended March 31, 2015. FCA examination reports are shared with the institutions' boards of directors, but not with the public.

Question 2. Could you explain the role of the Farm Credit System Insurance Corporation in providing oversight of the Farm Credit System and whether any taxpayer funds are involved in its operation?

Answer. FCA is the government entity primarily responsible for oversight of the System. The Farm Credit System Insurance Corporation (FCSIC) insures the timely payment of principal and interest on System-wide debt obligations issued to investors on behalf of the System banks. By protecting investors, the Insurance Corporation helps to maintain a dependable source of funds for farmers, ranchers, and other System borrowers. As of December 30, 2015, investors held \$243 billion in insured System debt obligations. To minimize risk to investors and the Insurance Fund's exposure to potential losses, the Insurance Corporation actively monitors and reviews key ratios and financial trends throughout the System and has the authority to require troubled System institutions to undergo special examinations, if needed.

The Insurance Corporation assesses and collects premiums from System banks and manages the Insurance Fund. The Insurance Corporation's costs are paid out of the Insurance Fund, and no taxpayer funds are involved in the operation of the Insurance Corporation. Congress also gave the Insurance Corporation certain other specific statutory responsibilities, such as the authority to regulate golden parachute and indemnification payments made by System institutions.

The Insurance Corporation's basic statutory authorities are modeled on those of the Federal Deposit Insurance Corporation, including the responsibility to act as conservator or receiver of a System institution. However, unlike the FDIC and other Federal entities with receivership authority, the Insurance Corporation's resolution authorities have never been updated and modernized, creating potential legal uncertainty in the event of a System institution failure.

Question 3. The Farm Credit System has the authority to lend to rural infrastructure projects—rural electric, telephone, broadband, water and sewer, these types of things. Are you seeing the System working closely with USDA on these types of efforts?

Answer. Yes. CoBank works closely with the Rural Development (RD) agency in USDA on rural utility lending. In addition, the entire System works with RD on investments in rural infrastructure projects and the Rural Business Investment Company (RBIC) program.

Question 4. How is the agency working to control its costs?

Answer. We are a small agency, with the majority of our operating costs in human capital and travel expenses for our examiners to complete onsite examinations. While we work hard to manage costs on travel expenses, it is very important for our examiners to spend time onsite in the institutions we regulate. As you know, FCA is not taxpayer supported, but funded by assessments on the System institutions we regulate. We are proud that FCA's cost to System borrowers equates to only 1.8 basis points on outstanding assets—a measure of our productivity that has reflected an improving trend for the past 30 years.

We are controlling travel costs by taking such measures as using video-conferencing, issuing cost-saving travel procedures, and controlling conference expenses. We have leveraged technology to maintain examination effectiveness (*e.g.*, workflow programs, electronic files, loan database, extending equipment lifecycles when appropriate). Finally, FCA has carefully managed its resources. We have managed the cost of service providers, standardized equipment purchases, increased electronic distribution and publication of material, and shared resources across the organization.

Question 5. Why does the FCA not disclose the names of the institutions that have corrective or enforcement actions taken against them?

Answer. Under Board Policy Statement PS-34, FCA only discloses the following information about enforcement actions to the public: (1) the date and type of enforcement action taken; (2) the type of institution that is subject to the enforcement action or, if the action is against an individual or entity, the relationship between the person or entity and the institution; and (3) a description of the essential facts pertaining to the action, excluding information that would identify the institutions or persons involved. Some enforcement actions have required FCS institutions to disclose a summary of the enforcement actions in their annual reports to shareholders.

In contrast to other Federal regulators of financial institutions that take deposits, Congress has not mandated that FCA disclose the identities of FCS institutions that have been subject to enforcement action. The Freedom of Information Act (FOIA) explicitly exempts information “contained in or related to examination, operating, or conditions reports prepared by . . . an agency responsible for the regulation or supervision of financial institutions” from disclosure in response to a FOIA request.

We believe that publicly disclosing the identity of FCS institutions that have been subject to an enforcement action would adversely affect the ability of FCA to promptly and effectively correct violations of law or unsafe and unsound conditions in the System, as it would adversely impact the willingness of System institutions' boards of directors to enter into formal written agreements with FCA.

Question 6. It is my understanding that the CFTC has exempted Farm Credit System institutions from swap dealer registration requirements regardless of their level of swap dealing activity. In the absence of this exemption, are you aware of any System institutions that would currently exceed the CFTC's *de minimis* registration threshold of \$8 billion in swap dealing activity?

Answer. Currently, no Farm Credit System institution is required to register as a swap dealer with the CFTC. This is because no System institution, at this time, meets the criteria of a swap dealer under the applicable provisions of the Com-

modity Exchange Act and CFTC regulations. Currently available information indicates that no Farm Credit System institution (1) holds itself out as a dealer in swaps, (2) makes a market in swaps, (3) regularly enters into swaps with counterparties in the ordinary course of business for its own account, or (4) engages in activity causing itself to be commonly known in the trade as a dealer or market maker in swaps. In addition, a CFTC regulation grants System banks and associations an exception from registering as swap dealers because they are cooperatives that deal in swaps on behalf of their borrower-members. Separately, the CFTC granted an exemption to depository institutions in connection with originating loans to their customers.

In further response to your question, CoBank, ACB, has a notional amount of derivatives totaling over \$25 billion of which over \$22 billion notional is in interest rate swaps as of September 30, 2015. The vast majority of these derivatives are not cleared through a clearinghouse. Farmer Mac has swaps totaling about \$8 billion notional, the majority of which are cleared through a clearinghouse.

Question 7. With USDA projecting continued softness in commodity prices, how important is it for Farm Credit institutions to be able to have a diversified loan portfolio? Are there things that the agency can do to help institutions achieve more diversity in their loan portfolios?

Answer. As the System's safety and soundness regulator, we believe it is very important for System institutions to diversify their loan portfolios. By law, the System is restricted to lending to agriculture, rural utilities, farm-related service businesses, and certain rural homeowners. System institutions will be better able to manage risks and meet the credit needs of eligible and creditworthy borrowers if they have a flexible and appropriate set of tools to diversify their loan portfolios.

FCA does several things to help System institutions achieve greater diversity in their loan portfolios. We routinely evaluate and assess the concentration and individual lending limits at FCS institutions. When we identify through our oversight process that an institution has an unsafe level of exposure (relative to its risk-bearing capacity) to a particular commodity, market segment, industry, or obligor, we require the institution to take corrective action, such as developing plans to effectively reduce the concentration within a certain period of time. Risk must be properly managed, and institutions must hold adequate capital.

FCA regulations and policy encourage System institutions to use their statutory authorities to buy and sell loan participation interests with each other and non-System lenders so they can achieve greater geographic and agricultural sector diversification in their loan portfolios. Another way that System institutions can diversify their loan portfolios is to buy whole loans and assignment in loans from each other. Also, we encourage System institutions to consider loan guarantees and Farmer Mac credit protection programs as risk management strategies to manage concentration risk.

Similar-entity participations with commercial lenders provide an avenue for System institutions to diversify their loan portfolios. This was the intent when the Farm Credit Act was amended to authorize these credits in 1992. There are limits on the total amount of similar-entity participations that may be purchased or held by System institutions. One such limit is a 15 percent portfolio limit on each institution. At the hearing, Congressman Costa and Congressman Kelly asked specifically about how this limit is applied. Our answer and the discussion of the issue may have been confusing. To clarify, the 15 percent portfolio limit on similar-entity participations applies at the institution level.

Question 8. The FCA withdrew a proposed "Rural Community Investments" pilot project program and a related proposed rule in 2013. But in September of 2014, the FCA released an informational memo providing guidance for investment requests. As I understand it, a key question relating to the investments issue is whether the financing is labeled as a loan or as an "investment."

Can you explain the distinctions between loans and investments?

Answer. We review each investment request on a case-by-case basis and evaluate the underlying characteristics of the investment to determine whether the requested investment would be considered an investment from legal, accounting, and market recognition perspectives. In making this determination, we analyze applicable case law, Federal securities laws, accounting guidance, and knowledge of market norms regarding investment products versus loan products. Case-by-case investment requests require FCA Board approval and are subject to specific conditions of approval, including requirements that the investments must be accounted for as investments under GAAP and be securities under Federal securities laws.

Question 8a. Since the release of the investments guidance memo last September, can you provide examples of the investment projects FCA has approved that are

non-farm in nature and whether any of these projects would be illegal if considered as loans?

Answer. Since the release of the investments guidance memo, FCA has approved four investment requests. The first and second requests approved an investment by two institutions in a rural hospital located in Minnesota. FCA has clear statutory authority to approve investments on a case-by-case basis and does so as provided by regulation § 615.5140(e). A rural hospital would not be eligible to obtain loans from the System under the lending authorities provided by the Farm Credit Act. The two institutions invested in the rural hospital by purchasing debt securities issued by the hospital.

The third investment request was for an institution that invested in a bond issued by an agribusiness—with the proceeds used to expand a grain milling company in rural Indiana. While this financing was completed through the association's investment authority, the borrowing entity is eligible to obtain loans from the association, and grain milling is an activity that the System can finance under its statutory lending authorities.

The fourth investment request was for an institution to purchase rural housing mortgage-backed securities. This type of mortgage-backed security is an eligible investment for liquidity purposes. However, this investment was approved as a mission-related investment under § 615.5140(e) because of the Farm Credit Bank's intention to hold the investment to maturity and not make it available for sale for liquidity purposes. The underlying rural housing mortgages were extended by commercial lending institutions serving rural areas and this secondary market activity serves to improve liquidity to that marketplace.

Question 9. Are you finding that credit is generally available for production agriculture? Are there any areas where the market is not being adequately served by FCS and commercial banks?

Answer. Yes. We are finding that traditional and nontraditional agriculture is being well served by the System and community bankers, and other commercial lenders. At our recent strategic planning session, we heard from a number of experts and lenders who indicated that the agricultural credit market is highly competitive, and for the most part is well served by FCS and commercial lenders. Nonetheless, through other venues, we have also heard some evidence that there are pockets of areas that are less well served—such as microcredit to start-ups for highly specialized commodities and nontraditional producers and urban agriculture. We are committed to identifying and removing any regulatory or other barriers that would prevent System institutions from providing creditworthy producers in these markets with necessary financial services.

Question 10. Many assume that as a GSE, the Farm Credit System has an “implicit guarantee,” similar to Fannie Mae and Freddie Mac. Thus, in the late 1980s when the Farm Credit System was in trouble, the U.S. Government bailed it out. Do you agree that GSEs, including the Farm Credit System, are provided an implicit guarantee that the Federal Government will not allow them to default on their obligations? In other words, are they too big to fail?

Answer. A determination of whether the System is too big to fail would ultimately be made by Congress. Congress would need to consider various financial, economic, and political factors when it decides whether or not to provide assistance to a GSE. In our regulation, examination, and supervision of the System, we do not in any way assume that Congress would act to provide financial assistance to the System. The assumption of an implicit guarantee is just that—an assumption. Although the rating agencies often reference the “implicit guarantee,” those references refer to the expectations of investors, not those of FCA.

FCA uses all of the examination, regulatory, and supervisory tools at its disposal to ensure that the FCS always operates in a safe and sound manner. For this reason, FCA does not ever consider implicit guarantees a backstop to its safety and soundness authorities. As far as the System is concerned, much has changed since the 1980s. Legislation in 1985, 1986, and 1987 converted FCA into an arm's-length safety and soundness regulator, established FCSIC to insure System-wide bonds, restructured the FCS, created Farmer Mac as a secondary market for agricultural loans, and enacted other reforms that substantially reduce the risk that Congress would need to consider a bail-out of the FCS in the future.

Question 11. In September of 2013, the Farm Credit System Insurance Corporation secured a \$10 billion line of credit from the Federal Financing Bank, an arm of the U.S. Treasury. What is the current asset base of the Farm Credit System Insurance Corporation and why was this \$10 billion line of credit obtained? Should we be concerned?

Answer. Currently, the Insurance Corporation has \$4 billion in assets. Those assets are invested only in U.S. Treasury securities. Unlike other financial institutions, the System does not have guaranteed access to the Federal Reserve, the U.S. Treasury, or any other lender of last resort leaving it vulnerable to a market crisis similar to what occurred in 2007 and 2008. The Insurance Corporation has statutory authority to provide financial assistance to System institutions, including during a liquidity crisis in which external market conditions have jeopardized the System's ability to fund itself. The Insurance Corporation obtained the credit line to provide more assistance to System banks in such a market crisis than would otherwise be available in the Insurance Fund to protect investors and taxpayers from losses.

Question 12. Your testimony highlights the Farm Credit Insurance Fund. Do other GSEs have similar insurance funds or reserves?

Answer. The three housing GSEs do not have similar insurance funds. Treasury may provide direct financial assistance to them by purchasing their debt obligations. (Separately, Treasury has injected capital into Fannie Mae and Freddie Mac, which are currently under U.S. Government conservatorship, so they have sufficient capital to meet their obligations.)

In further answer to your question, we note that Farm Credit System debt is ultimately backed by the joint and several liability of the System banks, not the full faith credit of the United States. The obligations of Farmer Mac are not insured by FCSIC. However, Farmer Mac can issue obligations (not to exceed \$1.5 billion at any time) to the Secretary of Treasury, the proceeds of which may be used by Farmer Mac solely for the purpose of fulfilling its obligations under any guarantee it provides under the Farm Credit Act.

Question 13. From 1998 to 2013, the USDA defined small farms as those farms with gross sales less than \$250,000. In 2013 the USDA raised the cutoff to \$350,000 to better reflect price increases for farm commodities. According to the FCA's 2014 annual report, the FCA still uses the old cutoff. Why is the FCA using the more limited threshold and how many small farmers might be left out as a result?

Answer. FCA has formed a workgroup that is studying whether we should adopt USDA's Economic Research Service's new threshold of \$350,000.

Question 14. Regarding the Farm Credit's equipment financing program AgDirect, how do you ensure that the borrowers are credit worthy? Additionally, if any equipment dealer can use AgDirect, how do you guarantee that the borrower meets the qualifications to be a Farm Credit customer?

Answer. FCA does not determine the creditworthiness of the borrower. The FCS institution must do this through its underwriting standards, which we review during our examinations. Likewise, AgDirect has controls to ensure that the borrowers meet qualifications to borrow from the System. We review these controls during our examinations.

Question 15. The FCA held a series of symposia in January and February of this 2014 to discuss future FCS consolidations and mergers. We understand that the symposia were by invitation only, and not open to the general public. Why were these meetings not open to the public? Was this in violation of Federal open meeting laws?

Answer. The symposia were held with interested parties, including representatives from academia, the System, and former Members of Congress to gather information on past experiences and future thoughts on FCS consolidations and mergers. Invitations were limited to allow FCA to hold the briefings at FCA's headquarters and manage expenses. The symposia were informational briefings in nature and not designed to gather input on any regulatory or policy proposal. The FCA Board did not conduct policy deliberations, and for this reason, the symposia were not meetings under the Government in the Sunshine Act. Transcripts of the symposia were provided to the public via FCA's website. Accordingly, we believe that attendance at the symposia was appropriately limited, and that the symposia were conducted in full compliance with all relevant Federal laws.

Questions Submitted by Hon. Collin C. Peterson, a Representative in Congress from Minnesota

Question 1. I know that one of the major distinctions between Farm Credit banks and commercial banks is the ability to take deposits. However, there is information on the Farm Credit Services of America's website that promotes something called CashPlus that says, "CashPlus offers a convenient way to handle your cash flow through one interest-bearing account—make deposits and pay bills anytime without penalty or fee." During the hearing it was indicated that an account such as this is allowed and that it can be interest bearing. I just wanted to clarify on the interest

bearing ability as well as the ability to write checks from such an account. Are these actions allowed?

Answer. Yes, such accounts are authorized for customers who have outstanding loans with an association. We refer to these accounts as Voluntary Advanced Conditional Payment (VACP) accounts. VACP accounts are expressly authorized by sections 1.5(6) and 2.2(13) of the Farm Credit Act. In addition, section 4.37, 12 U.S.C. 2219b, requires funds in a borrower's VACP account to "be immediately applied as payment against the indebtedness of any outstanding loans of such borrower" if the institution is placed in liquidation. VACP accounts are subject to the FCA's regulatory and supervisory authority under the current statutory framework. Currently, FCA regulation § 614.4175 and an FCA booklet, BL-30, apply to VACP accounts at FCS institutions.

Funds received from customers with VACP accounts, such as CashPlus accounts, are either applied to the borrower's outstanding loan balances or held for future payments and interest is paid on funds held. Appropriate disclosures are made to the borrowers that funds placed in these accounts are not federally insured. FCS institutions pay interest on VACP accounts. Drafts, which function similar to a check, are not written directly on the VACP account, but on established lines of credit. System borrowers have been using drafts to access their lines of credit for several decades.

Question 2. A question was asked regarding lending ability to qualified borrowers in the U.S. Virgin Islands. I wanted to clarify whether an existing System institution could ask to have their charter expanded to begin lending in the USVI. Is that how it would work? Could an existing entity ask to serve the islands? Or would you need to charter a new bank?

Answer. Under section 1.2(b) of the Farm Credit Act, 12 U.S.C. 2002(b), FCA may extend the FCS to the USVI if the agency first determines that extending credit and providing other authorized services to farmers and other eligible borrowers there is feasible. In the past, FCA has studied this issue and concluded that it would not be economically feasible for the System to extend credit and provide other financial services in the USVI. If FCA were to determine that providing credit in the USVI would be feasible, it would first assign the USVI to one of the Farm Credit districts, as the statute requires. Afterwards, FCA could either charter a new association to serve the USVI in accordance with several provisions of the Farm Credit Act, or it could modify the charter of an existing association so its territory would include the USVI. In the absence of an active association in the USVI, the Farm Credit bank could make mortgage loans there in the interim. We would gladly work with interested parties to evaluate the possible scenarios and circumstances involved.

Question 3. There was discussion during the hearing regarding the ability to track participation in Farm Credit System lending beyond the current categories of size, time in farming and age of borrower. Are you able to legally track borrowers by race/ethnicity or age?

Answer. As with all creditors, the Equal Credit Opportunity Act (ECOA) generally prohibits System institutions from asking the race or ethnicity of loan applicants or borrowers. The ECOA permits creditors, including System institutions, to ask the age of applicants; this information can be used only for limited purposes in credit decisions, as specified in the ECOA. System institutions may consider age when determining if an applicant or borrower is a "young" farmer (aged 35 or younger) who may qualify for favorable lending treatment. In certain residential lending, the ECOA requires creditors, including System institutions, to ask each applicant his or her race, ethnicity, and age for monitoring purposes, but the applicant is not required to provide this information and a creditor may not use this information in making credit decisions.

Question 4. The FCA had a proposed rule on "Rural Community Investments" and withdrew it. FCA also had a pilot program on these investments and withdrew it. FCA then issued a guidance memo that allowed approval of projects being considered in the proposed rule and pilot program on a case by case basis.

Did all or most of the pilot projects being financed continue even though the program was ended? How many, if any, pilot projects were discontinued?

Answer. To our knowledge, no pilot projects were discontinued, and FCA did not direct any institutions to discontinue funding any projects. System institutions were specifically allowed to continue funding projects where commitments were extended prior to December 31, 2014. The FCA Board permitted System institutions holding investments on December 31, 2014, under the Pilot Programs to continue to hold those investments subject to the conditions imposed by FCA for the applicable Pilot Program. Those investments could be held only through the date of maturity that existed as of December 31, 2014, without renewal or extension, except as approved

on a case-by-case basis by FCA. After December 31, 2014, institutions could fund commitments for Pilot Program investments only if the commitments were made prior to that date.

Question 4a. Does the guidance memo basically allow FCA to approve financing categorized as an investment for virtually any purpose if it's a viable credit? Is the entire proposed investment program approved or is approval granted to individual investments?

Answer. FCA evaluates the merits of each request on a case-by-case basis. In addition to the risk characteristics, investment requests must detail the purpose and objectives of the investment. Each request must demonstrate that the proposed investment is mission related, and it must address factors such as supplementary liquidity and earnings diversification. Since the end of the pilot programs, FCA has approved requests from four institutions to make investments under strictly defined conditions of approval.

Question 4b. How are these investments structured?

Answer. Three of the investment requests were structured as bonds. The fourth investment request was for the purchase of rural housing mortgage-backed securities.

Question 5. CoBank's gotten a lot of attention for making a \$725 million loan to Verizon and other large loans to large telecommunication companies under the "similar-entity" provision of the Act. Can you describe the circumstances regarding the Verizon, U.S. Cellular and AT&T lending interactions with System institutions?

Answer. The Farm Credit Act authorizes CoBank to lend to rural telecommunications utilities. Rural utilities are eligible to borrow from CoBank if they either have a loan, loan commitment, or loan guarantee from the Rural Utilities Service (RUS) or the Rural Telephone Bank (RTB), or are eligible for credit from the RUS or RTB under the Rural Electrification Act of 1936, as amended. Wireless carriers (including U.S. Cellular) that qualify for credit under the Rural Electrification Act are eligible to borrow from CoBank. Since the wireless communication industry's infancy, CoBank has been lending to wireless carriers serving customers located in rural areas. As the industry has matured, most of the rural startup cellular companies have been purchased by larger companies, such as Verizon or AT&T. Telecommunication carriers that are not rural utilities under the Rural Electrification Act may qualify as similar entities under section 3.1(11)(B) of the Farm Credit Act. Both Verizon and AT&T qualify as similar entities. Also, each has an extensive wireless network in rural areas.

CoBank often acts as the System's lead lender for similar-entity participations, utilizing its statutory authority to lend to rural utilities. The lead commercial bank(s) on the \$13 billion syndicated loan transaction for Verizon offered CoBank, as the System lead, the opportunity to purchase a portion of the credit, which CoBank completed (approximately six percent of the total syndication) on its own behalf as well as other System partners.

FCA's review of the Verizon participation purchase (as well as the AT&T deal) found that the legal authority exists for this participation activity and the risk management benefits achieved through balance sheet and earnings diversification are consistent with the intent of the authority granted by Congress. Similar-entity authority also provides opportunities for commercial lenders and the Farm Credit System to work together to meet the needs of agriculture and rural America by mitigating risk.

Under the Farm Credit Act, the System can only participate in similar-entity loans when a commercial lender is involved. Commercial lenders must retain 50 percent or more of the credit. Congress also imposed limits on the extent of this activity to no more than 15 percent of an institution's portfolio. At this time, similar-entity volume is less than ten percent of the System's outstanding loan volume.

Question 6. What is the status of the merger between the failed FCS Southwest and their merger with California's Farm Credit West? Has this been voted on by shareholders and if so what was the outcome? Can you provide a written summary of what led to the failure of this association?

Answer. FCS Southwest was not failing before it merged with Farm Credit West. An incident involving possible fraud by an employee occurred that led to substantial losses, but the association continued to meet all regulatory capital requirements. Upon discovery of the fraud incident, we were onsite immediately and took appropriate actions to ensure the association addressed the incident in a timely and appropriate manner. The Agriculture Committees were notified, and the FCS in its report to investors reported the incident and the potential cause. The Board of FCS Southwest elected to pursue merger with Farm Credit West. The voting stockholders approved the merger of FCS Southwest with Farm Credit West, the funding

bank approved the merger, and FCA granted its approval. The merger became effective on November 1, 2015.

Question Submitted by Hon. Bob Goodlatte, a Representative in Congress from Virginia

Question. But I am sure you would agree that the Farm Credit System has certain advantages and benefits that small community banks don't have. Alternatively, what advantages do community banks have over the Farm Credit System?

Answer. The advantages that community banks have over the Farm Credit System stem largely from their broader charters, which allow them to accept deposits, offer more financial services, and allow for a broader range of lending authority. The following provides a brief summary of some of those advantages:

The deposits of community banks are insured by the Federal Deposit Insurance Corporation, and the deposit insurance fund is backed by the full faith and credit of the United States. The FDIC has a line of credit with the U.S. Treasury, which it has utilized during recent banking crises. FDIC insurance provides community banks with a stable, low-cost source of funding. The existence of FDIC insurance greatly lessens the impact of the bank's financial condition on the cost and stability of its funding.

Community banks are authorized to offer a broad range of financial services to its customers. This provides community banks the opportunity to attract low-cost funds for lending, and to diversify earnings sources.

In contrast to the System, community banks are not restricted by law to lending primarily to a single sector of the economy. As a result, community banks may lend to a full range of businesses, industries, and consumers for all types of purposes and needs. Community banks may also offer consumers and businesses a broad array of financial services and products that the System cannot offer its customers. As a result, community banks have greater flexibility than the System to manage loan portfolio concentration risks.

Community banks have the option of becoming a member of the Federal Reserve Bank in their district. The Federal Reserve Banks are lenders of last resort to their member banks, and they provide discount and other services to such banks, much like those that banks provide for their customers. These services include collecting checks, electronically transferring funds, and distributing and receiving cash and coin.

An independent study titled "Lending Competition of Community Banks and the Farm Credit System" was published in August 2009 by the Federal Reserve Bank of Kansas City. This study provides an excellent discussion of the advantages and disadvantages of commercial banks and the System. It can be found on the Federal Reserve Bank of Kansas City's website at <https://www.kansascityfed.org/publicat/fip/LendingCompetition08-09.pdf>.

Questions Submitted by Hon. Frank D. Lucas, a Representative in Congress from Oklahoma

Question 1. Do you agree that the Farm Credit System should not be in the business of holding on to long-term assets, such as oil and gas and other minerals?

Answer. The Federal Land Banks, which were predecessors to the Farm Credit banks, and the defunct Farm Mortgage Corporation, which was a wholly owned government corporation that was a System institution until Congress dissolved it in 1961, acquired mineral rights through foreclosures on farms starting in the Great Depression of the 1930s. Thus, it became common practice for the former Federal Land Banks and the Farm Mortgage Corporation to retain the mineral rights on foreclosed farms and sell the surface rights. The 1961 statute that dissolved the Farm Mortgage Corporation transferred its mineral rights to the Department of the Interior. The Farm Credit Amendments Act of 1985 added section 4.35 to the Farm Credit Act of 1971 to require Farm Credit System institutions that acquire real property through foreclosure to sell both the surface and the mineral rights to the same buyer. However, this statutory amendment does not apply retroactively to mineral rights that System institutions previously acquired. Mineral rights that System institutions acquired before 1985 and continue to hold do not violate the law, do not pose a safety and soundness risk to the System, and are consistent with long-term assets held by FCS institutions.

Question 2. Does the FCA know the cost basis and present value of AgriBank's mineral assets? If so, can you provide that information to the Committee?

Answer. AgriBank's mineral rights currently have no book value; these intangible assets have no recorded value on the bank's Statement of Condition. AgriBank (successor to the Federal Land Banks and Farm Credit Banks of St. Paul, St. Louis, Louisville, and AgAmerica) acquired all of its mineral rights before Congress en-

acted the 1985 statute. The majority of revenue-producing mineral deposits are located in North Dakota and Arkansas (the bank holds mineral interests in 13 states). Upon acquisition, the rights were likely recognized at fair value and amortized over the estimated useful life. FCA does not have the information necessary to determine what the cost basis was when acquired, nor do we have sufficient information to calculate the present value. AgriBank's mineral income in 2015 was \$56.5 million.

Question 3. Will the FCA require AgriBank to dispose of its mineral assets, which the bank has held for over 5 years? If not, please explain.

Answer. As noted above, mineral rights that AgriBank acquired before the Farm Credit Amendments Act of 1985 do not violate the law, and they do not impair the safety and soundness of the bank. Under the circumstances, FCA has no legal basis to require AgriBank to dispose of these assets.

Question Submitted by Hon. Glenn Thompson, a Representative in Congress from Pennsylvania

Question. And then my other question—and I am not going to have time for a verbal response, but I would appreciate one for the record—what safeguards do you have in place to prevent mission creep? Because mission creep in government is well known and certainly in quasi-government agencies as well. I think it is a human natural tendency. And I would love, for the record, if you could send the Committee a list of, what are the safeguards you have in place to keep you within the lines of what Congress envisioned when this authorizing legislation was passed?

Answer. The System's mission is defined by the Farm Credit Act. Essentially, the Farm Credit Act authorizes the Farm Credit System to lend to agricultural producers and their cooperatives, rural utilities that meet certain requirements, exporters of agricultural products and capital equipment, farm-related service businesses, and certain rural homeowners. In addition, System institutions have authority to participate in loans that non-System lenders originate to entities that are not eligible to borrow directly from the System, but engage in activities that the System routinely finances. FCA has promulgated regulations pertaining to eligibility, scope of financing, and similar entities that provide adequate safeguards against mission creep. A list of those eligibility regulations is provided as follows:

PART 613—ELIGIBILITY AND SCOPE OF FINANCING

Subpart A—Financing Under Titles I and II of the Farm Credit Act

- 613.3000 Financing for farmers, ranchers, and aquatic producers or harvesters
- 613.3005 Lending objective
- 613.3010 Financing for processing or marketing operations
- 613.3020 Financing for farm-related service businesses
- 613.3030 Rural home financing

Subpart B—Financing for Banks Operating Under Title III of the Farm Credit Act

- 613.3100 Domestic lending
- 613.3200 International lending

Subpart C—Similar Entity Authority Under Sections 3.1(11)(B) and 4.18A of the Act

- 613.3300 Participations and other interests in loans to similar entities

FCA examinations routinely evaluate System institutions' compliance with the above eligibility criteria. The System's statutory authority is broader than the System's competitors acknowledge. FCA is proud of the job our staff has done to ensure the System stays within its mission while fully recognizing that agriculture continues to evolve and the System must continue to evolve as well to meet the vast credit needs of producers and the agribusinesses on which they are dependent. In supervising the System, FCA constantly strives to strike the proper balance so System institutions stay within the parameters of the statute while, at the same time, ensuring that they are always able to furnish adequate and affordable credit to American agriculture.

Questions Submitted by Hon. Jackie Walorski, a Representative in Congress from Indiana

Question 1. We all want to ensure access to credit for our farmers. However, as the hearing demonstrated, there are concerns about mission creep and whether the Farm Credit System is becoming a competitor rather than a complementary source of credit. I received an e-mail from a local banker talking about a situation where

a local, well-established farmer bought a couple hundred acres at auction. He already owned a sizable plot of land and had no debt. Farm Credit offered him a 3.15% fixed rate for 15 years while a Treasury bill was yielding 2.2%. The best the local banker could offer was 4.16% over 15 years. The farmer did what any sane person would do and took the lower rate. I can't blame him and the banker couldn't either. He is concerned that the System is prioritizing loan growth targets above all and that, in order to meet those targets, they are seeking out large, established farmers to grow the portfolio, potentially at the expense of small and beginning farmers. And an anecdote like that certainly does raise eyebrows. What does the FCA do to maintain a complementary role in the credit market? Does the FCA give any guidance on portfolio growth rates and targets and incentives to meet the rates and targets to ensure that it's not undercutting banks, who do not enjoy the tax benefits that Farm Credit does?

Answer. The statute does not designate the Farm Credit System as lender of last resort that lends only to borrowers who cannot obtain credit elsewhere. Similarly, the Farm Credit Act does not specify that the System is a complementary source of credit to commercial banks and other agricultural lenders. Instead, the FCS has authority to compete with commercial banks and other lenders in making loans to eligible borrowers. Accordingly, the System operates in a very competitive agricultural credit market, and it competes for business against commercial banks, life insurance companies, and companies providing trade credit. The Farm Credit Act directs the institutions of the Farm Credit System to "provide equitable and competitive interest rates to eligible borrowers." For this reason, FCA examinations routinely evaluate the pricing practices of System institutions to ensure that all loans cover the cost of funds, including the operating costs of the institution—provisions for loan losses, costs of servicing, and the need to retain earnings and provide for adequate capitalization.

Aside from the tax benefits that the System's competitors often highlight, the System has evolved into an efficient business model. The System's efficient business model was highlighted in an independent study completed by staff of the Federal Reserve Bank of Kansas City: "Lending Competition of Community Banks and the Farm Credit System." It can be found on the bank's website at <https://www.kansascityfed.org/publicat/fip/LendingCompetition08-09.pdf>.

Question 2. Have you been contacted by the Government Accountability Office to provide information for a study they are conducting on the Farm Credit System? If so, what information were you asked to provide?

Answer. No, we have not been contacted recently by the Government Accountability Office to provide information for a study it is conducting on the Farm Credit System.

Questions Submitted by Hon. Mike Bost, a Representative in Congress from Illinois

Question 1. According to USDA, 49% of Illinois farmers hold jobs off of the farm and view agriculture as their secondary occupation. This shows why rural economic development is so important to supporting agriculture. FCA recently completed a pilot program called "Investments in Rural America" where Farm Credit institutions worked with community banks and other rural stakeholders to broaden access to capital to support rural communities. Could you briefly discuss the results of that pilot program and whether there are other initiatives at the agency to encourage Farm Credit institutions to work with local community banks on financing rural projects in a collaborative manner?

Answer. The pilot programs were determined to be successful and informative in evaluating the appropriate scope of rural investment by System institutions. Consistent with the finding of the pilot programs, FCA issued a proposed rule to codify the authority for System institutions to make certain types of mission-related investments. However, a final rule was not pursued. Subsequently, in September of 2014, FCA released an Informational Memo providing guidance for investment requests. As was the case prior to the pilot programs, we review each investment request on a case-by-case basis and evaluate the underlying characteristics of the investment to determine whether the requested investment would be considered an appropriate mission-related investment from legal, accounting, and market recognition perspectives. One of the key criteria used in this evaluation is whether the System institution is working with local community banks to partner in the rural project. While we evaluate these investment requests by System institutions, FCA is not leading any initiatives to encourage Farm Credit institutions to work with local community banks on financing rural projects in a collaborative manner.

Question 2. Can you please explain what actions the FCA is taking to ensure that FCS institutions are complying with state insurance laws when it comes to the licensing and regulation of FCS employees selling crop insurance?

Answer. FCA examinations routinely include FCS employees' compliance with all applicable laws concerning the sale of crop insurance. Our examinations have not found any instances of wrongdoing, and as a result, no enforcement actions have been taken.

Question 3. Can you explain AgDirect to me? How do you ensure that the borrowers are credit worthy? Additionally, if any equipment dealer can use AgDirect, how do you guarantee that the borrower is a farmer or at least meets the qualifications to be a Farm Credit customer?

Answer. AgDirect is an equipment financing program offered by participating Farm Credit System associations of AgDirect, LLP, through representative equipment dealers. The program uses standardized underwriting practices to determine creditworthiness of the borrower. It has controls that ensure borrowers meet the qualifications to be a Farm Credit customer. AgDirect, eligibility controls, and the underwriting standards are subject to ongoing FCA examination.

Question 4. If a borrower uses AgDirect, do they have to buy the \$1,000 worth of stock to become a Farm Credit customer? Do they have voting rights in the Farm Credit Association that offered the AgDirect loan?

Answer. If a borrower uses AgDirect to finance the purchase of equipment, he or she does not buy stock in an association. The equipment purchase is completed using a retail installment sales contract with the equipment dealer. AgDirect borrowers are obtaining credit from the dealer, not the FCS association. The FCS association then purchases a participation interest in the sales contract. The FCS association is participating in the credit but is not the lender of record. For this reason, the borrower does not buy stock in the association. If that is the borrower's only relationship with Farm Credit, then he or she does not have voting rights. However, the majority of farmers and ranchers using AgDirect own stock in a Farm Credit association because of another loan product that affords the borrower voting rights.

Question 5. What was the total asset size of AgDirect at the end of 2013? How much new loan volume did AgDirect book in 2013?

Answer. AgDirect volume is pooled on an annual basis through participations sold to AgriBank. At year-end 2013, total volume reported at AgriBank was \$2.5 billion. During 2014, AgDirect booked an additional net increase of \$500 million, resulting in total volume reported at AgriBank of \$3.0 billion at year-end 2014. Outstanding AgDirect volume will be reported at year-end 2015 in AgriBank's financial statements.

Question 6. Is there any concern with the AgDirect program since equipment sales are down and there are some potential struggles on the horizon for equipment dealers?

Answer. There is reason for concern in any lending relationship with farmers during difficult economic conditions. AgriBank reported that it added \$5 million during the third quarter of 2015 to its allowance for loan losses for exposure related to AgDirect volume.

Questions Submitted by Hon. John R. Moolenaar, a Representative in Congress from Michigan

Question 1. Can you expand on the process of mortgage and homeowner lending? What is the default rate for home and commercial loans across the Farm Credit System?

Answer. The credit quality of homeowner loans and commercial loans extended by the System is excellent. At September 30, 2015, just 0.9 percent of rural residential real estate loans and 0.8 percent of commercial loans were non-performing.

Question 2. In your view, what are the competitive advantages and disadvantages of the Farm Credit System compared to community banks?

Answer. It is our view that Congress provided the System with certain advantages in the marketplace to allow the System to meet its mission through good times and bad. We believe that, likewise, commercial banks are provided distinct advantages to meet the needs of its customers. The System has two distinct advantages. First, it sells bonds with spreads close to Treasuries. Second, its cooperative structure means that System institutions are owned by their farmer-borrowers, rather than investors, which means profits generated by the System institutions go back to the farmer-borrowers instead of investors. Community banks have three distinct competitive advantages over the System. First, the assets and liabilities of community banks are more diverse than those of the FCS. In contrast to the FCS, community banks are not required to primarily lend to a single sector of the economy. Their investment authorities are also broader. They also have more funding sources than the FCS. Second, the low-cost deposits of community banks are expressly backed by the full faith and credit of the United States whereas System bonds are not. Also,

many community banks (but not all) have a lender of last resort, which is their Federal Reserve Bank. In contrast, the FCS has no guaranteed lender of last resort.

The agricultural credit marketplace is competitive, with commercial banks and the System each maintaining about 40 percent market share, while insurance companies and trade creditors together have a 20 percent market share. This competition directly benefits the farmers and ranchers of America. For a more complete and unbiased discussion of the advantages and disadvantages of the System and community banks serving the agricultural marketplace, we refer you to a study published in August 2009 by the Federal Reserve Bank of Kansas City, titled "Lending Competition of Community Banks and the Farm Credit System." It can be found on the bank's website at <https://www.kansascityfed.org/publicat/fip/LendingCompetition08-09.pdf>.

