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TAX ADVANTAGED FARM CREDIT SYSTEM GSE

CBI's Position

- If FCS lenders continue efforts to expand into non-farm lending markets, then CBI urges Congress to either abolish the FCS, or at a minimum restrict the FCS to its historical mission of serving the agricultural marketplace.

- CBI adamantly opposes the FCS's expansionist agenda to allow FCS lenders to become the equivalent of commercial banks while retaining their GSE status and inherent tax and funding advantages.

- The Farm Credit Act (Act) should further define and narrowly target FCS lending activities to refocus on serving bona-fide farmers and ranchers and young, beginning, and small farmers and their farmer-owned cooperatives.

- FCS lenders should be subject to taxes when they exceed a given asset threshold, when they lend to large borrowers, or if they engage in any non-farm lending activities.

- CBI strenuously opposes the successor to the Farm Credit Administration's "Rural Community Investments" proposal, withdrawn in November 2013, but now adopted via regulatory guidance under the guise of FCA's "case-by-case approval" of "investments" authority.

- FCS lenders should only be allowed to purchase loans or loan pools of failed banks from the FDIC as a purchaser of last resort. The FCS should be required to work with commercial banks as a funding source.

- The three-person board of the FCA, the FCS's regulator, should include a member of a federal banking agency or the U.S. Treasury Department to ensure public transparency and accountability.

- The FCA should be required to engage in joint rulemaking with federal banking agencies when proposing regulations that could involve allowing non-farm lending activities for FCS lenders.

- Mergers of large FCS entities should be limited to curtail the concentration of financial assets within the System and preserve more localized service. All mergers should be subject to the same approval procedures as required for associations to exit the System.

- The FCA should require greater transparency of FCS activities and should publish instances of illegal FCS lending, both past and present, and any exemptions granted for such lending.

- FCS institutions should be required to register a class of stock with the Securities and Exchange Commission (SEC) and provide full disclosure required by the Securities Exchange Act of 1934. The FCS should be subject to regulations equivalent to those that apply to community banks and the housing GSEs, including oversight by the Consumer Financial Protection Bureau.

- FCS institutions should be subject to regulatory capital requirements that are more stringent than those that apply to community banks -- i.e., the Basel III regulatory capital framework -- since FCS institutions are government sponsored enterprises ultimately backed by U.S. taxpayers.

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Background
Farm Credit System lenders enjoy an unfair advantage over rural community banks in competing for loans by leveraging their tax and funding advantages as a government sponsored enterprise (GSE). FCS was chartered by Congress to serve bona fide farmers and ranchers, but has in recent years sought numerous non-farm lending powers in an effort to compete directly with commercial banks for non-farm customers. These vast and broad new powers would essentially make FCS institutions the functional combination of commercial banks and tax-exempt credit unions, but with intrinsic GSE tax and funding advantages. While the FCS's legislative proposals were not included in the 2008 farm bill and no legislative expansion powers were granted in the 2012 farm bill, FCS has sought to push its legislative agenda through its compliant and accommodating regulator, the Farm Credit Administration (FCA).

Farm Credit Administration's Aggressive Agenda. In addition to the broad consumer, housing, and retail and business lending legislative proposals advocated by the FCS, the FCA proposed a "Rural Community Investments" regulation aimed at allowing non-farm financing if such financing projects are labeled as "investments." FCA/FCS's envisioned financing authority under the Rural Community Investments proposal was very broad, allowing FCS institutions to finance otherwise illegal lending in any city of under 50,000 residents, including non-agricultural business loans, manufacturing, apartment complexes, dental facilities, doctors' and lawyers' offices, and many other loans prohibited by law. Though the RCI proposal was nominally withdrawn, it now appears to be substantially embodied in FCA's 'case-by-case' approval authority. FCA has not made any plans for public transparency of the "investments" approved under this authority.

FCA has also inappropriately changed the definition of "rural" to apply to localities within metropolitan statistical areas (MSAs) if any other federal program defines these areas as "rural" areas.

In recent years, FCA has allowed various deposit-taking programs by FCS lenders that siphon local funds out of rural communities and has expanded the FCS mission without informing the public. In addition, on several occasions, FCA has violated the Administrative Procedures Act. The cumulative impact of these changes represents a dramatic departure from FCS's historic mission and congressional intent – to serve bona-fide farmers and ranchers – and these abuses have no basis in the law or legislative history.

CBI Opposes Consolidation Trend Within the Farm Credit System. FCS should either be dismantled if they continue seeking to become non-farm lenders or be refocused as a wholesale funding source for community banks serving agriculture and provide more of a correspondent banking function rather than operating as a direct retail competitor with GSE tax and funding advantages. Many FCS associations have merged in recent years, resulting in several large multi-state regional lenders. Significant additional mergers could occur going forward. Any future mergers between FCS institutions should abide by the FCA's "termination" regulations, and FCA should publicly explain any mergers between geographically distant or separated associations. Large, multi-state or regional FCS entities enjoy tax advantages allowing them to siphon away high-quality loans from much smaller community banks. These tax advantages include exemptions from paying taxes on real estate and mortgage loans, avoidance of state and local taxes and state franchise taxes, exemption of mortgage recording fees and exemption from taxes on retained earnings. These exemptions provide a huge advantage over community banks, whether C corporations or sub S Corporations, in their ability to facilitate new growth.

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Reform of Farm Credit Administration Governance. Congress should reform the FCA by requiring that one FCA board seat be held by a representative of a federal banking regulator or the Treasury Department. The FCA should refocus its regulatory actions on increasing safety and soundness of FCS institutions and mission oversight in lieu of proposals to expand FCS powers. Any FCA proposal allowing FCS non-farm lending activities should be subject to joint rule-making with federal banking regulators and should trigger taxes equivalent to those paid by a C corporation.

More Disclosure and Transparency Needed. Since the FCS is a GSE, each Farm Credit System bank should be required to register a class of its equity securities with the SEC under the Securities Exchange Act of 1934 to be consistent with Fannie Mae, Freddie Mac and the Federal Home Loan Banks. Like other GSEs, FCS institutions should also be required to comply with the disclosure requirements of the Act by preparing and filing appropriate reports including audited financial statements.

The FCS is unique in that it is the only GSE that competes against private-sector banks at the retail level yet is exempt from many of the regulatory and tax burdens banks face. FCS lenders should comply with the same disclosure and transparency requirements as community banks and other GSEs. FCS institutions should also be subject to Consumer Financial Protection Bureau regulations in the same manner that commercial banks are.

Parity in Regulatory Capital. Beginning in 2015, community banks are phasing in new regulatory capital requirements under the Basel III regulatory capital framework. While CBI has concerns regarding key components of Basel III (see Regulatory Capital resolution), it is imperative that comparable, and preferably more stringent, regulatory capital requirements apply to FCS institutions. CBI fully supports the Farm Credit Administration's proposed capital rule for FCS institutions, issued in late 2014, which would significantly revise regulatory capital requirements, enhance capital transparency, and allow for easier comparison with the Basel III capital framework. However, because the FCS is a GSE with the implicit backing of U.S. taxpayers, regulatory capital requirements should be more stringent, not comparable to, those that apply to community banks. The FCA proposed rule should be considered an initial step rather than an end point.

About CBI

The Community Bankers of Iowa exclusively promotes and defends the common interests of independently owned and locally controlled Iowa community banks whose services are vital to the preservation of economic diversity and rural America. More than 330 independent community banks are located in Iowa, representing more than 1,000 communities across the state and employing over 5,000 Iowans. CBI members have in excess of $3.2 billion dollars in common sense loans to consumers, small businesses, and the agricultural community. For more information, visit www.cbiaonline.org.