REVIEW THE FARM CREDIT SYSTEM AND ITS PROVISIONS FOR ASSOCIATIONS TO EXIT THE SYSTEM

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSERVATION, CREDIT, RURAL DEVELOPMENT, AND RESEARCH

OF THE

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REVIEW THE FARM CREDIT SYSTEM AND ITS PROVISIONS FOR ASSOCIATIONS TO EXIT THE SYSTEM

WEDNESDAY, SEPTEMBER 29, 2004

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSERVATION, CREDIT,
RURAL DEVELOPMENT, AND RESEARCH,
COMMITTEE ON AGRICULTURE,
Washington, DC.

The subcommittee met, pursuant to call, at 1:34 p.m., in room 1300, Longworth House Office Building, Hon. Frank D. Lucas (chairman of the subcommittee) presiding.

Present: Representatives Moran, Osborne, King, Holden, Case, Dooley, Etheridge, McIntyre, Herseth, and Stenholm [ex officio].

Staff present: Ryan Weston, subcommittee staff director; Dave Ebersole, Jen Daulby, Claire Folbre, Callista Gingrich, clerk Tyler Wegmeyer, and Russell Middleton.

OPENING STATEMENT OF HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. LUCAS. This hearing of the Subcommittee on Conservation, Credit, Rural Development, and Research will come to order and a review of the farm credit system will begin.

Providing credit to America's farmers and ranchers is a necessary and serious undertaking for many lenders in the United States. Today's hearing is going to provide a venue where we can discuss the Farm Credit Act, its guidelines on the Farm Credit System Association that wishes to exit the Farm Credit System.

There is no doubt that the proposed purchasing of the Farm Credit Services of America by Rabobank has generated a great deal of discussion. It is our job in Congress to review the laws and to make sure that they are being interpreted correctly and followed accurately.

Since the Farm Credit Administration has yet to receive a formal exit proposal from the Farm Credit Services of America, it may be difficult for us to get all the answers to many questions we would like to have answered. However, this is the perfect opportunity to discuss in depth the current law and how FCA interprets the law.

The Farm Credit System traces its roots back to 1916, when Congress enacted the Federal Farm Loan Act. The System, like all other lending institutions, has gone through a great deal of change since 1916.

According to the Congressional Research Service, the System currently holds 30 percent of the farm sector's debt, which consists of short- and long-term debt. This number alone shows that the System is and has been very active in rural America. In comparison, commercial banks hold approximately 39 percent of farm sector debt.

There are many questions that will be asked today, but none more important than discussing if associations should retain the local right to choose the business models or should Federal law be altered in some form to give more direction to the associations? There are many alterations that could be a basis for discussion, No. 1, should the law remain exactly as it is, or No. 2, should it allow associations to have the option to purchase an association that wants to merge, dissolve or exit the System or, No. 3, should the associations be allowed to exit the System altogether?

Another question before us today is, "What, if anything, has changed that has prompted a commercial bank to become interested in purchasing a Farm Credit System Association?"

The exit provisions that provide for an association to leave the System had a statutory start in 1987 and the final regulations came out in 2002, but these provisions have not been discussed in front of this subcommittee during my time in Congress. Under current law, it is clear that an association can leave as long as the Association's Board presents FCA with an exit proposal, the FCA approves the proposal, and then a majority of the Association's shareholders vote to approve the proposal.

If changes to the exit language are considered, is it the appropriate time to consider other changes to the Farm Credit Act? Numerous topics have been raised in the past, such as capital requirements, types of loan products allowed to be offered, new product availability, and Government-sponsored enterprise status.

Today's witnesses will provide differing views of what has led us here today, and we must diligently discuss any changes that are needed regarding the current law. I look forward to hearing today's testimony.

And now I turn to the ranking member, the gentleman from Pennsylvania, Mr. Holden, for any comments he may have.

OPENING STATEMENT OF HON. TIM HOLDEN, A REPRESENTATIVE IN CONGRESS FROM THE COMMONWEALTH OF PENNSYLVANIA

Mr. HOLDEN. Thank you, Mr. Chairman.

Thank you for having this hearing today, which gives the members of this subcommittee an opportunity to learn more about the current events taking place within the Farm Credit System.

I am very interested in the proposed acquisition of the Omaha-based Farm Credit Services of America by the Netherlands-based Rabobank. If this deal happens, it will have potential long-term impacts and significant implications for the Farm Credit System and the farmers, ranchers and rural communities it serves. While everyone in this hearing room knows what Farm Credit System is, sometimes I think we forget why it is needed and why the Congress created the Farm Credit System almost 90 years ago.

That reminder came to me last year when I told you Wachovia—besides exiting the farm loan business in Delaware and Pennsylvania because of the high-risk nature of agriculture loans—I am not criticizing the business decision, but there is one less financing option for farmers in rural Pennsylvania, and it highlights the continued needs for ranchers in the Farm Credit System. The purpose is to obtain credit. The sole purpose of the Farm Credit System is agriculture lending.

The Farm Credit System of America and Rabobank deal has raised many questions and concerns about the motivations for the transaction: equitability of the purchase price, stockholder profit-making, and whether the sale of a Government-sponsored enterprise is in the public interest. This could also set a dangerous precedent in the Farm Credit System and may cause a chain reaction leading to the downfall of the entire system.

Mr. Chairman, I believe we need to remove the exit provision of the Farm Credit Act. We need to prevent institutions from leaving the System. Farmers need ready access to credit, and I believe that only the Farm Credit System has the ability to provide it without regard to financial times.

The Farm Credit System has a statutory mandate to serve agriculture as a permanent, reliable source of credit even in difficult times. There is inherent risk involved in agriculture lending and the Farm Credit System plays an important role in agricultural risk management.

Mr. Chairman, I look forward to hearing the testimony of the panel today and look forward to hearing the testimony. Thank you.

Mr. LUCAS. The Chair thanks the ranking member.

As is custom, of course, the Chair recognizes the ranking member of the full committee today, Mr. Stenholm.

OPENING STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. STENHOLM. Thank you, Mr. Chairman. I will be very brief. Thank you for holding this very important hearing today to provide members of the subcommittee with an opportunity to learn more about the proposed acquisition of Farm Credit Services of America, based in Omaha, by Rabobank.

The underlying specific issue of the Rabobank question is the issue of the entire Farm Credit System. I believe that I am the only current committee member who was involved in the 1987 Farm Credit System assistance legislation.

I can tell you that the provision for an association departing the System was considered only in the instance of associations who were compelled to contribute capital under the requirements of joint and several liability. These contributing institutions felt that they were financing the imprudent management of other institutions at the expense of their own careful management. Never did we envision that the Farm Credit System associations might be acquired by outside institutions.

That being said, we need now to understand the nature of the acquisition, the source of the Omaha bank assets that are being acquired, and the implications for stockholders and current borrowers. Perhaps most important, we must know the implications for the System itself, which is still required to provide agriculture financing to those producers desiring its services.

In particular, the proposed sale raises many questions that need to be answered. First and foremost, what is the motivation for the sale? How do Farm Credit Services of America benefit from this sale by exiting the System and leaving behind a reported $800 million of stockholder money? This is not an insignificant amount of money.

I look forward to hearing today's testimony and to asking any questions that might arise.

Thank you, Mr. Chairman.

Mr. LUCAS. Thank you, Mr. Ranking Member. Other statements by Members may be included in the record at this point.

[The prepared statements follow:]

PREPARED STATEMENT OF HON. BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE COMMONWEALTH OF VIRGINIA

Mr. Chairman, thank you for convening the hearing this afternoon to take another look at the changing relationships between farmers and ranchers and their lenders. As you undoubtedly remember, the full committee last year examined the rising importance of new generation farmer cooperatives and the role of CoBank in meeting the financing needs of this different breed of farmer associations. The hearing today continues that examination, and I look forward to the testimony from the witnesses you have called.

Obviously, the economics of agriculture continues to change. The Doha round of world trade talks points directly at those changes, and even as our trade representatives meet to hammer out a new trade agreement, our farmers are confronted by new and more aggressive competitors around the globe. Thus, we would assume that lenders will be following these new players in world agricultural markets and that new relationships will be forged between lenders, and in this day of instant global communications and commerce, we also should assume that new international banking relationships will development in agriculture just as they do in other sectors of our economy.

This committee's concern always has been with making certain our farmers and ranchers had adequate credit readily available when it is time to get in the field or make capital expenditures to expand operations and in order to build revenues. During the last decade, we have been assured by lenders—and I personally believe it has been true—that adequate credit has been and will be available for credit-worthy borrowers. Certainly, in last year's hearing, we learned that equity capital, never a large part of the operations of individuals or small groups of farmers, is becoming a necessary part of competing in today's world. We need to see that those needs are met.

Within the last few months, we have learned about other needs—this time in the lending community itself in which a large Farm Credit System association wants to leave the cooperative community. Congress has provided the authority—and the Farm Credit Administration has rules in place to carry out that authority—for association stockholders to make that decision if they believe it is in their interest.

However, questions, one may even say questions of profound importance to the future of U.S. agriculture and our rural communities, remain about where the Farm Credit System is headed without further congressional direction and whether or not a special entity farm lender is still necessary. I happen to believe the Farm Credit System is an integral part of our farming and ranching communities; I say that having seen the local Farm Credit System association step up to help constituents in the Shenandoah Valley to continue their farming occupations. Apparently, there are some, at least in the four States of Iowa, Nebraska, South Dakota and Wyoming who have other thoughts about the importance of their own local association. Again, these questions are basic to whether or not farmers and ranchers still have and want to keep the sense of community that has been the backbone of rural America for decades. I hope we get an idea of where that thinking may be taking the System in the coming years.

Thank you, Mr. Chairman.

PREPARED STATEMENT HON. GIL GUTKNECHT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Good afternoon, Mr. Chairman, ranking member, other members of the subcommittee and honored guests. I wish to thank Chairman Lucas for holding a hearing on this very important and timely matter.

I have very serious questions about the long term ramifications that the proposed sale of FCS America to the Rabobank Group may have on farmers and rural communities. I am hopeful that this hearing will answer three critical questions that need to be explored and answered before a deal is approved by the Farm Credit Administration.

First, how will this proposed sale affect farmers seeking credit in rural communities throughout the upper Midwest? Second, what type of precedent are we setting for the Farm Credit System and their commitment to rural communities? Finally, how can we regulate an institution which is headquartered in a foreign country thousands of miles away, yet serving farmers in rural America?

PREPARED STATEMENT OF HON. MIKE MCINTYRE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA

Mr. Chairman, I would like to thank you and Ranking Member Holden for holding this hearing on legislation that is crucial to the future of Farm Credit Services of America.

Rabobank's recent announcement of its intention to acquire Farm Credit is an issue that is vitally important, not only to farmers and ranchers in Nebraska, Iowa, South Dakota, and Wyoming, but also to Farm Credit offices across the Nation, including the Cape Fear Farm Credit Association in southeastern North Carolina.

The proposed acquisition represents an unprecedented development in the history of the Farm Credit System. It raises a host of serious questions and creates a wide range of policy issue concerns. As a result, the proposal deserves our detailed scrutiny and I look forward to hearing from todays panel.

The more than 2,400 members of the Cape Fear Farm Credit Association in southeastern North Carolina and Farm Credit associations across the Nation recognize that the prime benefits of the Farm Credit System could be significantly impacted if this proposal becomes reality.

The mission of the system is to serve rural America and provide for a productive farm community which is essential to the economic security of our Nation.

Farm Credit members value the Farm Credit System's mission and its dedication to that mission across the years. They appreciate and support the Farm Credit System's customer-owned structure and they appreciate the value of the dividend programs that allow them to share in the earnings of the organization.

I am committed to ensuring the Farm Credit System remains financially sound and adequately equipped wit the tools it needs to continue its service to agriculture and rural America for years to come.

Mr. Chairman, I look forward to working with you and Ranking Member Holden in using whatever means are at our disposal to preserve the Farm Credit charter.

I thank you for holding this important hearing and look forward to hearing from today's distinguished panel.

PREPARED STATEMENT OF HON. STEPHANIE HERSETH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

I want to acknowledge and commend Chairman Lucas and Ranking Member Holden for calling this important and timely hearing today. I know everyone that is involved in agriculture is watching this issue closely, but none more closely than those of us from the four-State region that would be directly affected by this proposed transaction.

I want to acknowledge and offer a special welcome to one of the witnesses here today, Mr. Myron Edelman. Myron is a cattlemen and farmer from Watertown, South Dakota. He also is a shareholder and former board member for Farm Credit Services of America. He is here representing a group called "Farmers for Farm Credit," a group formed specifically to oppose this transaction. He is recognized throughout the region as an expert on issues of agricultural credit and I commend his testimony to all of my colleagues here today.

As I said at the outset, this hearing is both timely and important, but I think there is a more important venue. As comfortable and ornate as this room is, it is a long way from Omaha. The people that will be affected by this transaction live in South Dakota and Iowa and Nebraska and Wyoming. I would like to see this subcommittee—and even the full Agriculture Committee—hold a public hearing in

Omaha or Des Moines or Sioux Falls or Cheyenne or anywhere in the four-State region. It is very difficult for South Dakota farmers and ranchers to travel out to Washington for a hearing like this, especially at this time of year—during harvest. But the issue is important enough that they would certainly jump in their cars or trucks and drive to a hearing if they could.

I have serious concerns about the substance of this proposed transaction. The Farm Credit System was created in 1916 and has successfully served farmers and ranchers across this country for almost 90 years—through good times and bad. I view it as a critical component of the system of agricultural credit that exists in this country to provide capital to farmers and ranchers across the country.

I have traveled extensively throughout South Dakota over the past several weeks, talking to farmers and ranchers. Many have raised this issue with me during that time, and none of them have expressed enthusiastic support. Opinions have ranged from curiosity or uncertainty—desiring more info before taking a position—to skepticism or outright hostility. The South Dakota and National Farmers Unions are strongly opposed to this transaction, and I think it's worth noting that the Farm Credit Council—the trade association that represents every other member of the farm credit system—is opposed to this transaction as well. I'm sure this raises some red flags with those on this subcommittee.

I also think that it is worth noting that this transaction will likely have a significant effect on the overall Farm Credit System. As the system is currently configured, all of the member associations of the System are jointly and severally liable to their sister associations. If FCSA is allowed to leave the system, this undermines the integrity of the entire system—and I believe the financial markets will take note of that going forward. All interested parties need to be very careful before pursuing further a transaction that could weaken the entire farm credit system.

Lastly, this begs the question: is the entire Farm Credit Act in need of revision? Because of the serious implications this has on the whole system, we may want to consider revising the Act to further limit the ability of association members to leave the system or, at the very least, impose additional requirements to do so that protect the interest of the borrower and the system itself. I look forward to exploring this possibility during today's discussion.

Thank you and I yield back the balance of my time.

Mr. LUCAS. I would now like to invite our first panel to the table. Ms. Nancy Pellett, chairman of the Farm Credit Administration from McLean, Virginia.

Chairwoman, whenever you are ready, please begin.

STATEMENT OF NANCY C. PELLETT, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION

Ms. PELLETT. Thank you.

Mr. Chairman, members of the subcommittee, I am Nancy Pellett, chairman and Chief Executive Officer of the Farm Credit Administration. On behalf of my board colleagues who are present today, Doug Flory and Michael Reyna, I am pleased to be here this afternoon to comment on the future of the Farm Credit System.

I have submitted more extensive remarks on this subject, and I would ask that they be made a part of the record.

Mr. LUCAS. Seeing no objection, so ordered.

Ms. PELLETT. Thank you Mr. Chairman.

The mission of the Farm Credit Administration is to ensure a safe, sound and dependable source of credit for farmers, ranchers, aquatic producers, farmer-owned cooperatives and rural homeowners.

To achieve our mission, we oversee the operations of the Farm Credit System, a Government-sponsored enterprise that Congress established to serve agriculture and rural America. The System is comprised of five banks and 97 retail-level lending institutions associated with those banks. We also oversee the operations of Farmer Mac, which provides a secondary market operation for agricultural mortgage loans.

As a Government-sponsored enterprise, the System serves a critically important purpose, providing American agriculture and rural America with a dependable source of credit in good times and in bad. Currently, the System provides about $100 billion to about 500,000 borrowers throughout the Nation. Without this well-conceived, financially sound and time-tested GSE, I believe the strength of our Nation's agriculture and the quality of life in rural America would be diminished.

On August 3, one of the System's retail-level lending institutions, the Farm Credit Services of America, notified us of its intent to terminate its status as a member of the System. Though rare, such an action is permissible under the statute, and we have regulations that allow for the orderly exit of an institution from the System.

Since my board colleagues and I must make objective decisions on any termination request submitted to us, it would be inappropriate for me to comment on the merits of an application. Therefore, I hope that you will appreciate that I may not be able to respond to certain questions here today.

My written testimony provides information on the key decisions that we must make when assessing a termination plan. I would also note that we have briefed staff from the full committee on our termination process. And, Mr. Chairman, we would be pleased to update interested parties as we move through the process.

The end result of an approved termination would be that a $7 billion institution, serving 50,000 borrowers in a four-State area would no longer be an instrumentality of the U.S. Government. It would become a privately owned commercial venture.

The loss of an established Farm Credit System presence is a matter of serious concern for all of us, and it would require considerable effort, cost, and time for the System to reestablish its presence in this four-State area. However, I assure you that should the Farm Credit Services of America termination process proceed, we will act swiftly to maintain a system presence in the vacated territory.

Since I was appointed to the FCA board almost 2 years ago, I have heard frequent comments about whether changes are needed to the Farm Credit Act to make the System more effective. I believe Congress' decision decades ago to create the Farm Credit System remains valid today, but I also believe the time has come when Congress may want to consider modifications to the act that could enhance the System's ability to serve to better serve agricultural and rural economies of the future.

In the early 1990's, the Government Accountability Office reported to Congress that the System did not need new statutory authorities in the near term, but that ongoing changes in agriculture and rural America could justify such changes in the longer term. GAO noted that, over time, as agriculture and rural America changed, the System's authorities might need to be updated to ensure the System is not hampered by outdated research in serving its customers.

Mr. Chairman, the changes in agriculture and rural America the GAO alluded to have been well documented by several Government and academic sources, and I mentioned some of them in my written testimony. Overall, these changes clearly point to a need to modernize an act whose basic structure has not changed in almost 35 years. Although the commercial banking system was modernized in the late 1990's, the System's statute has not received a general update to reflect changes in the marketplace or rural America since 1971. As a result, the Farm Credit Act does not accommodate many of the market conditions and economic forces nor reflect the rural America that exists today.

At FCA we recognize that major changes have taken place in agricultural and rural America. Our intent is to maintain a flexible and responsive regulatory environment. And, where appropriate, we should eliminate or revise regulations that needlessly impair the System's activities. The System has the financial capability to serve customers and engage in financial transactions not previously contemplated by the act. However, these activities sometimes stretch the limits of what was initially conceived by Congress, and heightens the concern of other parties who questioned the System's actions. We believe Congress is in the best position to resolve some of these issues.

At FCA, we would welcome the opportunity to work with Congress to bring the Farm Credit Act into the 21st century and to provide the System with the direction it needs to better serve agriculture and rural America.

In conclusion, Mr. Chairman, my agency is committed to ensuring that the Farm Credit System remains financially capable and operationally equipped to fulfill its statutory mission to serve agriculture and rural America under all economic conditions.

Thank you for the opportunity to appear before you today, and I stand ready to answer questions you or members of the subcommittee might have.

[The prepared statement of Ms. Pellett appears at the conclusion of the hearing.]

Mr. LUCAS. Thank you, Ms. Pellett.

And within the responsibility and propriety of your position, you said early on that FCA had received an initial notification of a potential application. Have you received anything since then?

Ms. PELLETT. No, sir, we have not.

Mr. LUCAS. Prior to 1987, was it possible for a System institution to leave, or were there any ambiguities that you know in the law, for a situation like this?

Ms. PELLETT. Mr. Chairman, prior to 1987, I am not sure. However, since then, there has been one institution leave the System, and the situation under which it did so was that the board had only one member at the time. It identified that there was not a quorum and, therefore, it did not act.

The System, upon the end of the specified period of time, did go ahead and send the vote to their stockholders, and the stockholders voted to proceed, that they would leave the System; following this there were a series of judicial reviews and, it finally ended up in the halls of Congress. That association did leave the System.

Since then the statute does allow for a Farm Credit System to leave—for a Farm Credit Association to leave the System, and our board has regulations that further define that ability.

Mr. LUCAS. If an institution does leave the System, Ms. chairman, is it your interpretation that a new system, a new association, will have to be created in that void; or is it possible for geographically adjoining associations to step in? Could you enlighten us a bit, perhaps, on the thoughts that have gone through your mind in that regard?

Ms. PELLETT. Yes, I would be happy to.

The Farm Credit Administration has the ability, mandated by Congress, to either charter a new association in this territory or to amend some existing charters. This association is serviced by AgriBank, and the regulations and statute mandate that this bank should make a recommendation to the administration, to the agency, as to how this territory would be serviced by a farm credit institution.

Upon receiving the termination application, if we should receive it, that bank would make a recommendation to us and it would be a factor that we would consider in chartering new or altering an existing charter for that territory. That territory will be serviced by a Farm Credit System institution.

However, I think it would be unrealistic to think that it would receive comprehensive service such as it is receiving now, in the short term. Long term, yes, but in the short term, it will be very difficult for that to be accomplished.

Mr. LUCAS. And, of course, the reason I ask that question is the potential effect on those individuals out there who have been using the services. It would appear, at least at a distance, that creating something from scratch—as you said, would take time and effort; the potential for joining associations to come in and fill the void would be quicker. That was the perspective that I was looking for.

Do you have the resources at the agency to be able to respond to this kind of an enterprise? If you are called upon to review an application, do you have the necessary people in resources to review everything that would be involved in a timely fashion knowing, of course, that this would be a new experience of such a magnitude?

Ms. PELLETT. Mr. Chairman, something such as this is unprecedented and is of a huge magnitude.

My charge to our staff was that they should use the resources, both human and financial, that are available to them, with the help of outside expertise, to do the very best analysis that they can to provide my colleagues and me the information that we need to make our decision. We have taken the time since the notification to prepare for that process, should it come about.

Mr. LUCAS. One last request. I realize the difficulty of three panels in your schedule today, but would it be possible for you to have some of your technical people remain throughout the hearing in case we have questions that the committee might want to direct to them, even if you need to leave?

Ms. PELLETT. Yes, thank you.

Mr. LUCAS. Thank you.

The Chair now turns to the ranking member.

Mr. HOLDEN. Thank you, Mr. Chairman.

Madam Chairman, I know you can't speculate as to the motivation of the transaction, but some in the System believe that recent decisions by the Farm Credit Administration are partly to blame for FCSA's decision to exit the System. One example is the decision regarding syndications, and I was just wondering how you would respond to that.

Ms. PELLETT. Mr. Chairman, the association in their termination application has to tell why they are terminating from the System. We don't have that yet, so I can merely speculate. And I know there is frustration in the System, as it deals with an act that many of them consider to be outdated.

Our job is to interpret that act, and we try to do so to the very best of our ability.

Mr. HOLDEN. As you heard from my opening statement, how I feel about the importance of farm credit because of the Wachovia situation in Pennsylvania, and you briefly touched upon it in your oral testimony. But I was just wondering how you would respond to those who say there are multiple lenders out there and farm credit has outlived itself and there is really no necessity for the Farm Credit administration.

Ms. PELLETT. Congressman, I have traveled the country visiting farm credit associations. I have heard the testimony and the conversation from many, many borrowers who are passionate about what farm credit, the Farm Credit System and their particular association has done for them to keep them in business, to make them able to pass on that farm, that ranch, that agricultural enterprise on to the next generation.

I think that the growth of the Farm Credit System points today to the viability of the Farm Credit System and its work in rural America. I personally believe that we would—and I did offer those in my comments—that rural America and agriculture are more viable today because of the work of the Farm Credit System.

Mr. HOLDEN. Thank you.

One final question: Does FCA have a way of monitoring and encouraging System institutions to actively serve not only larger, lower-risk borrowers, but smaller, higher-risk farmers and ranchers, provided they are absolutely creditworthy?

Ms. PELLETT. Absolutely. And we have a mandate from Congress to see that the Farm Credit System—to ensure that the System does just that.

Mr. HOLDEN. How do you monitor it?

Ms. PELLETT. We have examiners that are in each association once, at least, every 18 months. They do a very comprehensive review and examination of that association. And part of it is determining whether the needs of young, beginning and small farmers are met.

Mr. HOLDEN. Thank you.

Mr. LUCAS. The Chair now turns to the gentleman from Kansas, Mr. Moran.

Mr. MORAN. Thank you, Mr. Chairman.

Thank you, Madam Chairman, for your testimony. I think I have just one question.

Your testimony indicates that it is your initial decision of whether or not to approve or disapprove any termination application; it says is from a broad perspective, including whether a proposed termination will have a material adverse effect on the remaining System institutions in fulfilling their statutory mission.

The “including” would suggest there are other criteria which I am interested in knowing.

And second, it is my understanding that the language that you cite is a regulation of FCA. And if you could better define for me, or fill in the blanks, the criteria by which the administration would determine whether or not there are adverse effects.

Have you developed the framework by which you make a decision?

Ms. PELLETT. The statute does give the agency very broad authority where termination is concerned. a former FCA board did pass regulations recognizing that broad authority that is given. One, as you mentioned, is the material adverse effect upon the remaining institutions to meet their public mission.

The term is not further defined. And instead, we must determine, based on the facts and circumstances of each particular case, what that might be. And our staff has been at work during this period of time to make that determination and has sought additional counsel that if we do receive a termination application, will help make that determination.

The other regulatory information that must be included is full disclosure to the stockholders, full disclosure of the information that they might need to make an informed decision. And several things are included in that, among them, a fairness assessment and so forth of the value of that institution.

There is another offer on the table at that association, or has been. It is a merger, and our staff will determine how much of that information needs to be included for the stockholders to make an informed decision.

Mr. MORAN. I would like to stay with the first criteria that you mentioned.

Ms. PELLETT. All right.

Mr. MORAN. The adverse effect upon the remaining system, if I understand what you are telling me correctly, is that the staff of the FCA is developing how to define those words? And at this point there is no clearer definition.

Will there be something in writing that you will have before you make a determination as to what the definition of “adversely affecting the remaining system” is? Or perhaps a better question is, can you give me examples of things that you think would adversely affect the credit system?

Ms. PELLETT. Yes. And, Congressman, this is determined really on a case-by-case basis as well; and there will be a record on that at the conclusion of our determination and our vote.

Some of the things that we will look at will be how it might affect the cost of funds to the remaining System institutions, the availability of service, the continuity of service. The service to the YBS group that we talked about previously, all of these things will be determined as we go along and on a case-by-case basis.

Mr. MORAN. It seems clear to me that there would be no question but that there would be an adverse effect on the remaining system institutions. I think, in my estimation, that is a given. There has to be an adverse effect when one of you or your members departs.

And I think the commission's question that they will have to answer is whether it is a material adverse effect. And so I think what I am looking for is, how do you define a material adverse effect? And my assumption is that you ought to have an idea, the commission ought to have an idea of what that is before you sit down to make a decision.

Ms. PELLETT. And, sir, our staff has been at work making that determination; and we will keep you apprised, if you would like, as we go along with that.

Mr. MORAN. Thank you, ma'am.

Mr. LUCAS. The Chair now turns to the newest member of the Agriculture Committee, who I don't believe has been placed on subcommittees yet. So the custom is—when I was a special election child 10 years ago, Stephanie—to be able to sit on panels.

We are pleased to have you here today, the gentlelady from South Dakota, for your questions.

Ms. HERSETH. Thank you, Mr. Chairman, Ranking Member Holden. It is a pleasure to be serving on this subcommittee and to be here at the hearing today to pose some questions to all of our panelists.

Madam Chairman, assuming you receive the termination plan from Farm Credit Services, is it your intention to hold any public meetings on each of the matters, on each of the four States that would be affected by the transaction?

Ms. PELLETT. That possibility is under high consideration right now. We might be looking at a meeting, out in the territory, and we are constrained by time here. We have 60 days after receiving this application in which to act, and so we may be limited to one meeting.

I do know that Senator Daschle has presented a bill in Congress, and we will adhere to whatever Congress intends for us to do.

Ms. HERSETH. When making the decision, though, on whether or not to approve or disapprove, what weight—and Congressman Moran was just asking in terms of the material adverse effects on the System—but what weight, or any consideration, are you going to give to the producer-borrowers, understanding that if you approve it, they are entitled to a vote?

But yet, if the information then provided to the borrowers includes a fairness assessment, I would think that you would want to have these public hearings making it easier for the borrowers, especially at this time of the year in the harvest season, to be able to give their concerns and their view of whether or not this is fair. Because once you approve it, I am going to assume that the fairness assessment is proof that you based it on the fact that you thought it was fair in terms of the sale.

Ms. PELLETT. The fairness assessment does deal with the true value of the Association. Many more factors are going to be included in this, and part of the package that they will be presenting to us, and that we will be sure is complete, is a full disclosure to the stockholders so that they can make an informed decision. And we will weigh the testimony, any testimony that is given to us through a public hearing. That will be a part of our determining factors, too, that we will weigh into our decision, absolutely.

Ms. HERSETH. OK. I appreciate that. I have no further questions—just to encourage you and the folks that you are working with as you develop this framework that, despite the time constraints, you do all that you can to be in each of the four States affected or somewhere centrally located, so that folks can see you in person, talk with you about their concerns, about the information they may or may not be receiving that can help inform your decision-making process and review of the determination plan.

Ms. PELLETT. Thank you very much.

Mr. LUCAS. The Chair thanks the lady and turns to the gentleman from Nebraska, Mr. Osborne, for his questions.

Mr. OSBORNE. Thank you, Mr. Chairman.

Thank you for being here today.

Ms. PELLETT. Congressman, thank you.

Mr. OSBORNE. I have a fair amount of interest in this because Omaha is right in the middle of this thing. And I know this is kind of a speculative question, but assuming that you do receive a formal proposal—I know you haven't to this point gotten one—do you have a rough time line as to how long it would take to work through the whole process of having the farm credit organization leave the System?

I realize it is kind of a tortuous process and a lot of things have to happen. But do you have any idea how long it would take?

Ms. PELLETT. Our rough estimate has been about 7 months from the time that we received the termination application.

Mr. OSBORNE. Let's say that Rabobank would acquire the Farm Credit Association in Omaha. What services would be lost to producers in that area that they now have? Do you have any list of services that definitely would not be available for a period of time?

Ms. PELLETT. Congressman, the Farm Credit System was established to be a dependable source of credit for farmers and ranchers, rural America, rural homeowners, et cetera. We all know that agriculture is a very cyclical industry. And it is an unknown factor whether a non-System entity, without the mandates that the System does have from Congress will, be there during good times as well as bad.

Congress has also given a mandate to the Farm Credit System that they are to service the eligible borrower, all eligible borrowers from that young, beginning and small farmer group. And that is also an unknown factor when we are dealing with a non-Farm Credit lending institution.

Mr. OSBORNE. One other question here: I know that once a Farm Credit were to be acquired by Rabobank, you would be required to establish another Farm Credit organization in the area.

Ms. PELLETT. Yes.

Mr. OSBORNE. Is it necessary that you establish an entirely new and separate entity, or could existing Farm Credit agencies be expanded into that area? Have you given thought to that?

Ms. PELLETT. Yes, we have. We have given thought to that, as has AgriBank, who is the funding bank for the present four-State territory and its association. And we will act—there will be a farm credit presence in this four-State area, and we will act upon the recommendation of AgriBank, as well as upon other factors.

Mr. OSBORNE. But it is a possibility, then, that you would have other entities? I imagine that might be a little cheaper for you, rather than to establish a new one. I don't know for sure.

Ms. PELLETT. It will be a difficult process, at best, for any of them.

Mr. OSBORNE. One last thing here is that we often hear from bankers who complain about cherry-picking. I am sure you have heard that. You realize that the Farm Credit System is not the lender of last resort; it is, rather, the FSA offices. And how do you, as a regulator, find an appropriate balance and encourage the System to make loans to those who need them, make a sound portfolio of loans?

In other words, what distinction do you have as to who receives loans and where they go, Farm Credit as opposed to FSA? We are assuming that FSA generally takes a higher-risk category, whereas Farm Credit maybe not so much. But do you have any set procedures as to how you look at these two agencies and their function as you regulate them?

Ms. PELLETT. Congressman, we do examine each institution at least every 18 months. And it is a very comprehensive examination, with one of the things, a look at their loan portfolio. And each loan officer and with the Association is given the responsibility to assess the creditworthiness of each borrower, as well.

We also have a new regulation with a reporting mechanism involved for YBS, the young-beginning-small farmer, reporting to ensure that the mandate of Congress is fulfilled by the Association.

Mr. OSBORNE. Thank you, Mr. Chairman.

Mr. LUCAS. Thank you, Mr. Osborne.

The Chair would note that we have a series of two votes under way, a 15-minute and a 5-minute. The next member to ask questions is the ranking member, so I would ask Mr. Stenholm if he would prefer to do his series now or wait until we return.

The floor is yours, Mr. Chairman.

Mr. STENHOLM. I will take the time right now, Mr. Chairman. Thank you.

I don't believe I caught it if Mr. Holden asked you a question—I don't want to repeat just in case I am the only one who didn't get the answer. Some believe that decisions by the Farm Credit Administration are partly to blame for FCSA's decision to exit the System. One example is the decision regarding syndications.

How do you respond to those critics?

Ms. PELLETT. Congressman, the agency and its staff interpret the statute, and we do the very best job possible that we can to do that. The statute is very limiting in some aspects of modern day agriculture and modern day finance and business. Syndication is one of those areas.

Syndications, as it relates to agriculture anyway, probably was not in the thought process when the statute was written. And so, yes, I think it has been very frustrating for some associations and banks. The syndication issue is an example. There are others that are very limiting as far as the statute is concerned.

We have a rural population factor of 2,500 in which they make rural housing loans. USDA qualifies just 2,5000 in a rural area. These are just several examples of the limitations of the statute as it relates to the Associations and how agriculture as well as finance has changed in the last 30 years.

Mr. STENHOLM. I think it is rather fascinating, as we deliberate. As yet, you say, you haven't received the formal application for the exit of the System in question?

Ms. PELLETT. No.

Mr. STENHOLM. But yet it is been very frustrating as we have attempted to walk through in a cooperative way what some now call syndications and what others would call how best to serve rural America regarding housing, et cetera, and working with our banks, independent banks, et cetera.

But—we constantly had divisions of opinion on that, but all of a sudden we have now found ourselves with the possibility at least that you are going to have at least one area of our country having that which has been strongly opposed by some over the years.

One final question, just for my own understanding now. You have not received a formal application?

Ms. PELLETT. No, sir, we have not.

Mr. STENHOLM. After you receive it, you have 60 days in which to review and/or disapprove?

Ms. PELLETT. Right.

Mr. STENHOLM. That was in response to Mr. Moran's question a moment ago?

Ms. PELLETT. Yes.

Mr. STENHOLM. At what point do the stockholders of the Association in question become relevant in the final decision process?

Ms. PELLETT. If the FCA Board should vote to approve the termination, then it goes to the stockholders for a vote.

Mr. STENHOLM. Thank you, Mr. Chairman.

Mr. LUCAS. And the Chair thanks the ranking member. Let's return in 20 minutes. I would ask the chairman to stand by. We are in recess until we return from these series of votes.

[Recess.]

Mr. LUCAS. The subcommittee will return to order. And the Chair now turns to the gentleman from North Carolina, Mr. McIntyre, for his questions.

Mr. MCINTYRE. Thank you, Mr. Chairman.

Madam Chair, the proposed acquisition, as you stated and discussed today, presents to all of us unprecedented development in the Farm Credit System. I want to ask you for a very practical matter, although the proposed—how would such a purchase affect States such as I represent, the Farm Credit Services in southeastern North Carolina? There is a great concern there and they are concerned about the precedent that might be set and farm credit availability and Farm Credit Services; and specifically what I am saying is, how do the implications of this application affect other parts of the country?

Ms. PELLETT. Congressman, that will be part of the determination that will be made under the materially adverse effect on the remaining System institutions to fulfill their public mandate, and that will be part of the determination that our staff, with the help of outside counsel, will be making. And our mandate is, by our regulation, that there be no adverse material effect on the remaining institutions, and that would include yours from your State.

Mr. MCINTYRE. Would that be scrutinized by you and you make that information and your time line?

Ms. PELLETT. Our application, should it hit our doorstep, is 60 days and the time clock starts clicking if the application is complete.

Mr. MCINTYRE. Thank you.

Thank you, Mr. Chairman.

Mr. LUCAS. Thank you.

And we now turn to the gentleman from North Carolina also, Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

Thank you for being with us today.

And let me thank the chairman and ranking member for holding this meeting.

We talked a lot today about the purposes of the Farm Credit System and its mission to provide American farmers with a stable, competitive, and reliable source of financing. And despite every change in economics, as you have talked about earlier, I believe the purchase of Farm Credit Services holds a great potential of materially harming that, the remaining system institutions and their ability to fulfill the mission.

So a couple more points that I am going to ask a broad question about in that context. Because this acquisition is unprecedented, as you know, in the System's 88-year history, and it raises a serious question about the future of the Farm Credit System as a whole.

While some members of this audience probably would like for the System to wither on the vine and die, I do not. And I know that you agree that it is absolutely imperative that we maintain a strong and thriving Farm Credit System. Otherwise, like many institutions in this country, it would have a difficult time surviving the performance.

I believe the Farm Credit Administration allows the exit of FSAs. It would send a signal to other System members at banks and farmers that the Farm Credit System is right or dismantled. And we know we can't direct you to decide this matter in a certain way and wouldn't dare do it.

But as someone who is close to the farmers and uses the System, I want to add my voice to urge you and the other members of the board strongly to look at disapproving that application until the FCA and Congress have had more time to assess the consequences that the FCSA's departure would give to the Farm Credit System.

Now, I know you can't answer that specifically, so I will ask you a more general question.

Currently, the Farm Credit System has approximately $119 billion in assets, $94.3 billion in loans and $19.7 billion in capital. Assuming the bank purchase takes place and that others might follow, billions of dollars will leave the System, and the monies left in the System will be spread so thinly as FSA extends the charter to the remaining System institutions, here is my question.

Where is the threshold for the system's viability? And, second, how much capital and assets would have to leave the system for it to be impossible for the remaining institutions to carry out their missions and their charge for the farmers in this country?

Ms. PELLETT. Congressman, I think this is a job for our staff and their assessment of an application, should it come. Not to say that, if it does not come, they will not continue to look at your very question. But I have a strong suspicion that this question, along with others, will be studied in several institutions, academia being one of them.

Mr. ETHERIDGE. Well, let me follow that up, because I think this is a critical question. And if we aren't debating this question now, we ought to be. So let me request that that question be answered by the staff, and I would like to have it in writing, if you are not prepared to answer it today.

Ms. PELLETT. We would be pleased to do that.

Mr. ETHERIDGE. And I would be happy to submit it to you in writing if someone didn't take it down.

Ms. PELLETT. We would be pleased to do that.

Mr. ETHERIDGE. Thank you.

I yield back, Mr. Chairman.

Mr. LUCAS. The Chair now turns to the gentleman from Hawaii, Mr. Case.

Mr. CASE. Thank you, Mr. Chairman. Initially I had received a letter dated September 16 of this year from Ted Tokinago, who is the president of Farm Credit Services of Hawaii expressing some thoughts on the subject matter of the hearing, and would ask unanimous consent to include that letter in the record.

Mr. LUCAS. Seeing no objection, so ordered.

Mr. CASE. Thank you very much.

chairman Pellett, I want to just read you the questions that Mr. Tokinaga expresses, and get your thoughts on them.

If a system institution is allowed to be sold to an entity such as a Rabobank and nothing is done about the exit provisions in the statutes, will other nonsystems or foreign buyers knock on other institution system doors and make similar offers? And then, in the same breath, how many more farmers across the country will have to face a foreign bank or other nonsystem entity that is seeking to capture their farmer-owned organization? Now, clearly that is a rhetorical question and you can get the drift of Mr. Tokinaga's position. But I think clearly the question is, is the possibility of this acquisition an isolated occurrence, or is it something that is going to happen left unchecked? I mean, are there in fact other entities that you know of that have the same interests as this particular entity in other parts of the country?

Ms. PELLETT. Congressman, there are none that I know of.

Mr. CASE. OK. Some of the questions thus far have focused on the questions with Mr. Moran as an example the adverse effect on various parts of the system. Let me ask you to focus specifically on the end user, the customer, the borrower, the farmer. And let us just use an analogy from Hawaii. You know, the small aqua farm, very untraditional collateral, arguably higher risk, benefiting from this particular system. I cannot believe that a nongovernmental, nonsubsidized, nonstatutorily-controlled entity would have the same evaluation of that entity from a borrowing perspective or lending perspective as the system that we have in place right now, and so I cannot really believe that that small aqua farm would have the same chance of obtaining credit in a higher risk environment.

I guess the first question is, am I being unfair in that characterization? No. 1. And, No. 2, if in fact these entities are bought out by a more commercial entity, nongovernment connected, will we, in fact, see a diminution of credit being available to smaller, less traditional, higher risk agricultural operations? Because that is what we are trying to do, I think. We are trying to make sure that, as you said in your testimony, credit is available in good times and bad. And banks, they love good times but they don't like bad times. And so how do we handle the bad times if this trend goes forward if, in fact, it is a trend?

Ms. PELLETT. Congressman, the permanency of capital from a non-Farm Credit System entity, lending entity is an unknown, and your question is very fair and very justified. The permanent, the permanency of a provider of credit to rural America, to aqua farmers, to the rural areas, to agriculture is at the very core of the basis of the Farm Credit System.

Mr. CASE. Right. And so the question then is, is it fair to think that that permanency would be hindered if, in fact, the system allowed for the acquisition such as what may happen with Rabobank. I mean, who is going to pick up the pieces, in other words? Mr. Moran or somebody over here asked the question, well, will other Farm Credit service agencies in other States pick up the slack? And that may or may not be. But assume that is not to be the case. Who would pick up the slack then and provide the permanency of capital availability?

Ms. PELLETT. We are mandated that all parts of the United States is serviced by a Farm Credit System institution. But as far as a nonfarmed credit system institution is concerned there is an unknown as to the dependency of their credit.

Mr. CASE. Now, when you talk about the requirement of evaluating the adverse effects of the transaction, is the statutory mandate broad enough to encompass direct evaluation of the adverse effects upon the borrower itself, the consumer, the customer, the farmer? We talked about the adverse effect upon the system, the agency, but not necessarily on the person that we are doing this for.

Ms. PELLETT. It is the language of the regulation that states material adverse effect to the remaining system institutions. And why are they there? To serve those farmers and ranchers.

Mr. CASE. So is your understanding that, as you apply that regulation—thanks for the correction. As you apply that regulation, your inquiry is broad enough to encompass the effect on the farmer itself?

Ms. PELLETT. I think without a doubt.

Mr. CASE. OK. Thank you.

Mr. LUCAS. The gentleman's time has expired.

The Chair wishes to thank chairman Pellett for her insights and testimony today, and to note that she has a potentially challenging time ahead of her as she implements the policy that we have created down through the years. And, with that, we thank you for your time. And now ask the next panel to come forward.

I would like to invite our second panel to the table. Mr. Jerold L. Harris, CEO, U.S. AgBank, FCB, Wichita, Kansas, on behalf of the Farm Credit Council. Mr. Roger D. Monson, president and CEO of Citizens State Bank of Finley, Finley, North Dakota, on behalf of the American Bankers Association. Mr. John Evans, Jr., chairman of the Ag-Rural America Committee, Independent Community Bankers of America, Burley, Idaho.

Whenever you are ready, Mr. Harris, you may begin.

STATEMENT OF JEROLD L. HARRIS, CEO, U.S. AgBANK, FCB, WICHITA, KS

Mr. HARRIS. Thank you, Mr. Chairman, and good afternoon, Mr. Chairman and members of the subcommittee. I am Jerold Harris, CEO of U.S. AgBank headquartered in Wichita, Kansas.

AgBank operates as a wholesale Farm Credit bank funding 30 retail associations. Those associations serve about 40,000 farmers, ranchers, and agri business borrowers in 10 States.

My testimony is on behalf of the Farm Credit Council and its member institutions of the Farm Credit System. We appreciate you holding these hearings to explore the potential implications of the announced plans by Rabobank to acquire Farm Credit Services of America. That association is the second largest in the Farm Credit System with about $7.8 billion in assets. My testimony will provide a brief overview of what we know about this proposal, why we think it should not be permitted to move forward, and what needs to be done to address this situation including the repeal of the termination authority on which the proposal is based.

On July 30, the board of directors of FCS of America authorized management to move forward to terminate its status as a Farm Credit System institution and to be acquired by Rabobank. This transaction would set a dangerous precedent that could harm America's farmers and ranchers. The termination authority was added to the Farm Credit Act in 1987 because one small association was seeking to avoid its financial responsibilities to the rest of the system during the difficult time of the 1980's. Regulations to implement the termination authority actually were not finalized by the Farm Credit Administration until 2002, so we have never had an institution leave the Farm Credit System using the process set out in these regulations.

According to public statements, FCS of America and Rabobank, this transaction involves a $600 million payment to stockholders; in return, Rabobank would get an institution that had $1.35 billion in capital and unallocated surplus June 30 of this year, over $200 million in loan loss reserves, 900-plus employees, and more than 40 offices with total assets of $7.8 billion.

The Association earned $114 million in 2003, and $59 million so far the first 6 months of this year. We have assigned no value to the goodwill and loyalty of thousands of stockholders which would normally add significant value to such a transaction. We simply can't see how the Rabobank purchase proposal works out as a good deal for stockholders.

Attached to my written statement is a brief history of the financial difficulty that the predecessor institutions of this association had during the 1980's, and, more importantly, a summary of the substantial financial assistance that other Farm Credit institutions voluntarily provided to keep them in business. This institution would not exist today without the $631 million in financial assistance it received. A significant amount of these dollars came from farmers all across America, not the current borrowers of FCS of America.

Mr. Chairman, we also know that this decision has been controversial. We understand from reliable sources that the FCS of America board was split on whether to move forward on this. And, as you will hear in later testimony, this proposal is not being received well by many farmers and ranchers. Irrespective of the numbers, it makes no sense for a system institution to terminate its system status or for Congress to allow it. The termination provision of the act are inconsistent with the basic mission and purpose set out by the Congress for the Farm Credit System. The act states that the Farm Credit System is to be a permanent source of credit for all sizes and types of agricultural producers, and the system exists to promote farmer ownership and control of these financial institutions. How is it possibly consistent with those stated goals for any system institution to exit the system? I have been a system employee for over 40 years, and I know first-hand that the presence of a healthy, competitive, farmer-owned Farm Credit institution helps all farmers, even those who borrow from other sources receive more competitive interest rates. The termination authority allows an institution to abandon its congressionally-mandated mission and purpose. Yes, the Farm Credit Administration will extend the charter of another institution to step in and serve the territory, but that system institution would have no staff, no office locations, no market share, no capital. A very difficult assignment.

So that brings me to my final point. We need to change to prevent this from happening. We are asking that this committee repeal the termination authority as soon as possible. Today's situation is quite different than when the authority was put into the act. The departure of FCS of America will leave a gaping hole in system's service to agriculture in four key agricultural States. Retention of authority leaves open the door for future disruption of the system and disruption of service to farmers and ranchers, and it has the potential to cause the money markets to question our commitment to holding together as a system.

Mr. Chairman, we need to look at why this institution has said it needs to leave. Their public statements have pointed to the operating limitations of the Farm Credit Act and the conservative regulatory interpretations of the Farm Credit Administration. The rest of the system is entirely sympathetic to their position, but instead of choosing to depart the system, we have chosen another route, one of which involves a comprehensive review of what we need as institutions to make sure that we can continue to fulfill the mission you have given to us and to ensure we can serve agriculture of the 21st century. I don't have those answers for you today, but we have a process in place and will get those answers by this time next year.

Mr. Chairman and subcommittee members, thank you for this opportunity. And I would be glad to answer any questions.

[The prepared statement of Mr. Harris appears at the conclusion of the hearing.]

Mr. LUCAS. Mr. Monson.

STATEMENT OF ROGER D. MONSON, PRESIDENT AND CEO, CITIZENS STATE BANK OF FINLEY, FINLEY, ND, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. MONSON. Thank you, Mr. Chairman, members of the committee. I am pleased to appear before you to discuss the Farm Credit System. As noted, I am Roger Monson; I am president of the Citizens State Bank in Finley, North Dakota, and I am also serving as the chairman of the American Bankers Association's Agricultural and Rural Bankers Committee.

For nearly 90 years, the Farm Credit System has occupied a unique place in American agricultural finance. Today it is extremely profitable, has a mountain of capital, has a portfolio of high volume, low risk credits. It is a special purpose, tax advantaged, retail lending, Government sponsored entity that is limited to specific areas of the financial services market. It was designed by Congress to be that way to balance the Government's grant of advantages with a specific mission, providing credit to farmers and ranchers.

Today, many system managers want to offer more products to a wider range of customers over a wider area of the country. One FCS institution by announcing that it is selling and leaving recognizes that the answer for system institutions that wish to expand is to cut their ties with the Federal Government. This is a natural evolution, and we support it. Even if this transaction is not consummated, it is a step in the right direction. System institutions that wish to offer a broader array of products and services must seek those opportunities outside the system. Those institutions that wish to remain part of the system must accept that there are limits to what they can do because the special privileges Congress bestowed upon the system were designed to enable the farmer-owned system to meet a clearly defined need.

There is no economic or public policy argument that could be made to justify expanding the charterless system into areas that are already well served by the private sector.

From a business perspective Farm Credit is a large sophisticated and highly profitable financial services institution that happens to be organized as a Government-sponsored entity. Other than the GSE business organization, there is nothing to distinguish Farm Credit from any other commercial enterprise. It has $119 billion in assets, $19.7 billion in capital, and had net income of $939 million in the first 6 months of 2004. In 2003, it made $1.8 billion. Farm Credit is the only Government-sponsored enterprise that competes directly with the private sector by doing direct retail lending, in competition with tax-paying private enterprises like our tax-paying members.

A clearly defined procedure for institutions to exit the system exists in statute. The procedure is fair. Taxpayers recapture some of their investment by the requirement that departing institutions leave all capital in excess of 6 percent of total assets with the system. The Farm Credit Administration must review and approve the termination plan. And, most importantly, the farmer owners of a system institution must vote for or against the plan.

Farm Credit institutions that seek broader authorities should leave the system. From statements made by the selling association, we understand that the reason for the sale is to offer the owners of the association, which are 51,000 farmers, ranchers, home owners, and business people, a broader array of financial services that only a non-GSE institution can provide. Their actions underscore our point. For system institutions that want to expand, they should do so by becoming privately held or publicly traded institutions which do not have a direct or indirect connection to the taxpayer. We oppose efforts to prohibit or make it more onerous for Farm Credit institutions to exit. We believe that existing statute provides a fair, clear, and understandable process for institutions to follow if they wish to leave.

We also oppose efforts to broaden the charter of the Farm Credit system, and we urge you to resist the rhetoric from system managers who claim that broader authorities and increased dependence upon the Federal Government is the answer for the system to protect it from today's economic realities. Broader authorities for the Farm Credit System by definition means off-farm, nonagricultural lending since the Farm Credit System can lend for any agriculturally-related purpose now.

There is an abundant supply of available credit to all Americans. Tax-paying private sector banks and financial firms provide it. The good news is that some Farm Credit institutions want to leave the system because they are large, highly profitable, sophisticated financial services companies that desire to be involved in the broader nonGSE credit market. If that is what the farmers and owners of system institutions want, then the recently announced sale is a clear path for that goal.

Thank you for your opportunity to share the beliefs and the views of the American Bankers Association. And I will be happy, Mr. Chairman, to answer any questions you may have.

[The prepared statement of Mr. Monson appears at the conclusion of the hearing.]

Mr. LUCAS. Mr. Evans.

STATEMENT OF JOHN EVANS, JR., CHAIRMAN, AG-RURAL AMERICA COMMITTEE, INDEPENDENT COMMUNITY BANKERS OF AMERICA, BURLEY, ID

Mr. EVANS. Thank you very much, Mr. Chairman, and members of the subcommittee. We appreciate the opportunity to testify. I am John Evans, Jr., CEO of the D.L. Evans Bank in Burley, Idaho, and chairman of ICBA's Agricultural-Rural America Committee.

Mr. Chairman, the proposed purchase of FCS America has generated a lot of discussion. Our members are very concerned about FCS aggressively cherry-picking the best farm loans from our loan portfolios. We are also quite concerned about whether community banks will have adequate access to the funding sources going forward, an issue important to help ensure a prosperous rural America.

In regard to exiting the system, when this was first announced ICBA did raise several questions. We have also surveyed bankers from 12 States. We asked the banks whether they opposed or favored the merger. There was mixed opinions. A majority of bankers including, our Ag Rural America Committee, favors the purchase, but there are pros and cons. What drives supporters is the belief that bankers can compete against anyone if they are on a level playing field. But they see FCS with tax exemptions and low cost funding aggressively cherry-picking our best loans. They also see FCS continuously expanding, and conclude that this GSE is running amuck, getting far away from its intended purpose.

Bankers also point out there are plenty sources of credit today, thousands of banks, finance companies, arms of seed, feed, machinery, and fertilizer dealers, and insurance companies. However, some bankers worry about having a major new competitor getting quickly established through the purchase of a large FCS association. This allows acquiring a large book of business that was built up over many years through GSE subsidies enabling the purchaser to leapfrog into a market having bought by a regional lending presence that, while privatized, has residual GSE advantages such as buildings, staff, loan officers, operational expertise, and extensive databases. Some bankers wondered about the regulatory oversight. Even if the sale doesn't go through, the purchaser has indicated it may acquire commercial banks to enter the market.

We do have some recommendations for exiting the FCS. The existing regulations are quite cumbersome to exit. A stockholder vote should remain an important component of this exiting. Now, we don't worry about an institution leaving FCS and converting to a commercial bank, as did the California livestock PCA in 1991.

However, there may need to be a distinction made at some point between individual associations converting on their own versus having a large outside investor purchase a large FCS association, allowing the large investor with access to worldwide funding to get a ready-made regional lending infrastructure. The current exit procedure is flawed in sending the exit fee to the FCS insurance fund. We recommend it go back to the taxpayers via the U.S. Treasury. We do not believe the territory being exited needs to be rechartered. FCA can simply designate FCS associations to quickly and easily engage in farm loans through loan participations with community, community banks, and that is a win-win situation for all of us.

We want to stress that we will continue to look at this issue during the upcoming months as part of our policy development process.

CoBank proposal. One issue raised by the proposed purchase is how one squares opposition by some in the system to the proposed purchase with the support of these same FCS representatives for a legislative proposal that allows outside investors to invest in and control an LLC cooperative by limiting farmers to only 50 percent voting control.

Does this mean that while opposing the outright purchase of FCA, FCS representatives could nevertheless support the proposed purchase if the purchaser restructured the FCSA with only 50 percent farming voter control? We believe that any legislation in this area should be carefully drafted to avoid the takeover of farmer-owned cooperatives, and we are working on that issue.

Over the years community bankers have proven to stick by their borrowers through good times and bad. We have to for survival of the communities and to keep the town strong. But our survey revealed that community bankers cannot compete with the cherry picking that FCS engages in, and they are losing their best customers, weakening their loan portfolios and threatening their long-term survival. This is simply not good for rural America if the banks are left to serve only high-risk customers. FCS can't afford to cherry-pick due to their low cost funding and their tax advantages. In recent years, the FCS has sought incremental changes to become more and more like banks. Even now, a variety of regulatory proposals are on the table to further accomplish this mission creep.

The FCS is the only GSE that competes against the private sector at the retail level using tax and funding advantages. This is far different from the housing-related GSEs which provide a secondary market and liquidity function to the private sector. Ultimately, as community banks are driven out of the marketplace, the result is fewer credit choices for farmers and consumers, and the FCS interest rates will then rise since there will be less competition, having driven the banks out of business. When FCS obtains expanded authorities, these types of problems only are compounded as FCS pursues nonagricultural lending.

So what is the intent? That is a very, very important question. Was the goal of Congress when it created FCS in 1916 to eventually drive community banks out of the agricultural credit market? Was the goal also to allow for the ongoing expansion of the FCS into virtually all key functions of commercial banks? We really doubt these were the intentions, but it appears to be that is what is occurring.

FCS, tear down that wall. A fundamental question before this committee is how best to ensure a competitive playing field in the agricultural market. That is why we are asking Congress, as Ronald Reagan said, to tear down that wall around FCS that prevents sufficient access to FCS funds for communities banks. Such funding access is what Congress historically has envisioned in the OFI provisions of the Farm Credit Act last updated a quarter of a century ago. A common-sense approach. As one nonbanker organization recently said, Congress should enhance competition in the agricultural lending by enabling locally-owned community banks to also raise money for farm loans through Government backed Farm Credit System bonds. Not just allow this for FCS. That would enable local banks to be more competitive, it would prevent Government backing from being used by Farm Credit System banks to build a dominant position in farm lending only to be turned over to an international conglomerate.

In conclusion, Mr. Chairman, we are very concerned about the future of rural America. Its population is aging and will only grow older. Young people are leaving, deposits are being drained away. Community banks have competition on every side from a variety of lenders and companies that provide credit. There is also a predatory GSE lender using tax and funding advantages to cherry-pick the best customers from the portfolios of community banks, weakening their long-term ability to serve agricultural and rural America. We should explore opportunities to cooperate and work together where we can, and we look forward to working with the committee to address these important issues. Thank you very much.

[The prepared statement of Mr. Evans appears at the conclusion of the hearing.]

Mr. LUCAS. Thank you, gentlemen.

Let us get down to the nitty-gritty. Coming from a long, long historic line of debtors, I have a certain perspective about all of this. No offense.

Mr. Harris, as has been alluded to here about the traditional mission of Farm Credit since 1916 using the capital markets to raise money to then provide capital in the form of loans in rural areas that, most assuredly, in 1916, were incredibly capital starved. But the price for that of course, as well as some tax advantages, is the fact that you can't take deposits, you can't sell insurance, you can't sell real estate, you can't issue consumer credit cards, you can't engage in a number of these other enterprises. And I know, since I have been a Member of Congress, there has been discussion about why couldn't Farm Credit engage in all these other enterprises.

But setting that aside for a moment, it would seem to me that if Rabo, for instance, feels that they can purchase a four-State association, if they can pay off all these obligations, if they can remove themselves from the bond markets that the present association has, if they can give up the tax status that the present association might have, but yet by acquiring your physical plants—by that, I mean the Farm Credit associates in that four-State, the good people, and the loan portfolio—that, by then chartering as a State or a Federal bank, and adding all of these other services, that they could make more money than the associations made and do it in a big enough way to buy them out, that just brings the ultimate question to my mind.

If Rabo believes that the assets of that association have such tremendous value, what has been the discussion amongst Farm Credit about just becoming a giant nationwide bank? Has that been the kind of thing discussed, the expansion of powers, the ability to move forward? Clearly Rabo thinks you have a tremendous potential.

Mr. HARRIS. Well, I think the Farm Credit System does have tremendous potential even as a GSE and as we are chartered today, as mandated by Congress. And, yes, from time to time during my tenure, there have been discussions about the types of authorities that the Farm Credit System needs to be viable and to be effective in serving the rural marketplace. And over the years—and I started in 1963—we have seen the Farm Credit System come before this subcommittee and the Congress and update the act, update the authorities for the system. That is not new to any of us at this table or anybody on the subcommittee.

So there is tremendous value in each and every institution out there. And if the FCS of America is allowed to leave, that has implications for every other Farm Credit System institution as well as the public policy statement by the Congress.

Mr. LUCAS. Question, Jerold. How do I tell farmers and ranchers in that association that they should not have the authority to sell if they choose? That is a deep question that we are agonizing over up here.

Mr. HARRIS. Absolutely the right question to ask. I think we need to remind ourselves, why is there a Farm Credit System? Many before us in 1916 determined that, from a public policy standpoint, we needed to have a farmer-owned, member-owned and controlled Farm Credit System, a dependable source of credit to all creditworthy borrowers in good times and bad times. That has been a public policy statement by this Congress throughout the decades. And there have been occasions where the enabling subcommittee and the Congress have said this is our policy. And I think that should take precedent over a single institution board which might say we choose not to fulfill that congressional mission, we choose to do something else.

I think the congressional mission, the congressional policy, the public statement policy takes precedent over a single institution. There has been one other time I think that I am aware of, and Congressman Stenholm will remember this. In 1987, there was a suggestion to, in helping the Farm Credit System get through its difficulties, there was a suggestion in the subcommittee that we didn't need 37 Farm Credit banks, we needed some number less than that. And I remember at that time a number of farmers and ranchers saying, no, we want to make that decision ourselves. And this committee and the Congress ultimately said, no, we know better in this circumstance; and to cut out some of the overhead, we are going to reduce the number of banks in the Farm Credit System. I can find no one in the system today that says that was the wrong decision.

My suggestion here is that occasionally this subcommittee and the Congress must make these policy decisions that ought not be left up to individual system institutions.

Mr. LUCAS. Thank you, Mr. Harris. And the Chair will honor the clock but note that there will be a second round.

Mr. Holden.

Mr. HOLDEN. Thank you, Mr. Chairman.

Mr. Harris, I had a question of you about what you thought the motivation for the transaction was; but I believe you answered that adequately. But, Mr. Harris, how do you respond to the charge that many system institutions cherry-pick customers by using predatory pricing to attract low risk, larger and wealthier farmers, and not doing enough to serve the credit needs of smaller, high risk agriculture borrowers that have creditworthiness?

Mr. HARRIS. Oh, there is an initial reaction. But what I do is I look at the facts. I look at the fact that over half the loans in the Farm Credit System are less than $50,000. I look at what the 30 associations are doing that I fund as AgBank. And those associations, they have a mandate to serve all creditworthy borrowers in rural America. And creditworthy borrowers, some are large, some are small, some are medium, they are of all sizes and shapes. And I see lending programs in each and every one of the 30 associations that own AgBank having various programs to, in fact, meet all of the marketplace needs.

And so on large credits, is there a tremendous amount of competition? Do we go after those kind of credits as well as smaller credits head to head, competing head to head? Absolutely, we do. And who are the winners out of that? It is farmers and ranchers and agri businesses in rural America. That isn't new. That has been the way it has been ever since I have been in Farm Credit, and that is, in my opinion, the way it should be. The more competition, the better off we all are, the stronger of the financial system in this country, and the better we can serve farmers, ranchers, and rural America.

Mr. HOLDEN. Expanding on that. How do you respond to your critics that the system is not needed anymore to serve the credit needs of farmers and ranchers?

Mr. HARRIS. I would just remind us, let us look back at agriculture. It is a cyclical industry. And when you look at investor-owned companies, investors look for return. And there are parts of the country that you might not get a reasonable return by serving that part of the country with a Farm Credit System or any other entity. Other entities can pull out.

My folks farmed in southwest South Dakota right on the Pine Ridge Indian reservation out in the middle of nowhere, I guarantee you. And it was hard to find commercial banks to want to loan in that type of environment. My family used Farm Credit Services because there is the mandate that Farm Credit be available in all counties, all townships, all States of this country. So I think there is a need for Farm Credit as much today as when it was created in 1916.

Mr. HOLDEN. Thank you. Mr. Monson and Mr. Evans, I guess in the interest of full disclosure, is Rabobank a dues paying member of either of your organizations?

Mr. MONSON. No, sir. Not that we are aware of.

Mr. EVANS. No, sir.

Mr. HOLDEN. And the same question for both of you. If the advantages of the Farm Credit System gives them an unfair advantage in farm lending, why is the Farm Credit Services of America board willing to exit the system and forfeit their GSE status to become a bank and pay $800 million to do it?

Mr. MONSON. Congressman, that is an excellent question, and I am afraid I don't have access to the Rabobank philosophy or why they are doing this. But it does raise some very interesting perspectives that I believe Chairman Lucas brought up about paying the premium for an organization and giving up access to that particular capital market as well as some tax advantages.

Mr. HOLDEN. Currently, private banking institutions and Farm Credit work together on financial services for farmers and ranchers. I wonder if you could give me some examples and elaborate how you do cooperate to try to make financial services available to our farmers and ranchers. All three of you.

Mr. HARRIS. I will start with that. We have a number of associations that do loan participations back and forth with commercial banks. In our bank, AgBank, we have an OFI program, and we have had bankers sign up for the OFI program, which gives them a line of credit to GSE funding through the Farm Credit system. Those banks also have access to the Federal home loan bank, they have access to the Fed window, they have access to Farmer Mac. And what is interesting, a number of lines that we have had with commercial banks have gone unused, and the report to us is that their source of funding through CDs and other sources are cheaper than what they can get through Farm Credit.

And we would price comparable to what associations are being priced at considering the amount of capital differential between the two entities. So they have got a lot of access to GSE funding, but we do have relationships with commercial banks. Our bank has a relationship with Rabobank. We participate on large credits. So regardless of what might be said, there is a lot of cooperation among rural lenders, Farm Credit, and other competitors.

Mr. HOLDEN. Mr. Monson.

Mr. MONSON. If I could, I would like to also respond. I am from a community of slightly over 500 people in east central North Dakota, and we have had an OFI since 1981 and we continue to use it. I am not exactly sure of the numbers, but I believe that there are something less than 30 in the country right now. And you may ask why that is. Well, again, it has been somewhat cyclical. However, it is not easy to open up an OFI these days compared to 1981 when we started. I suggest to you that that is an excellent way for financial institutions to cooperate together for the good of the farmer.

And my colleague also mentioned participations; those are also common. There are participations between banks and farm credits, there are participations between banks, and all for the purpose of being able to fund those requests. Cooperation is very much of a necessity in the financial services industry.

Mr. HOLDEN. Briefly, Mr. Evans?

Mr. EVANS. Congressman, I would like to answer your question, at least my answer, the last question, why would the shareholders approve of this. If you were going to get $12,000 return on a $1,000 investment, that is a pretty big reason to sell, especially if you can go back in and go to another Farm Credit agency and borrow the money at the same rate in just a few months. And so I think that is the motivation that the stockholders of that association is why they are selling.

The OFI, there has been very, very few banks participate with the OFI provision of the Farm Credit Act. I don't know any bankers—well, I have got one banker on our committee used to do it, no longer does it because it is cumbersome, it takes a lot of time, and they find other ways to do it.

Mr. MONSON. Congressman, I am sorry, could I make a clarification to Congressman Holden's question about ABA and the membership of Rabo so I can clarify the record?

Mr. HOLDEN. Sure.

Mr. MONSON. Rabobank owns a bank in California. That California bank is an ABA member, but Rabobank is not a member of the ABA.

Mr. LUCAS. Thank you, Mr. Monson.

Mr. Moran.

Mr. MORAN. Mr. Chairman, thank you. One of the greatest challenges I think we face in agriculture and rural America is access to credit. To my bankers on the panel, one of my life's goal was to own a bank. But the size of the community in which I could afford to buy a bank was one in which the population were in their 60's, 70's, and 80's; their children lived someplace else, usually in the city; and upon the death of mom and dad, the deposits that were in that bank departed that bank and went to where the kids lived. And I think it is a tremendous challenge we face in rural communities across Kansas and across the country, is how do we make certain that our small business farmers and ranchers have access to credit? I think you all three have a significant role to play in answering that question. And I want to see a viable industry, viable financial industry that meets the needs of farmers, ranchers, and business, small business in particular in rural communities.

It seems to me that there are issues about a level playing field, about the so-called cherry-picking and those issues. I am not sure what they have to do with today's hearing, unless there is a belief that the approval of this departure and purchase by Rabobank has an adverse effect on Farm Credit, and therefore in a sense is a solution to the concerns you have about the competition that comes from Farm Credit. So I am interested in knowing whether, how you see this playing out. If the dissolution, the departure and acquisition is approved by FCA, what do you think that means for Farm Credit? Does it hasten the demise and therefore answer your concerns about the level or unlevel playing field that you described?

And then, kind of a broader question that would involve Mr. Harris as well. I was concerned by the answer I received from the chairman about the criteria by which this decision will be made. I have since had a chance to review the regulations and as, I understand, assuming that I know what regulations apply, the regulations say we will review a termination application and either give a preliminary approval or disapproval within 60 days. And then it says: In addition to any other reason for disapproval—and I don't know what those reasons might be—we may disapprove a termination of the determination that the termination—let me say that differently. We may disapprove a termination if we determine that the termination would have a material adverse effect on the ability of the remaining system institutions to fill their statutory role.

My question is, in that regard, is have any of you reviewed the law, the regulations, and reached any conclusions as to what the criteria that FCA should be using to make this decision? It seems to me to be very broad here, in addition to any other reason they name one, and that is the material adverse effect upon the Farm Credit System. And so in some ways, I think the concern that the community bankers and the American bankers raise is a topic for a different day, but I may misunderstand why it is a topic for today.

And then so my point is two. What do you think the outcome is of approval of the departure? And then, second, what criteria should the Farm Credit Administration be using? The idea that when they tell me that it is a case-by-case situation, that is true. Every case that every agency or every court decides is case by case. But it seems to me it is very dangerous to operate in an area in which there is no standards, by which you make a case-by-case decision.

So assuming my questions make any sense to anyone, I would be delighted to hear from you.

Mr. HARRIS. I would be glad to start with that, Congressman.

The implications I think are extremely serious. I think the implications are, in fact, perhaps the beginning of the demutualization of the Farm Credit system. And I think that begins to very quickly erode the public policy mission that the Farm Credit system has been fulfilling for nearly 90 years. And the fact that one institution might leave—of this size and leave that gaping hole doesn't just impact the customers, the 51,000 current members in those four States. It has implications for farmers and ranchers in each State of this country.

And let me explain exactly how that would happen, in my judgment, in my experience. And I apologize for the lengthy answer. But one of the success stories of the Farm Credit System is we have access to dependable sources of funds through the GSE status. The system is financially sound, and investors have a great deal of confidence in these institutions, the banks are jointly and severally liable for the payment of those bonds, and that those bonds are going to be paid. So we are able to borrow based on investor confidence. They also understand that we disclose as a system the capital that is available for the repayment of those bonds.

And if one institution leaves, the very first question the investor is going to ask is, well, here is one that has left. How many more are going to leave? So we could begin to see doubt created in the financial markets. And rating agencies are already asking the question, if this one leaves, how many more will leave? And I can tell this subcommittee that some association CEOs have already had inquiry from commercial bankers saying we didn't know we could buy a Farm Credit institution. Would you be interested if this one goes through? So this is just the beginning if it is allowed to happen.

I think there are other issues at stake here. I have been asked questions by a number of farmers, ranchers, producers. One of the panelists is from Idaho. I was in Idaho last week talking with a customer. And while he doesn't fund with AgBank or one of its associations, his question to me was: I borrow from Farm Credit. Will our institution be sold next? He said, I don't think it is a good idea.

So it begins to create doubt in members' minds who borrow from other Farm Credit institutions in other States. And if they don't think there is going to be a Farm Credit system there tomorrow to provide dependable funding for young, beginning small farmers, in fact, all creditworthy borrowers, they begin to wonder what is the viability of the Farm Credit system over the long term? And so I think it is a dangerous path to go down if we do not close this exit window.

Mr. MORAN. The chairman has reminded me that I asked a 4½ minute question. But assuming that he will indulge me, I would still like to hear from the bankers.

Mr. LUCAS. It is not the bankers' fault, Jerry.

Mr. MONSON. Thank you, Mr. Chairman. I also agree that this is a dangerous action that is being proposed but for a different reason. I am very concerned about closing the gate, so to speak, and creating this wall for a government's sponsored entity that would be in direct competition with commercial banks and other financial service providers of this country, and the danger of adding expanded powers on to that for some reasons of financial viability that are being proposed. It was mentioned in some earlier testimony, we are not in the same place we were in 1916 nor are we in the same place we were in 1970 or 1987.

The financial service industry has evolved, and I think it is appropriate for this House to consider the role going forward of the Farm Credit System, perhaps as a GSE that provides funds to all financial institutions in the agricultural market. We are still accomplishing the same goals.

There has been some comments about Farm Credit System being there when times are hard. And I apologize, Mr. Chairman, for my lengthy answer here. But if you think back to the 1960's, the Farm Credit System and the commercial banks in this country by dollar volume were neck and neck. In the 1970's, the Farm Credit System experienced extremely rapid growth, and then we had something called the 1980's that resulted in drought and depressed prices, in a credit crisis, if you will. And if you look at the statistics, if you look at the numbers of loans outstanding in the 1980's, the Farm Credit System goes like this, and the whole time commercial banks are on this kind of a playing field all the way through. And today—and today, the commercial banking industry still holds more dollar volumes.

So I am suggesting that the banks have always been there. As my colleague said, we live in those communities, we own homes in those communities.

Mr. EVANS. I think the proposed merger should be closely scrutinized, no doubt about it. The impacts could be horrendous. To have a big institution sold to a foreign company is dangerous. The door shouldn't be completely closed by, in not allowing other smaller institutions if they so decide, to sell. We still live in a free market system, and the shareholders should decide the fate of their organization or their company.

Mr. LUCAS. Thank you.

The Chair now turns to the gentlelady from South Dakota.

Ms. HERSETH. Thank you, Mr. Chairman.

I want to thank each of you for taking the time to be here today to share your thoughts. But I just have a couple of questions for you, Mr. Harris. First, just to clarify from your testimony and your written statement, that the termination provisions found in the Farm Credit Act are inconsistent with the basic mission purpose of the Farm Credit System. Now, you propose the solution to that problem is for Congress to repeal that termination authority as soon as possible as opposed to letting the Farm Credit Administration run its course?

Mr. HARRIS. That is correct. The Farm Credit system existed for 70 years without that provision in there; and during the mid 1980's, when there was the financial stress that has already been talked about, the Farm Credit System came to this Congress for assistance to help get through those trying days. And one small institution in California wanted to leave the system so it didn't have to contribute capital to those left behind having difficulty. There was a way they got that in the act in 1987, and at that time that was a statewide association and territory that it covered was also chartered by many other associations. So there were multiple charters over that territory; and this one exception was made for that small institution which, if memory serves me right, was $25 million or something like that. I have never heard anyone contemplate the kind of action that is before us today. So it was a one-time exception that stayed in the act, and now it is being utilized for something that no one ever anticipated. And when it did leave, there was no gap in service to that territory because there were already competing Farm Credit institutions serving that same territory, unlike what would happen at FCS of America.

Ms. HERSETH. OK. And then is it true that other Farm Credit System associations have provided funds to FCSA when it was in need?

Ms. HARRIS. That is absolutely correct.

Ms. HERSETH. Does it cause you any concern that there is no provisional law for reimbursement of those funds?

Mr. HARRIS. Over the years, the Farm Credit System, assistance was provided through the sale of Treasury guaranteed bonds that were issued and Farm Credit institutions have been accruing and/or repaying those bonds. I am happy to report to this subcommittee that in June of next year all of that financial assistance will have been repaid by the Farm Credit System with interest.

Ms. HERSETH. OK.

Mr. HARRIS. So all of that assistance has been paid. And, in fairness to all institutions, we have been accruing the final payment of those bonds.

Ms. HERSETH. OK. And my final question is, you have talked a little bit about what your thoughts are and the ramifications in terms of the larger Farm Credit System if the sale were to be approved and voted on in favor by a majority of the shareholders. You have talked about how it affects not only the four States in question that are served by FCSA but in every State as you just talked about in response to another question. Do you see that there are potential ramifications for cooperatives more broadly if this goes through and has these impacts on the system itself?

Mr. HARRIS. I guess I haven't really sat back and tried to analyze the implications to cooperatives on a broader basis; I have been pretty focused on this issue. And when I first heard rumors that this might happen, I said to myself, I can't believe that this is a possibility. So I haven't tried to extrapolate this move and try to assess how that might impact other cooperatives, the greater issue. So I am just not prepared to respond very well to your question.

Ms. HERSETH. Thank you.

Mr. LUCAS. The time of the gentlelady has expired.

We now turn to the gentleman from Minnesota, Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman. And I feel like an interloper at your hearing, but I do want to thank you for having this hearing. I am not a member of this subcommittee, but I have a keen interest for a variety of reasons in this whole discussion. I think fundamentally there are three questions that we need to get answered. We have heard some discussion of at least two of the three already. No. 1, what are the effects going to be to farmers and ranchers who look for credit? No. 2, how do you regulate an entity which is in a foreign country thousands of miles away on the other side of the Atlantic? And the third question is, what kind of a precedent does this set for other entities like this?

I am not certain that this panel is really the right one to talk about the regulations side of it, although you are more than welcome to. But I think we are all products of our past. And I want to get to a question that disturbs me, and it goes to something Mr. Evans just said. And it was something to the effect that if shareholders decided they wanted to sell their shares, they ought to have that right. I do not disagree with that. But as a former real estate broker and auctioneer, it was part of our moral and legal obligation to present any and all offers. And one of the things that disturbs me about this transaction is it has been brought to my attention that there may be other suitors out there who would like to put other offers on the table. And it strikes me that the board of directors here has a moral and a legal obligation to present to the shareholders all of those offers.

Would you or any of the other members care to respond to that?

Mr. EVANS. I would encourage other offers. I think sell for the highest price, open it up. I don't see, if they are going to sell to a Netherlands conglomerate, why not open it up to United States banks? I don't see any reason why they wouldn't.

Mr. HARRIS. It sounds like the suggestion is to just put Farm Credit institutions up for sale and sell it or them to the highest bidder.

Mr. GUTKNECHT. Mr. Harris, I did not say that.

Mr. HARRIS. No. I am responding to what I just heard from another panelist.

Mr. GUTKNECHT. OK.

Mr. HARRIS. There is, as I understand it, another offer by another association, AgStar. And the details of that proposal, I think, have been provided to this subcommittee. And we think that is a very attractive alternative for that board to consider, and we likewise would be fully supportive of what you are saying, that if it ever goes to the stockholders, they ought to be able to see other offers. I don't know where that association board is as far as considering the AgStar offer, but we look at it as being a very attractive offer. We think it has other valuable attributes to it in that, one, it is not a sale of that institution, it is a merger between two current Farm Credit institutions; the offices, the employees, the capital, by and large, can stay in place and be employed where it needs to be employed, we don't have to go back in and create a lending institution there. There is a way to go ahead and merge—and even FCS of America today could turn around and implement a patronage program if it chose to return some of the earnings back to the current members that it has today. So we think the AgStar alternative is a very viable and attractive option.

Mr. GUTKNECHT. Mr. Monson?

Mr. MONSON. If I could respond to that. I too share that I guess in common with my panelists that I believe that the shareholders of the Farm Credit Services of America should examine all offers. I hope that happens.

Mr. GUTKNECHT. Well, Mr. Chairman, again, thank you for allowing me to sit in on this panel. Because I really do think if you are going to make a decision like this and the shareholders are going to be at least offered this sale, it seems to me that the board has a moral and legal obligation. If not, I don't know if it is a legal obligation, but it should be a legal obligation to present to the shareholders all of the options that are out there to them if they decided that a transaction is going to be done.

With that, I would yield back my time.

Mr. LUCAS. The gentleman's time has now expired.

The gentleman now turns to the ranking member for his wisdom.

Mr. STENHOLM. Thank you, Mr. Chairman.

I thank the panelists today. It has been a great discussion of the issue. Having been here through several of these panelists, though—having been here in 1987 when the decision was made that, in hindsight, turns out to have been a short-sighted decision for all the good reasons has now become a problem, the opportunity to exit, I want to ask a question.

Mr. Evans, your answer to a question a moment ago precipitated this question to me. When you answered why the Farm Credit Services of America might be willing to sell—and that is a $10,000 return or a $12,000 return on a $1,000 investment—a fairly accurate answer. The question I want to ask of Mr. Monson and you, Mr. Evans, if we were to eliminate the GSE status, who would be the loser? GSE status for Farm Credit, who loses and who gains?

Mr. EVANS. I think if FCS would participate with community banks, I don't think you will see any problems funding agricultural or rural America. There are 7,000 community banks out there that are there to help to loan money to farmers. And why does FCS have a—have their entire bonding structure for their own FCS institutions? Why not open that up for community banks to participate?

Mr. STENHOLM. You are proposing the kind of compromise I have been interested in for 20 years.

Mr. Monson, answer the question, if we were to do as you suggested in your testimony today, you believe that the GSE status for Farm Credit ought to be eliminated. Who gains and who loses?

Mr. MONSON. Congressman, I guess I am not sure that I was proposing that the GSE status be eliminated. As a matter of fact, I think that the GSE status of the Farm Credit System is a powerful tool for providing capital in rural America. I am not so sure that the current delivery system is the one that should be there. I am proposing that it be made available for all agricultural lenders in this country.

Mr. STENHOLM. Well, if it were made available to you, would you participate in the same manner in which the Farm Credit System participates and change your mode of operation over to a cooperative system? And you don't have to answer that. You wouldn't, I know, in that endeavor.

Mr. MONSON. May I answer that?

Mr. STENHOLM. Sure.

Mr. MONSON. I am participating with the Farm Credit System right now through an ag credit company, OFI.

Mr. STENHOLM. Well, then, Mr. Evans, I agree. The thing we overlook in this dispute we get into in this town between the three entities there overlooks what you both just stated. Rural America is the loser when we do not come up with cooperative ways to work together in our small towns and communities. Every one of you said that in a little different way, but you are making proposals at different times that do not achieve that end result, and that the GSE status.

The problem—one of the problems with Farm Credit Services of America, that board of directors did not operate as a cooperative. When they built up the equity and did not distribute it to their members, they created an opportunity—a tremendous opportunity to buy a tremendous amount of assets that I think any one of the three of you at that table would snap up in a heartbeat, which is why AgStar is interested, why you answered very honestly you would be interested, too.

That is what happens—and when cooperative management does not operate as they are supposed to operate under the rules and regulations and the creditor—the policy that this committee has authorized, they get in trouble.

And, Mr. Monson, you were totally correct in analyzing the banking steadiness, because you have now 39 percent of all the agricultural loans. Farm Credit has 31 percent, and it was going the other way.

But we had a lot of folks in Farm Credit that got a little carried away back in the 1980's, and I gave up about all the hide I could give up for my country back in those days because of the disputes and the disagreements, but we ultimately worked out a compromise in the 1987 act that has worked, and I am so glad to see that we are about to pay back the taxpayers of that investment in the system.

But I would hope—as we work our way through this and Farm Credit System—or the Farm Credit Administration is going to have to work through it, and then we are all going to work through this dilemma—I hope the stockholders of the Farm Credit Service of America take care of this problem. That is the best solution, and I hope that sooner, not later, they will do so.

But I would hope that we will do, Mr. Evans, as you suggested, all three of you at that table, look for ways to work together for the benefit of rural America. And the answer that I was wanting, if you eliminated the GSE status, which some would like to see, farmers would be the loser and rural America would be the bigger loser.

But if we could come up with a method of working together on these, I had one instance—and my time has expired here—but I have a small town and community that is having a difficult time attracting teachers. They need to build some homes. They are not able to attract anyone willing to make an investment in homes. The Farm Credit System would like to make it, but they can't.

It would seem to me that that would be a perfect opportunity for a partnership between the community bank in that community and the Farm Credit to work together for something and use the benefits of the GSE system for the mutual benefit of rural America.

I hope as we work through this and we look at the ultimate resolution down the line that you will continue to emphasize, Mr. Evans—and, Mr. Monson, I hope you will come along with him—cooperativeness instead of confrontation.

Mr. EVANS. We want to work with FCS. We do. We want to be able to take advantage of their GSC status, but we don't. I think it is all community banks desire to give the lowest possible rate to our farm loan customers.

Mr. STENHOLM. Mr. Chairman, one other observation.

I remember when we were creating Farmer Mac, very controversial, Farm Credit was vehemently opposed to it. But to me, Farmer Mac was a form of a GSE status that we put in in order to allow others to benefit somewhat from the concept of GSE. Today, Farm Credit is using that which they didn't think too much of back then, but banking has suddenly not used it as I thought you would. Another paradox.

Mr. LUCAS. Thank you, Mr. Chairman.

The Chair would note that we are in a series of two votes, the final votes of the day. We will return for the final panel. But before we go, I have to ask one last question of my banker friends, since I didn't have the opportunity earlier.

My perspective as a Member is from Main Street back home. If my local financial institutions were in that four-State area, being a veteran or a victim, however you want to describe it—I have now 10 years on the Financial Services Committee as well as this one—my question to you is, if that association is purchased and becomes a bank and acquires all the additional powers that would be available to reinstate the insurance, the retail loans, all of those powers that would be available, if my local banker thinks that Farm Credit is a 10-ton gorilla, doesn't that make that, for instance, Rabobank institution on the corner a 20-ton gorilla to compete with?

Mr. MONSON. Mr. Chairman, if I could respond, I agree. Rabobank is an intimidating organization. However, it is not new. We have competition every day from institutions that have those very services that you talked about that are multiple times the size of my $47 million bank. But I survive, and I compete, and I compete very well because it still is my hometown, and I live there, and I know my people.

Mr. LUCAS. But if Farm Credit is a son of a gun and along come the people with deep pockets that reach the people across entire continents, it would seem that that would put incredible pressure not only as they compete not only for the loan portfolio but as they are out there competing for the deposits, too.

I just—having watched the financial industry from my position as a member over in Financial Services change in the last decade, you are in a tough competitive business that is changing every hour—not every day or month or year, every hour.

Last thought and dismiss the panel. The chairman, the ranking member and, who knows, chairman again someday maybe. But, at any rate, credit hopefully someday if I need it, Mr. Ranking Member.

The best compromise may be like many compromises in this body. It may be simply an effort to stand pat, to return to where we were before, to not move forward boldly with any new authorities, but, by the same token, restore the playing field to its position before. I would just ask all of you to think about that as we work our way through the coming challenges.

The committee stands——

Mr. STENHOLM. Mr. Chairman.

Mr. LUCAS. Yes.

Mr. STENHOLM. I would like to yield the time that I do not have to you to continue to talk favorably about me.

Mr. LUCAS. The camera is on.

We are in recess during the vote.

Mr. STENHOLM. Thank you very much.

[Recess.]

Mr. LUCAS. I would like to invite our third panel to the table: Mr. Mark Gage, president of the National Association of Wheat Growers from Page, North Dakota; Mr. John K. Hansen, president of the Nebraska Farmers Union from Lincoln, Nebraska, on behalf of the National Farmers Union; Mr. Myron Edleman, chairman of the Farmers for Farm Credit in Watertown, South Dakota; and Mr. Glen L. Keppy, Producer of the National Council of Farmer Cooperatives, Davenport, Iowa.

Mr. LUCAS. Mr. Gage, whenever you are ready.

STATEMENT OF MARK GAGE, PRESIDENT, NATIONAL ASSOCIATION OF WHEAT GROWERS, PAGE, ND

Mr. GAGE. Mr. Chairman, members of the committee, my name is Mark Gage, and I farm near Page, North Dakota, where I raise hard red spring barley, wheat and soybeans. I am currently president of the National Association of Wheat Growers.

On behalf of NAWG, I wish to thank you for holding this hearing on this important matter giving me the opportunity to testify on behalf of the Nation's wheat growers, the Farm Credit System and give evidence of the important role it plays in agricultural lending.

The message from the wheat growers to this subcommittee is very clear. The Farm Credit System is a partner to many producers. NAWG's policy reflects the commitment to the Farm Credit System, and we seek to preserve that system.

While we have no objections to Rabobank competing in the market to serve farmers and hold them in high esteem, only Farm Credit has an ongoing mandate to provide credit to agriculture.

We are concerned that the acquisition of Farm Credit Services of America by Rabobank will adversely affect the entire Farm Credit System. We believe it would be extremely short-sighted to sell one of the associations whose mandate it is to serve farmers. Many of the benefits, such as programs for beginning farmers, are not guaranteed through Rabobank.

While the acquiring bank may provide some borrowers rights, they are not required to provide the same requirements of FCS. A successful takeover would result in ownership by an entity unconstrained in dealing with farmers outside the direct reach of Congress with no mandates to serve farmers.

There is more at stake than one association. Should Farm Credit Services of America exit the Farm Credit System, we believe it would impact customers throughout the system. Regulations require a new institution be rechartered in the areas served by Farm Credit Services of America, which would drain the system of experienced staff, infrastructure and pull capital from other institutions in the system, limiting the capital available to borrowers.

If one component of the system is sold off, that action will unquestionably invite other offers from non-FCS institutions to acquire other associations. Stronger associations would be sold, compounding the problem, further weakening the remaining Farm Credit System.

Mr. Chairman, we see a number of concerns relating to the disposition of assets of this association. FCSA's assets include a reserve that represents dividends due borrowers who have paid off their loans, having never received patronage dividends due them. It also includes monies transferred from other districts in the form of financial assistance that allowed FFA to continue to operate in the 1980's when it had financial problems.

NAWG will point out that there is a strong argument that acquisition by Rabobank at a discounted price includes capital to which former borrowers and other associations may have legal claim.

While the cash payment to two members of FCSA may be attractive in the short term, we have grave concerns about the consequences to the entire FCS system in the long term from allowing this acquisition to proceed. This could be solved by a merger with AgStar Financial Services of Minnesota, which has offered the same benefits to farmer members.

Mr. Chairman, it is our expectation that the testimony from this hearing will illuminate many facets of this transaction and would assist stakeholders in making their decisions regarding agricultural credit in this country. Furthermore, we do not believe that the termination provision is consistent with a healthy Farm Credit System, and we ask that termination authority be repealed.

Thank you.

[The prepared statement of Mr. Gage appears at the conclusion of the hearing.]

Mr. LUCAS. Mr. Hansen.

STATEMENT OF JOHN K. HANSEN, PRESIDENT, NEBRASKA FARMERS UNION, LINCOLN, NE, ON BEHALF OF THE NATIONAL FARMERS UNION

Mr. HANSEN. Mr. Chairman, Ranking Member Holden, members of the subcommittee. Thank you for the opportunity to appear before you today.

First, our National Farmers Union policy supports the mission of the Farm Credit System as an original supporter of the cooperative-style farmer owned and controlled Farm Credit System. We believe that FCS should stay true to its original purpose to focus on meeting the agricultural needs of family farm and ranch operations. We believe that as long as farmer-borrowers vote for the board of directors and ultimately control the direction over their own ag credit lender, we still have the power to fix problems when necessary.

The National Farmers Union supported the farmer-friendly section of the Ag Credit Act of 1987 including, No. 1, Congress' ability to monitor loan availability and servicing activities; No. 2, policies that ensure equal access to credit, regardless of gender and race; and, No. 3, a farm credit policy that is adequately financed to help American farmers and ranchers. Our members support these strong farmer and rancher provisions.

Last week, the National Farmers Union Board of Directors unanimously adopted a position of strong opposition to the proposed takeover of the Omaha-based Farm Credit Services of America by the Netherlands-based financial conglomerate Rabobank, reported to be the largest ag lender in the world.

We took this position because we feel the sale of this FCS unit could potentially damage and weaken the four-State region but also the entire FCS system.

First of all, is this proposed sale necessary? Absolutely not. The FCSA is one of the most stable, profitable, financially secure ag lenders in the Farm Credit System. They do not need to sell nor do they need to merge in order to provide their borrowers with the services they want or need. The sale to Rabobank would provide borrowers with a partial one-time return on their equity, and it would eliminate the potential of borrowers to receive any future additional returns on their equity through dividend payouts. That is our idea of a penny-wise and pound-foolish offer, especially for those owner-borrowers who have already invested decades of equity into their own institution.

The real question that Farm Credit Services of America borrowers should be asking is why their cooperative lender has not been paying them regular dividends.

In our view, if Rabobank acquires FCSA, current borrowers will lose congressionally mandated assistance to beginning and minority farmers, commitments to local communities, and access to competitive agricultural credit for all producers and their borrowers rights requirements. That is not our idea of an improvement in lending practices.

Rabobank has not been shy about admitting its aggressive lending to U.S. And foreign entities that are vertically integrated, industrialized operations that often compete unfairly with our farmer-owned farmer and rancher operations. We not only need a lender that is with us in good times and bad but is dedicated to putting our best interests first.

The proposed sale of FCS of America to a private venture outside the Farm Credit System would shortchange both the ag borrowers who have invested decades of borrower equity and the taxpayers who also indirectly invested their tax dollars. That is unacceptable.

We oppose the sale. Before the idea goes any further, we urge Congress, especially this committee, and the Farm Credit Administration to take action, to quickly and decisively hold regional hearings in each of the four States affected so that the borrowers and the owners of FCS of America and the public at large can fully comprehend the implications of such a proposed takeover. We like the idea of a 180-day waiting period on the sale offered by Senator Daschle and others in the Senate yesterday. The time to shut the barn door is before the horse is gone.

In summary, the board of directors of the National Farmers Union does not believe it is in the best interest of the farmers and ranchers to give up control of their ag-lending institution, congressionally mandated credit availability, borrowers rights and an ownership stake in their lender in order to gain a one-time, reduced, short-term partial payout of farmer equity.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Hansen appears at the conclusion of the hearing.]

Mr. LUCAS. Mr. Edleman.

STATEMENT OF MYRON EDLEMAN, CHAIRMAN, FARMERS FOR FARM CREDIT, WATERTOWN, SD

Mr. EDLEMAN. Mr. Chairman, members of the committee, thank you for allowing me to address you on a matter of the utmost importance to people who live in rural America and people who work the farms and ranches of the Midwest.

I am a South Dakota cattleman. I also raise corn and alfalfa hay. I am a member of the South Dakota Cattleman's Association and the National Cattleman's Beef Association. I am also a stockholder in Farm Credit Services of America, a farmer-owned and farmer-controlled lending cooperative that serves rural communities in four States; and I am pleased that we have finally gotten to a witness that is personally affected by what is happening in this proposed sale.

The principle of maintaining a farmer-owned and farmer-controlled lending cooperative is important, Mr. Chairman. In fact, that is the reason I come before you today as chairman of Farmers for Farm Credit. I am proud to represent a coalition of stockholders of Farm Credit Services of America that opposes the sale to Rabobank.

As you know, one of the treasured hallmarks of the Farm Credit System is customer ownership. Farmers and ranchers who borrow from a Farm Credit co-op automatically become stockholders.

FCS of America's management and board of directors have decided to sell our co-op to Rabobank. To date, stockholders have had almost no say in that decision, and it is not clear that the board itself has thoroughly studied the alternatives. Our review of the public announcements about this acquisition have convinced us that it is a very bad deal. It is a bad deal for FCS of America, a bad deal for stockholders and a bad deal for farmers and ranchers and rural communities who have come to rely on Farm Credit for its competitive lending rates and reliability.

Attached to my testimony is a listing of the reasons we think this transaction is a bad deal for farmers in rural America. I would ask that this attachment be included in the record of this hearing.

Mr. LUCAS. Seeing no objection, so ordered.

Mr. EDLEMAN. We formed our coalition to ensure that our voice as stockholders would be heard and to ensure that other Farm Credit Services of America stockholders could learn the awful truth about the sale of their co-op.

Farmers for Farm Credit is not alone in opposing the Rabobank takeover. Several Members of Congress, including Senators Daschle, Coleman, Johnson and Lincoln, and several members of the House have come out against it as well. The National Council of Farmer Cooperatives, National Farmers Union and many State and local agricultural groups also oppose the sale, as well as the National Association of State Departments of Agriculture.

As the distinguished agricultural economist, Neil Harl of Iowa State University, said recently, this is likely to have an impact on the lending landscape in agriculture for some time to come.

In some ways, Mr. Chairman, that is an understatement. This deal is so bad, it is breathtaking.

All of the assets of our co-op, including all of its loans, will be sold to Rabobank. Over $1 billion of borrower-contributed capital will be wiped off the books of FCS of America. Hundreds of millions of dollars will be flushed down the drain as FCS of America exits the system and pays over $800 million as an exit fee.

None of this money belongs to the management of the FCS of America. It belongs to the stockholders, and only a fraction of that money will be returned to stockholders under the sale proposal. FCS of America's capital was built up over many years from the earnings generated on thousands of loans. This capital helps to ensure that our families and future generations of Midwest farmers will have access to a financially strong, borrower-owned source of credit.

For 85 years, lending cooperatives of Farm Credit System have dedicated themselves to ensuring that farmers and ranchers have access to competitive loans in good times and bad. This Farm Credit mission is a mandate from Congress. The Rabobank takeover of FCS of America would disrupt that mission and dismantle a mechanism created to ensure that farmers and ranchers would have access to capital at all times.

There will continue to be a lot of discussion about the economic aspects of this transaction, rightfully so. However, the fact that we are here today is evidence of the true value of our cooperative.

As a farmer stockholder in FCS of America, I am entitled to question the business decisions made by the board of management of my cooperative. As a part of the Farm Credit System, FCS of America is subject to congressional oversight and is required by Congress to provide protections to borrowers that no other lender provides; and Farm Credit Services of America operates under the watchful eye of a Federal regulator accountable to Congress.

If Rabobank becomes the lender for FCS of America's 51,000 customers, all of the business decisions that today are subject to scrutiny by farmers, Congress and the FCA will be the sole prerogative of Rabobank management. It is not possible to put a dollar amount on what we as farmers will lose, but the costs will be enormous.

As farmers have come to understand what is at stake, the proposed sale of FCS of America has become increasingly unpopular among the stockholders. I hope this committee will note the lack of farmers and farm organizations here today to speak in favor of this sale.

The board of FCS of America cannot help but be aware that the opposition to this sale is overwhelming. However, we suspect that management of Farm Credit Services of America may have entered into a secret contract with Rabobank that is so onerous the board is now struggling to find a way to unwind this decision without costing stockholders millions of dollars. For reasons of corporate transparency and to protect the interest of farmers, we think it would be entirely appropriate for this committee to ask Rabobank and FCS of America to disclose the terms of any contract that may exist between their organizations, including any formal or informal agreements that may exist relative to compensation and management bonuses.

In conclusion, Mr. Chairman and members of the subcommittee, our coalition strongly opposes the sale of the FCS of America. We do so because it is a bad deal but also because it will have serious adverse consequences for rural America. This sale will replace a dedicated, mission-driven cooperative with a foreign, profit-driven conglomerate, and it will do so at a price that robs farm and ranch families of their capital.

Our coalition is grateful for anything this subcommittee can do to stop this ill-advised acquisition.

Thank you for your time and your interest, and I am pleased to take any questions that you or members of the subcommittee may have. Thank you.

[The prepared statement of Mr. Edleman appears at the conclusion of the hearing.]

Mr. LUCAS. Mr. Keppy.

STATEMENT OF GLEN L. KEPPY, PRODUCER, NATIONAL COUNCIL OF FARMER COOPERATIVES, DAVENPORT, IA

Mr. KEPPY. Thank you, Mr. Chairman. We appreciate this opportunity to appear before you today and commend you on your leadership for holding this important hearing on the Farm Credit System.

My name is Glen Keppy; and I am from Davenport, Iowa. With my wife, Jean, and four children, I operate a third generation family farm consisting of a farrow-to-finish hog operation and approximately 1,000 acres of corn, soybeans, oats and alfalfa hay. I am also actively involved in a number of farmer cooperatives, including CHS, a member of the National Council of Farmer Cooperatives on whose behalf I appear today.

The National Council of Farmer Cooperatives is the national trade organization representing America's farmer-owned cooperative businesses. Its members include nearly 50 national and regional marketing, supply, bargaining and credit cooperatives. These in turn are comprised of approximately 3,000 local cooperatives whose member owners represent a majority of the Nation's 2 million farmers and ranchers. The Council's membership also includes 26 separate regional and State councils.

We believe this hearing is extremely important and timely to look at the Farm Credit System, its mission and purpose and whether it is as important today as when it was created by Congress.

The Farm Credit System was created by Congress to provide farmers and ranchers and their cooperatives with access to a dependable and competitive source of credit in good times and bad.

As created by Congress, the Farm Credit System system is made up of banks and associations that are locally owned and controlled by farmers, ranchers and their cooperatives. By providing for a cooperatively owned system, Congress helped make sure it would be responsive and dedicated to meeting agriculture credit needs, while also giving it a unique accountability. As a farmer and member/director of a cooperative, I understand and appreciate the important role the Farm Credit System plays when it comes to agricultural finances.

Many things have changed when it comes to agriculture in today's global economy. What has not changed, however, is the need for farmers, ranchers and their cooperatives to have a dependable and competitive source of credit and capital to operate, to modernize, to expand and to take advantage of new market opportunities.

For this reason, the cooperatively owned Farm Credit System, as created by Congress, is as vital today as ever.

This is why the NCFC is strongly opposed to the sale of Farm Credit Services of America to Rabobank and the termination of its status as part of the Farm Credit System.

The proposed termination of FCS America as part of the Farm Credit System would impact not only its members in the four-State area it serves but farmers, ranchers and their cooperatives throughout the entire Farm Credit System and across the United States.

Specifically, it would eliminate local control and ownership of FCSC America since it no longer would be part of the Farm Credit System. This would also eliminate current borrowing protection and requirements to serve young, beginning and small farmers and ranchers.

Reduce available capital and capacity of the Farm Credit System. While it is true a termination fee of approximately $80 million would be required, such payment would not be considered as additional capital with regard to any individual Farm Credit bank.

It would require the transfer of capital from other system institutions as part of chartering of a new farm credit entity to serve the area now served by FCS. In addition to reducing their overall capacity, such transfers could affect future patronage distributions and result in higher effective interest rates for their borrowers.

It would also reduce competition and choices for farmers. While a new and expanded farm credit charter would be granted for the area served by FCS, the reality is it would be difficult to achieve. It took nearly 90 years for FCS to be where it is today and established, and it would be impossible to recreate that overnight. Any new institution would begin without any people, offices or loan portfolio. Overcoming this would obviously come at a cost, and it would affect the competitiveness.

Threatening the continued status of the cooperatively owned Farm Credit System and its mission and purpose as established by Congress, especially to the extent that such action encourages future sales to outside banks and financial institutions.

Accordingly, NCFC recommends the following:

That the Farm Credit Administration upon review should reject the proposed termination of FCS America because of its material adverse impact.

If a stockholder vote is required, the process should be made fully transparent and that members have access to all information, including alternative proposals, so that they can make an informed decision.

Congress should consider changes in the Farm Credit Act to specifically address this issue by eliminating the authority for farm credit institutes to determine their system status. We do not believe current law was ever intended to provide for the sale and dissolution of the Farm Credit System, a Government-sponsored enterprise dedicated to serving agriculture and rural America.

Congress should also consider and approve additional changes to modernize the Farm Credit Act to insure that the cooperatively-owned Farm Credit System continues to be able to meet the credit needs of farmers, ranchers and their cooperatives.

A good example of the type of changes that are needed involves the ability of new and emerging types of farmer cooperatives to borrow from CoBank. In an effort to better capitalize and finance their businesses, farmers, ranchers and cooperatives are looking at various business models and corporate structures that were not contemplated just a few years ago. Such actions would help make farmers, ranchers and their cooperatives continue to have as many options and choices as possible when it comes to financing and capitalizing their business and preserving competition.

Again, Mr. Chairman, the mission and purpose of the cooperatively owned Farm Credit System remains as critically important today as when it was created by Congress. For this reason, we strongly urge Congress and the administration to take action to insure that the Farm Credit System continues to be cooperatively owned and able to meet the credit needs of farmers, ranchers and cooperatives.

Thank you, again, Mr. Chairman, for this opportunity to share our views. We look forward to working with you and the members of the committee on this important issue. I will be willing to answer questions, and I do have a written proposal to enter into the record.

[The prepared statement of Mr. Keppy appears at the conclusion of the hearing.]

Mr. LUCAS. Without objection, so ordered that it be added to the record. Thank you, Mr. Keppy.

Mr. KEPPY. Thank you.

Mr. LUCAS. Mr. Edleman, you obviously are on the ground in a sense, so to speak, up there. Since we have not seen a formal letter or notice according to the regulator this morning moving anything forward, it is conceivable that that might not be the case for a while. Under the rules of that association, when would the next election for directors be held?

Mr. EDLEMAN. It is scheduled generally to be held in the fall of the year, and we have some question about whether or not that is going to happen right now. We have not been notified of any. In fact, I asked the association for the written process, and I just received that, I understand, as I left home yesterday. So we are checking in to see when that election will beheld.

Mr. LUCAS. Off the top of your head, what percentage of directors stand for election each year?

Mr. EDLEMAN. About a third.

Mr. LUCAS. OK.

Mr. Hansen, a question for you that could easily be directed to everyone. One of the topics brought up here clearly, of course, is that whatever happens or might happen in the present set of circumstances is done under present Federal law and Federal rules. How does this subcommittee respond to the question about overriding the local association's ability to decide their fate under the present set of Federal statutes and rules?

Mr. HANSEN. Well, Mr. Chairman, I would kind of put this example under the general heading of "have expensive lawyer under retainer/will find loophole."

When this process was set forward—and I think it has been said today by folks who were here and a part of that process—this is not one of the options that were contemplated when those provisions were drafted and put into law. Any time that you do something within the system by one of the players that causes the rest of the system to be at risk, that is obviously not from a team perspective the kind of thing that you would hope for out of one of your cooperative components.

I was awful in geometry as a student, but I remember axiom No. 9, which is that the whole is equal to the sum of the parts and is greater than any one of them. And that axiom to me is appropriate here as you think about the overall system.

We look at the overall system and think that this sets a precedent that will cause the weakening of the entire system. So we are at the point where, after we have struggled through this whole process of talking to our members, gathering facts, talking to the principles, our board said that we think that the sale ought not go forward.

Mr. LUCAS. Gentlemen, as a whole, you do represent many different parts of the country, different commodity groups, broad general farm organizations. Assess for me ever so briefly how you think the availability of credit is being met in this country at present by all credit-providing entities. Are our needs being met out there at this moment, generally, across the country? Clearly, they were not 100 and some years ago.

Mr. KEPPY. I will take a shot at that, but I would like to go back to the question you just asked Mr. Hansen.

Mr. LUCAS. Please.

Mr. KEPPY. I think stability is one thing that is extremely important in the credit system. I think that is where the farm system has shined.

As an example, the local bank that is in my local community—I have never changed the building I am banking in, but five different names have appeared on that building. So I think stability is important in agriculture.

To answer your second question, I think that there has been opportunity for agriculture to get the needed credit. But I think we are coming into a phase—and I have two sons that have just come home to farm with me. They have picked up an additional thousand plus acres. They are both custom-feeding pigs. We are looking at niche marketing, ways of cooperatively working together with other farmers in our community in niche marketing the pigs and also the three different grains that I am identity preserving.

So I think that there is a—we are coming into a time where we are going to need the experience that the Farm Credit System has to offer. So I haven't had a problem getting the credit, but I think that the crunch time is coming for agriculture.

Mr. EDLEMAN. Mr. Chairman, if I could go back to your previous question about stockholders' votes. I think that is a very important one.

Being a cattleman from South Dakota, I am very protective of my personal rights, as you imagine. But as I look at this issue, it is completely different. If we understand the Farm Credit System and how it is structured, I don't think that Congress ever envisioned that the Farm Credit System would be sold off either in whole or in part or in pieces.

I asked myself, who should have the right to vote on it? Should it be present-day stockholders or should it be past stockholders or should it be future stockholders? Why should I be able to benefit by some past distribution because I am a borrower today and some borrower who may have borrowed money in the late 1970's, bought high-priced land, paid his interest and paid his principal through the rough 1980's, paid off his loan a year ago and got nothing?

To me, that doesn't seem to be fair in a cooperative, like cooperative principles we deal with. I think we have to ask ourselves, who really should vote on this and if that is the appropriate way to do it, because I don't think it probably is.

Mr. LUCAS. Thank you.

The Chair now turns to the ranking member, the gentleman from Pennsylvania, Mr. Holden.

Mr. HOLDEN. Thank you, Mr. Chairman.

I do not have any questions of this panel, but I would like to make part of the record correspondence that I received an hour ago from the Pennsylvania Department of Agriculture expressing their serious concerns about this transaction due to their concerns about the negative implications on the long-term security of the Farm Credit Association. I just want to make that part of the record, Mr. Chairman.

Mr. LUCAS. And without objection it shall be added to the record. So ordered.

The Chair now turns to the lady from South Dakota.

Ms. HERSETH. Thank you, Mr. Chairman; and thanks to each of you for your testimony here today.

I apologize. I wasn't able to be here for the first two panelists. But I do have a couple of questions and a special welcome to Mr. Edleman from South Dakota for travelling here today and your efforts to get some questions answered in representing farmers for Farm Credit.

I am wondering, in your effort, have you had any difficulty identifying the borrowers, the present shareholders?

Mr. EDLEMAN. Yes, we have had considerable difficulty. In fact, the 1987 act—part of the borrower act says that stockholders would have a right to the shareholder list and the institution should give it to them within 7 days of receipt of that request.

My first letter was sent to the association. They received it on August 5. Six days later, I got a notification that it was denied for some reason, that they needed more information. So I—the second letter I sent probably 2 or 3 weeks later, which was reviewed by an attorney. That letter was also denied for the same reasons.

Both letters I was told by FCA fulfilled the letter of the law and the regulation. We then made a complaint to FCA. FCA then looked at it and told the association that they had to give us the list.

I believe in that communication it also said, do we need to give them the addresses as well? And the answer was, of course you have to give them the addresses. The purpose is for communication. I received my list of the stockholders Monday morning of this week, 53 days after they received my first request.

Ms. HERSETH. OK. Rabobank claims in testimony that its buyout of FCSA will create more competition for farm loans in the four

States. Based upon the testimony we have heard today, there is a lot of skepticism. I am going to assume you share that skepticism. But could you elaborate on your—if you disagree with Rabobank's statement and why.

Mr. EDLEMAN. I certainly would be glad to.

I find that amusing. Because, as I look at it, in my personal situation—I live out near Watertown, SD. Watertown, SD, has a Rabobank loan officer at Watertown, SD. It also has a Farm Credit service office at Watertown, SD. If Rabobank buys out FCS of America, to me that means there would be less competition. Now it would be all Rabobank, until the point in time that the Farm Credit System can reestablish itself in those 4 State areas.

And I don't think—don't underestimate the amount of effort and capital that it would take to reestablish that presence. We are talking about 43 offices, 900 and some plus employees, very seasoned loan officers, and $1.35 billion in capital to reestablish the presence they have today. That is not going to happen tomorrow or next week.

So in the short run there will be less competition, and I don't think any of us in this country can say in the long run there will be as much or more competition. That decision, whether Rabobank is here next week, next month or next year, will be made in a foreign country. That decision won't be made here. So——

Ms. HERSETH. I have got a couple of other questions along this line. But because my time may run out on me, I want to come back to a line of questioning that I pursued with the chairman who was in the first panel today on the importance of these public hearings that many of us would like to see held in each of the four States directly affected and whether or not you, Myron, or you, Mr. Hansen, can speak to this whole issue where, under the regulation, the plan of termination, as FCA reviews that, has to include a proposed stockholder information statement.

It would seem that, given some of the difficulty that you have had in getting certain information, that within the 60 days that they have to review that plan that to have the public hearings in each of the four States or at least somewhere centrally located to help them get the information on what you would want to see in this type of package in determining whether or not it would move forward in approving or disapproving. Can either of you or any of you comment on that?

Mr. EDLEMAN. Yes, I would be glad to.

I have seen a number of disclosure statements on mergers between associations they are very complex, very thick. The Farm Credit System in and of itself very complicated. Unless you have been involved in a system for many years—and, Mr. Chairman, you certainly understand the complexity of the Farm Credit System—but to send this thick packet of information—and it always says it must be in language that the average person can understand—but it takes a considerable amount of discipline to sit down and to read that thing and to really understand what it actually says.

And I think that some of the misconceptions that are out there, that one of them says that this $600 million will be new money—I mean, if you stop and think about it, the assets that will be sold in public announcements are $500 million for which Rabobank is paying $600 million for. It does not say that there is $208 million in allowance for loan loss reserves.

Now from an accounting perspective the allowance per loan loss reserves is just deducted for your loan volume, but it is cash. So now you have $700 million being bought for $600 million. Now they have—they could have reversed some of that. But even if it is dollar for dollar, if it is $600 million for $600 million, that is like—if you have a dollar and I have a dollar and I give you my dollar and you give me your dollar, is that new money to me? Well, that is stretch—that borders on the point of being ridiculous, if this is new money that is going into agriculture.

Mr. HANSEN. If I might, it seems to me—and, Mr. Chairman, I give you high marks for having this hearing today, and I have been following very closely because of the number of phone calls and my members who are active as both borrowers and participants in this system for a very long time. As you can imagine, my phone has been ringing, and I have been following this situation very closely. I found out a lot of new information today by virtue of the fact that you had this hearing. Thank you for doing that.

What we have found is that when we call the board of directors we don't get any answers. They won't talk to us. They won't talk to me. They won't talk to my members. So to get information, it all comes out of headquarters, and it is very carefully packaged and controlled.

Some jaded folks like me who have been around for a long time would call it spin, and that is not what folks need in order to be able to make an informed decision about what ought to happen with their cooperative. So what we are calling for, in our view, is an opportunity to get the facts on the table, to get the considerations clearly understood. And I don't know how that is going to happen unless there is some kind of a process or mechanism to help do that.

I am very skeptical of any deal that is put before me and you either got to take it or leave it and it better be quick. That is almost always a warning flag. It seems to me if this is a good deal and members want to do it later on, do it after a full and complete disclosure has happened.

I suspect that the agenda of the folks who want to make this sale happen is to lock it down, control information and rock and roll and get it done as quick as possible.

Mr. LUCAS. The time of the gentlelady has expired.

One last question, Mr. Evans. Repeat one more time the time line and the number of pieces of correspondence from you as a member of the association to the association it took to acquire that basic information.

Mr. EDLEMAN. OK. As an individual I have a right to a shareholder list.

Mr. LUCAS. I understand.

Mr. EDLEMAN. A registered letter that they signed for that they received on August 5.

Mr. LUCAS. OK

Mr. EDLEMAN. I got the shareholder letter on Monday of this week, 53 days after my first request. I sent a second request, which was also denied. Both letters were looked at and said they do satisfy the law and the regulation, and only when FCA intervened because of our complaints did they then say, yes, OK, we will send you the list. Only then, with the caveat do we have to send the addresses, also.

Mr. LUCAS. Fascinating. Thank you for those insights and to this panel and the previous panel for all of the insights that have been provided. I can assure you this saga is a long way from being over.

With that, without objection, the record of today's hearing will remain open for 10 days to receive additional material and supplementary written responses from witnesses to any question posed by a member of this panel.

This hearing for the Subcommittee on Conservation, Credit, Rural Development and Research is adjourned.

[Whereupon, at 4:59 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF JOHN K. HANSEN

Chairman Lucas, Ranking Member Holden, members of the committee, I am John Hansen, president of the Nebraska Farmers Union. Our National Farmers Union represents over 260,000 independent, diversified, owner-operated family farms and ranches across the nation. We appreciate the opportunity to appear before you today to discuss the overall situation of the Farm Credit System and in particular the recent proposal of a foreign owned bank takeover of a unit of the FSC. In the interest of time, let me get right to our list of farm credit system considerations.

Our National Farmers Union policy, set by our members, is very clear on the role of the Farm Credit System (FCS) and the family farm. As an original supporter of the farmer-owned Farm Credit System, we believe the FCS should follow its original purpose and Congressionally defined mission to keep the family farmer and rancher on their land by actively providing the necessary credit to all family farm and ranch operations. We strongly believe in the value of this cooperative style system of farmer-owned, farmer-directed, and farmer-controlled agricultural lending. If and when there is a problem, as farmer borrowers we still have the power to fix what is wrong when needed.

Farmers Union opposed a (FCA) "Choice" proposal that would have allowed associations to lend outside their designated territories and expand their lending roles. We were concerned the "Choice" proposal could have jeopardized the Farm Credit tax exempt status, promoted "cherry picking" of borrowers and reduced local services. We also opposed differential interest rates for FCS member-borrowers because they are contrary to cooperative principles.

National Farmers Union fought hard in Congress for farmer friendly sections in the Agricultural Credit Act of 1987, including: (1) Congress' ability to monitor loan availability and servicing activities and to take necessary action; (2) Policies that ensure equal access to credit, regardless of gender or race; and (3) A farm credit policy that is adequately financed to help re-establish

American family farmers and provide special assistance to young, beginning farmers and minority farmers. Our members continue rely on and support these strong farmer and rancher provisions.

Now on to more recent issues.

RaboBank proposed acquisitionLast week, the Board of Directors of the National Farmers Union unanimously took a position of firm opposition to the proposed acquisition of the Omaha-based Farm Credit Services of America (FCS of America), by the Netherlands-based financial conglomerate, Rabobank, reported to be the largest agricultural lender in the world.

NFU is extraordinarily concerned about the short and long-term effects of this proposal on the four state region, as well as the national implications of future conversions of other federally sponsored cooperatives to privately owned ventures. We feel that the sale of this FCS unit could potentially damage and weaken the entire FCS system by setting a potentially lethal precedent.

First of all, is this sale necessary? The FCS of America is one of the most stable, profitable and secure units of the Farm Credit System. We also believe that RaboBank's proposed one-time, partial, and reduced payout, would end the potential of dividend payouts forever. We think this is a penny-wise and pound-foolish offer, especially for those owner-borrowers who have decades of equity in their own institution.

If the Rabobank/FCS of America transaction is consummated, we are extraordinarily troubled that requirements such as borrower's rights, Congressionally mandated assistance to beginning and minority farmers, commitments to local communities, and access to competitive agricultural credit for all producers will be shoved aside as the new owner establishes its U.S. lending practices within the global banking environment in which it already operates.

It is apparent that the sale of the Omaha-based farmer-owned and directed system will terminate the ability of farmers to control their agricultural lender forever, and turns agricultural lending decisions over to an international bank that often lends to entities that are vertically integrated, industrialized operations, that often compete unfairly with our family-owned farmer and rancher operators. We strongly believe that American farmers and ranchers should continue to own and control the strong financial services cooperative that is dedicated exclusively to putting their needs first.

Congress, some 80 years ago, designed and mandated the Farm Credit System to provide agricultural credit to rural America. Congress clearly restated that commitment again in 1987 during our Nation's most severe agricultural credit crisis since the Great Depression. As you may remember, many FCS institutions were recapitalized through taxpayer loans and assistance to maintain the system's integrity and preserve its commitment to American producers and rural communities. In light of the proposed sale of FCS of America to a private venture, the

commitment and value of this recapitalization by U.S. taxpayer assistance should not be ignored or minimized. NFU fought hard in Congress for the recapitalization of the FCS in 1987 by taxpayer assistance, and for this sale to be brought forth without any consideration of U.S. taxpayer investment, we find unacceptable.

Through the cooperatively owned institutions of the Farm Credit System, American agricultural producers and rural communities have historically been provided access to competitive sources of credit during both good and bad agricultural production and price cycles, a key feature of the cooperatively owned nature of the FCS. We think that the business pressures of global banking would surely impinge on this type of access to credit afforded U.S. farmers and ranchers by the FCS system.

It has been reported that the FCS of America board of directors has voted to approve the transaction and has recommended that the shareholders of FCS of America vote on the proposed sale, an action that could occur as early as November of this year.

Therefore, we urge Congress, especially this Committee, and the Farm Credit Administration and to take careful, thorough and decisive action by holding regional hearings in each of the states affected so that the borrowers/owners of the FCS of America, and the public at large, can fully comprehend and explore the implications of such a takeover. We strongly urge that these hearings be held well in advance of any steps that might allow the takeover of the FCS of America.

In summary, the Board of Directors of the National Farmers Union does not believe it is wise policy for farmers and ranchers to give up local control, congressionally mandated credit availability, borrower's rights, and an ownership stake in their lender in order to gain a reduced one-time, short-term partial payout of farmer equity.

Thank you for the opportunity to appear before you today.

STATEMENT OF GLEN KEPPY

Thank you, Mr. Chairman. We appreciate this opportunity to appear before you today and commend you for your leadership in holding this important hearing on the Farm Credit System.

My name is Glenn Keppy from Davenport, Iowa. With my wife, Jean, and other family members, I operate a third generation family farm consisting of a farrow-to-finish hog operation and approximately 1000 acres of corn, soybean, oats and alfalfa hay. I am also actively involved in a number of farmer cooperatives, including CHS, a member of the National Council of Farmer Cooperatives on whose behalf I appear today.

The National Council of Farmer Cooperatives is the national trade association representing America's farmer owned cooperative businesses. Its members include nearly 50 national and regional marketing, supply, bargaining and credit cooperatives. These, in turn, are comprised of approximately 3,000 local cooperatives whose member owners represent a majority of our nation's two million farmers and ranchers. The Council's membership also includes 26 separate regional and state councils.

We believe this hearing is extremely important and timely to look at the Farm Credit System, its mission and purpose, and whether it is as important today as when it was created by Congress.

Overview

The Farm Credit System was created by Congress to provide farmers and ranchers and their cooperatives with access to a dependable and competitive source of credit in good times and bad. Congress did so because it recognized the unique challenges and risks associated with agriculture that often affected its ability to obtain such credit on a sustained basis. Its establishment was also in recognition of the importance of agriculture to meeting the food and fiber needs of consumers at home and abroad, and as a key sector of our economy.

As created by Congress, farmers, ranchers and their cooperatives locally own the Farm Credit System. By providing for a cooperatively owned system, Congress helped make sure it would be responsive and dedicated to meeting agriculture's credit needs. Being cooperatively owned, the Farm Credit System exists for the mutual benefit of its member owners, which also gives it a unique accountability. As a farmer and a member/director of a cooperative, I understand and appreciate the important role the Farm Credit System plays when it comes to agricultural finance.

Many things have changed when it comes to agriculture in today's global economy. What has not changed, however, is the need for farmers, ranchers and their cooperatives to have dependable and competitive sources of credit and capital to operate, to modernize and expand, and to take advantage of new market opportunities. The cooperatively owned Farm Credit System, which was created by Congress to help meet this need, is as vital today as ever.

Proposed Termination of FCS America and Impact

This is why we as an organization are opposed to the proposed acquisition of Farm Credit Services of America (FCS America) and the termination of its status as part of the Farm Credit System. The issue is not about Rabobank's involvement in financing U.S. agriculture. The issue is about the current and future status of the cooperative Farm Credit System and its ability to carry out its mission as mandated by Congress. Both its status and its ability to carry out its mission, we believe, would be put at serious risk if such a proposed acquisition goes forward—whether it involves Rabobank or any other outside financial institution.

The proposed termination of FCS America as part of the Farm Credit System would impact not only its members in the four-State area it serves (IA, NE, SD, WY), but farmers, ranchers and their cooperatives throughout the entire Farm Credit System through the following adverse consequences:

- Elimination of local control and ownership of FCS America since it would no longer be part of the Farm Credit System. This would also eliminate current borrower protections and requirements to serve young, beginning and small farmers and ranchers.
- Reduction of available capital and capacity of the Farm Credit System. (While a termination fee of approximately $800 million would be required, such payment would not be considered as additional capital with regard to any individual farm credit bank.)
- Requiring the transfer of capital from other system institutions as part of chartering a new farm credit entity to serve the area now served by FCS America. In addition to reducing their overall capacity, such transfers could affect future patronage distributions and result in higher effective interest rates for their borrowers.
- Reduction of competition and choices for farmers. While a new or expanded farm credit charter would be granted for the area served by FCS America, the reality is this would be difficult to achieve. It took nearly 90 years for FCS America to be established and it would be impossible to recreate that overnight. Any new institution would begin without any people, offices or loan portfolios. Overcoming this would obviously come at a cost, which would also affect its competitiveness.
- Threatening the continued status of the cooperatively owned Farm Credit System and its mission and purpose as established by Congress, especially to the extent such action encourages future sales to outside banks and financial institutions.

Action and Recommendations

In recognition of the impact the proposed acquisition and termination would have, the National Council of Farmer Cooperatives recommends the following:

- The Farm Credit Administration upon review should reject the proposed termination of FCS America because of its material adverse impact.

• If a stockholder vote is required, the Council urges that the process be made fully transparent, and that members have access to all information, including alternative proposals, so they can make an informed decision.

• Congress should consider changes in the Farm Credit Act to specifically address this issue. We do not believe current law was ever intended to provide for the sale and dissolution of the Farm Credit System, a Government sponsored enterprise dedicated to serving agriculture and rural America.

• Congress should also consider and approve additional changes to modernize the Federal Farm Credit Act to ensure that the cooperatively owned Farm Credit System continues to be able to meet the credit needs of farmers, ranchers and their cooperatives.

A good example of the type of changes that are needed involves the ability of new and emerging types of farmer cooperatives to borrow from CoBank. In an effort to better finance and capitalize their businesses, farmers, ranchers and their cooperatives are looking at various business models and corporate structures that were not contemplated just a few years ago. Several states have adopted, or are considering adopting, new cooperative laws to provide farmer cooperatives with greater flexibility to raise equity capital to help their farmer members take advantage of new value-added opportunities to improve their income from the marketplace. The National Conference of Commissioners on Uniform State Laws is also working on a project to develop a new uniform cooperative state statute.

Because of changing state laws brought about by evolving market structures, the Federal Farm Credit Act also needs to be updated so that these new and evolving farmer cooperative businesses can continue to be eligible to borrow from cooperative banks, such as CoBank, which itself is a cooperatively owned lending institution. Such action would help make sure farmers, ranchers and their cooperatives continue to have as many options and choices as possible when it comes to financing and capitalizing their businesses, while preserving competition.

The mission and purpose of the cooperatively owned Farm Credit System remain as critically important today as when it was created by Congress. For this reason, we strongly urge Congress and the Administration to take action to ensure that the Farm Credit System continues to be cooperatively owned and able to meet the credit needs of farmers, ranchers and cooperatives.

Mr. Chairman, we appreciate this opportunity to share our views. We look forward to working with you and the members of this Committee on this important issue.

Statement of Mark Gage

Mr. Chairman and members of the committee, my name is Mark Gage. I live in eastern North Dakota where I raise hard Red Spring wheat, barley and soybeans. I am currently the president of the National Association of wheat Growers.

On behalf of NAWG I wish to express my deep appreciation to you, Mr. Chairman, for holding a hearing on this important matter. I am pleased to have the opportunity to present testimony on behalf of the wheat growers of the United States on the Farm Credit System and to give evidence of the importance of the role of the Farm Credit System in agricultural lending.

The message of the wheat growers to this subcommittee is very clear. The Farm Credit System is a partner for many of our producers. NAWG's policy reflects this commitment to the Farm Credit System, and we seek to preserve that system.

We are very concerned about preservation of that system in light of the recent proposal that would result in the acquisition of Farm Credit Services of America (FCSA) by Rabobank. We have a number of concerns that I will outline for you that relate to this specific issue. We believe that this acquisition will adversely affecting the entire Farm Credit System.

Let me say at the outset that we do not oppose entry of Rabobank into the U.S. agricultural finance business. Rabobank is a respected and strong company with a good track record in agricultural finance. What we do object to is the method by which they propose to enter the business by purchasing a component of the established Farm Credit System, and in so doing, putting the entire System in jeopardy.

The resources of America's farmers, other Farm Credit associations, and the United States Government have gone into the development of the Farm Credit System. NAWG understands and appreciates the value of a system that provides for ag-based lending. Farmers have come to rely on this system that was chartered in 1916 and to rely on the stability that FCS brought to agriculture. While the System has changed throughout the years to accommodate growth, so has agriculture.

Assets May be Discounted

In many ways, FCS has grown with us, and it would be unacceptable for this investment in vision and planning to be sold for less than fifty cents on a dollar. Just how discounted this sale is, is uncertain. There are lingering questions about the value of the transaction; one source says that Rabobank would be acquiring the assets of FCSA for 41 cents on the dollar. It is our understanding that such transactions are currently valued between one and two times book value. We expect that the testimony from this hearing will illuminate this and other facets of the transaction, and would assist stakeholders in making their decisions.

Loss of Farmer Control

One of the resolutions that NAWG has adopted recognizes the importance of preserving the farmer ownership of the Farm Credit System. The resolution opposes any restructuring of the Farm Credit System that replaces elected farmer members of system boards with commercial bankers. The proposed acquisition of FCSA by Rabobank, which would put this System institution under complete control of Rabobank, would violate this tenet of NAWG policy.

Drain on the System

There is more at stake here than one association. Should FCSA exit the Farm Credit System, we believe that it would adversely impact customers throughout the System. Regulations require that a new institution be chartered in the area served by FCSA, which would pull capital from other institutions in the System, limiting the otherwise available capital for borrowers. Further, the acquisition would drain the association area of loan officers, experienced support staff and infrastructure at a time in the lending season when loans are booked.

If one component of the system is sold off, this action would unquestionably invite offers from other non-FCS financial institutions for other associations. Stronger associations could be cherry-picked from the system, leaving the weaker ones behind, with a detrimental impact across the entire system. Each time one of those associations was sold in the future, the remaining parts of the FCS would be required to recapitalize a new institution to take its place, compounding the problem.

A Lender with a Mandate to Serve Agriculture

Less than 6 months ago, I testified before the Subcommittee on General Farm Commodities and Risk Management, expressing wheat growers' appreciation for crop insurance. While we have all experienced droughts and floods, wind and hail, we have not recently dealt with some of the crises that have affected our country nationwide. I would remind all of us that we may again deal with a series of years of farm crises with increased debt delinquencies and the decline in value of our farms. We believe that it would be extremely shortsighted to sell off one of these associations whose mandate to serve farmers.

Many of the benefits that farmers have experienced through FCS are not guaranteed through Rabobank. NAWG recognizes such benefits as we seek continued financing programs for beginning farmers. While an acquiring bank may provide some borrower rights they are not required to fulfill the same requirements of FCS. A successful takeover would result in ownership by an entity unconstrained in dealing with farmers and outside the direct reach of Congress with no mandate to serve farmers. While we have no objections to Rabobank competing in the market to serve farmers and hold the company in high esteem, only Farm Credit has an ongoing responsibility to provide credit to agriculture.

Repayment of Capital

Mr. Chairman, we see a number of concerns relating to the disposition of the assets of this association. We are very concerned about the fact that FCSA's assets include a reserve that represents dividends due to the association's farmer members and should have been paid to them. While there will be benefits paid to the current members of the association under the terms of the acquisition, there are many borrowers who have paid off their loans, never having received the patronage dividends due to them. Thus, the sale to Rabobank transfers funds that belong to farmer members. These assets include an excessive amount of unallocated capital that has not been paid as patronage.

In that regard, while the cash payout to members of FCSA may be attractive in the short-term, we have grave concerns about the consequences to the entire Farm Credit System in the long-term from allowing this acquisition to proceed. One potential way out would be for FCSA to instead consider merging with AgStar Financial Services of Minnesota, which would keep FCSA in the System.

Further, during the 1980's FCS America was the recipient of financial assistance from other associations that provided assistance. Due to the joint and several liability of the associations of the Farm Credit System this assistance made it possible for FCS of America to continue to function. Capital provided by other districts was transferred to the Omaha district during this period. If there is capital still on loan in Farm Credit Services of America, those other System institutions which provided the capital have a right to have it repaid with interest before FCSA would be allowed to exit the System.

Mr. Chairman, earlier I referred to growth in both the Farm Credit System and in production agriculture. This growth is constructive and is evidence of a vibrant and flourishing agricultural economy. The Farm Credit charter is now over 30 years old. Agriculture has changed substantially and farmers need the credit tools to be competitive in the global marketing place. It may be that this issue could provide the stimulus to consider updating the charter to better serve the agricultural community.

However, our immediate concern, of course, is to make secure the System that is in place. The Farm Credit System is focused on agriculture. The message of the National Association of Wheat Growers is to ensure that this cooperative remains healthy and viable. It would be foolhardy to make this System vulnerable through the acquisition of a major portion by Rabobank.

This concern is one which NAWG takes seriously. Rabobank has publicly announced that it would reinvest U.S. profits through expansion. That may well include the offer of purchase of other lending institutions. This new threat may require new safeguards. NAWG looks forward to having an opportunity to consider responses not only to this current concern, but to maintain the Farm Credit Services as an integral tool in agricultural finance.

STATEMENT OF NANCY C. PELLETT

Mr. Chairman, members of the Subcommittee, I am Nancy Pellett, chairman and Chief Executive Officer of the Farm Credit Administration (FCA or Agency). On behalf of my colleagues on the FCA Board, Doug Flory and Michael Reyna, I am pleased to be here this afternoon to discuss the current and future state of the Farm Credit System (FCS or System).

The FCA is the independent Federal agency responsible for regulating and examining the FCS and the Federal Agricultural Mortgage Corporation (Farmer Mac), Government-sponsored enterprises (GSEs) designed to serve agriculture and rural America.

The FCS is a nationwide network of borrower-owned cooperative financial institutions and affiliated service organizations that serve all 50 states and the Commonwealth of Puerto Rico. The FCS is the oldest of the financial GSEs. Congress created the FCS in 1916 as a means to achieve affordable and dependable credit for farmers and ranchers.

The mission of the System is to serve agriculture and rural America through good times and bad. In establishing the Farm Credit Act, Congress set out its objectives by stating,

It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative FCS be designed to accomplish the objective 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.

The FCS currently provides approximately $100 billion in loans to farmers, ranchers, producers and harvesters of aquatic products, rural homeowners, agricultural cooperatives, rural utility systems, and agribusinesses. This includes loans for production agriculture, operating needs and capital purchases; rural housing needs; farm-related businesses; rural utilities, including water and sewer systems; and money to ensure that rural Americans have access to the latest communications technology. Almost a half million borrowers and several million rural residents benefit from System funding.

Overall, the FCS has about a 30 percent market share of total agricultural credit. FCA derives its authority and responsibilities from the Farm Credit Act of 1971, as amended (Act). The Act authorizes the FCA to "exercise the powers conferred on it [under the enforcement provisions of the Act] for the purpose of ensuring the safety and soundness of System institutions."

The mission of the Agency is to ensure the FCS, including Farmer Mac, remain a safe, sound, and dependable source of credit and related services for agriculture and rural America. To achieve our mission, we examine, regulate and supervise the banks and associations of the System and Farmer Mac. In our regulatory oversight role, we also have enforcement powers that are similar to those of other Federal financial regulators that can be exercised should the need arise. At the same time, we are dedicated to maintaining a flexible regulatory environment that meets current and future rural credit needs while ensuring safety and soundness.

I am pleased to report that the System is sound in all material respects. Earnings and capital levels have continued to strengthen and asset quality remains high. Without the FCS, we believe the soundness of agriculture and the quality of life in rural America would be greatly diminished. American consumers have benefited enormously from American agriculture's high productivity and efficiency as reflected in the declining share of income that Americans spend on food from 21 percent in the 1970's to around 14 percent today.

While the System is presently sound, there are many challenges facing agriculture and rural America today that raise the question of whether there should be modifications to the System's chartering legislation in order to enhance agricultural and rural economies of the future.

In the early 1990's, the General Accounting Office (GAO), at the request of Congress, conducted a comprehensive study of the cost and availability of credit in rural America. Congress requested GAO to address, among other things, whether the FCS should be granted new authorities to serve other credit markets in rural America. The GAO Report, released in March 1994, concluded that the System did not need new statutory authorities in the near term, but that ongoing structural changes in agriculture and rural America could justify such changes in the longer term (emphasis added). GAO noted that over time, as agriculture and rural America continued to change, the System's charter might need to be updated to ensure that the System is not hampered by outdated restrictions in serving its existing customer base.

Mr. Chairman, the changes in agriculture and rural America alluded to in the GAO Report have arrived. Such changes are borne out by the national statistics, which are staggering. In 1970, 26 percent of the American population was considered rural. By 2000, Americans living in rural areas had dropped a fifth to only 21 percent of the population. Over the same period, the total American labor force exploded by 70 percent, while agricultural employment actually dropped by 5 percent. Additionally, the number of farms in operation declined from 3 million in 1970 to around 2 million in 2000, a decrease of one-third. Agriculture has been transitioning to a bi-modal industry during the last decade, resulting in fewer traditional family farms as we knew them in the 1960's, 1970's and 1980's.

Farm real estate has undergone some dramatic changes since 1970 as well, dramatically increasing the need for readily available credit, particularly for young, beginning and small farmers. U.S. farm real estate values (all land and buildings on farms) have increased from $196 per acre to $1,360 per acre in 2004, a 594 percent increase, or equivalent to an average increase of around 17.5 percent a year in nominal dollar terms. This year represents the 17th consecutive year U.S. farm real estate values have increased.

The challenges of financing agriculture in a safe and sound manner remain great. This is particularly true given uncertain weather and commodity prices, changing world competition and public policy, continued concentration and integration in agriculture, and concerns regarding safety and security of the food system, transition to the next generation of farmers and ranchers, and improving producer's income through value-added agriculture.

In responding to these changes and their effect on agriculture, the FCA Board adopted a 5-year Strategic Plan after holding a series of planning sessions that obtained input from farmers and ranchers; the Farm Credit Council and other System representatives; economists and finance specialists; the American Bankers Association; the Independent Community Bankers of America; former FCA Board Chairmen; and FCA Senior Management.

What we learned is that we must maintain a flexible and responsive regulatory environment. And where appropriate, we should eliminate or revise regulations that unnecessarily impair the System's activities.

However, the limits of that flexibility are currently being tested as the changes in agriculture and rural America have eclipsed the legislative parameters initially granted to the System. The mission-driven desire and sometime financially-driven need of the System to expand its operations, not only within agriculture but also to rural America presents some challenges within existing authorities.

The FCA Board considers the Agency's 5-year Strategic Plan to be a dynamic document, requiring modification as conditions and circumstances change. Three strategic goals were adopted this year reflecting the changes taking place in agriculture and rural America. The goals are as follows:

Goal 1: Ensure the Farm Credit System and Farmer Mac fulfill their public mission for agriculture and rural areas.

Under this goal, FCA will continue to emphasize the public purpose and mission-related responsibilities of FCS and Farmer Mac. As a part of fulfilling its mission, we will encourage System institutions to develop both public and private partnerships and alliances with other financial service providers to further advance their service to agriculture and America.

Goal 2: Evaluate risk and provide timely and proactive oversight to ensure the safety and soundness of the Farm Credit System and Farmer Mac.

FCA's examination and supervisory programs have been recognized for their high quality and effective results. Goal 2 focuses on preserving and enhancing the integrity of FCA's examination and supervisory programs by making improvements to address changing risks in the institutions we oversee. We will stay abreast of changing market needs and customer forces, we will have a cost effective examination process that makes full use of available technologies, and we will take the necessary supervisory action to proactively ensure safety and soundness of the System and Farmer Mac.

GOAL 3: IMPLEMENT THE PRESIDENT'S MANAGEMENT AGENDA.

We will implement to the fullest extent the five Government-wide initiatives that comprise the President's Management Agenda, which include: strategic management of human capital; improved financial performance; expanded electronic Government; budget and performance integration; competitive sourcing.

In developing the 5-year Strategic Plan, the FCA Board identified a number of factors that could affect achievement of one or more of the Agency's goals. Among the external factors identified, some relate to the structural changes taking place in agriculture that could pose challenges for the System and FCA, and also demonstrate the need to reassess current authorities in the Farm Credit Act. For example,

- Structural changes in agriculture and rural areas. The farm sector is increasingly reliant on off-farm income and Government payments. In addition, many rural counties in traditional farming communities are losing population and their rural infrastructure is declining. Many producers are part-time farmers and rely on additional business opportunities to improve their economic welfare.
- Lack of investment equity in many rural areas. Some rural areas are suffering from a loss of critical infrastructure, population, and business investment necessary to support opportunities. Furthermore, much of the capital in rural areas is held in the form of fixed assets and is not easily converted for investment purposes. Therefore, there is a need for more flexible, innovative forms of capital that will help rural areas reach their economic potential.
- Importance of GSE status. GSE status of the System and Farmer Mac helps maintain a safe, sound, and dependable source of credit and related services for agriculture and rural America. This is because GSE status facilitates a competitive source of credit for eligible and creditworthy borrowers in good times and bad. Furthermore, it results in a capital structure that is vital to the borrowers themselves and to the safety and soundness of the System and Farmer Mac.

As the System comes under increasing pressure, in the face of these emerging changes, to provide the same level of accessible and affordable credit to agriculture and rural America that it has in the past, Congress may want to consider whether the Act is responsive to such demands or whether changes are warranted. Among some of the areas FCA has pondered that Congress may wish to consider are:

Change rural home lending authorities that restrict such lending to towns of 2,500 in population so that such loans can be made in larger rural communities.

2. Provide more flexibility for System institutions to engage in syndication lending. In addition, authorize banks to engage in syndication lending.

These are just a few examples of changes that could be made to the Act that would make it more relevant and responsive to the needs of rural America.

I would hope that today's hearing sets the stage for Congress to enlist the aid of FCA, the System, and representatives from agriculture and rural America in seeking legislative solutions that will result in an updated Act responsive to meeting the economic, social and cultural needs of today's farmers, ranchers and rural Americans. Although we are not in the middle of a farm credit crisis, as we have been before, we recognize that the Act was Congress' way of acknowledging that protecting and sustaining American agriculture, providing for national security, and those living and working in our Nation's rural areas, was and is crucial to our country's economic and social well being.

At FCA we would welcome the opportunity to work with you to help bring the Farm Credit Act into the 21st century while maintaining its original mission, which is as valid today as it was when it was formulated.

Let me now turn to a matter that has spawned much attention and has raised questions about the applicability of the Act and the purpose of the Farm Credit System. In early August, a System institution, the Farm Credit Services of America, ACA (association), notified us of its intent to terminate its status as a System institution. Such an action is permissible under the Act and we have regulations implementing these provisions of the Act that allow for the orderly exit of an institution from the System.

Since my colleagues and I would sit as the deciding authority on any termination application submitted to us, it would be inappropriate for me or anyone at FCA to comment on the particulars of the association's announced intention to terminate its System status. Therefore, I hope you will appreciate that I will not be able to respond to questions relating to this specific association's intended termination at this time.

What I can share with you is a brief summary of the key elements involved in the termination process. Within the Act and our regulations we have two very important decisions to make. First, we must approve or disapprove any termination application from a broad perspective, including whether a proposed termination will have a material adverse effect on the remaining System institutions in fulfilling their statutory mission.

Second, if we provide preliminary approval to a termination application, we must ensure that the termination plan, including the disclosure material describing the intended action that is provided to stockholders for a vote is complete and accurate. This is critical so that the stockholders can make an informed decision.

Concurrent with any termination of System status by an institution, FCA would take steps to ensure that FCS service to the terminating institution's territory is maintained. We believe that making credit available to all eligible borrowers regardless of location is necessary to carry out the purposes of the Act. The Board of the Farm Credit Administration has complete confidence in the Agency's ability to carry out all of its regulatory responsibilities as it relates to the oversight of System activities, including our ability to reach an informed decision on any termination requested by a System institution.

In conclusion, Mr. Chairman, FCA is committed to ensuring that the Farm Credit System remains financially sound and operationally equipped to fulfill its statutory mission to serve agriculture and rural America well into the future.

Thank you for the opportunity to appear before you today and I stand ready to answer questions you or members of the subcommittee might have.

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

October 6, 2004

The Honorable Jerry Moran
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Moran:

At the September 29, 2004 hearing of the House Agriculture Subcommittee on Conservation, Credit, Rural Development and Research, you asked that the Farm Credit Administration (FCA or Agency) provide you with a statement of factors that would constitute a "material adverse effect" within the meaning of § 611.1230 of the Agency's regulations on termination by a Farm Credit System (System) institution.

Determining whether the termination of an institution from the System has a "material adverse effect" requires an analysis of the specific facts and circumstances. We have latitude to define the term within the bounds of reasonableness. I note that the term "material adverse effect" is used at least ten times in the regulations of other Federal agencies, but in no case is the term defined.

We have determined that the following factors, among others, are issues that we will analyze when and if we receive a termination application.

- What will be the anticipated costs to System funding in the securities market?
- What costs will AgriBank incur to provide capital and funding to the System institutions(s) assigned to serve the vacated territory?
- What costs will this (these) System institution(s) incur to rebuild the infrastructure needed to provide service in the vacated territory?
- What competitive conditions will result in the vacated territory due to the loss of an established Government Sponsored Enterprise?
- What costs will be incurred to reestablish a young, beginning, and small farmer and rancher program in the vacated territory?
- What quantifiable reputation risk will result within the territory, as well as nationwide, due to a System institution vacating the territory?
- What costs will the affiliated System bank incur to unwind debt instruments needed to retire the terminating institution's direct loan?
- What implications will the exit have on future termination requests from other System institutions?

Also, as I indicated at the hearing, the FCA Board will conduct a public meeting to gather input from a variety of sources on what effect the anticipated termination action will have. We will ask testifiers to provide analyses to support the position that they take. Further, we will obtain outside expertise in legal, financial, and other necessary areas as needed to complete a thorough analysis of the proposal.

Should you have questions please contact me at (703) 883-4008 or Carl Clinefelter, Acting Director of Congressional and Legislative Affairs, at (703) 883-4056.

Sincerely,

Nancy C. Pellett

Nancy C. Pellett
Chairman and Chief Executive Officer

Copy to: The Honorable Bob Goodlatte
The Honorable Charles Stenholm
The Honorable Frank Lucas
The Honorable Tim Holden

STATEMENT OF FARM CREDIT SERVICES OF AMERICA

Mr. Chairman and members of the Subcommittee, Farm Credit Services of America, is pleased to submit this written testimony for the record, and thanks you for this opportunity to comment on the status of Farm Credit System and the statutory exit provisions.

BACKGROUND

Farm Credit Services of America and its predecessor associations have served the states of Iowa, Nebraska, South Dakota and Wyoming since 1917, when the Farm Credit System was created by an act of Congress. As a Government Sponsored Enterprise (GSE), System institutions operate on a cooperative basis with farmer elected boards of directors. However, with GSE status, and the tax and funding advantages it brings, come certain definite restrictions in who the System can finance, where, and for what purposes.

In its planning process, FCSAmerica endeavored to go beyond the standard 3-year plan, and tried to look out 10 or more years. In looking forward, the board and leadership of FCSAmerica saw continued globalization of the economy, and agriculture in particular. Likewise there is a proliferation of life-style farmers, the continued growth of larger operators and agribusiness, and the ongoing struggle of many rural communities. Notwithstanding the Agricultural Credit Act of 1987, which specifically addressed issues arising out of the "Ag Crisis of the 1980's", the last comprehensive look at the System, its mission and authorities occurred with the passage of the Farm Credit Act of 1971, over 35 years ago. With this forward look, there was a sense that the needs of agriculture, farmers and rural communities had out stripped the ability of the System to serve them, given the restraints imposed by the Act. As the Farm Credit Administration (FCA) moved from a supervisory agency to an arms length regulator, it too, labored between the choices of expansive interpretation of the enabling statute vs. strict construction.

Current Regulations have not evolved with agriculture and asset utilization leading to inconsistent interpretation, inadequate customer focus, inefficient credit delivery and complaints from competing financial institutions. We support updated regulations that allow Farm Credit institutions and others to shift their focus away from scope of financing and eligibility debates and toward a healthy competition for ag loans the focus should be on the customers. To achieve this, the Farm Credit Act itself needs to be modernized, and the language made clear and consistent

Farmers. Basically the System loans to farmers. Seemingly clear enough, but who is a farmer? Is it defined by source of income, nature of assets, time spent or some other criteria? What definition should be used? Should a full time farmer be financed for different purposes than a part-time farmer? Put another way should an individual who actually farms 40 acres on the weekend be entitled to loans for different purposes than an individual who owns 1280 acres but just cash rents them? And what can the loan be for? Only Ag purposes, family needs, or anything to the extent the customer can repay? Is the recreational use of land an agricultural purpose? Should loan purposes differ depending on how "farmer" is defined? System institutions wrestle with these questions every day. The issues are confusing, and sadly the answers are not uniform. This inconsistent interpretation means some eligible customers are denied credit or at least underserved.

Farm Related Businesses. The System may also write loans to those who "provide services directly related to ag production". The sale of "goods" alone does not qualify. Thus, a store selling only agricultural chemicals or seed is not eligible for a loan, but if they apply any of those chemicals for a fee, provide agronomy services or custom mixing, or provide custom planting, then at least that part of the business is eligible for System financing if it accounts for 50 percent or less of the income. The whole business can be financed if more than 50 percent of the business is attributable to the services (and attendant goods) provided. Such arbitrary distinctions hinder the availability of credit and serve no useful purpose, except to complicate the analysis and slow or deny the delivery of credit, in some cases to the very type of businesses that are closely ag related and help to anchor rural communities.

Chartered Territories. System institutions operate under charters issued by FCA that specify territories. Depending on whether the customer's operation is wholly within, partially within, or wholly outside the "territory" of a given Association, and compounded by where the "operation" is "headquartered", a System institution can either write the loan, or it must either give notice to, or ask permission from, the association or associations where the headquarters or operation is conducted. Were it not for the protection of Capper-Volstead such outdated concepts would not survive. The Association should be able to follow the customer to wherever they choose to do business, and likewise, just like in any other situation, the customer should be able to choose the association with whom they do business without such artificial constraints. A System with geographically restricted institutions does nothing to provide a reliable source of credit, if it must stop at county or state lines. Further it does nothing to aid in the safety and soundness of the various institutions as they remain limited not only in the type of loans they can write, but the physical territory in which they can be written. This is not only a severe limit on the institutions ability to diversify risk, but it is also cumbersome and inefficient forcing the customer to maintain two or more lines of financing.

Loan Participations and Syndications. One area where diversification of risk can occur, both as to type of loan (commodity) and geography is in the participation and syndication of loans. However, this authority is similarly hampered due to the fact that the participation and syndication authorities are contained in different Titles of the Farm Credit Act, which were granted at different times and contain different definitions. As a result, their utility is greatly limited as different regulations have been applied. This result also poses a great hindrance to System institutions working with the commercial banking sector. Syndications, in which there is an overriding Credit Facility, but with separate notes running to the members, are treated as loans, therefore, the System requirements of a stock purchase and borrower rights apply. This is a major disincentive to other lenders to allow the System to join in the syndication as they are not subject to these rules and it unduly complicates servicing the "loan". While the purchase of participation by a System institution does not bring with it the requirement for the purchase of stock and borrower rights, participations are no longer the vehicle of choice for larger complex credit facilities. The syndication and participation authorities need to be updated and made consistent as again, these are distinctions without meaningful differences. Over time these restrictions impact the institution's ability to grow and diversify which could hamper its reliability as a lender in the cyclical downturns in the ag economy.

Borrower Rights. Borrower rights were imposed upon the System in several stages culminating in the Agricultural Credit Act of 1987. While it can be argued that these provide some meaningful protection for individual customers, there is no reason these rights cannot be waived by a "sophisticated" borrower, such as a legal entity of a given asset size, or a loan of a certain amount. This concept was already recognized in 1987 when the Banks for Cooperatives were not included in the definition of covered institutions subject to those provisions.

Rural Residents. The System may also make housing loans to build, buy or remodel "moderately priced" rural residences for non-farmers in the county or towns of 2500 population or less. Again these restrictions are outdated, meaningless and arbitrary. Rural and urban demographics have changed and shifted. The possibility to loan in a town of 2501 is prohibited, while the ability to loan in an unincorporated subdivision abutting a metropolitan area is arguably open. Similarly, tying the value of the home to Farmer Mac securitization limits, or the 75th percentile of local value serves no meaningful purpose if the goal is to make affordable housing available to rural residents. Creditworthiness will do that. Likewise, the inability of the System to provide home equity loans puts existing System customers at a disadvantage, and treats them differently than the "farmer" customer. Those who live in true rural areas and smaller communities (certainly even larger than 2500) are already underserved with limited options to financial services.

Financially Related Services. Financially Related Services are another area where System has some authorities, but the requirements to qualify such a service are cumbersome. Other than depository functions, System institutions should be allowed to offer financial, risk management and insurance services as approved by the local Association Board of Directors, and subject to what, if any, other state or Federal licensing or regulatory procedures apply. The local Board of Directors is ideally placed to determine the needs of the farmers and rural residents in its area.

Equity InvestmentsSystem institutions need specific authority to invest in agricultural enterprises in rural America by way of purchasing equity, not simply making loans. There exists a process to obtain approval for "mission related investments" on a case by case basis, but again, the Board of Directors should be allowed to determine how the capital of the institution is to be "invested". There are many worthy projects that would aid in the re-vitalization of the rural communities, but would not be appropriate for loans.

Effective Interest Rate. The System is also subject to the requirement to provide the customer with an "effective interest rate disclosure" (EIR) on any loan not subject to the Truth in Lending Act. The primary purpose is to show the customer the impact of the required purchase of stock in the local Association on the stated rate for the loan. No other lender is subject to anything like this requirement on non-consumer loans as agricultural and business loans are not subject to Truth in Lending. The regulatory burden associated with the EIR disclosures is great given the infinite number of interest rates, rate plans and repayment schedules. The requirement should be eliminated, or reduced to a simple requirement that the customer be given written notice that "if your loan required the purchase of stock in (Name of Institution) it will increase the stated rate of interest contained in your note". The purchase of stock is not a "hidden charge". This disclosure is another inefficient procedure adding time and overhead expense to the loan process with virtually no benefit to the customer.

Moreover, the items discussed above, while perhaps meaningful when enacted, impair the ability of the System to meet the needs of its customers and to evolve as agriculture and rural America develops in the 21st century. The restrictions cited are no longer a reasonable exchange for GSE status and can be adjusted or removed to make the Mission of the System "that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective 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" truly attainable.

Support for Keeping the Exit Provisions. FCSAmerica supports maintaining the exit provisions written into the Act and regulations.

The exit provisions allow farmer elected boards of directors to pursue strategic alternatives that they believe are in the best interests of their stockholder members. These strategic options should remain available to any Farm Credit Entity enabling them to adjust to an ever changing agricultural world by pursuing alternatives that provide stockholders, farmers and ranchers, and rural America new opportunities.

The exit provisions allow for both the Farm Credit Administration and, importantly, the organization's stockholders to decide if exiting the Farm Credit System is in the organization's best interests. The FCA can address the safety and soundness issues, and assure the information disclosed to the Stockholders is accurate and complete. And then, as it should be in a cooperative system, the actual shareholders will have the final decision. This is not a matter decided by the just the Board of Directors or Management. To eliminate this option is tantamount to declaring that the customer shareholders are incapable of making such a business decision.

Today's exit provisions include significant financial parameters to insure that any Consolidated Debt incurred on behalf of the exiting institution is adequately covered, and that the capital gained by virtue of System membership and its GSE advantages is left behind. That is all as it should be. Again, while this is a significant financial hurdle and disincentive to exiting the system, any Farm Credit entities that choose to exit and pay this fee, should be allowed to do so.

Ultimately, stockholders should decide what they want for their cooperative. Stockholder choice is built into the exit provisions today, and Farm Credit System entities should not be held captive by the Farm Credit System or the Farm Credit Administration.

Removing the exit provisions limits choice stockholders and their elected board members should not have their choices and options artificially restricted. The Exit provisions are not about fulfilling the "mission" of the System. They are about the freedom of customers to choose in what form and with whom they do business. If the choice is to leave the System, it would be based on a decision, by the customers that it is in their own best interest. The System's statutory Mission remains intact and in the capable hands of the remaining Farm Credit System institutions and their arms length regulator.

Changes to Exit Provisions. FCSAmerica supports changes to the existing exit regulations. Specifically, FCSAmerica encourages the FCA and Congress to change the public disclosure regulations.FCSAmerica would support any revisions to public disclosure facets of the exit regulations that could be modeled on SEC rules and regulations to assure that the not only is the System protected, but most importantly the stockholders have access to complete and thorough information free from deliberate outside interference. If the regulations are to be modified, there should be a requirement for a thorough preliminary conditional disclosure to go to the Stockholders with the Notice of Commencement. It should clearly state that all the material is subject to review and approval by FCA and will be modified by the information statement actually received prior to any vote.

However, FCSAmerica believes that just as the exit provisions are currently written, the decision to exit the system is where it belongs, and should be decided by the farmer and rancher elected board members that represent stockholders, the Farm Credit Administration, and most importantly, the stockholders themselves.

If Exit Provisions Removed. Upon considering removal of the regulatory exit provisions, one has to consider the ramifications and potential questions:

If the exit provisions are removed, and unless changes are made to the current funding source regulations, system entities will always be reliant upon GSE status to remain competitive. The exit provisions allow a Farm Credit System entity the choice to terminate their GSE status and fund customer loans via alternative capital market sources.

If the exit provisions are removed, one should ask who assumes the role of making the system more economically efficient with increased productivity. Would the FCA, whose current role focuses on safety and soundness, be mandated to improve efficiency which ultimately benefits farmers and ranchers through lower costs?

The exit provisions allow forward thinking, customer focused system organizations to pursue actions on behalf of their stockholder members that they believe make their organization more efficient, and better able to provide additional products and services.

Many financial services companies and other business have pursued business models seeking the correct balance of customer service, delivery systems, and economic efficiency. The exit provisions allow Farm Credit System entities to do the same.

No one Farm Credit System Association accounts for more than single digit percentages of the total System debt or assets. To eliminate the ability to exit seemingly implies that the entire System is so fragile that the member institutions must remain forever captive. Given the concerns periodically expressed about the implied Government guarantees surrounding the debt of the various GSE's, this would appear to be a strange outcome. The success of Sallie Mae's cession of GSE status should serve as proof that such exits do not, per se, lead to financial chaos.

SUPPLEMENTAL TESTIMONY FOR THE RECORD

Mr. Chairman and members of the subcommittee, Farm Credit Services of America is pleased to submit this additional written testimony to supplement the testimony it previously submitted.

We wish to clarify several items that were raised in the testimony as well as oral responses of various Panelists at the September 29, 2004 hearing.

The first issue we wish to clarify relates to FCSAmerica's communications with its shareholders concerning the Rabobank transaction.— Several witnesses and opponents of the Rabobank transaction have suggested that FCSAmerica's communications with its shareholders have been inadequate and have implied FCSAmerica was not forthcoming with information regarding the proposed FCSAmerica Rabobank transaction. Nothing could be further from the truth.

FCSAmerica has avoided communicating the details of the transaction with shareholders for one simple reason: the Farm Credit Administration has directed us not to do so. On August 26, 2004, the FCA directed FCSAmerica not to distribute to its shareholders any information concerning the transaction until FCA had reviewed and approved FCSAmerica's Information Statement. (Attachment 1). See also, 12 C.F.R. 611.1215. The Information Statement has not been filed, and FCA's directive to FCSAmerica remains in place. As a diligent and law-abiding System institution, FCSAmerica has abided, and will continue to abide, by the instructions of its primary regulator, the FCA. Any suggestion that FCSAmerica has anything to "hide" is simply wrong.

FCSAmerica does not wish to run afoul of the regulatory process, but in point of fact only wants the process to be allowed to work so that there can be a shareholder vote after full and complete disclosure. The FCA has made it very clear that an Information Statement must be provided before any FCSAmerica substantial shareholder communication and vote. Critics and opponents of the proposed transaction have ignored these clear FCA directives to FCSAmerica.

FCSAmerica also wishes to make the point that nothing can happen until there is a complete disclosure and to even imply more time or hearings are necessary implies the shareholders are incapable of making a decision for themselves, the FCA will not do its job, or that the disclosure will be incomplete or misleading. There are no facts supporting any of these implications.

We would add that opponents of the Rabobank transaction and competitors of FCSAmerica have freely communicated through the media and in other ways their views of the transaction and have, in our view, made incorrect and misleading statements. We believe this creates an unfair and uneven playing field in which opponents may freely communicate their opposition to the deal, while FCSAmerica must remain silent. FCSAmerica has apprised FCA of its concerns in this regard. FCSAmerica has urged all System institutions to refrain from communicating incomplete or incorrect information to FCSAmerica shareholders. If legislation is proposed by Congress affecting system institutions exiting the System, we strongly urge Congress to require the FCA to prohibit any and all system institutions from issuing statements that are false and misleading.

Secondly, concerning the statutory ability to exit the Farm Credit System, it should be noted that the revised exit regulations were originally proposed in November of 1999, and were not made final until April 12, 2002. Only two comment letters were received, one by the Farm Credit Council, and one by the ICBA. There were no comments from Congress during the 30-day pre-publication period or otherwise. Neither of the commentators said System associations should not be permitted to leave; in fact, the FCC wanted the exit provisions limited to System institutions and the ICBA wished to exclude System Banks. At no time was there any discussion of amending the Act to remove the exit provisions.

Third, pointed comments were made concerning the request for FCSAmerica Shareholder lists. In the current atmosphere of Sarbanes-Oxley and appropriate concern over privacy and shareholder rights, as well as consumer privacy issues such as identity theft, selling customer lists, "don't call" lists, spam concerns and confidentiality of account information, FCSAmerica has a deep and legitimate concern that a simple recitation of the permissible purposes in the regulation governing release of the shareholder list was insufficient. FCSAmerica did respond within the required periods, but was seeking additional and specific clarifications as to the proposed purpose of the proposed shareholder communication. Once the FCA ruled the certification sufficient, including the addition by FCSAmerica of language concerning an exception for providing the list to third-party mailers, the information was released to the requesting parties. This occurred even though there is no recourse for misuse by the requestor, and the release without additional certification as to the requestors intended use and purpose seemed at odds with the approach the FCA has previously taken in its Policy Statements on customer privacy.

FCSAmerica also is aware of irresponsible and untrue comments about "secret contracts" or "side agreements" between FCSAmerica management and Rabobank. These comments are made without any factual basis and are patently false. As noted, FCSAmerica has been required by law to keep the details of the transaction "secret," at least until the FCA approves the FCSAmerica Shareholder Information Statement. Any suggestion that FCSAmerica has kept this information confidential for any reason other than FCSAmerica's compliance with the law is false and a clear misrepresentation of the facts.

Statement of Roger D. Monson

Mr. Chairman, and members of the committee, I am pleased to appear before you to discuss the role the Farm Credit System (FCS, Farm Credit, or System) currently plays in agricultural lending, and to share our views of if and how Farm Credit System institutions should be allowed to leave the System.

My name is Roger Monson and I am president of the Citizens State Bank in Finley, North Dakota and I am the chairman of the American Bankers Association's Agricultural and Rural Bankers Committee (ABA). For those of you who are not familiar with Finley, it is located about an hour and a half north of Fargo. Approximately 550 people call Finley home. Citizens State Bank of Finley has $47 million in assets and makes credit available to individuals, businesses (including farmers) and cooperatives.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks makes ABA the largest banking trade association in the country.

For almost 90 years the Farm Credit System has occupied a unique and enviable place in American agricultural finance. It is extremely profitable, has a mountain of capital, and has a portfolio of high volume, low-risk credits. In short, the Farm Credit System has everything a well run financial institution should desire.

The Farm Credit System is a special purpose, tax advantaged, retail lending, Government sponsored entity that is limited to specific areas of the financial services market. It was designed by Congress to be that way to balance the Government's grant of advantages with a specific mission: providing credit to farmers and ranchers. Some System managers want to offer more products to a wider range of customers over a wider area of the country. One FCS institution, by announcing that it is selling to a non-FCS institution, recognizes that the answer for System institutions that wish to expand into new areas of the financial services market is to cut their ties to the Federal Government. This is a natural evolution, and we support it.

For those that wish to remain part of the special purpose, tax advantaged, retail lending, Government sponsored Farm Credit System, they must recognize that with the advantages Congress has bestowed upon them, there are limits and responsibilities. There is no economic or public policy argument that can be made to justify expanding the charter of the System.

The July announcement that one FCS association intends to sell itself to a non-System lender illustrates this point. That elected board of directors recognized the limitations of the special System charter, and decided that that it was time to seek broader opportunities outside the confines of Government sponsorship. Even if this transaction is not consummated, it is a step in the right direction. System institutions that wish to offer a broader array of products and services must seek those opportunities outside the System. Those institutions that wish to remain part of the System must accept that there are limits to what they can do because the special privileges Congress bestowed upon the System were designed to enable the farmer owned System to meet a clearly defined need. Once that charter is deemed to be too narrow by the farmer/owners of System institutions, it is appropriate for them to seek solutions that are outside the charter.

A Brief History of the Farm Credit System

The Farm Credit System is America's first Government Sponsored Enterprise (GSE). It was created in 1916 when Congress chartered 12 cooperative regional farm credit banks in order to increase farmers' ability to finance the purchase of farms and ranches. The Farm Credit System was patterned after cooperative farm lenders found in the Netherlands and Germany, but was given the unique enhancement of Federal financial sponsorship.

In 1933, Congress responded to the banking crisis by creating cooperative Production Credit Associations to lend money directly to farmers and ranchers. To this day, the FCS remains the only GSE that has direct, retail lending authorities.

Over the years the FCS has received additional authorities, most notably in 1971 when lending to farm businesses was authorized. Significant changes to FCS lending practices were also authorized by the 1971 legislation, including a major liberalization of its real estate lending limit.

The FCS was a major player in the agricultural credit market of the 1970's and 1980's. From 1971 to 1980 FCS farm and ranch lending quadrupled, rising from \$13.2 billion in 1971 to \$53 billion by the end of 1980. By 1982 the FCS had more than \$64.5 billion in loans outstanding to American farmers and ranchers (34 percent of the total agricultural credit market). Farmers and ranchers took advantage of low real interest rates and borrowed heavily from all lenders. When interest rates jumped in the early 1980's, farm real estate values crashed and the FCS found itself burdened by a high number of non-performing loans and an interest cost structure that could not be sustained. Congress responded by passing emergency legislation in 1985 and 1986 to help but both attempts failed to restore the FCS to financial health.

By 1987, it became clear that the FCS would default on its bonds without a cash infusion. In addition, the farmers and ranchers who borrowed from the System were at considerable financial risk since they had to buy FCS stock in amounts up to 10 percent, or more, of their total borrowings.

Finally, in 1987 Congress authorized a \$4 billion line of credit rescue package for the FCS. Specifically, the FCS was authorized to sell up to \$4 billion in taxpayer-backed bonds to assist troubled FCS institutions.

The 1987 legislation established new guidelines governing the role of the Federal Government and the role and responsibilities of the farmer borrower/owners of the System. Provisions in the 1987 Act have a great deal of bearing on where the System is today, and where it may be going in the future:

- First, the legislation protected all of the FCS bondholders by making what had been an implied Federal warranty on Farm Credit bonds an explicit Federal guaranty since the Treasury backed them with a \$4 billion line of credit.
- Second, the legislation protected all of the FCS owner/borrowers from any loss on their FCS stock. In addition, the legislation reduced the required stock purchase that FCS borrowers had to make from 10 percent (or more in some cases) to the lesser of \$1,000 or 2 percent of the amount borrowed. Today, no borrower/owner of the FCS has more than \$1,000 invested in System stock.
- Third, the 1987 legislation established an explicit exit procedure for System institutions that wanted to leave.
- Fourth, the 1987 legislation required the FCS to establish an insurance fund to protect System bondholders against future losses.

• Fifth, the Farm Credit Administration (FCA) was established as an independent regulator. Among other actions, it established minimum capital standards and other safety, soundness, and mission standards for System institutions.

During the period of restructuring following the Federal bailout, the FCS shrank its farm loans by nearly $30 billion over 9 years. The organization has, since 1987, contracted rapidly with 13 banks for cooperatives consolidating into one and 12 farm credit banks consolidating into four. At the retail lending level there has been massive consolidation as well, with 895 associations in 1983 consolidating to less than 100 in 2004. Today, many System associations are far larger and cover territories that are far more expansive, than most ABA member banks. Their size, combined with their Federal subsidy makes them formidable players in the market place.

The Farm Credit System Today

As of June 30, 2004, the Farm Credit System had approximately $119 billion in assets, $94.3 billion in loans, $19.7 billion in capital (a 16.5 percent capital ratio), a loan loss reserve of $2 billion (2.1 times non-performing assets), and had net income of $939 million in the first six months of 2004. In 2003, the System made a $1.825 billion net profit.

The Farm Credit System today, from a business perspective, is a large, sophisticated, and highly profitable financial services institution that happens to be organized as a cooperative. Other than its cooperative business organization, there is nothing to distinguish the Farm Credit System from any other large commercial enterprise.

From a public policy perspective, the justification for why the System continues to enjoy such extraordinary governmental support is tenuous. The recently announced plan by one System association to put itself on the auction block underscores the tenuousness of that continued Government support. The Farm Credit System is the only Government sponsored enterprise that competes directly with the private sector by doing direct, retail lending in competition with tax paying private enterprises like our tax paying members.

The reasons that made sense in 1916 for Congress to create a taxpayer-subsidized, retail lending, Government sponsored enterprise focused on making small loans to farmers and ranchers no longer exists. The System, which got its start with the capital investment of the American taxpayer, and got bailed out by taxpayers following a decade of spectacularly poor lending practices, is now a highly profitable, highly sophisticated financial services provider which has no apparent public policy mission to fulfill in the American economy. Why should taxpayers continue to subsidize its activities and to be at risk for future blunders?

The Farm Credit System Enjoys Unfair Advantages in a Crowded Agricultural Credit Market

Since the 1987 bailout legislation, and the subsequent recovery of the agricultural economy, the System has re-emerged as a powerful competitor in the rural credit market. Since the 1990's bankers and other private sector lenders have become alarmed as the Farm Credit System re-emerged as a competitor that exploits its GSE status to the fullest. Specifically the FCS has:

• Used below market pricing to regain market share. Bankers and other private sector lenders have filed numerous complaints with the FCA about below market pricing. The FCA has ignored nearly all of our complaints.

• Established a holding company model that has helped System institutions to lower their effective tax rate while profits have steadily increased.

• Used deft exploitation of statutory and regulatory loopholes to enable many System entities to take non-insured deposits from their customers.

• Ignored young, beginning, small, and women-owned farming enterprises by focusing on low risk loans to larger and wealthier farmers. Countless surveys, studies, and other data collected by USDA and others show a clear pattern that System lenders provide Government subsidized credit to those that need it the least.

• Focused attention and marketing muscle on the rural rich; encouraging those that can afford it to use the System's subsidized credit to finance their country estates, weekend get-aways, hunting preserves, golf courses and just about everything else that System lenders cynically label as farming enterprises, or those that have the potential to be farming enterprises.

• Pressured the FCA to modernize regulations by refining basic concepts like farmer, and modest priced housing, with the clear intent of extending more and more taxpayer-subsidized lending beyond the farm gate, and beyond those the System was chartered to serve.

• Pushed for national charters that would have set the System on a dangerous path of intrasystem competition as expansionist lenders sought authority to lend anywhere in the country.

• Pushed for the ability to enter into the farm management business.

• Pushed FCA for trust powers, which would have put them in numerous conflict-of-interest situations with their borrowing customers.

In short, the System is a company which feels it has outgrown farming and the rural America it was chartered to serve. At no time, however, have System institutions ever suggested that it should surrender its GSE privileges, or its Federal tax breaks, in order to pursue its expansionist agenda, until this July.

Farm Credit System Institutions Have a Clearly Defined Path in Federal Statute That Allows Them to Leave the System

The 1987 Act established a statutory procedure for System institutions to exit the System. In our view, the procedure is adequate because it allows taxpayers to recapture some of the benefits they have bestowed on System institutions for the past 88 years by requiring System institutions to leave all capital in excess of 6 percent of total assets with the System, allows the Farm Credit Administration to review the termination plan, and most importantly, requires the farmer/owners of a System institution to vote for or against a proposal, for up to three times.

First, the elected board of directors must vote for any exit plan; for the most part, an FCS board of directors is made up of the farmer/owners of the System institution. Second, after FCA gives preliminary approval to the exit plan, all of the farmer/owners of the System institution have the opportunity to vote for or against the proposal. Finally, even if the termination plan is approved by a majority of the owners, as few as 15 percent of the dissenting farmer/owners can force a reconsideration vote of all the owners again. We believe this provides an extraordinary level of shareholder participation, an extraordinary level of shareholder protection, and an extraordinary level of shareholder democracy.

Recent statements made by System managers who oppose the announced sale have called into question the wisdom of their farmer/owners. They have done this despite the fact that the farmer/owner board of directors of the selling association approved the proposed sale. These statements alarm us. Opposing System managers have been quoted in the press as saying that the proposed deal was done with a lack of transparency, and that the proposed purchase price is too cheap. They have also suggested that the deal was being done to benefit the management and board of the selling association, not for the benefit of its farmer/owners. Representatives from these very same System institutions recently made public statements extolling the wisdom of their farmer/owners and of the local boards that, at the time, they claimed governed their institutions.

At an FCA public hearing last summer, the chairman of the Farm Credit Council Board told FCA, each System institution remains governed by an elected board of directors. These boards set the policies that guide the activities of these institutions. Our focus is on making sure agriculture is served.

At that same public meeting, a representative from the CoBank-Northeast Farm Credit Regional Council noted, Farm Credit System boards should have the flexibility to determine how best to serve agriculture and rural areas. Being made up of farmers from the area served, an Association's board of directors is elected because they understand the local agricultural environment.

System managers want to have it both ways. When it is convenient for System managers to extol the virtues of their local boards they do so, but when a local farmer/owner board makes a decision that displeases management, they heap abuse on their motives and on their character. Who really runs the Farm Credit System?

Farm Credit System Owners Should Be Allowed to Decide Their Future

Our position is that the Farm Credit System no longer deserves a privileged place in the market and that the continuance of GSE status and tax advantages has no basis in economic need because the System no longer has a real public policy mission.

The recently announced proposal by one FCS association to seek a buyer outside of the FCS sphere makes our point. From statements by the selling association and the acquiring bank, we can discern that the reason for the sale is to offer the owners of the association (51,000 plus farmers, ranchers, rural homeowners, and business people) a broader array of financial services that only a non-GSE institution can provide. This desire makes sense. Their actions underscore what the American Bankers Association has said for years: if the System wants to expand, it should do so by becoming a privately held or publicly traded institution which does not have a direct or indirect connection to the taxpayer. There are limits to a GSE charter since they have a privileged place in the marketplace. Once that privileged place in the marketplace limits the growth of the institution in the eyes of the owners, then the institution should relinquish its GSE status and seek new ways to be relevant.

The American Bankers Association Opposes Efforts to Increase the Dependence of the Farm Credit System on the Federal Government

The American Bankers Association opposes efforts to prohibit, or to make it more onerous, for Farm Credit System institutions to exit the System. We believe that existing statute provides a fair, clear, and understandable process for System institutions to follow if they wish to exit the System.

Further, the American Bankers Association opposes efforts to broaden the charter of the Farm Credit System. The recent announcement of the sale of a Farm Credit System association is an indication that our economic system works. When the structure of an organization no longer fits the economic model that the owners of the entity want, it is reasonable that the structure be abandoned in favor of something that fits their new strategic vision. Apparently, the owners of the Farm Credit System institution in question desire new services, a wider range of options, and help meeting the challenges of a globalized economy. They seem to have found something that meets their needs. We wish them well.

We urge Congress to resist the rhetoric from System managers who claim that broader authorities, and increased dependence upon the Federal Government, are the answer for the System, in order to protect it from today's economic realities. In fact, the term broader authorities for the FCS by definition means off-farm, non-agricultural lending since the FCS can lend today for any agriculturally related purpose. Since there already is an abundant supply of competitive off-farm credit available to all Americans, provided by taxpaying private-sector banks and financial firms, there is no rational need to expand that supply with subsidized GSE credit.

The good news is that some Farm Credit System institutions want to leave the System because they are large, highly profitable, and sophisticated financial services companies that desire to be involved in the broader, non-GSE credit market. If that is what the farmer/owners of System institutions want, then the recently announced sale is a clear path to that goal.

Thank you for the opportunity to share the views of the American Bankers Association. I will be happy to answer any questions you may have.

STATEMENT OF PAUL DEBRIYN

Chairman Lucas and members of the subcommittee:

Thank you for the opportunity to provide written testimony on the issue of Rabobank's proposed purchase of Farm Credit Services of America.

I am Paul DeBriyn, president and CEO of AgStar Financial Services, ACA. This is a critically important issue for the nation's agricultural community and one that warrants thorough review—we appreciate your attention to it.

Please allow me the opportunity to briefly introduce AgStar Financial Services:

- AgStar Financial Services is the sixth largest Farm Credit lender in the United States, with nearly $3 billion in assets and more than 19,000 clients. We are based in Mankato, Minnesota and chartered by the Farm Credit System to serve farmers, ranchers, rural homeowners and agri-businesses in Minnesota and northwest Wisconsin.
- AgStar is owned by more than 12,000 stockholders and controlled by a 17-member Board of Directors.
- As a member of the Farm Credit System, we have a Congressional mandate to provide financial services to farmers through good times and bad, as well as to young, beginning and small farmers. We are proud that for over 85 years we have been able to serve agriculture and rural America.

With an issue this critically important, we appreciate the opportunity to present our views in respect to the proposed Rabobank acquisition of Farm Credit Services of America and its impact on the Farm Credit System. This transaction is perhaps one of the most important developments regarding the future of the Farm Credit System and agriculture since the dark days of the mid-1980s.

Most importantly, the outcome of this situation will have significant future implications for farmers, ranchers and rural communities throughout the country. I would like to highlight three key areas of importance as it relates to this proposed transaction:

- What is wrong with the Rabobank proposal?
- Why the AgStar proposal is superior.
- AgStar's views on reforms to the Farm Credit System.

What is wrong with the Rabobank proposal?

If the Rabobank acquisition of Farm Credit Services of America is approved the future of the Farm Credit System will be at serious risk.

The acquisition of Farm Credit Services of America would leave a gaping hole in rural America, starting a dangerous trend for the country. By acquiring FCSA, Rabobank will take one of the largest Farm Credit System lenders completely out of the System, depriving tens of thousands of farmers and ranchers throughout the Midwest access to the federally chartered lender that has served them in good and bad times for over 85 years. In addition, current stockholders would have no voting control over the company and customers would lose the valuable borrower rights and protections granted under the Farm Credit Act.

But the effects are likely to be felt far beyond the states of Nebraska, Iowa, South Dakota and Wyoming. Eliminating one of the largest FCS lender in the country will leave many other System lenders the target of take-overs, initiating a domino effect in the country that, rather than increasing competition, will actually reduce access to fair and responsible credit.

The advantages to Rabobank of acquiring FCSA are clear. Rabobank wants to buy the country's largest FCS lender on the cheap—at less than half of FCSAmerica's book value, so they can take advantage of the strong infrastructure FCSA has built. Rather than starting from the ground and working to build a competitive entity, Rabobank will gain immediate access to existing offices, trained staff and a network of relationships that have been cultivated through the Farm Credit System over generations.

In addition, Rabobank will drain at least $800 million of FCSA stockholder capital to pay the exit fee required to leave the Farm Credit System. This capital, built by generations of stockholders, was never intended to be used as petty cash by an acquirer.

What is equally clear is the lack of advantages for the farmers and ranchers FCSA currently serves, not to mention FCSA stockholders. A successful acquisition would mean that FCSA would cease to exist. The Farm Credit Administration would no doubt act quickly to assign the charter for these four states to another association within the System. But the costs and time necessary to build a competitive lender in a new market are prohibitive. Service by a System entity would be severely disrupted for an extended period of time. There would be no established lender with a mandate to serve farmers through good and bad economic times; to serve young, beginning and small farmers; and to consistently serve the financial needs of agriculture in rural America.

Rabobank understands that it is more economical to acquire an existing infrastructure than it is to build one without an established client base. This is exactly why they are attempting to purchase FCSA. The effect of this purchase will be to transfer their cost of entering the market to farmers and ranchers in other parts of the country who would bear the expense of rebuilding this infrastructure.

A key sentiment expressed by stockholders is that larger stockholders will reap a windfall from the sale of their cooperative. The planned payout from Rabobank is slanted in favor of the large producers. The small farmers, and ones who need the System the most, will receive the smallest payout because the amount paid to each farmer is based on volume of business done with the association and not on the level of profitability contributed to Farm Credit Services of America. Meanwhile, the long-standing producers who have the misfortune of retiring their loans and stock prior to the transaction will receive nothing. In sum, the current stockholders raid the surplus built by their parents and grandparents, leaving nothing for future generations of farmers and ranchers. Certainly not the way a cooperative should work.

Since the Rabobank acquisition was announced, we have been struck by the level of opposition to the proposal. We have heard from a countless number of stockholders, customers and farm leaders saying that they share the sentiments outlined above and are concerned about the future of the System, not to mention the opportunities for the next generation of farmers in their area.

If the Rabobank acquisition of FCSAmerica is allowed to go through, there is little to stand in the way of similar acquisitions throughout the country quickly eliminating the strength, and possibly the very existence, of the Farm Credit System.

Why the AgStar proposal is a superior proposal. The AgStar merger proposal will preserve and enhance Farm Credit Services of America, maintaining a Farm Credit System lender with a mandate to serve farmers, ranchers and rural America.

We believe that the proposal we've offered to FCSAmerica is far and away the superior option. The merger of our two entities, which have worked side-by-side for more than 85 years, would give us an opportunity to extend our shared commitment to serve farmers, ranchers and rural communities that depend on a strong and reliable farm lender. The AgStar merger proposal is superior for several important reasons:

- First and foremost, the merger of AgStar and FCSAmerica would create a cooperative that would remain a member of the Farm Credit System, with a mandate to serve the financial needs of farmers through good and bad economic times.

• The stockholder-customers of the merged entity would retain the ownership and control of the farm credit lender serving them.
• AgStar's proposal includes a cash distribution of $650 million—$50 million more than the Rabobank offer. In addition, $50 million more of purchased stock remains on the balance sheet as paid-in capital. Together, this makes the AgStar proposal $100 million above the Rabobank acquisition.
• AgStar will extend its policy of paying patronage dividends, based on future profitability, to FCSA stockholders.
• This merger would create significantly more long-term economic value and financial return to stockholder-customers. It carries a high degree of safety and soundness as defined by the Farm Credit Administration's "financial institution rating system".
• A merger of FCSA and AgStar will create an even stronger Farm Credit lender as we will be able to further diversify and manage risk both geographically and by ag sectors.

At a time when many businesses are abandoning rural America and our leaders work to find ways to help our rural economies, it is essential that the lifeblood of many of these communities—agriculture—continues to be served by a Farm Credit System lender. In all respects, the AgStar merger proposal retains the important services farmers and rural communities need.

AGSTAR'S VIEWS ON REFORMS TO THE FARM CREDIT SYSTEM.

AgStar recognizes the need for reform and supports efforts to that end, but is compelled to relay the message that the Farm Credit System has a multitude of strengths that make it viable and necessary long into the future.

FCSA leadership has publicly communicated several reasons for their desire to be acquired by Rabobank and exit the System. One key factor cited has been to be able to provide a broader range of products and services to their customers. Another has been to be able to serve their customers with no limitations on geographical boundaries, up to and including providing financing outside of the U.S. It is our position that limitations on products and services, as well as the geographical constraints imposed on System institutions, should be addressed in the future. Meanwhile, forming alliances and other business relationships can be utilized to deliver additional products or services to customers. AgStar actively works with community banks, input suppliers, and equipment dealers to provide products to farmers. We acknowledge that farmers, ranchers and rural residents have financing needs that constantly change. We believe, however, there are no product or service needs even remotely important enough to warrant exiting the Farm Credit System to satisfy. The cost of leaving behind System benefits, disbanding the cooperative structure and forfeiting stockholder control are too great to consider this an option at any price.

Where we differ from the leadership of FCSA is that AgStar believes that reform of the System can best be accomplished by a healthy internal dialogue, followed by appropriate statutory and regulatory changes. This belief has been strengthened through the significant amount of input we have received on this transaction with stockholders of both AgStar and FCSA and agricultural leaders. The strengths that are inherent within the Farm Credit System have recently been put into new perspective. At times the things most valued are taken for granted until there is a threat that they may disappear. This is one of those times.

These elements and provisions within the Farm Credit System are held in the highest regard by Farm Credit stockholders:

• Stock ownership and voting control of their cooperative
• Required service to young or beginning farmers
• Provisions for borrower rights and protections
• Mandate to serve farmers of all sizes through good times and bad
• Headquartered locally

Although the factors listed above are not often topics of everyday discussion, they appear to be fiercely defended when threatened. The Farm Credit System has strong support in rural America and should not be taken for granted. Although some updating is needed, we dare not lose sight of the many benefits that this System delivers to its current stockholders and will deliver to the next generation of farm families.

In closing, I want to thank the committee for taking the time to examine this issue. This transaction is much more significant than just competing financial institutions bidding to acquire another lender. There is an extremely important public policy issue at stake here—not only as it relates to the future of the Farm Credit

System, but more importantly, the future of available credit and financial support for farm operations and rural communities throughout America.

By discussing and evaluating this situation, you recognize the significant impact this transaction could have on the future of the Farm Credit System and the constituents we are chartered to serve. AgStar is proud of our role in serving agriculture and we believe the Farm Credit System is a critical entity that should be preserved and enhanced, not whittled away.

Thank you again for this opportunity to provide input on this critical issue, and I am glad to respond to any questions that you or your colleagues may have.

STATEMENT OF THE FINANCIAL SERVICES ROUNDTABLE

Mr. Chairman and members of the Subcommittee, The Financial Services Roundtable is pleased to submit written testimony to the Subcommittee on Conservation, Credit, Rural Development and Research in connection with its Review of the Farm Credit System at a public hearing the Subcommittee is holding on September 29, 2004. Specifically, this testimony will address the two stated purposes of this hearing:

1. Review the Farm Credit System (FCS) and the role it currently plays in agricultural lending.
2. Consider views of if and how FCS associations should be allowed to leave the FCS.

Since this hearing has been triggered in part by the announcement by Farm Credit Services of America (FCSA) that it seeks to be acquired by RaboBank, a large Dutch agricultural bank, this testimony will address the purposes of the hearing in the context of the proposed FCSA-RaboBank transaction.

The Roundtable is an association of 100 of the largest banking, insurance, and securities firms providing financial services to American individuals, businesses, governments, and non-profit organizations. Many Roundtable members are active agricultural lenders and key suppliers of equipment and services to agriculture with a keen interest in meeting rural America's credit and financial services needs.

SUMMARY OF THE ROUNDTABLE POSITION

The Roundtable strongly recommends that Congress not take any action with regard to the proposed FCSA-RaboBank transaction. This situation can readily be resolved under the existing provisions of the Farm Credit Act governing termination of FCS institution status by an individual FCS association. It would be unwise for Congress to "lock" associations into the FCS, by repealing the termination provision, in light of the dynamic nature of the U.S. financial system and the ever-changing credit needs of agriculture and rural America. Competition in the marketplace among financial services providers should establish the structure of the delivery of financial services in rural America. Freezing the structure of the FCS would unwisely impede the continuing evolution of the financial services industry in rural America.

Likewise, the FCS should not be given expanded powers as those powers will lead the FCS even further astray from its special congressional mission of lending to those farmers and ranchers, specifically young, beginning, and small (YBS) farmers and ranchers, who cannot obtain adequate credit from other sources. It has become plainly evident, as the RaboBank deal unintentionally demonstrates that the FCS increasingly directs its implicit $1 billion-plus annual taxpayer subsidy towards America's most creditworthy farmers, ranchers, and agribusinesses. Since FCS associations can now lend for any agricultural purpose, broader powers for the FCS will greatly exacerbate that perverse trend.

THE HISTORY OF THE FARM CREDIT SYSTEM

Congress has long sought to ensure that there is a sufficient supply of reasonably priced credit in rural America, not only for farmers and ranchers, but also for businesses and residents in rural America not directly engaged in agriculture. Concerns about inadequacies in rural credit availability drove the creation of the FCS in 1916, through the congressional chartering of 12 regional Federal land banks. At that time, almost all rural banks were quite small, usually limited to just one office due to branching restrictions then in place. Also, many state-chartered banks could not accept farmland as loan collateral or were highly restricted in doing so while national banks had only recently gained that lending authority. World War I drove up farmland prices which made it even more difficult for farmers and ranchers to finance real estate purchases; oftentimes, sellers had to finance buyers. By chartering the regional land banks, Congress overcame one negative effect of the restrictive banking regulations of that era.

Rural America experienced another credit crunch with the failure of 9,000 banks in the 1930–33 period. Most of these banks were very small, single-office institutions serving highly localized areas. State bank branching restrictions, which Congress reinforced in 1927 with passage of the McFadden Act, prevented banks from diversifying their credit risk geographically. When an agricultural disaster struck a locality, the local bank often was a victim, forced to close its doors because many of its farm customers could not repay loans which had been used to finance spring planting or the purchase of a tractor. Congress responded to the vast holes in the availability of agricultural credit those bank failures caused by authorizing the formation of local production credit associations (PCAs) to replace failed banks.

In the 71 years since Congress authorized the PCAs, the availability of credit in rural America has improved greatly, yet the rationale for the continuing existence of the FCS has not been rigorously examined. The delivery of credit in rural America has been modernized to the extent that few could have envisioned in 1933, yet the FCS operates as if rural America had not moved beyond 1933. The Subcommittee's hearing provides the opportunity for a long overdue examination of the future role, if any, the FCS should play in financing American agriculture.

Since 1933, and most notably in recent decades, American banking has undergone enormous modernization. Bank branching restrictions have disappeared almost entirely at the state level, reinforced by Congress's passage of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. Not only have large interstate banking companies, capable of financing large agribusinesses, emerged over the last decade, but community banks have grown through branching so that they, too, can meet the credit needs of many farmers and ranchers. Equipment and input suppliers have increasingly become a source of agricultural credit, financing the equipment, seed, fertilizer, and other production inputs they sell. Life insurers continue to play an important role in financing farm real estate, as do sellers of farm properties. Finally, the USDA, through the Farm Service Agency (FSA) continues to finance financially weaker farmers through direct loans and, increasingly, guarantees of bank loans to farmers and ranchers.

Interestingly, although the FCS has a specific statutory mandate (12 U.S.C. Sec. 2207) to lend to YBS farmers and ranchers, studies by the Economic Research Service and the Government Accountability Office have repeatedly shown that FCS associations widely shirk their YBS obligation. Banks in particular have gladly assumed that responsibility.

THE STATUS OF AGRICULTURAL AND RURAL CREDIT TODAY

Agricultural and rural finance has become highly competitive, and is becoming more so every day, due in part to the increased role the Internet plays in broadening access to credit. Further, commercial banks demonstrated in the 1980's and early 1990's that during difficult times in agriculture, they readily lend to viable farming and ranching operations. As many older farmers will testify, banks provided credit to farmers whose FCS loans were called as the FCS struggled to recover from the consequences of its overlending on farm real estate as the farmland bubble expanded in the 1970's, only to burst when interest rates reached stratospheric levels in the early 1980's. As the FCS's share of total agricultural credit dropped from 34 percent in 1982 to 23.9 percent in 1994, commercial banks' share of agricultural credit rose from 22.2 percent in 1982 to 40.1 percent in 1994.

Over the last decade, the FCS has regained some of that lost market share by focusing increasingly on lending to the financially strongest farmers and ranchers and for non-farm purposes, such as financing country estates and hunting preserves while taking full advantage of its very favorable tax status in lending to farmers and ranchers. The FCS is exempt from all corporate income taxes (Federal, state, and local) on its real estate lending and exempt from state and local income taxes on its non-real estate lending. Most FCS associations have shifted in recent years to the "ACA parent" organizational model, [1] which has enabled the FCS as a whole to lower its effective tax rate from 12 percent in the 1990's to 7 percent for the first half of 2004.

Today, the FCS is a significant provider of credit to agriculture and to non-agricultural borrowers in rural America. However, the FCS does not lend to those who would otherwise go without credit because the FCS focuses increasingly on lending to the most creditworthy. Those least needing the FCS's substantial taxpayer subsidy are the primary recipients of that subsidy. The broader powers Congress has given the FCS, particularly in lending for non-agricultural purposes, has enabled the FCS to duck its responsibility to lend to those farmers and ranchers, specifically YBS farmers and ranchers, who cannot obtain credit from other sources. In effect, the FCS has gotten badly off-track as to whom it provides credit. Further, more intense competition among private-sector lenders and the growing use of FSA loan guarantees increasingly ensures that even weak borrowers can obtain financing for commercially viable agricultural activities.

THE RABOBANK DEAL AND ITS IMPLICATIONS

Ironically, RaboBank's proposed acquisition of FCSA proves the point that the FCS today focuses on lending to agriculture's most creditworthy borrowers, those least deserving of the FCS interest-rate subsidy. Not only is RaboBank, a private-sector firm operating without any Government support, willing to assume FCSA's $7.4 billion loan portfolio without any Federal subsidy whatsoever, but it also is willing to pay a $100 million premium, equal to 1.5 percent of FCSA's outstanding loans, to acquire those loans. Simply put, FCSA's loans are so creditworthy that they do not need any Federal support. In fact, the FCSA loans are so desirable that an AAA-rated institution (RaboBank) is willing to pay a premium to purchase them. This truth holds throughout the FCS. Additionally, Rabobank's profits on the FCSA loan portfolio would be subject to U.S. Federal and state income taxation. Based on the amount of FCSA loans outstanding on June 30, 2004, the Roundtable estimates that RaboBank's annual tax bill would be in the range of $14 million in Federal and state taxes. Last year, FCSA recorded an income tax liability of $6.7 million; for the first half of 2004, it recorded an income tax liability of just $2.5 million.

RaboBank's acquisition of FCSA's loan portfolio will increase lending competition in the four states FCSA serves (Iowa, Nebraska, South Dakota, and Wyoming), for two reasons. First, the Farm Credit Administration (FCA) will reassign FCSA's four-state territory to neighboring FCS associations, as it is empowered to do under the Farm Credit Act. Those associations will try to wrest borrowers away from RaboBank. Second, commercial banks, by competing on a level playing field with RaboBank, will have an opportunity to attract customers they cannot attract when competing against the taxpayer-subsidized credit FCSA now offers.

Although not a primary purpose of the FCSA-RaboBank deal, one side effect of it will be to reduce the Federal budget deficit by as much as $800 million in the fiscal year in which the deal closes. Presumably, that closing will occur in Fiscal Year 2005. As a Government-sponsored enterprise, the FCS is an "off-budget" creature of the Federal Government, subject to the same budgetary treatment as the Federal Reserve System and the United States Postal Service. However, the Farm Credit System Insurance Fund, which is administered by the Farm Credit System Insurance Corporation (an arm of the FCA), is an "on-budget" Federal agency. Therefore, FCSA's payment of an $800 million exit fee to the FCS Insurance Fund will be counted as revenue to the Federal Government for budget and deficit-calculation purposes. That revenue gain may be partially offset in future years by reduced premiums paid by other FCS associations to the FCS Insurance Fund, but the net effect of this exit-fee payment will be positive in the near term, from a budgetary perspective.

Some oppose the RaboBank deal because RaboBank is headquartered in The Netherlands. They contend that foreign ownership of FCSA's loan portfolio could lead to reduced credit to farmers and ranchers now borrowing from the FCSA. That argument has no validity. Numerous large foreign-based banks and financial companies own substantial American banks and financial firms. These include Roundtable members such as ABN-AMRO, AEGON, Allianze, AXA Financial, BNP Paribas, Royal Bank of Scotland, Credit Suisse First Boston, Bank of Montreal, HSBC, Royal Bank of Canada, Mitsubishi Tokyo Financial Group, and Zurich Financial Services. These companies compete aggressively and fairly to provide credit and other banking and financial services to Americans and to American businesses. We expect no less of RaboBank should it acquire FCSA.

By the same measure, many U.S. headquartered financial firms, including Roundtable members such as Citigroup, JP Morgan Chase, Bank of America and Merrill Lynch, provide extensive banking and financial services in other countries. Finance has become a global business, as has agriculture—witness how important foreign markets are for American farmers and ranchers.

There is no sound reason to believe that RaboBank would curtail the supply of credit to farmers and ranchers should it acquire FCSA. Since RaboBank acquired California's Valley Independent Bank (VIB) in 2002, RaboBank has nearly doubled VIB's total loans outstanding to $1.64 billion while increasing its agricultural lending nearly eight-fold, to $487 million by June 30 of this year. That growth counters any argument that RaboBank would shrink its agricultural lending in the four states FCSA now serves.

THE COMPETING AGSTAR OFFER FOR FCSA

As members of the Subcommittee know, senior management within the FCS strongly opposes the FCSA-RaboBank transaction, notably CoBank and the Farm Credit Council, the trade association for FCS institutions. Their opposition stems from a fear that other FCS associations may seek to terminate their status as an FCS association. Therefore, to block the FCSA-RaboBank deal, its opponents have rallied around a counteroffer from AgStar, a neighboring FCS association, with $2.65 billion of assets, serving southern and eastern Minnesota and northeastern Wisconsin. AgStar's counteroffer is comparable to a minnow trying to swallow a whale since it is just one-third the size of FCSA, which had $7.83 billion of assets on June 30, 2004.

AgStar proposes to pay a one-time dividend of $650 million to FCSA's member-borrowers if they vote to merge the two associations. That dividend payment would consume almost one-half of FCSA's capital, potentially leaving the merged institution undercapitalized. University of Illinois professor Peter Barry, a long-time supporter of the FCS, has written that AgStar will solve this capital problem by selling $1.5 billion of loan participations and $100 million of preferred stock to other FCS institutions. While these transactions would raise AgStar's capital ratios, they would merely move around assets and capital within the FCS, leaving the FCS as a whole with less capital than it now has, but with the same amount of assets.

The RaboBank deal would not have that decapitalizing effect as that transaction would remove both assets and capital from the FCS balance sheet, leaving its capital ratios roughly where they now are. Questions also must be raised about the difficulties AgStar would face in taking over an organization three times its size. There is no guarantee that that merger integration would go smoothly.

THE ROUNDTABLE'S LEGISLATIVE RECOMMENDATIONS

Two legislative proposals have been discussed since the FCSA-RaboBank deal was announced on July 30. One, repeal those provisions of the Farm Credit Act which permit an individual FCS association to terminate its status as an FCS institution, as governed by 12 U.S.C. Sec. 2279d. Two, grant FCS associations broader lending powers. The Roundtable opposes both proposals.

The 1987 Farm Credit legislation, which bailed out the FCS with a $4 billion, taxpayer-guaranteed line of credit, also wisely gave FCS associations the right to leave the FCS, after paying an exit fee to the FCS Insurance Fund equal to 100 percent of the association's capital in excess of 6 percent of its assets. This provision created an escape hatch for those associations who believe, for whatever reason, that they can fair better outside the FCS. Two PCAs actually have left the FCS, one before and one after the 1987 legislation. Although perhaps not intended by Congress, the termination provision effectively permits pools of loans to leave the FCS should those loans no longer need a taxpayer subsidy. That is precisely what will happen if FCSA concludes its proposed deal with RaboBank—the financing of a group of loans that obviously do not need a taxpayer-supplied interest-rate subsidy will leave the FCS, to be funded by a taxpaying, private-sector firm, RaboBank. Congress should leave this escape hatch in place so that other FCS institutions can pass through it, if they so desire, into the private-sector.

Some within the FCS argue that the proposed transaction proves that the FCS needs broader lending powers in order to survive. Nothing could be further from the truth. As the FCS financial results have shown, it has recovered nicely from the agricultural crisis of the 1980's. On June 30, 2004, the FCS had total assets of $119.6 billion, loans outstanding of $94.3 billion, total capital of $19.7 billion (for a very healthy 16.5 percent capital ratio), and it earned $928 million during the first half of 2004, net of a $70 million tax bill. These are hardly the indicators of a weak financial institution facing extinction. If anything, the FCS is overcapitalized given the high quality of its loans.

In fact, the FCS has become increasingly aggressive in its off-farm lending as it tries to become an organization prepared to lend to anyone anywhere for any purpose. As it has stealthily expanded its off-farm lending, it has largely abandoned financing all but the most creditworthy of farmers and ranchers.

Broader lending authority for the FCS must of necessity be limited to off-farm lending since the FCS can lend today for any agriculturally related purpose. Increased off-farm lending authority will take the FCS even further from its original mission, and the only rationale for its continued existence—providing credit to those farmers and ranchers who cannot otherwise obtain credit. Since there already is an ample supply of off-farm credit in rural America, provided by taxpaying private-sector banks and financial firms, there is no need to expand that supply by granting the FCS broader off-farm lending authority.

Mr. Chairman and members of the Subcommittee, The Financial Services Roundtable is pleased to have had this opportunity to submit written testimony on a topic of importance to its members and to the future of rural America. Roundtable staff would be pleased to respond to questions from Subcommittee members and staff. Please contact Mr. Paul Leonard at 202–289–4322.

STATEMENT OF JOHN EVANS JR.

Thank you, Chairman Lucas and Congressman Holden for conducting this hearing today to examine the Farm Credit System's role in agriculture lending and whether and how FCS Associations should be allowed to leave the System. These are two very important issues and we appreciate the opportunity to testify before this subcommittee.

ICBA MEMBERS—SERVING AGRICULTURE & RURAL COMMUNITIES

I am the president of the Chief Executive Officer of the D.L. Evans Bank in Burley, Idaho. I'm also chairman of ICBA's Agriculture-Rural America Committee. Our bank is very involved in agricultural lending.

Seventy-five percent of ICBA member banks are located in small communities of under 10,000 population and our members have a long-standing interest in providing credit to American agriculture and our rural communities. ICBA is the only national trade organization that exclusively represents the interests of our nation's community banks.

SCOPE OF TODAY'S HEARING & BANKER SURVEY VIEWS

The subcommittee is asking two very important questions in regard to today's hearing. As you know, the recent announcement of an agreement by a large foreign co-operative bank to purchase FCSAmerica (FCSA) has generated a lot of discussion both inside and outside of the System. This development has also raised a number of complex questions not only in terms of exiting the System, but also in terms of the role of the FCS in lending to agriculture.

Community bankers have had numerous ongoing concerns with what they rightly recognize as unfair competitive advantages and questionable lending activities of the System. These unfair competitive advantages have long ago outlived their initially intended purpose and we believe a restructuring of the System is long overdue. The FCS is the only GSE that competes against the private sector at the retail level using tax and funding advantages not available to commercial lenders. This is far different from the housing related GSEs, which provide a secondary market and liquidity function to the private sector.

When this proposed acquisition was announced on July 30th, ICBA issued a press release raising several issues discussed below. We also surveyed bankers in the four states that would be directly impacted by the acquisition as well as bankers in surrounding states since the proposed acquisition would also be the basis of expanding the new entity's lending into other states.

We received several hundred responses to our survey for a response rate of approximately 20 percent. Due to the large number of responses, the final tabulation of results is still underway, but we will highlight some of their comments in our testimony. Our survey focused on three key issues including the proposed purchase of FCSA; whether banks have adequate access to funding sources; and recommendations to Congress regarding the System's role in serving agriculture.

ISSUES REGARDING EXITING THE FARM CREDIT SYSTEM

FCS INCONSISTENCY—NATIONAL POLICIES OR LOCAL BOARD DECISION MAKING?

Since one issue the subcommittee is looking at is the role of the System in serving agriculture, we want to first point out several inconsistencies by System representatives on the proposed acquisition of FCSA because these inconsistencies by FCS officials relate to important policy changes now under consideration. When the proposed purchase was announced, several FCS spokesmen quickly denounced the purchase agreement and questioned whether this development would be in the best interests of farmers.

We'd like to point out that the decision to exit the FCS was made by the Board of Directors of the FCSA. However, just last June, System representatives had the audacity to lobby the FCA requesting expanded scope and eligibility authorities so FCS entities could make loans to individuals who have little relation to agriculture and for loan purposes completely unrelated to agriculture. In fact, FCS representatives suggested to their regulator that the FCA should remove itself from oversight of the System's scope and eligibility (who they can lend to and for what purposes) activities. They stated that national regulations are not appropriate to address local and regional needs across the country. Instead, System representatives suggested that the boards of directors of FCS associations should be allowed to make these decisions.

FCS representatives made statements such as these:

"Agriculture, the structure of farming, and the other financing needs of operators are too diverse for one policy to be set in McLean that will make sense nationwide."

"We suggest that it be left to the boards of directors of System institutions to establish their lending policies."

"FCS boards should have the flexibility to determine how best to serve agriculture and rural areas . . . Being made up of farmers from the area served, an Association's board of directors is elected because they understand the local agricultural environment."

"Speaking as a System owner, remember that each System institution remains governed by an elected board of directors. These boards set the policies that guide the activities of these institutions. Our focus is on making sure agriculture is served. We are perfectly capable of keeping the System focused on serving farmers, ranchers and all of modern agriculture."

"A second fact that needs to be remembered is that all FCS entities are directed and controlled by farmer customers. Service to any market segment is carried out under board policy direction with regular reporting on results. These farmer board members are uniquely positioned to know just what their marketplace needs to meet the System's mission."

In fact, in past years when the System has lobbied for expanded powers, they have often said that their local boards of directors would not allow the associations to adopt decisions and pursue strategies that are not in the best interests of their farmer owners.

And yet, when an FCS board of directors made a decision to exit the System, the FCS's lobbying arm in Washington D.C. quickly announced that this decision was not in the best interest of farmers and would "fundamentally hurt" farmers.

We suggest you can't have it both ways. You can't say on one hand, "Leave everything up to our local boards of directors because decisions handed down from Washington aren't suitable for the diversity of needs that exist across rural America." And then on the other hand say, "Our Washington-based lobbying group has determined that this decision made by the Association's local board of directors is inappropriate and must be forever stopped."

Outside Investors Taking Over Farmer-Owned Cooperatives?

A second example of the System's self-serving inconsistency is the contradiction raised by the CoBank proposal requesting new authorities to lend to entities that form as Limited Liability Corporations (LLCs) that have both a producer and investor class where the producer class would have as little as 50 percent voting control. Under this arrangement, the outside investor could easily take control over this new style of LLC "cooperative".

But in the case of FCSA, their cooperative has 100 percent farmer voting control! And yet, the System's representatives strongly oppose the proposed sale and allowing it to go to a vote of the farmer owners. Why is the System supporting legislation to potentially allow every other cooperative in the U.S. to be on the chopping block except for its own? If a cooperative with 100 percent farmer voting control should not be allowed to vote on its termination, as FCS officials opposed to the FCSA sale are arguing, then what does that say about a structure where farmers have only 50 percent farmer voting control? It says that Congress should be very careful and concerned about how any LLC-farm cooperative legislative proposal is drafted and also about outside investors taking control of farmer cooperatives.

Exiting the FCS—Some General Banker Views

The first survey question we asked bankers was whether they favored or opposed the proposed purchase of FCSA. While there is a mix of opinions, a majority of bankers favored the proposed purchase. Bankers recognized that the new entity would pay taxes on all of its lending income, unlike the FCS, which is exempt from paying taxes on real estate income, exempt from paying sales taxes and exempt from various state and local taxes.

Following are some sample survey comments of bankers:

"FCS just cherry picks the best customers with their tax-favored pricing!"

"It's all about funding. Right now I cannot compete against FCS due to their ability to fund loans with interest rates lower than I can obtain. Rabobank on the other hand is a tax paying entity which would level the playing field for us."

"We feel that we can compete with any bank on a level playing field."

"Taxpayer subsidized lenders are always more difficult to compete with than a private company in a free market."

Some bankers felt the proposed sale indicates that the marketplace is suggesting it doesn't need the System in its current form. They pointed out that in today's lending environment there are a multitude of lenders providing credit and services to farmers. There are several thousand community banks heavily involved in serving agriculture, approximately 2,500 banks are "ag banks" as defined by the Federal Reserve. Other types of lenders serving agriculture include the finance arms of seed, feed, equipment and chemical companies as well as mortgage companies and life insurance companies, the latter of which also make real estate loans. Without question, there are many more credit providers for agriculture than when the System was formed in 1916.

Some bankers did express some concerns regarding the whether the new FCSA entity would be regulated as strictly as state or national banks are regulated.

In terms of those bankers who had concerns about the proposed purchase, a basic issue is the prospect of having another competitor that would be buying a large book of business that was built up over many years using GSE tax and funding advantages. Thus, community banks would have a major new competitor with residual GSE advantages as well as having another GSE being re-established in the same area. The residual GSE advantages also include the lending infrastructure that has been built up over many years " buildings, staff, loan officers and operational expertise and extensive databases.

Recommendations for Exiting the FCS

The Farm Credit Act (Sections 7.10 & 7.11) does allow its individual institutions to exit the System under very detailed procedures which include: approval by the association's board of directors; approval by the Federal regulator, approval by the association's stockholders, procedures for a revote of any approval by stockholders; imposition of a significant exit fee paid to the FCS insurance fund; and re-chartering of other FCS associations to serve the abandoned area. This combination of procedures makes it pretty tough to leave the System.

We offer several thoughts for your consideration of whether and how an institution should be allowed to exit the System, keeping in mind the already cumbersome procedures mentioned above. In general, we would not be overly concerned about an FCS association that seeks to voluntarily leave the System on its own for purposes of converting to a state or nationally chartered commercial bank. A commercial bank entity would pay taxes and have strict regulations to comply with.

In 1991 the California Livestock Production Credit Association exited the FCS and became Stockman's Bank which is in operation today. Exiting the System would allow an existing FCS association to keep itself intact; otherwise the only option may be for that association to be merged into a larger FCS association. Merger removes the localized service and decision-making that the FCS association offered and leads to the further concentration of financial assets. Where a distinction could be made is between the termination of an FCS entity on its own for the purpose of converting to a commercial bank versus the purchase of an FCS entity by an outside investor. Purchase by an outside investor could allow a large company with access to worldwide funding sources a ready-made regional lending infrastructure. In this instance, community banks that concentrate on agricultural lending in the affected states would compete with both the lending prowess of a former GSE and a newly re-chartered GSE. The benefits afforded would include, as mentioned above, the residual GSE benefits that the entity was allowed to develop through years of GSE subsidies afforded to FCS institutions. And, as mentioned above, this issue raises the overall question of whether farmer co-operatives should be allowed to be taken over by outside investors.

One serious fault in the current termination process is that the exiting association pays a fee to the FCS insurance fund. We believe that the exit fee should be directed to the U.S. treasury. The FCS insurance fund will no longer be insuring against losses of the assets of the exiting FCS entity and the entity's assets were built up over time due to GSE benefits that are ultimately backed up by taxpayers.

Bankers made comments similar to these:

- "If you sell your house, do you have to pay the insurance company a fee?"
- "Instead of Rabobank paying the exit fee to the FCA, the fee should be paid to the U.S. Treasury because taxpayers of this nation have subsidized the profits that allowed FCS entities to build the capital they have over the years. We the people, through our Government, bailed out the entire Farm Credit System throughout the 1980's while small, rural ag banks were allowed to fail in staggering numbers, ruining many communities."

We also do not believe that the territory being exited needs to be covered through the re-chartering of an existing FCS institution. The FCA could simply designate neighboring FCS entities to be eligible to engage in agricultural lending through loan participations with community banks. This would allow FCS to quickly have an ongoing presence in the territory while working through commercial lenders and would be a "win-win" for all parties.

We want to stress that we'll continue to look at this issue during the upcoming months as part of our policy development process.

The Role of the FCS in Serving Agriculture

Community Banks Are the Ones Serving Agriculture in Good Times and Bad

The System likes to suggest to Congress that the FCS is needed to ensure that American agriculture has a competitive, stable source of credit in good times and bad. This is disingenuous. When tough times occurred in agriculture in the mid–1980's, tens of thousands of borrowers were turned away from the System, which received a Federal bailout, while hundreds of community banks were allowed to fail. During those difficult times, it was the community banks that picked up the System's discarded borrowers. It was the community banks that were there for farmers in good times as well as bad, not the FCS. We also point out that community banks must meet the lending needs of their communities to keep their local economies strong and vibrant in order for the bank to survive. Community banks do not fold up the tent and leave town in a bad economy, because they are permanent members of their local communities.

Regulator Aided Mission Creep

Frustration has been expressed by many bankers because of the clear mission creep of the FCS. The System was originally formed to serve agriculture because the market lacked a mechanism to finance long-term, fixed-rate real estate loans. In recent years bankers have witnessed the expansion of the FCS into agricultural business lending that was already well-served by commercial banks and other areas.

The frustration of bankers over this expansion and the cherry picking activities of the FCS is further exacerbated by the System's regulator, which often proposes regulatory expansions of FCS lending activities. For example, recent or pending proposals or decisions include:

- Scope and Eligibility proposal that would allow unlimited lending to anyone for non-agricultural purposes even if the borrower has only a tangential involvement in agriculture.
- Development of broad new lending programs under the guise of "investment" authorities, e.g. farmer notes proposal.
- Preferred stock proposal which has deposit-like features allowing FCS entities to compete for deposits with community banks.
- Allowance of illegal activities by institutions if using "excess capacity in good faith".

It is important to point out that such actions by the FCA have a direct bearing, not only on FCS institutions, but also on all lenders involved in the rural credit markets, including thousands of community banks across the country.

Looking at Agriculture's Competitive Landscape

Further expansion of what is supposed to be a limited purpose GSE to one that competes against the private sector by providing retail banking products and services to all rural residents will diminish the ability of community banks to serve agriculture and rural communities, resulting in fewer credit choices for rural residents.

We believe that a fundamental question before this committee is how to best ensure a competitive playing field in the agricultural marketplace. A constant complaints from bankers is that the System engages in cherry picking of their best customers. Generally the customers the FCS is going after are the prime or best customers in community bankers' portfolio.

This allows the System to concentrate their efforts on the top one-third of the most profitable farmers and those with the highest equity positions. The System does this because the top one-third of farmers is a very low credit risk and they generally do not require much of the lender's time. Bankers have noticed that the bottom one-third of farmers will not qualify for FCS loans. They have low equity positions and struggle with cash flows most years. They pose the greatest credit risk, yet they need financing and it's often by community banks. When defaults occur, the liquidation of their assets to cover the indebtedness is often problematic. Losses frequently occur. These situations take much more of the lenders' time and decreases productivity.

This leaves the middle one-third of farmers for FCS to pick over. These farmers generally have more marginal balance sheets and cash flows than the top tier producers. A great deal of time must be committed to the evaluation of the financial reports and management ability of these producers. There is a higher degree of total risk for these farmers compared to the top one-third. Obviously, the tax benefits of the FCS are a major competitive advantage that enables this cherry picking. Some questions bankers raise are: 1) Since the average size of FCS lenders now approaches $1 billion, do multi-billion dollar FCS lenders really need tax advantages to compete with $50, $100, or $250 million community banks?; 2) If the customer is supposedly the ultimate beneficiary of such policies, then why not make the tax advantages available to all lenders?; and 3) If the FCS is using these tax advantages to cherry pick the best customers from community banks " what are they doing to actually earn their GSE advantages?

When the FCS raids the portfolios of community banks, it can cause some community banks to question whether it is worthwhile to serve only those producers in the bottom to medium equity positions. If community banks aren't able to effectively compete for the top one-third of producers, then the quality of their overall portfolio declines and this can raise questions among bank examiners as to why the bank is so heavily involved in the riskier ag loans.

Over time, this can reduce the number of banks serving specialized agricultural markets, whether it is dairy producers, hog producers, fruit and vegetable producers or others. Ultimately, this suggests fewer choices of credit for producers and less competition if commercial lenders are forced out of the marketplace because they can't compete against the subsidized lending of the FCS. When FCS obtains expanded authorities, these types of problems are only exacerbated.

WHAT WAS THE INTENT?—AN IMPORTANT QUESTION

Was the real goal of Congress when it created the FCS in 1916 was to eventually drive community banks out of the agricultural credit market? Was the goal also to allow for the ongoing expansion of the FCS into virtually all the key functions of commercial banks? We really doubt that these were the intentions, but this appears to be what is occurring.

Bankers expressed very strong opinions on this issue, e.g.:

- "As a small community bank with an FCS office in town we have lost most of our prime ag credits to them. We can't compete with the terms and interest rates they offer. If they are allowed to offer the same products as us, small town banks will be a thing of the past!"
- "We feel we can compete with banks (that is those who pay taxes) but we can not compete when others don't pay taxes."
- "Our ag portfolio used to be above 30 percent of the bank's loans. FCS and the ag economy have reduced that to about 10 percent over the last 15 years."

Is it in the best interests of rural America to have commercial banks driven out of their marketplace due to unfair competition, thus ensuring fewer credit choices for farmers and ranchers? You can't have it both ways. Community banks aren't always going to be able to serve agriculture if they can't effectively compete against the subsidized tax and funding advantages of the FCS.

FCS—TEAR DOWN THAT WALL!

Therefore, we believe that if Congress wants to do what is best for rural America, it should look at opening up the funding window of the FCS to community banks. The current unlevel playing field is one reason why bankers have sought to at least have equal access to the FCS funding window as FCS associations. This would provide community banks engaged in agricultural lending a long-term funding source and would ensure the FCS functions as a wholesale supplier of credit to community banks as Congress has long envisioned.

The wholesale funding function is a key role that GSEs play in the financial markets. This was the intention of the Other Financial Institutions (OFI) provisions that are in the Farm Credit Act. Unfortunately, these statutory provisions were last changed in 1981, almost a quarter of a century ago, and do not allow for access to long-term, fixed-rate funds.

Bankers felt very strongly about the need to access more funding sources:

• "The FCS competition issue in my area is dramatic. With continued consolidation of farms, below market interest rates make it difficult to retain customers. Also, liquidity in rural areas is very tight with no foreseeable improvement in the future. Access to other reasonable funding sources is critical for community banks to survive."

• "If community banks enjoyed the same tax & funding advantages as FCS, competition for these loans would increase dramatically & Rabobank would less likely want to compete in this market."

• "Banks have access to FCS utilizing the OFI funding from FCS. However, OFIs are looked upon as a bastard child of the system and not treated equally. If FCS was forced to treat OFIs the same as its own retail lenders then banks would have a reasonable source of funding for ag purposes."

• "FHLB funding for small business and ag loans is available but is very limited based on the criteria set by each FHLB. We have some credit advances using this as collateral but it is no where near the source of funding we thought it would be when we joined the FHLB."

• "Although FHLB has a process for accepting ag loans as collateral, in practice they are not too interested in this area."

• "Sources of funding will become very important in the future due to the decline of population in rural areas. This decline is further impacted by the passing away of elderly depositors, the primary source of funding for banks. A majority of heirs reside in metropolitan areas and funds migrate to where they live."

• "Community Banks should be able to access low rate FCS funding."

• "While the FHLB funding is beneficial, it isn't geared towards agricultural lending. The hope would be that FSC funding would be more 'user friendly' for agriculture."

• "If my bank has the same funding source as FCS then the playing field is equal as far as funding goes. I still have a tax issue to be dealt with."

• "Population decline in rural areas is drying up local deposits as a source of funding."

• "FHLB amortized fixed rate loans are limited to 15 year terms—would like the ability to lock in a longer term at a competitive fixed rate."

• "We need to take advantage of the capital markets using FCS's GSE status to decrease funding costs. The FHLB long term advances are not competitive with what FCS can fund their loans for."

• "We need a dependable long term source of funds at favorable rates to do the best job possible in managing our entire portfolios. Too many times, investment brokers are pilfering our deposit base making liquidity a problem. The typical deposit custumer today stays short with their deposits not exceeding 24 months while the ag borrowers are very interesting in longer term fixed rate borrowing. This makes for an extreme interest rate risk that we should be able to better manage."

• "I believe it to be prudent to have diversified sources of wholesale funding as we are relying on that side more and more. This reliance will increase in the future."

• "FCS understands agriculture. FHLB understands housing. These two are not the same and should be served by the entity created for that purpose. FCS should adopt a wholesaler's function for money instead of its retailer position."

• "Our rural areas are growing slowly in money available for deposits. For example, in my county in Wisconsin, deposits grew by only 2 percent in 2003. If we as a bank are going to make funding available to build a better rural America we can not rely on local CD money only. We need to have access to the same bond funding sources as the FCS."

• "Community banks need all the funding sources they can find. Seasonality of borrowings and deposits make multiple funding sources a necessity, especially when the alternatives may be high-priced deposits in national markets where our name recognition is minimal."

These are just a few sample comments from bankers in many farm states. Their emphasis on funding is consistent with congressional intent in the Farm Credit Act to allow community banks greater access to funding sources to better serve their rural borrowers.

A COMMON SENSE APPROACH

Non banker organizations also recognize the important of rural community banks accessing FCS funds to enable banks to maintain a competitive presence in rural areas. For example, The Center for Rural Affairs made several of the same points mentioned above in their September newsletter, stating:

"The (FCS) banks were initially created with Federal money (since repaid) and to this day enjoy competitive advantages over local rural banks. System banks are tax exempt and the Feds back the bonds issued to raise money to loan to farmers. But Farm Credit Services of Omaha has not always used those advantages in the interest of all of agriculture.

"It (FCSA) has positioned itself as a leading financier of industrial agriculture. It has financed some of the biggest corporate hog operations and has a reputation for cherry picking the biggest and most lucrative farm borrowers. Congress should examine the aggressive focus of Farm Credit Services on industrial agriculture and explore new avenues for ensuring adequate credit availability to the rest of agriculture.

"Congress should (also) enhance competition in agricultural lending by enabling locally-owned community banks to also raise money for farm loans through Government-backed Farm Credit System bonds—not just Farm Credit banks. That would enable local banks to be more competitive. It would prevent Government backing from being used by Farm Credit System banks to build a dominant position in farm lending only to be turned over to an international conglomerate. (Emphasis added)

Mr. Chairman, thanks for the opportunity to testify today. We appreciate your committee looking at some of the complex issues surrounding these topics. Last year the House Agriculture Committee held a hearing on the issue of whether outside investors should be able to invest in farmer owned cooperatives. A member of Congress expressed his concern that our rural communities are dying and its time to try to work together on ways to help the survival of our rural communities.

There are differing views on the prospects of rural America's future. Its population is aging and will only grow older. Young people are leaving. Deposits are being drained away. Community banks have competition on every side from a variety of lenders and companies providing credit. At the same time, we have a predatory lender called the Farm Credit System, which is using its tax and funding advantages to cherry pick the best customers from the portfolios of community banks, weakening their long-term ability to serve agriculture. That cannot be good policy in the eyes of this committee if you want to lay the foundation to create a better future for rural America.

It is time, as Ronald Reagan said in challenging the outmoded isolationism of the Soviet Union's division between East and West Germany, to "Tear Down That Wall!" The FCS currently has built a wall around the ability of others to access its funding window for the betterment of rural America. At the same time the FCS wants to get all the powers it can to act like community banks while denying funding to community banks.

Expanding FCS direct lending powers diminishes the tax base of our rural communities. This makes it harder to fund schools, roads, and other vital infrastructure and services necessary to keep our rural communities viable. If Congress does not reign in the expansionist agenda of the FCS then the long term survival of many community banks and many communities may be jeopardized. We are certainly willing to try and work together with the System, but currently this is a one-way street in favor of the System.

We look forward to working with your committee to further address these issues. We appreciate the opportunity to share our views today and the views of many community banks who responded to questions we raised in our survey on these key issues. Thank you.

STATEMENT OF MYRON EDLEMAN

Mr. Chairman, and members of the committee, thank you for allowing me to address you on a matter of the utmost importance to people who live in rural America, and to people who work the farms and ranches of the Midwest.

My name is Myron Edleman. I am a South Dakota cattleman; I also raise soybeans, corn and alfalfa hay. I am a member of the South Dakota Cattleman's Association and the National Cattleman's Association. I am also a stockholder in Farm Credit Services of America, a farmer-owned and farmer-controlled lending cooperative that serves rural communities in four states. FCS of America is part of the Farm Credit System.

The principle of maintaining a "farmer-owned and farmer-controlled lending cooperative" is important, Mr. Chairman; in fact, that is the reason I come before you today as chairman of Farmers for Farm Credit, a coalition of stockholders of FCS of America.

As you know, one of the treasured hallmarks of the Farm Credit System is customer ownership. Farmers and ranchers who borrow from a Farm Credit co-op automatically become stockholders.

FCS of America's management and board of directors have decided to sell our co-op to a Dutch banking conglomerate called Rabobank. To date, stockholders have not had a say in that decision and it's not clear that the board itself has thoroughly studied alternatives. Our review of the public announcements about this acquisition have convinced us that it is a very bad deal—a bad deal for FCS of America, a bad deal for stockholders, and a bad deal for farmers and ranchers and rural communities who have come to rely on Farm Credit for its competitive lending rates and reliability.

Attached to my testimony is a listing of the specific reasons we think this transaction is a bad deal for farmers and rural America. I would ask that this attachment be included in the record of this hearing.

We formed our coalition—to ensure that our voices as stockholders would be heard, and to ensure that other FCS of America stockholders could learn the awful truth about the sale of their co-op.

Farmers for Farm Credit is not alone in opposing the Rabobank takeover. Several members of Congress, including Senators Daschle, Coleman, Johnson and Lincoln, and several members of the House, have come out against it. The National Council of Farmer Cooperatives, National Farmers Union and many state and local agricultural groups also oppose the sale.

As the distinguished agricultural economist, Neil Harl of Iowa State University, said recently: "The deal is likely to have an impact on the lending landscape in agriculture for some time to come."

In some ways, Mr. Chairman, that is an understatement. This deal is so bad, it is breathtaking.

All the assets of our co-op, including all its loans, will be sold to Rabobank. Over $1 billion of borrower-contributed capital will be wiped off the books of FCS of America. Hundreds of millions more dollars will be flushed down the drain as FCS of America exits the System and pays over $800 million as an "exit fee" into a fund designed to protect Wall Street investors—not farmers.

None of this money belongs to the management of FCS of America. It belongs to the stockholders, and only a fraction of that money will be returned to stockholders under the sale proposal. FCS of America's capital was built up over many years from the earnings generated on thousand of loans. This capital helps to ensure that our families and future generations of Midwest farmers will have access to a financially strong, borrower-owned source of credit.

For 85 years, lending cooperatives of the Farm Credit System have dedicated themselves to ensuring that farmers and ranchers have access to competitive loans in good times and bad. This Farm Credit mission is a mandate from Congress. The Rabobank takeover of FCS of America would disrupt that mission, and dismantle a mechanism created to ensure that farmers and ranchers would have access to capital in good times and bad.

There will continue to be a lot of discussion about the economic aspects of this transaction, and rightly so. However, the fact that we are here today is evidence of the true value of our cooperative.

As a farmer stockholder in Farm Credit Services of America, I am entitled to question the business decisions made by the board and management of my cooperative. As a part of the Farm Credit System, FCS of America is subject to congressional oversight and is required by Congress to provide protections to borrowers that no other lender provides. And, Farm Credit Services of America operates under the watchful eye of a Federal regulator accountable to Congress.

If Rabobank becomes the lender for FCS of America's 51,000 customers, all of the business decisions that are today subject to scrutiny by farmers, Congress and the FCA will be the sole prerogative of Rabobank management. It's not possible to put a dollar value on what we as farmers will lose, but the cost will be enormous.

As farmers have come to understand what is at stake, the proposed sale of FCS of America has become increasingly unpopular among the stockholders. I hope this committee will note the lack of farmers and farm organizations here today to speak in favor of this sale.

The board of FCS of America cannot help but be aware that the opposition to this sale is overwhelming. However, we suspect that management of FCS of America may have entered into a secret contract with Rabobank that is so onerous the board is now struggling to find a way to unwind this decision without costing stockholders millions of dollars. For reasons of corporate transparency and to protect the interests of farmers, we think it would be entirely appropriate for this committee to ask Rabobank and FCS of America to disclose the terms of any contract that may exist between their organizations, including any formal or informal agreements that may exist relative to compensation and management bonuses.In conclusion, Mr. Chairman and members of the subcommittee, our coalition strongly opposes the sale of FCS of America. We do so because it is a bad deal, but also because it will have serious adverse consequences for rural America. This sale will replace a dedicated, mission-driven cooperative with a foreign profit-driven conglomerate, and it will do so at a price that robs farm and ranch families of their capital.

Our coalition is grateful for anything the subcommittee can do to stop this ill-advised acquisition.

Thank you for your time and interest, and I am pleased to take any questions that you and members of the subcommittee may have.

A STOCKHOLDER COALITION

FARMERS FOR FARM CREDIT

Dedicated to preserving our American farmer-owned and controlled cooperative lender

Rabobank's Acquisition of FCS of America is a Bad Deal For Farmers, for Rural America, and for the Nation

For 85 years, lending cooperatives of the Farm Credit System have dedicated themselves to ensuring farmers and ranchers access to competitive loans in good times and bad. This Farm Credit mission is a mandate from Congress.

Recently, a Dutch banking conglomerate, Rabobank, announced plans to acquire FCS of America, a Farm Credit cooperative serving rural communities in Wyoming, South Dakota, Iowa and Nebraska.

We believe the proposed sale will have irreversible adverse consequences and should be rejected.

- **It's a bad deal.** Rabobank proposes to pay stockholders $600 million. Yet FCS of America has total capital of $1.35 billion (June 2004). That's a payment of only ***44 cents on the dollar--before accounting for other lost assets!!***

- **$800 Million down the drain.** By law, the Rabobank acquisition would force FCS of America to leave the Farm Credit System and pay more than $800 million in "exit fees" to a federal agency that insures System bondholders. Shareholders will also lose other investments—including stock holdings in AgriBank and investments made in the Farm Credit System Insurance Corporation.

- **No reliability.** Across the U.S., Farm Credit institutions serve as a competitive alternative to commercial banks and exist to serve the needs of farmers and ranchers in good times and bad, as mandated by federal law. With FCS of America gone, rural communities will be forced to "rely" on lending institutions motivated by corporate strategy and profits rather than a mission of serving American farm and ranch families.

- **Loss of local ownership and control.** A fundamental characteristic of the Farm Credit System is "cooperative" ownership by its customers -- farmers and ranchers who share Farm Credit's mission of maintaining the quality of life in rural America and on the farm. The loss of FCS of America to a foreign bank means the loss of local ownership and control.

- **Whose money is it, anyway?** Farm Credit was established by Congress to be a permanent, customer-owned system of credit for agriculture and rural America. But somehow FCS of America's management has forgotten that the capital of the institution is **farmer** money – earnings generated from loans made to farmers over many years. This capital ensures a strong lender and any distribution of earnings should be made consistent with safety and soundness and cooperative principles.

- **The payout formula is inequitable and legally questionable.** Under the terms of the sale, some stockholders will receive a larger payout based solely on the date their loan was repaid. Long-time customers who may have contributed far more than short-time customers might get nothing. This payout scheme may generate lawsuits from current and former stockholders. Payouts should be fair to all shareholders who helped build the FCS of America co-op.

- **Borrower rights ignored.** By federal law, Farm Credit System lenders must afford borrowers with certain rights – rights that borrowers do not have with any other type of lender. Farmers fought hard for these protections in the 1980s, and FCS of America customers will lose them should Rabobank become their lender.

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Omaha, NE 68139
Toll Free (877) 891-6787

STATEMENT OF JEROLD L. HARRIS

Good afternoon Mr. Chairman and members of the subcommittee. I am Jerold Harris, CEO of U.S. AgBank, FCB (AgBank) headquartered in Wichita, Kansas. AgBank is one of five banks that serve the Farm Credit System. We operate as a wholesale bank providing funding to 30 retail associations that in turn serve about 40,000 farmers, ranchers and agribusiness borrowers in ten states.

I am testifying today on behalf of the Farm Credit Council and its member institutions of the Farm Credit System (System). We appreciate very much you holding this hearing to explore the potential implications of the announced plans by the Dutch-owned financial conglomerate, Rabobank Group International, to acquire Farm Credit Services of America (FCS of America). FCS of America is headquartered in Omaha, Nebraska and serves the farmers and ranchers in the states of Iowa, Nebraska, South Dakota and Wyoming. It is the second largest association in the Farm Credit System with about $7.8 billion of assets. My testimony will provide a brief overview of what we know about this proposal, why we think it should not be permitted to move forward, and what needs to be done to address this situation, including the repeal of the termination authority on which this proposal is based.

Let me outline the situation. On July 30th, the board of directors of Farm Credit Services of America adopted a resolution authorizing its management to move forward with a proposal to terminate its status as a Farm Credit System institution and to be acquired by the foreign bank, Rabobank Group International. This transaction, should it be completed, would set a dangerous precedent that could harm America's farmers and ranchers.

Authority for a Farm Credit institution to terminate its System status was added by the Agricultural Credit Act of 1987 at the request of one small institution that was seeking to avoid its financial responsibilities to the rest of the System during the difficult times of the 1980's. While that institution did eventually leave the System in 1991, regulations to implement the termination authority actually were not finalized by the Farm Credit Administration until 2002. So we have never had an institution leave the System using the process set out in those regulations, and it is our hope that we never do.

According to the public statements of FCS of America and Rabobank this transaction involves a $600 million payment to stockholders. But what will Rabobank be getting as a result of that payment? They would get an institution that had $1.35 billion in capital and unallocated surplus as of June 30, 2004, over $200 million in loan loss reserves, 900 plus employees and more than 40 offices, with total assets valued at $7.8 billion on the association's books. They will be acquiring an association that earned $114 million in 2003 and over $59 million in the first six months of 2004. To leave the System, FCS of America will have to pay an estimated $800 million to the Farm Credit Insurance Fund. These figures don't even take into account the value of the goodwill and loyalty of thousands of stockholders, which would normally add significant value to such a transaction. Based on these figures, we simply can't see how the Rabobank purchase proposal works out as a good deal for stockholders.

Attached to my written statement, I have provided a brief history of the financial difficulties the predecessor institutions of this association had during the difficult years of the 1980's. More importantly, the information includes a summary of the substantial financial assistance that other Farm Credit institutions stepped forward to voluntarily provide to keep them in business. This institution would not exist today if the System and Congress had not stepped forward to provide $631 million in financial assistance. A significant amount of these dollars came from farmers all across America, not from the current borrowers of FCS of America.

We understand from reliable sources that the decision to move forward was not a unanimous one on the part of the association board. Apparently a significant number of the board members actually voted against it, and as I am sure you will hear in later testimony this afternoon, this proposal is not being received well by farmers and ranchers in the four states most affected, or elsewhere across the country.

Irrespective of the numbers, Mr. Chairman, it makes no sense for a System institution to terminate its System status, or for Congress to allow it. The termination provisions of the Act are inconsistent with the basic mission and purpose set out by Congress for the Farm Credit System. The Act states that the Farm Credit System is to be a permanent source of credit for all sizes and types of agricultural producers and the System exists to promote farmer-ownership and control of these financial institutions. How is it possibly consistent with those stated goals for any System institution to exit the System?

I have been a System employee for over 40 years. I have seen very good times in agriculture and very bad times. I know first hand that the presence of a healthy, competitive, farmer-owned Farm Credit institution helps all area farmers, even those who borrow from other sources, receive a much more competitive interest rate.

Your predecessors knew that creating institutions owned and controlled by farmers would be the best guarantee that a competitive and adequate source of credit for farmers, ranchers, their cooperatives and rural America would be there to serve them. This termination authority is absolutely counter to that. It allows an institution to abandon its congressionally mandated mission and purpose. Yes, the Farm Credit Administration will be required to extend the charter of another institution to step in and serve this territory. But that System institution will have no staff, no office locations, no market share and no corresponding capital base.

So that brings me to my final point, Mr. Chairman; What needs to change to prevent this from happening? We are asking that this Committee repeal the termination authority as soon as possible. That provision was added to the Statutes seventeen years ago when the System's structure was completely different than it is today. It was meant to serve the interests of one very small institution at that time. Because that was a statewide livestock association, of which none exist today, its territory was over-chartered by several other associations. That means that more than one Farm Credit institution already served all of that territory. As a result, its departure did not leave farmers without access to the System.

Today's situation is quite different. The departure of FCS of America would leave a gaping hole in the System's service to agriculture in four key agricultural states. For all the reasons I have mentioned previously, repairing this hole would take considerable time and money.

Additionally, Mr. Chairman, we need to look at the root cause, or at least the stated reasons, why this institution has said it needs to leave. FCS of America's public statements have pointed to the operating limitations of the Farm Credit Act and the conservative regulatory interpretations of the Farm Credit Administration. The rest of the System is entirely sympathetic to that. But instead of choosing to depart the System, we have chosen another route—one which involves a comprehensive review of what we need as institutions to make sure we can continue to fulfill the mission you have given to us and to ensure we can serve the agriculture and the rural communities of the 21st century. I don't have the answers for you today as to what that is going to take, but we have put in place a process that will get us those answers so we can provide them to you by this time next year. For instance, the current provisions of law governing the eligibility of cooperatives for financing from CoBank need to be updated. We have already put forward specific proposals to deal with that. We look forward to working with this Committee at the appropriate time to discuss this and other needs and to work with you to get them accomplished.

I have attached to my written testimony a brief history of the financial stress of the 1980's in the territory served by FCS of America and how the $631 million of financial assistance was provided to what is now the Farm Credit Services of America territory. I strongly encourage you to also consider this information.

Mr. Chairman, and members of the subcommittee, thank you again for holding this hearing and providing us the opportunity to discuss these important matters with you. I would be happy to answer any questions you might have.

September 28, 2004

Hon. Sam Graves
U.S. House of Representatives
Washington, DC 20515

Dear Sam:

On behalf of Missouri Farm Bureau, I am writing to express our concern about the potential acquisition of Farm Credit Services of America (FCSAmerica) by Rabobank and the long-term effects this proposal would have on the availability of credit for farmers, ranchers, rural customers, and agribusinesses.

Congress created the Farm Credit System in 1916 as a nationwide network of borrower-owned lending associations devoted to providing financing for agricultural operations, rural housing, agribusinesses, and rural infrastructure. Today, the Farm Credit System continues to be a major source of short- and long-term financing for agricultural and rural borrowers.

In late July, FCSAmerica announced their board of directors had approved a proposal to withdraw from the Farm Credit System and become a wholly-owned subsidiary of Rabobank. Rabobank is a global banking cooperative based in the Netherlands that serves 9 million customers and has assets totaling $500 billion.

FCSAmerica serves 59,000 customers throughout Nebraska, Iowa, South Dakota and Wyoming and has $7.8 billion in assets. As a part of the proposed agreement, Rabobank will purchase stockholders' shares of FCSAmerica for $600 million.

To date, the Farm Credit Administration has not made a decision on FCSAmerica's request to terminate their association with the Farm Credit System nor has a stockholder vote been held. If this acquisition is ultimately approved, it will mark the first time a member of the Farm Credit System has been sold to a private entity. The precedent set by this sale would extend far beyond FCSAmerica. The concern we have for Missouri farmers, as well as others around the country, is that if this is allowed to happen in the four States that comprise FCSAmerica, where will it happen next?

Finally, it is my understanding that AgStar, which is a part of the Farm Credit System, has put forth a purchase offer that is actually more generous than the one from Rabobank. As a farmer, and president of the State's largest farm organization, I am confident I speak for Missouri agricultural producers in saying we would much prefer the Farm Credit System remain intact.

Sincerely,

Charles E. Kruse
President
Missouri Farm Bureau Federation

September 29, 2004

Nancy C. Pellett, Chairman
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Dear Chairman Pellett:

I am writing in regard to the anticipated application from Farm Credit Services of America (FCSA) to leave the Farm Credit System and be acquired by Rabobank Group. On behalf of Pennsylvania's 58,000 farm families and the thousands more agribusinesses who depend on their access to agricultural credit, I wish to add my voice to the many opposing this possible move.

While Farm Credit Services of America does not serve Pennsylvania, I believe the precedence has enormous negative implications. Representing nearly 10 percent of the entire System's portfolio, FCSA's departure would drain the farmer-owned network of needed assets, even as it left remaining Agricultural Credit Associations straining to provide services in the states vacated by FCSA.

There are many areas in Pennsylvania where Farm Credit is the primary, and in a few cases the only, agricultural lender. If FCSA is permitted to pull out of the Farm Credit System, could others be far behind? The temptation to follow suit might be irresistible, particularly given the opportunities outside of the Farm Credit System to diversify lending well beyond agriculture, to eliminate members' patronage payments, and to walk away from nearly two decades of borrowers' rights. I know what a disruption the loss of Farm Credit would cause the farmers of Pennsylvania, and can only imagine the same would be true for the 51,000 farmers and ranchers in four States who depend on FCSA for capital.

Once an application is formally submitted by Farm Credit Services of America, I hope you will choose to hold a hearing on this subject, providing FCSA borrowers in Iowa, Nebraska, South Dakota, and Wyoming an opportunity to express their views. I also would welcome the opportunity to further discuss the potential impact of FCSA's sale to Rabobank on those who depend on access to the Farm Credit System elsewhere in the country.

Remembering that the Farm Credit System exists because private sector lenders found agriculture too risky an investment, I cannot help but wonder how long it would be before Rabobank's competitors would leave the multi-national behemoth as the sole source of agricultural credit in the four states affected, and then how much longer before Rabobank's leaders in the Netherlands decided that profit margins were too slim to continue. It is difficult to envision a happy ending to a story that begins by walking away from a successful network of farmer-owned cooperatives.

Thank you for your consideration of my views.

Sincerely,

Dennis C. Wolff

Preference

AgPreference.com

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September 27, 2004

The Honorable Frank Lucas
United States House of Representatives
2342 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Lucas:

Thanks for holding the hearings on the Farm Credit System. Because of the enormous changes occurring in rural America, it is extremely important that the System continues to provide ways for farmers and ranchers to get credit and maintain financial stability. We really appreciate the opportunity to share our views with you. We respectfully ask that this letter be made a part of the record for the hearing to be held on September 29, 2004, before the Subcommittee on Conservation, Credit, Rural Development and Research.

With the movement away from rural communities, the center of capital allocation moves to metropolitan areas, and to an increasingly significant degree, to locations outside of our Oklahoma. There is an outward migration of population. We are losing jobs. What is even more troublesome, we are loosing our youth. We want to help change these trends.

The recent spate of mergers within the Farm Credit System is a significant concern to us, especially as it may relate to negative trends. On balance, the mergers appear to have resulted in a diminution in the effectiveness of local Farm Credit ownership and a reduction in the capability of individual associations to meet the needs of their respective markets.

We believe that previous decisions on mergers within the Farm Credit System have been based on individual institutions, and not on the effect to the System as a whole. In our view, mergers should consider the benefits to help the System carry out the mission Congress gave to it. If we continue to move down the mega-merger path, we believe that the Farm Credit System will soon merge itself out of existence. We are seeing the first evidence of this with the proposed acquisition by Rabobank of Farm Credit Services of America. As you might imagine, we are opposed to the acquisition.

From a safety and soundness view, we believe that Farm Credit should be structured in ways that support the smaller associations. This includes the rollback of the very large associations into smaller associations that are more responsive to the individual shareholders, and the communities in which they are located. Any rollback should distribute the capital more evenly into a greater number of shareholders, reduce risk associated with concentration of capital, and guarantee more control and representation by individual stockholders in the farmer owned associations.

There are too many problems in the rural areas to justify the sort of infighting that has characterized the relationship between rural banks and Farm Credit. We need to work together. This includes developing programs and incentives that will help deliver positive funding solutions to rural communities.

Rural infrastructures are in decay all across America. They are simply not suited for today's needs. Many rural communities desperately need new and improved services and amenities to help them survive and compete. Rural Oklahoma is a prime example where these needs are abundant. Quality infrastructure is also critical for agriculture, economic development, attracting residents and business, and the overall sustainability of rural communities.

Another area where rural communities need help is housing. Improving rural America's housing stock helps attract business and industry to rural communities that provide a source of off-farm income that is so important, especially for young, beginning, and small farmers. Off-farm employment also helps agricultural producers diversify and stabilize their incomes.

People that live and work in rural communities need to find ways to work together to solve the challenges and take advantage of the opportunities that will help them thrive in the future. The leadership in rural financial institutions can help lay the foundation for making it happen. By working together with the Congress, we can all create a vision of leading the lending in rural America back to local ownership and local control. That would be good for rural communities, good for agriculture, and good for America.

Sincerely,

Joe T. Kelly

Joe T. Kelley
Chairman

Cecil H. Sheperson
President and Chief Executive Officer

c: Honorable Nancy Pellett, Chairman, Farm Credit Administration
Honorable Douglas L. Flory, FCA Board Member
Honorable Michael M. Reyna, FCA Board Member
Mr. Roland Smith, Executive Director for Planning and Projects, FCA
Mr. John L. "Less" Guthrie, Chairman, U. S. AgBank, FCB
Mr. Jerold Harris, President and CEO, U. S. AgBank, FCB

HOLDEN

Hermsen, Liz

From: Pechart, Michael [mpechart@state.pa.us]
Sent: Wednesday, September 29, 2004 3:40 PM
To: Hermsen, Liz

Liz, I understand there is an anticipated application from Farm Credit Services of America (FCSA) to leave the Farm Credit System and be acquired by Rabobank Group. We have some concerns about this at PDA. While Farm Credit Services of America does not serve Pennsylvania, I believe the precedence has enormous negative implications. Representing nearly 10 percent of the entire System's portfolio, FCSA's departure would drain the farmer-owned network of needed assets, even as it left remaining Agricultural Credit Associations straining to provide services in the states vacated by FCSA. There are many areas in Pennsylvania where Farm Credit is the primary, and in a few cases the only, agricultural lender. If FCSA is permitted to pull out of the Farm Credit System, could others be far behind? The temptation to follow suit might be irresistible, particularly given the opportunities outside of the Farm Credit System to diversify lending well beyond agriculture, to eliminate members' patronage payments, and to walk away from nearly two decades of borrowers' rights. I know what a disruption the loss of Farm Credit would cause the farmers of Pennsylvania, and can only imagine the same would be true for the 51,000 farmers and ranchers in four states who depend on FCSA for capital. Once an application is formally submitted by Farm Credit Services of America, wehope a hearing will be heldon this subject, providing FCSA borrowers in Iowa, Nebraska, South Dakota, and Wyoming an opportunity to express their views.
Remembering that the Farm Credit System exists because private sector lenders found agriculture too risky an investment, I cannot help but wonder how long it would be before Rabobank's competitors would leave the multi-national behemoth as the sole source of agricultural credit in the four states affected, and then how much longer before Rabobank's leaders in the Netherlands decided that profit margins were too slim to continue. It is difficult to envision a happy ending to a story that begins by walking away from a successful network of farmer-owned cooperatives.

mike

CONCERNS, STABILITY OF FARM CREDIT SYSTEM

*Just received this email from Mike Pechart with P.D.A.

Farm Credit Services of Hawaii, ACA
Federal Land Bank Association of Hawaii, FLCA
Hawaii Production Credit Association

P. O. Box 31305
Honolulu, Hawaii 96820
(808) 836-8009 Fax: (808) 836-8610

The Farm Credit System

September 16, 2004

FAX: 202-225-4987
808-538-0233

The Honorable Ed Case
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Case:

On July 30, 2004, Farm Credit Services of America (FCS of America) announced its proposed acquisition by Rabobank International (Rabobank), a financial conglomerate organization headquartered in the Netherlands. FCS of America, headquartered in Omaha, Nebraska is a large provider of credit and insurance products to farmers and ranchers in Iowa, Nebraska, South Dakota and Wyoming.

The proposal has raised some serious concern among others in the Farm Credit System (System), as well as other audiences. I want to express to you, Farm Credit Services of Hawaii, ACA's very strong objection to the proposed acquisition. Not only will the farmers in Iowa, Nebraska, South Dakota and Wyoming lose their dedicated, farmer-owned, financial institution, we, in Hawaii, view the longer term impact of this possible transaction as threatening to farmers and ranchers all across the country.

The concern we have is simple: If a System institution is allowed to be sold to Rabobank and nothing is done about the exit provisions in the statutes, will other non-System or foreign buyers knock on other System institution doors and make similar offers? How many more farmers across the country will have to face a foreign bank or other non-System entity that is seeking to capture their farmer-owned organization? The Farm Credit System has served American agriculture well for close to ninety years, and is needed now more than ever.

Congress established the System to be a permanent source of capital for American agriculture. Because we are a single industry lender, we have built a strong capital position so we can be there to provide credit to agriculture and rural America in good and bad economic times. Any plan by a non-System lender to use any of these hard-earned equity dollars to buy out a System entity (and, in this case, potentially create the shift of hundreds of millions of dollars of FCS of America's capital through payment of an exit fee) should not be allowed by Congress. Because of this, Congress has the authority and, we believe, the responsibility to intervene to protect the interests of the System's current 600,000 borrower-owners and future generations of agricultural producers.

We see only one way to ensure that the Farm Credit System will remain in place to serve agriculture for future generations, and that is through legislative action to remove any statutory authority that would allow any System institution to depart the Farm Credit System. It is our understanding that Congressman Frank Lucas has called a hearing on this issue before his Subcommittee on Conservation, Credit, Rural Development and Research for Wednesday, September 29 at 1:30 p.m. We are hopeful that you will speak forcefully on behalf of your Hawaiian constituents.

We ask that you support legislation that would remove this authority and work with us to see that it is adopted in the Congress immediately. Unless the Congress shuts the door on these acquisitions, more could follow, casting doubts on the future ability of farmers to own their own permanent credit system, with devastating long-term implications for Idaho and U.S. agriculture.

Farm Credit Services of Hawaii, ACA has been providing financing to farms in Hawaii for more than 40 years. The FCS of Hawaii, ACA is locally controlled as the Board of Directors are elected by its stockholders and Outside Directors are appointed by the Board. The Board of Directors are: David "Buddy" Nobriga, Chairman, William W. Stearns, 1st Vice Chairman, Michael G. Fitzgerald, 2nd Vice Chairman, Faith Okabe, Director, Mamoru Kaneshiro, Director, Raymond Kawamata, Director, Joseph M. Souki, Outside Director and Wendell Koga, Outside Director. FCS of Hawaii, ACA presently serve 360 borrowers throughout the State of Hawaii with a loan portfolio of $80,000,000.

Please help us in Hawaii to put a stop to this ill-advised acquisition, as well as future acquisitions. Let's make clear that the Farm Credit System, designed by Congress and capitalized through the toil of generations of farmers and ranchers, is not for sale.

We appreciate your consideration on our request.

Sincerely yours,

Theodore M. Tokunaga, Jr.
Theodore M. Tokunaga, Jr.,
Chief Executive Officer and President
Farm Credit Services of Hawaii, ACA

cc: Jeana Hultquist, Legislative Officer (Fax-916-973-3092)
Farm Credit Services of Hawaii, ACA Board of Directors

Rabobank

Testimony on behalf of
Rabobank
before the
House Agriculture Subcommittee on
Conservation, Credit, Rural Development and Research

September 29, 2004

Rabobank – A Committed Partner to U.S. Agriculture

OVERVIEW

Mr. Chairman and members of the Committee, thank you for the opportunity to present this testimony for today's hearing on the Farm Credit System (FCS or System). Although the hearing is not specifically focused on Rabobank or our pending acquisition of Farm Credit Services of America (FCSAmerica), we recognize that the acquisition and the ensuing public discussion are among the factors which, however indirectly, may have prompted today's hearing.

Therefore, although we are not testifying in person before the committee, we believe that we have a responsibility to provide the committee with information about who Rabobank is, as our name may be unfamiliar to committee members, our role in agriculture finance around the world and in the U.S., and our pending acquisition of FCSAmerica.

We are providing this testimony so that committee members, regulators and other stakeholders understand the landscape in which the transaction evolved – Rabobank's rationale for partnering with FCSAmerica, details of the transaction itself, and the significant benefits we believe it holds for U.S. agriculture and rural America.

These benefits are, in brief:

- The distribution of $600 million in new, non-System funds into the hands of 51,000 FCSAmerica stockholders – farmers and ranchers who live and work in rural America;
- The return of over $800 million to the System, resulting in a 40% increase in FCS insurance funding and lower insurance premiums for all System members and the farmers they serve;
- More financial products and improved services for U.S. producers;
- Greater financial competition and choice in lending to rural America; and
- The generation of new tax revenues to contribute to local and state economies.

In addition, we can tell you that the net profits earned and generated by FCSAmerica, as part of Rabobank, will stay in the U.S. and be reinvested in the new Rabobank-FCSAmerica business. Existing loans will not change nor are there expected to be any management or operating changes to FCSAmerica. All credit decisions and policies will continue to be made in the U.S.

Current FCA regulations provide for a process by which a System entity can apply to exit the System; the right of stockholders of that entity to vote on the proposed exit is a critically important part of those regulations. In this case, stockholders of FCSAmerica will have ample time to consider and vote on our proposed transaction, and we believe it is imperative that the regulatory process be allowed to proceed so that the stockholders of FCSAmerica can exercise their right to vote.

This statement will provide information about Rabobank, discuss the pending transaction in more detail, and offer our views on certain aspects of the Farm Credit System relating to our transaction. Also as part of our testimony, we are including the original press release issued July 30, 2004, announcing the transaction, as well as maps of Rabobank's presence in the U.S. and Americas, and fact sheets about Rabobank and the transaction.

We welcome the opportunity to assist the committee.

RABOBANK: ROOTS IN AGRICULTURE

Rabobank Group is the leading financial institution for the global food and agriculture industry, and ranks among the 25 largest banks in the world. Headquartered in Utrecht, The Netherlands, Rabobank is a cooperative bank with over $500 billion in assets, 9 million customers, 57,000 employees, and operations in 35 countries. Rabobank consistently receives the highest credit ratings from leading ratings agencies, and is the only non-government bank with a AAA credit rating from both principal rating agencies. This rating signifies our financial stability, and translates into affordable financing and competitive pricing for our customers.

Rabobank was founded as a local credit cooperative in 1896, by Dutch farmers who felt their financing needs were not being met by existing lenders. The farmers saw a need for a financial lender who would be dedicated to the interests of farmers, and who understood the unique needs of agricultural borrowers. From those agricultural roots, Rabobank has grown into a global financial services leader, providing retail banking, asset management, insurance, lease financing, private banking, and corporate and investment banking services to individuals, farmers, small and medium enterprises (SMEs), and food and agribusiness firms in key markets around the world.

Throughout its growth, Rabobank has maintained its primary focus on financing agribusiness. Today, Rabobank is recognized as the financial link in the global food chain. This reputation is based on Rabobank's tremendous resources, its strong commitment to and focus on food and agriculture, the unparalleled quality of its research, and its extensive knowledge of the global food and agricultural industry.

Rabobank has also maintained its origins as a cooperative, reflected in its strong focus on customer relationships and service. Its internal mission is to create customer value, not to reap profits from its customers. All net profits are reinvested in its businesses to support their growth. This allows Rabobank to take a long-term view towards lending and banking, which is particularly important when serving the long-term nature of agriculture production. Reinvesting net profits in the business also allows Rabobank to take a long-term view towards banking performance, and to maintain a high capital ratio.

RABOBANK GROUP: STRUCTURE, GOVERNANCE, REGULATION

The Rabobank Group is structured as a group cooperative, comprised of a central banking association, "Rabobank Nederland"; an international banking arm, "Rabobank International"; 328 local cooperatives; and numerous specialized subsidiaries (see chart below). A cross-guarantee among all entities in Rabobank Group provides financial security and intra-group support.

- The 328 local Rabobanks are each cooperative entities that provide retail and community banking to customers from 1,743 branch locations throughout the Netherlands. Customers of each local Rabobank can become members of their local cooperative, but they do not own stock in it. Together, the 328 local Rabobanks serve a combined total of 1.4 million member-customers.

- The local Rabobanks in turn are the cooperative owners of the central organization, Rabobank Nederland. Because Rabobank Nederland's members are not individuals, the Rabobank Group does not distribute dividends or earnings.

- Rabobank Nederland advises, supports and supervises the local Rabobanks. It also acts as treasurer to the entire Rabobank Group, conducts wholesale banking, and is the holding company for various specialized subsidiaries that provide insurance, asset and investment management, leasing, private banking, and real estate financing. Rabobank International, which conducts banking in the United States and other key markets around the world, is a division of Rabobank Nederland.

328 Cooperative Local Rabobanks (Netherlands)
- 1.4 million member-customers
- No stock ownership by members

Rabobank Nederland B.A.
- Owned by 328 cooperative Rabobanks
- Supports, supervises local Rabobanks
- Treasurer for Rabobank Group
- Conducts wholesale international banking
- Holding company for subsidiaries

Specialized Subsidiaries
- Insurance / pensions
- Asset management
- Investment management
- Leasing
- Real estate finance
- Private banking

Rabobank International (division)
- Operations in 35 countries
- Focus on food and agriculture customers
- 25 years in the U.S.

Governance

Rabobank Group is governed by two boards: an executive board and a supervisory board. Rabobank International is governed by its own managing board. Like the ACAs in the Farm Credit System, the 328 local cooperative Rabobanks in the Netherlands each have their own boards and separate audited financial statements.

Regulation

Within the Netherlands, the Rabobank Group – comprised of Rabobank Nederland, all 328 local Rabobank cooperatives, and various Netherlands-based subsidiaries – is regulated by the Dutch Central Bank. As a non-governmental entity, Rabobank does not enjoy government-sponsored funding or tax-exempt status.

Rabobank International is subject to regulation and supervision by the various governmental authorities and regulatory agencies in the respective countries in which it operates. In the United States, Rabobank and its U.S. subsidiaries are subject to regulation, supervision and examination by the Federal Reserve Board and various state regulators based on the nature of its banking and other financial activities.

RABOBANK'S UNIQUE AGRICULTURAL OFFERING

Rabobank enjoys a reputation as a principal lender to food and agriculture around the world, and aspires to also be the lender of choice for U.S. agriculture – to provide U.S. farmers and ranchers with every financial product they need to grow their business and succeed. Rabobank is well positioned to serve U.S. producers: it has a century of agricultural lending experience, vast resources, financial strength and stability, deep agricultural expertise, and global perspective and geographic reach, all of which are unequalled by other agriculture lenders.

Rabobank also offers an unparalleled array of products and services that are tailored to meet the specific needs of agriculture and rural customers. Customers in regions around the globe benefit from Rabobank's portfolio of financial solutions, which include retail banking; depository services; farm vehicle leasing; crop insurance; input financing; hedging instruments and other risk management products, such as weather derivatives; wealth management and investment products; cash management; international expansion loans; home loans; real estate mortgages; and interest-only loans. No other private sector lender can match the combined strength, scope and quality of Rabobank's agricultural finance offering.

Founded by farmers, Rabobank enjoys a rich agricultural heritage, and thus has a thorough understanding of the cyclical nature and market variations in agriculture production. Through its global diversified portfolio, Rabobank is able to offset cyclical or economic fluctuations in one sector or geographic region with inverse fluctuations in other regions or sectors. This not only allows Rabobank to balance its overall risk, it also enables Rabobank to make a long-term commitment to producers and stay with them through up and down production cycles, wherever and whenever they occur.

Rabobank's involvement in Australia exemplifies this commitment: Rabobank entered the Australian agriculture market in 1994, when that country was in the middle of a serious drought. Rabobank stayed with Australian agriculture through a second drought in 2002-2003 and is still there today – with nearly ten times the number of clients it had after its initial acquisition.

Another example of Rabobank's commitment to serving agriculture is provided by a Harvard Business School case study:

> *Rabobank entered agribusiness finance in the United States at a time when most banks were exiting the sector. [During the 1980's,] a wave of farm bankruptcies and financial difficulties for agribusiness firms had driven many banks out of agribusiness lending and created a void in the marketplace. Rabobank stepped into the gap and demonstrated a strong, long-term commitment to the agribusiness community in a time of crisis.*

COUNTRY BANKING: BUILDING RELATIONSHIPS WITH LOCAL AGRICULTURE, GLOBALLY

Through a strategy that it calls "country banking," Rabobank fulfills its mission of serving key agriculture markets around the world. Rabobank exports its expertise and competencies in retail banking and agriculture lending to selected countries, such as the United States, to provide a broad range of financial services to farmers, SMEs, and other borrowers in non-metropolitan areas. By building long-term relationships with producers, emphasizing customer service, and focusing on agricultural markets, Rabobank seeks to become the bank of choice for farmers, ranchers and producers in those markets.

Rabobank's approach to country banking is focused on local articulation: local management, local hiring, and most important, local decision making. In all markets, all credit decisions and policies regarding local agriculture are made locally by local agriculture specialists.

Similarly, in all of Rabobank's country banking businesses, net profits generated in a country are reinvested in the local business within that country. No money earned or generated is paid or distributed back to the companies in the Netherlands. Instead, the capital earned in a country is redeployed within that country and reinvested in the business(es) there.

Rabobank's country banking operations outside of the Netherlands, where it has an 85% market share in agricultural lending, include:

- Australia – acquisition from the Government of Western Australia of Primary Industry Bank of Australia,1994.
- Canada – strategic alliance with ATB Financial owned by the Alberta Government, 2001.
- Ireland – acquisition of Agriculture Credit Corporation from the Irish government, 2002.
- U.S. – acquisition of Valley Independent Bank in California, 2002.
- U.S. – acquisition of Lend Lease Agribusiness (now Rabo AgriFinance), 2003.
- U.S. – acquisition of Ag Services of America (now Rabo AgServices), 2003.
- Poland – 35% stake in BGZ, leading Polish agricultural bank to be acquired from the Polish Government, 2004.

RABOBANK IN THE UNITED STATES

Rabobank opened its first international branch in the United States in 1981, and has steadily increased its role as a partner to U.S. agriculture in every successive year. Currently, Rabobank has over 1000 U.S. employees helping to finance American production, processing and distribution in over 75 locations across the U.S. Rabobank has acquired three U.S. agriculture lenders in the past two years, advancing toward its goal of directly serving the financing needs of U.S. farmers and ranchers.

- Rabobank U.S. Corporate Banking provides commercial lending and corporate finance to all sectors of U.S. food processing and distribution – from "farm gate to plate." Rabobank typically partners with quasi-government entities (such as CoBank and many ACAs), national and commercial banks in the syndicated loan markets.

  The U.S. corporate banking arm also focuses on import/export lending in conjunction with ExIm Bank and the USDA. Rabobank is the second largest financier of U.S. farm exports through the USDA's Export Credit Guarantee program. It is also a major participant in value-added processing and distribution, financing many of the processors who turn raw American farm commodities into value-added products. Corporate banking is staffed by 108 employees at the funding branch in New York and regional offices in Atlanta, Chicago, Dallas, and San Francisco.

- Rabo AgriFinance has been specializing in financing American agricultural real estate for over 90 years. It offers a full spectrum of loan products, the newest being a 15-year, interest-only, real estate-based revolving line of credit that is unlike traditional farm real estate loans. Borrowers can draw and repay funds as needed and as suitable to the cash flow from their farming operations, giving producers maximum flexibility in their investment decisions. Headquartered in St. Louis, Rabo AgriFinance works with a network of 35 loan originators and has 104 employees located in 16 states in the midwestern and western U.S.

- Rabo AgServices specializes in crop finance, providing seasonal operating loans to farmers and portfolio financing to input suppliers. In addition to "straight" crop financing, it offers a complete line of credit (AgriFlex Credit) to cover the range of farmers' planting and harvesting needs. Rabo AgServices serves a wide range of borrowers, with half of its customers having loans of under $100,000. Headquartered in Cedar Falls, Iowa, Rabo AgServices has 110 employees serving customers in 20 locations across the midwest.

- Valley Independent Bank (VIB) is a community bank founded by farmers over 20 years ago. It joined Rabobank in 2002 in order to expand its retail community banking services to rural customers, and to focus on agriculture lending in the western U.S. Headquartered in El Centro, California, VIB's 488 employees serve customers in 25 branches located in rural valleys from the Mexican border to Fresno.

As described above, the principles of Rabobank's country banking strategy hold true in all of its U.S. businesses. The U.S. businesses are all managed locally, by personnel with local market experience and U.S. agriculture knowledge. Credit decisions and policies are made and set locally by U.S. agriculture specialists.

Similarly, net profits earned and generated by these U.S. businesses are reinvested in growing the businesses. No profits are distributed or paid back to any Rabobank entity in the Netherlands.

FCSAMERICA ACQUISITION

The acquisition of FCSAmerica is a further step in Rabobank's goal of direct partnership with U.S. farmers and ranchers, to provide them with the full range of financial products and services, resources, and global agricultural expertise which Rabobank currently provides to producers around the world – and which U.S. producers deserve as well.

Rabobank has made a long-term commitment to serving the financial needs of U.S. producers, including small farmers and ranchers. FCSAmerica would provide Rabobank with an immediate channel for serving those small producers, and providing them a broader array of financial tools and resources than they currently have access to. In fact, Rabobank envisions further investment in FCSAmerica post-acquisition, in order to expand and enhance the services available to American farmers, ranchers and rural communities.

The transaction provides strategic benefits for FCSAmerica as well as Rabobank, and also offers meaningful benefits to FCSAmerica stockholders, FCSAmerica customers, and U.S. agriculture and rural borrowers in general:

- <u>$600 Million Cash Paid to FCSAmerica Stockholders.</u>

  Rabobank will acquire all the shares of FCSAmerica from the nearly 51,000 FCSAmerica stockholders for a total cash purchase price of $600 million. This is $600 million in *new* funds, from outside the System, that would be put into the hands of the farmers and ranchers who live and work in rural America.

  Actual stockholder payments will be determined according to a formula to be approved by the Farm Credit Administration (FCA). Based on the patronage formula that Rabobank and FCSAmerica have proposed, the average stockholder will realize a significant return on their initial investment of $1,000.

  According to that proposed patronage formula, stockholder payments would be as follows:

  - Over 20,000 stockholders in Iowa would receive approximately $250 million in cash for their shares.
  - Nearly 15,000 stockholders in Nebraska would receive approximately $200 million in cash for their shares.
  - Over 10,000 stockholders in South Dakota would receive approximately $92 million in cash for their shares.
  - Over 1,500 stockholders in Wyoming would receive approximately $17 million in cash for their shares.

Rabobank's $600 million purchase price represents a premium of $100 million over the remaining stockholder equity in FCSAmerica, following payment of the exit fee to the FCA. This purchase price was deemed fair by Duff & Phelps, LLC, the Chicago-based financial advisory firm who served as financial advisor to the board of FCSAmerica for the transaction and who rendered a fairness opinion to the board on the transaction.

FCSAmerica stockholders will have the right to vote on the transaction, and are afforded ample time under FCA regulations in which to understand the transaction and obtain answers to any questions or concerns they may have.

Rabobank's acquisition will infuse from outside the System $600 million into rural American communities by distributing the payments directly into the hands of FCSAmerica stockholders. This is a more appropriate means of financing the acquisition of FCSAmerica than is the distribution of $650 million in retained earnings to stockholders, in the form of a "super dividend," as has been proposed in an alternative acquisition offer.

Such a super dividend would also result in a significantly weaker capital structure of the resulting combined entity (with retained earnings of less than 10% of assets), which would run contrary to the common convention among Farm Credit System entities of maintaining 13% to 17% retained earnings. A significant capital ratio is critical to ensure the stability of "fail safe" institutions such as Farm Credit System associations, particularly following the farm crisis of the 1980's. For an entity one-third the size of FCSAmerica to propose funding its acquisition of FCSAmerica by leveraging up the combined entity sets a dangerous precedent for the entire Farm Credit System.

- <u>$800 Million Exit Fee Stays in the Farm Credit System.</u>

In accordance with the FCA's regulations governing the exit of a System entity, over $800 million of the retained earnings of FCSA will return to the Farm Credit System. Payment of this fee, which will be based on a percentage of FCSAmerica's retained earnings, will lead to an approximate 40% increase in FCS insurance funding. Not only will this payment then significantly strengthen the System, it will also lower insurance premiums for all System members and the farmers they serve for a considerable period.

It is entirely appropriate for taxpayer money, used by the government to build, support and sustain the Farm Credit System, to be retained by the System in its role as a government agency, rather than distributing such monies to shareholders in the form of a super dividend.

- <u>More Products and Improved Services for U.S. Producers.</u>

As part of the Farm Credit System, FCSAmerica is restricted in terms of the types of financial products and services it can provide customers, and limited to serving customers within the borders of its 4-state territory. For example, under FCA regulations, FCSAmerica cannot take deposits from anyone or offer home loans in rural communities with populations of over 2,500. Nor is FCSAmerica permitted to lend to customers who seek to extend their properties outside the geographic borders of Iowa, Nebraska, South Dakota and Wyoming.

It is understandable and reasonable for there to be restrictions governing the activities permitted to Farm Credit System entities in order to ensure the continued stability and quality of the System. However, it must be recognized that, as modern agriculture evolves, the financing needs of agriculture will change as well. It is reasonable, even professionally responsible, for an agricultural lender such as FCSAmerica to seek to enable itself to meet the changing needs of its customer base, and to equip itself to better serve needs of tomorrow's customer.

By partnering with Rabobank, FCSAmerica will be better positioned to anticipate and serve the needs of the next generation of U.S. farmers, as well as better able to meet the needs of today's farmer. Customers will be able to continue working with FCSAmerica as they expand their farming operations into territory in Minnesota, Kansas, Colorado or Missouri. Customers will likewise have access to a much broader array of financial solutions, as well as Rabobank's tremendous resources, agricultural expertise and global perspective, and the competitive pricing afforded by Rabobank's AAA credit rating.

- Increased Financial Competition.

  FCSAmerica's partnership with Rabobank will yield greater financial competition and choice in lending to rural America, particularly in Iowa, Nebraska, South Dakota and Wyoming. FCA regulation provides for another Farm Credit System entity(ies) to assume the charter vacated by FCSAmerica. As part of Rabobank, FCSAmerica will continue to operate in these states, alongside this newly chartered Farm Credit System entity(ies). Therefore, this transaction will result in a net increase in financing options available to customers within those states. Clearly, farmers and ranchers would benefit from a more competitive lending market in the midwest and indeed across the U.S.

- New Economic Contribution

  Under the terms of the acquisition, FCSAmerica will become a wholly owned subsidiary of Rabobank, and thus will begin generating tax revenues for the first time. Those revenues will contribute to local and state economies in Iowa, Nebraska, South Dakota and Wyoming.

- No Changes to Existing Loans.

  There will be no changes in existing loan terms for FCSAmerica customers as a result of the transaction. Customers will continue to work with the same FCSAmerica loan officers in the same locations they do currently.

- No Management Changes or Operating Changes.

  Under Rabobank, FCSAmerica will continue to be headquartered in Omaha, and will maintain all existing branch locations. There will be no changes to FCSAmerica's management team nor any lay-offs among employees, thus ensuring continuity in customer service and business operations. Rabobank values the talent and experience of FCSAmerica's leadership and staff, and trusts they will continue to run the business and serve customers as they do currently. Any acquisition or merger proposal which contemplates changes in FCSAmerica management presents risks to the business, including disruption of business operations and customer service.

Under Rabobank, FCSAmerica will have significant representation on the board of new entity. The new board will consist of 11 members, of whom four will be selected from the existing FCSAmerica board, two will be independent U.S. agriculture finance specialists, and five will be Rabobank appointees (one of whom will be the current President and CEO of FCSAmerica).

- All Profits Stay in the U.S.

  One of the areas of concern frequently voiced about the acquisition is the supposed redistribution of funds to Rabobank businesses in the Netherlands. This is a groundless fear. As is the case with all of Rabobank's international operations, profits are not distributed back to the Netherlands, but are retained and reinvested in the country where they are earned. The net profits earned and generated by FCSAmerica, as a part of Rabobank, will stay in the U.S. and be reinvested in the business.

- Local Decision Making.

  Again, as above, "foreign control" is a frequently heard but groundless criticism of the acquisition. FCSAmerica's business under Rabobank will continue to be managed and run in the U.S. by FCSAmerica's current management team. All U.S. credit decisions and policies will be made in the U.S. by local U.S. agriculture specialists.

It is currently anticipated that, following the acquisition, the new FCSAmerica-Rabobank entity will be chartered as a finance and credit corporation, subject to regulation, supervision and examination by state regulators in the states where it operates, just as Rabobank and all of its U.S. subsidiaries (including the new FCSAmerica entity) are subject to regulation, supervision and examination by the Federal Reserve Board and various state regulators based on the nature of its banking and financial activities.

There has been considerable discussion of Rabobank's acquisition of FCSAmerica, and much of the criticism has come from parties who have a vested interest in the outcome of the acquisition itself and/or the FCA's decision process. Rabobank is wholly in favor of an open exchange of information, opinion and debate with all stakeholders on the issues raised by the transaction. We believe a public dialogue plays a constructive role in the dissemination of the facts and ensures that stockholders in particular, as well as all constituencies, have a thorough understanding of the transaction and its implications for them.

However, we also believe that the level of third-party criticism of our transaction has reached a degree where the information being disseminated is frequently inaccurate, misleading, or incomplete. This is unfortunate, as it does a disservice to the stockholders who need to understand the issues from an unbiased perspective, and who will eventually vote on the transaction.

We look forward to the time when FCSAmerica stockholders have received the FCA-approved Information Statement and will have all the facts at their disposal. At that point, both FCSAmerica and Rabobank will be permitted and delighted to provide stockholders with all the necessary information and answers they seek regarding the transaction. The FCA regulatory process provides ample time for stockholders to learn the facts, consider the issues, and vote on the transaction. We believe it is important that the regulatory process continue to proceed apace so that stockholders are allowed to exercise their right to vote on the transaction, as is provided for under FCA regulations.

FARM CREDIT SYSTEM EXIT PROVISIONS

Rabobank recognizes that the regulation and governance of the U.S. Farm Credit System lies outside our purview. We wish only to comment briefly on the existence and application of the exit provision contained in the FCA's regulations, as it relates directly to our acquisition of FCSAmerica.

As this committee is well aware, FCA regulations contain a provision allowing a Farm Credit System bank or association to terminate its FCS charter. The original provision was added to the statute in 1987, providing for adoption of implementing regulations by the FCA. Pursuant to the statutory provision, the FCA subsequently adopted and proposed rules and, in April 2002, after much review and comment by interested parties, adopted the principal termination regulations that are currently in effect. The objectives of these 2002 amended regulations, as stated in the FCA's Final Rule in April 2002, are to:
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1. Provide a termination procedure for termination by which Farm Credit associations and banks can exit the System.

2. Ensure that non-terminating System institutions can continue to fulfill their congressional mandate of serving the credit needs of farmers, ranchers and cooperatives.

3. Ensure that non-terminating FCS institutions are able to operate safely and soundly.

4. Ensure all equity holders of a terminating institution are treated fairly and equitably.

5. Ensure that stockholder disclosure materials are accurate, informative and easy to understand.

Rabobank is fully complying, as is FCSAmerica, with the termination procedure governing our transaction as set forth under FCA regulations. Rabobank believes that the purchase price that it is paying to FCSAmerica stockholders, and the formula for determining stockholder payment, are fair and will treat all stockholders equitably. Duff & Phelps has already concurred in their fairness opinion on the transaction, in their role as financial advisors to FCSAmerica's board of directors.

Now, the FCA will review the termination proposal, along with all materials for FCSAmerica stockholders, particularly the Information Statement which describes the transaction for stockholders, to ensure accuracy and completeness of information. Rabobank and FCSAmerica will continue to work closely with the FCA to ensure our transaction complies with all FCA regulations relevant to the transaction, and will respond to any questions or requests the FCA might have throughout the process.

Some parties have expressed the fear that the exit of FCSAmerica from the System will irreparably weaken or even lead to the dissolution of the Farm Credit System itself. This is a hard case to make, in that FCSAmerica currently comprises well under 10% of the entire System's assets. In addition, the transaction will put more than $800 million in cash back into the System, thus strengthening the overall System, not weakening it. The FCA will of course need to decide this issue for itself. From any financial perspective, however, FCSAmerica's size is not material in terms of total System assets, and therefore it is scarcely credible that the withdrawal of such a relatively small portion of assets could cause the failure of the entire System.

As stated above, Rabobank has worked with a number of Farm Credit System institutions over the past two decades, in a variety of financial partnerships. We first became aware of the System's regulatory exit provision when we were approached by certain System institutions about the possibility of entering a more permanent form of partnership.

Among the most active opponents of our transaction and the loudest critics of the exit provision, are those same System entities who themselves approached Rabobank in recent years to broach the topic of a strategic alliance or a joint venture. These entities clearly perceived justifiable grounds for far-reaching cooperation with Rabobank which did not exclude their exiting the System as a potential outcome. Obviously, given their current stance, they have changed their positioning regarding the exit provision. In their opposition to the transaction and current proposals to remove the exit provision from FCA regulations, these parties are unquestionably disruptive to the regulatory process.

We are also surprised that the validity of the exit provision is only being seriously challenged for the first time now that someone wants to actually use it. Despite the existence of the exit provision over the past five years, and its recent review and emendation by the FCA, the call to rescind the provision has only arisen now that FCSAmerica has applied to exercise the provision. The provision has elicited no active protest until now and was accepted as appropriate by System stakeholders – and in some cases seen as a viable tool in their business strategy. FCSAmerica, as an enterprising lender seeking ways to better serve its customers, determined that the exit provision was the best option available to it under FCA regulations for achieving that goal. In doing so, it is operating within the framework of current FCA regulations and fully complying with the requirements and rules as set forth in those regulations by the FCA and Congress. For the FCA and/or Congress to consider changing those regulations now, in "mid-stream," or even to go so far as to rescind the exit provision altogether, would seem to call into question the purpose and credibility of Farm Credit System regulations in general.

The exit provision, which was so recently amended, provides sufficient criteria by which the FCA can consider FCSAmerica's application as well as its implications for the entire System. We believe it is important for the regulatory process to continue to move forward and for the

FCA to be permitted to conduct its oversight and review according to the regulations currently in place.

In the end, it is the stockholders of FCSAmerica who, on a fully informed basis, will decide on our proposed transaction. The FCA regulations, as currently written, provide for an ample period of stockholder consideration and voting. To change those regulations in mid-process and/or to preempt the rights of FCSAmerica stockholders to vote on this transaction would be a serious disservice to those stockholders, and indeed for all stockholders of FCS entities.

CLOSING

We hope this statement has made clear that Rabobank's acquisition of FCSAmerica is not intended in any way to be a comment or influence on the Farm Credit System. From Rabobank's perspective, this acquisition is purely and only about advancing our strategy of partnering directly with American farmers and ranchers. Rabobank is wholly committed to serving the financial needs of *all* American agriculture, from the larger firms involved in value-added processing and distribution to the smaller, individual producers who farm and ranch in rural America. The partnership with FCSAmerica moves us one step closer to our goal of moving "onto the farm" to serve American producers.

Rabobank's ambition is to deliver greater variety, enhanced services, and broader scope of financial solutions; to bring our century of agricultural expertise and our global knowledge to bear for the benefit of U.S. producers; to create more financial competition and options for rural borrowers; and to make our tremendous resources and competitive pricing available to all of American agriculture, just as they are available to the rest of the world.

We look forward to achieving these ambitions and to continuing to invest in the growth of U.S. agriculture for as long as crops are planted and livestock is raised in America.

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Statement of Jim Billington

Mr. Chairman, members of the subcommittee, I thank you for the opportunity to submit my testimony on behalf of the agricultural organization of the Oklahoma Farmers Union. As a third generation member of this group that has been in existence for 100 years, I have been asked to represent the farm and ranch producers of the state of Oklahoma and across this great nation.

I am confident from the experience and knowledge that was obtained through direct employment of the Farm Credit System that the topic I intend to address needs special and careful consideration. I was a former member of the Farm Credit Administration board. I was appointed by President Ronald Reagan to the FCA in the mid-1980's. During this period of time, I was involved and instrumental in the reform of the farm credit system, subsequent bailout of the system and the establishment of a method for borrowers rights. Many of the changes that are now in place were accomplished during my tenure, which resulted in adjusting Federal regulations and the passage of the Agricultural Credit Act of 1987. I was a certified FCA bank examiner and president of the farm system association. Later, I served as president and chief executive of a state chartered bank in Oklahoma.

My testimony today is to express our concern with the Rabobank Group proposed purchase of the Farm Credit Services of America, Farm Credit System, Omaha, Nebraska. We wish to raise some questions that need to be addressed before a sale or permanent transaction takes place. The Farm Credit Service of Omaha and others like it were built to provide rural families a source of funds to be used for agricultural purposes. The strength of the system was based on the support of the family farm and the unity of the system to help each other during times that one branch may require assistance from another. If that sequence is interrupted, then everyone looses. The perfect example of this principle occurred in the mid–1980 when an infusion of $410 million was provided to the Omaha district by the loss sharing agreement distribution based on the 1985 Act as amended. As of this date, no information has been provided for the repayment of that assistance or the preparation for assistance should other locations find themselves in need of capital. Does the Rabobank intend to repay the other Farm Credit locations the assistance received in the 1980's?

A second area of concern is the offer for the borrowers to be repaid for the equity or stock in the cooperative bank with their own money. How does that benefit the borrowers and does the payment received discontinue the right to future borrowings from the farm credit system? The offer to pay the members of the Omaha system suggests that they are being paid with their own money and without a reasonable return for their investment. It also suggests that the borrowers forego their rights secured by the Agricultural Act of 1987.

It is important for a detailed evaluation to be done of the reserves for losses of the Omaha location. Reserves are set aside accounts that are commonly created from the income of the bank. Those reserves are based on estimated losses that might occur from specific loans, which have been classified as a high risk. The reserve account also receives funds for the purpose of losses that might occur that are not identified. In both cases, the loss reserves are deposited to special accounts for the purpose of adequate recovery if predicted or unpredicted losses occur in the loan portfolio. Should the reserve account grow beyond the need based on the portfolio, the funds can be transferred backed to income. Once it arrives in the income stream, it becomes part of the measured Capital. The importance of this accounting technique is to determine the value of the bank based on inadequate, adequate or surplus of reserves. Each of the positions of the bank would reflect a different position of Capital. Therefore, what is the value of the lending institution under consideration for sale? The same is true with the Farm Credit Service Bank Of Omaha. There needs to be a determination of the present and future value of this bank.

The Omaha Farm Credit Services of America built the present capital structure through their borrowing activities. They left dividends in the corporation for their future and the future of other borrowers. How do we evaluate the due diligence of savings in the form of refusing to take dividends so that others can benefit in the system. Is it right to have Rabobank benefit from those efforts? How much of the current value of the system should be returned to its members? What is the value of the 43 locations of the system under consideration?

Make no mistake; Rabobank is a sound financial institution. The purpose of their existence is to have a responsible and sound return on investments. This particular venture would have a tremendous return since very little is being put into the transaction and a huge amount of gain will be accomplished. The intentions of the Farm Credit Service were not to maximize the amount of return from its existence but to provide a continuous and trustworthy source of lending to agricultural producers. The huge capital position of the Omaha Bank is proof of those efforts and the very reason that Rabobank is interested in the purchase of the bank. As a bank, Rabobank will also become involved in the depository privileges in the areas of service. What is their lending obligation to service that area with the deposits taken and at what rate? Will the agriculture producers trade a sound source of lending that they built to a source of funding that they cannot afford?

Small family farmers are at risk if there is not a farm credit system to provide financial services. Rabobank is structured to lend to corporate agriculture and their accounts include Cargill, Tyson-IBP and others. The family farmer who owns 160 acres is going to have a tough time obtaining financing from Rabobank and because of the size of the intended borrowed amount, most likely will not be able to afford the rate. This institution deals in mega large lending of funds and therefore small amounts are either not done or cost prohibited to the borrower.

The farm credit banking system is an integral part of the rural communities across the United States. Employees, directors, borrowers and others work together to support and maintain the balance that is presently healthy in the agricultural system of finance. Why do we even consider taking a system that is proven to work and trade it for an unknown? Why are we considering this project without investigating the ramifications of the outcome? The sale of a Farm Credit Service opens other doors of request and soon the system becomes obsolete. The system is not in trouble. The system is not need of repair. The system is not financially distraught. The system works. I respectfully request, from someone who understands the system, Please give this sale of the Farm Credit Service of Omaha to Rabobank your serious attention. On behalf of the Oklahoma Farmers Union and the farm community of this great country, thank you.

Statement of Dennis Everson

Mr. Chairman, and members of the committee, I am pleased to discuss the role the Farm Credit System (FCS, Farm Credit, or System) currently plays in agricultural lending, and to share my views regarding if Farm Credit institutions should be allowed to leave the System.

My name is Dennis Everson and I am president of the Agri-Business Division at First Dakota National Bank in Yankton, South Dakota. First Dakota was chartered in 1892 and is the oldest bank in South and North Dakota. First Dakota has 12 full-service banks located in nine different towns in South Dakota and five Loan Production Offices located in Nebraska and South Dakota. All of our First Dakota locations fall within the four-State territory that Farm Credit Services of America serves.

First Dakota has $486 million in assets with $180 million in ag loans making First Dakota the 36th largest agricultural bank in the United States. Over 46 of our entire loan portfolio is dedicated to agriculture.

In addition to the $180 million in ag loans on our books, First Dakota has originated and sold, or participated, an additional $100 million in loans to the secondary market. The secondary market for us has included Farmer MAC and two Farm Credit Institutions: Grand Forks Farm Credit and Ag Star Financial Services, ACA.

We at First Dakota do not feel the pending sale of Farm Credit Services of America is necessary. For the 20 years that I have directed agricultural banking at First Dakota National Bank, my philosophy has been to build alliances with community banks and GSE institutions because I felt it was an absolute necessity in order to provide more options to our customers.

In 1987, First Dakota and Farm Credit Services of the Midlands (later renamed Farm Credit Services of America) had a successful alliance through the establishment, by Farm Credit Services of America, of a loan participation program. The participation program offered competitive funding and additional liquidity to First Dakota and our farm borrowers. In 1997 Farm Credit Services of America terminated the program. In my opinion, this program was terminated due to competitive pressures. Farm Credit Services of America was no longer interested in working cooperatively with us, or any other bank in their service area. If the alliance had remained in existence the pending sale today to Rabobank would not be relevant. The alliance between Farm Credit Services of America and community banks would have enhanced Farm Credit Services of America's ability to expand their market through new participation partners instead of the pending acquisition.

Statement of Gary Sipiorski

FCS: What are they doing?

The question at hand is this: "Is the Farm Credit System (FCS) doing what they should be doing?" Maybe the right question to ask is: "What is FCS really doing today?"

The FCS lenders have now found themselves in a very opportunistic position. They have the means to loan to only the very best credit risk customers. As a GSE (Government Sponsored Enterprise) they have the privilege to borrow their funds at 35 basis points over the U.S. Treasury rates. On the other end of the transaction, they are exempt from paying most income taxes on their income generated from real estate loans. Compare this to a bank that works with retail deposits and will pay up to 41 basis points of income earned in taxes. These two provisions alone give the FCS a 76 basis point advantage over the banks that compete for the very same loans.

Lender Example. might make more sense to a farmer if I use a case example: There once was a group of farmers that grew vegetables. They all worked hard in the fields and sold their vegetables to customers at the farmers market in town. The farmers always noticed that one of their neighbors, for some reason, kept moving ahead of others year after year. There was newer machinery and more people on that farm compared to theirs. Then, they found out that the farmer was selling his farm produce at the farmers market for 33 percent less than the others. As a result, the vegetable customers were buying more from that farmer than from the others. The customers said that his vegetables were as green and colorful as any of the other farmers. So why shouldn't they buy where it cost them less. One day the well-to-do farmer explained that he received a special 33 percent volume discount on his seed, fertilizer and chemicals. He also had a special exemption from the government and did not have to pay the 41 percent income tax rate. Therefore, he kept more of what he made and could sell his produce for less. After all, it made better "community economic sense" for the customers that were buying his vegetables for less.

Which Farmers FCS Targets. The ability for FCS to offer lower rates allows them to be more selective in deciding who they loan money to. They can concentrate their efforts on the top one-third more profitable farmers and those with the highest equity positions. The top one-third of farmers is a very low credit risk and they generally do not require much lender time.

The bottom one-third of farmers will not quality for the FCS loans. They have low equity positions and struggle with cash flows most years. They pose the greatest credit risk, yet someone is financing these loans. When defaults occur, the liquidation of their assets to cover the amount of the loans is questionable. Losses will frequently occur. There is a large drop in lender productivity in these situations due to the non-productive time needed to deal with the legality of each situation.

This leaves the middle one-third of farmers for FCS to pick over and other lenders to determine the risk factors involved. These are farmers with marginal balance sheets and cash flows. A great deal of study time must be involved in the evaluation of the financial reports and management ability of these farmers. Success is possible, but there is a higher degree of total risk compared to the top one-third of farmers. These are the farmers that other lenders will have as customers. As financial progress is made, these farmers may feel an obligation to remain with the lender that helped them through a difficult learning process. As these farmers graduate into the upper one-third farmer group, they are now eligible for the lower rate FCS loans. The other lender must now look for the other middle one-third of producers with higher risks. As a result, these lenders cannot afford to guess wrong too many times.

The older, more established farmers have the lowest risk to FCS. They have proven that they will be the lowest risk loan. What avenues do the young and/or beginning farmers have? They have little net worth and at best only a few years of non-decision making experience. FCS will find little room for these farmers in their loan portfolios. Other lenders will again have a difficult choice to make. The USDA Farm Service Agency loan guarantee program will help limit the risk, but a great deal of staff time will be required to set up the loans and closely watch every step of the way. There is no room for mistakes or severe market turns with this group because of the lack of financial depth.

FCS Growth Strategy. The FCS has aggressively used the above strategy to grow their loan volume. More volume justifies more staff and a bigger organization with more control. This has been the thrust to broaden their lending authority in the name of "rural development". They have extended their lending arm in smaller communities into non-farm homes, businesses and agricultural related businesses. They have creatively circumvented the rules restricting deposit taking with funds held accounts and preferred stock offerings that function as deposit-like instruments.

FCS has taken advantage of low-rate funding sources and the exemption from some taxes to solicit low interest rate loans from the best of the farm community. They have, in essence, transferred the credit risk to banks that are servicing the rural communities and local depositors as well as local borrowers, but without the financial advantages given to the FSC system.

What the FCS should be doing. FCS should be allowing banks under $700 million in assets to access the same funding source that they use to fund loans. These are generally community banks in rural areas. This would give these banks the ability to use affordable funds. Many of these banks are not able to attract enough deposits since many are in rural areas where the economy and deposit growth is limited or decreasing. This would help these banks to build more rural structure. This would be non-local funds helping local communities. This is some of the same reasoning that FCS uses to justify access to these bond funds.

FCS should be taking on more credit risk with young and/or beginning farmers and farmers with less financial strength. It is still up to each lender to determine what their loan policy should be. However, it appears from the interest rate quotes and terms that cherry producers are receiving that they are being targeted with extremely attractive offers by the FCS. These offers are unmatchable for a profit-paying lender, such as community banks.

FCS should be following their mandate given by Congress to limit their loans to true farmers. Perhaps that definition should be altered to require individuals to have at least $25,000 in gross farm income generated from the sale of farm products to be eligible to borrow from the FCS.

FCS has said that much has changed since Congress chartered them over 80 years ago. FCS says that there are things that have changed beyond their control. This is their reasoning to be allowed to loan to a larger, more non-traditional agricultural base. All of us have seen the world change in the last 80 years. Banking laws and regulations have gone through many changes. Our deposit base has moved to the city and we need to fund the building of rural America with other funding sources as well. Specifically, community banks should have access to the same funds as the FCS at the same cost to make agricultural and rural loans.

Thank you.

Statement of Hector Valenzuela

I have lived in Hawaii for 13½ years, doing research and extension on crop production, crop ecology, and sustainable agriculture. I would like to share with you my concerns about crop biotechnology in Hawaii.

Overall I am concerned that the Federal Government has established a poor regulatory framework for the experimentation and release of GMO crops into the environment. To a large extent the Federal Government has relied on input and oversight by the biotechnology industry itself, by government officials with a history of employment with the biotechnology industry, and on the "independent" input of scientists that may have had indirect ties with the industry as well. An indication of this conflict of interest in establishing a proper regulatory framework is exemplified by the overwhelming industry representation of the panel that will be giving oral testimony at this hearings on June 23 (the panel includes members of Dow AgroSciences, Syngenta, Monsanto, Farm Bureau, and grain industry reps., all of which benefit financially directly or indirectly, from proceeds of the biotech industry).

For Hawaii this means that we are conducting what I believe to be an uncontrolled experiment by releasing novel DNA into our environment without having the knowledge about potential side effects on our environment, on the long-term viability of our agricultural systems, and on the health of our population. While our university has co-released the first gmo fruit to be released commercially in the US, I have been unable to obtain from our research professors the following research-based information: 1) Economic Analysis showing the actual economic benefits of this technology to our growers, to the industry, and to the state (as opposed to having used alternative technologies); 2) short and long-term environmental effects of having released gmo papaya into the state; and 3) short-and long-term human health assessment from the short- and long-term consumption of gmo papaya.

Furthermore, I am concerned that the University has not evaluated all the potential unexpected consequences (by failing to follow the precautionary principle) that may result from the release of gmo papaya into our environment. One clear example is the potential contamination of the non-gmo papaya seed supply in the state.

Prelimanary evidence- from testing procedures provided by UHM's biotechnologist Dr. Richard Manshardt- indicate that contamination of the seed supply may have already occured in several parts of the state (especially on organic farms). Gmo papaya contamination of organic farms results in "decertification" of our farmers, which means that they would not be able to sell organic papayas, nor to export them to Japan and other markets. This also means that the integrity of our local papaya germplasm, such as that of local varieties maintained by local small farmers or home-gardeners over generations, could be compromised in perpetuity—again, with potential unexpected consequences to the environmental health and food security of the state.

In addition I have several environmental and human health concerns about the unregulated open-field experimentation of a host of gmo crops in Hawaii, some of which are closely related to some of the crops grown by small farmers and home-gardeners in the state.

Below, I would like to provide a copy of testimony that I provided in this regard to Maui County last year, and a copy of a commentary that I submitted to local newspapers (but of which none chose to publish):

PROBLEMS WITH CROP BIOTECHNOLOGY IN HAWAII

My name is Hector Valenzuela, I have worked as a crop production specialist at the University of Hawaii in Manoa for about 12 years. My research focus is in the area of crop ecology, organic farming and sustainable agriculture. The main point of my talk today is that we are currently allowing new or novel biological organisms into the state- organisms that may cause long-term unexpected consequences on the environment or on human health. We are allowing this organism in- despite our strict quarantine rules- thanks to what the Los Angeles Times called a "muddled" regulatory scheme set up by the Reagan Administration in 1986 that designated three separate agencies to regulate GM organisms- a process that under industry pressure determined that GM crops were "substantially" equivalent to their non-modified counterparts.

Biotech foods have been consumed by humans since 1992. In 2002 over 145 million acres were planted globally with biotech crops. Today over 70 percent of the food products found in the supermarket shelves contain GM ingredients. And this fact, the hyper-expansion of this industry is one of the issues that concerns me. In the US and in Hawaii few people are fully aware of biotechnology and of how this technology has permeated their lives. In Hawaii, over 1,400 permits have been issued for field testing of biotech crops on 4 islands. There is little to no public information about these trials, and as Carol Okada from the DOA indicated earlier this year regulatory agencies lack the personnel to inspect all of these plantings.

Overall, based on a growing body of evidence, an international consensus is arising, that call for greater regulation, if not for an actual moratorium of biotechnology crop releases, and a call to halt the patenting of living organisms. Today 99 percent of GMO production is concentrated in four countries: US, China, Canada, and Argentina. Many countries throughout Latin America, Asia, Europe, and Africa have rejected the planting and use of biotech crops. Some countries such as Bosnia, India, and Zambia have even rejected free-shipments of GM grains for use as food or feed.

Because so little is known, some critics indicate, perhaps correctly, that we are currently conducting large-scale, uncontrolled, experimentation with our environment and our health, through the unregulated release of biotech products. This summer Michael Meacher, until recently a British Minister for the Environment (equivalent to the head of our EPA) visited Canada for a couple of weeks to learn about their experience with GM crops because Canada has used them extensively since 1997. He reports that originally farmers in Canada were enthusiastic about the use of GM crops. Monsanto promised them higher yields, less herbicide use, little to no cross-contamination, and containment of "volunteers" (Volunteers are plants that survive harvest and become weeds in future plantings). But the minister reports that "It has not turned out like that at all." The minister reports that "Yields were found to be lower herbicide use was not reduced, and often had to be increased, and volunteers were much more difficult to deal with than expected." Among the most important lessons of relevance to England, the minister indicated was that "co-existence of organic and conventional farming is a mirage. In Saskatchewan (which has over 33 m acreage in agronomic crops), organic canola has been wiped out by cross-contamination from Monsanto's Roundup GM canola." He added that "Even more disturbing is that pollution of organic crops does not come primarily airborne, from pollen, but from contamination of the seed supply." And Canadian consumers seem to be worried about their GM industry. Several polls have shown that 92–97 percent of Canadians believe that their government should require the labeling of GM products.

In the meantime public concern has also begun to increase in the US about the lack of regulatory efforts, and the move away from developing more sustainable agricultural practices. A host of communities throughout the US (including 70 towns in Vermont) have passed biotech resolutions calling for improved regulations, to labeling, to actual moratoriums. A Los Angeles Times editorial from 2001 indicated that "it came as a shock to many when a Clinton administration science official acknowledged that Washington is all but unable to assess whether GM plants and animals are harming ecosystems in unforeseen ways," and the editors concurred with a joint US-EU advisory panel that called for a "comprehensive and rigorous examination to ensure safety for human health and the environment before altered foods are marketed."

From an ecological standpoint, a problem with the biotech paradigm, is that it relies on the same one-dimensional 'model' of industrial agriculture that relies on "magic bullets" (such as pesticides and chemical fertilizers) that in the long-term have shown detrimental effects on the environment and human health. A recent editorial in the New York Times, in making reference to the fact that weeds have become resistant to the Roundup herbicide (which is applied on GM crops that are resistant to Roundup) indicated that "Industrial Agriculture is always searching for a silver bullet, forgetting that eventually a silver bullet misfires." Silver bullet solutions not only make the farmer more dependent on external inputs for their livelihood, but the one-dimensional approach also contradicts the concept espoused by organic farming, by Integrated Pest Management, and by the sustainable agriculture movement- all of which espouse a holistic and multi-tactic approach toward improving soil quality, and toward establishing an ecological balance in the farm.

Requirements prior to release

"The call to action, initiated by the Genetically Engineered Food Alert-a coalition of environmental and consumer groups demands that genetically engineered food ingredients or crops should not be allowed on the market unless:

1) Independent safety testing demonstrates they have no harmful effects on human health or the environment;2) They are labeled to ensure the consumer's right-to-know; and3) The biotechnology corporations that manufacture them are held responsible for any harm."

"Nader suggested that a fourth condition be added to the list, that genetically engineered food ingredients or crops should not be allowed on the market unless "there are significant benefits for human needs not available outside this technology."

Crop Biotechnology, a boon or bust for Hawaii?

Biotechnology has been heralded as a hot industry to help Hawaii's fragile economy loosen its dependence from tourism and the military. State policy makers and university administrators have enthusiastically subsidized, and allocated substantial resources to establish a biotechnology industry in Hawaii. The UH College of Tropical Agriculture and Human Resources, the state unit responsible for fostering unbiased research and education on human, natural and agricultural resources for the state, has had from 60–70 researchers working on crop biotechnology.

In these lean times, the college even created an extension faculty position to help promote this industry- although to date UH has released only one genetically modified crop- the increasingly controversial GM papaya (more on that later).

The large international corporations that do their in-house field research in Hawaii have funded the creation of astro-turf (seemingly grassroots-but artificial) groups to help promote biotechnology in the state. The pro-biotech views of these PR firms and their consultants (such as Maui's Don Gerbig, who promotes a biotech agenda without acknowledging his ties to the industry), and from UH, are frequently displayed in the local media in op-ed's and letters to the editor. Unfortunately, in their commentaries, the biotech industry and several CTAHR faculty/administrators have tried to discredit opponents of the biotech industry, by describing them as 'emotional', 'extremists', and 'activists' that spread 'propaganda' and 'false innuendoes' by failing to look at the 'hard facts'- even though no 'hard-facts' are presented.

I find it disconcerting when such powerful entities chose to attack the messengers (remember McCarthyism?), instead of focusing on the real issues at hand, to which I turn below. A key problem is a well documented lack of oversight by regulatory agencies. Industry provides regulatory data on a "voluntary" basis.

Both Federal and local regulatory agencies have admitted that they lack the staff and resources to oversee most research. Regulators yielding to industry pressure, and the intimate ties that exist between industry and Federal regulators have similarly been pointed out as the "weak-link" surrounding the introduction of Mad Cow Disease to the US. Concerns about the release of biotech crops in Hawaii include potential pollution of our fragile ecosystem, cross-contamination of wild species or conventional non-GM varieties, and potential short- and long-term effects on human health.

Such concerns have been raised after the release of the GM virus-resistant papaya by UH. Organic farmers on the Big Island have found that many of their farms (which grow certified GM-free papaya), and even areas in Waipio Valley are contaminated by GM papaya. This means that in the future local organic growers may be prevented from shipping papayas to Japan or Europe- a prime export market for papayas. UH thus released a novel organism (GM papaya containing foreign viral DNA) but has been unable to contain it to prevent contamination of the papaya seed supply in the state. Farmers are normally liable if they contaminate their neighbors' land with chemicals or pesticide drift.

But who is liable for polluting GM-free areas and our natural habitats with invasive GM products? Who will compensate our local farmers when their seed supply is contaminated with GM-seed and key markets are lost? And, from a philosophical standpoint, who gave corporations and universities the right to contaminate our crops, community gardens and native vegetation with foreign DNA- especially without public input on the matter?

The projected economic benefit and environmental/human safety of the UH released GM papaya remain questionable. To date no "hard data" has been provided to back up claims of:

a) economic benefits of having introduced GM papaya instead of having used other pest management alternatives

b) economic benefit to individual papaya growers

c) environmental safety

d) human health safety data from the short-and long-term consumption of GM papaya.

In essence, there should be no rush to release novel GM germplasm, or to experiment with them in our soils, without solid scientific evidence that these products pose no threat to the health of Hawaii's environment, its population, and our future generations.

Hector Valenzuela, a Crop Production Specialist at the UHM College of Tropical Agriculture and Human Resources, conducts research and education on organic farming and sustainable agriculture.

Statement of Tane Datta

Papaya Example-from Hawaii.

1. The Rainbow (GMO) Papaya was developed to help farmers beat the ringspot virus and it has been approved by the USDA to be safe to eat. Residents been told the market outlook for Rainbow papaya is good and have been encouraged to sample it at the annual farm fair. It is also sold in supermarkets throughout the islands.

The rainbow papaya was developed by Cornell University and Univ. of Hawaii to be resistant to the papaya ringspot virus. Approval was based on public comment and literature search by the USDA-APHIS. Quoting from the USDA document APHIS has determined that the Sunset lines 55–1 and 63–1 lines do not pose either a direct or indirect plant pest risk and, therefore, will no longer be considered as regulated articles under APHIS regulations. After describing several determinations related to the likelihood of the strain causing new viruses or increasing the resistance of weeds to viruses it declares that the strain is not substantially different from traditional papayas. It goes on to permit without further testing cross breeding the GMO strain with any other strain of papaya. Once this was concluded APHIS decided there will no longer be any permits required for field testing, importation or interstate movement of this strain or its progeny. In simple words it is allowed to be planted anywhere in Hawaii and the only restrictions are by the owners of the strain for commercial purposes.

The public comments were taken between May 3, 1996 to July 2, 1996. There were 18 comments all positive from university researchers, county extension service, papaya growers, the state dept. of agriculture and other stake holders.

The literature search only looked at plant interactions. There was no actual testing done on animals nor were the possible effects on human health looked at.

On that simple basis it was approved to be planted and used for human consumption with no restrictions or required labeling. Why? because the USDA considers it same as regular papaya.

It is not the same as regular papaya and this is why.

It contains four DNA segments from two different bacteria including three from E.coli, four DNA segments form two different viruses. Using literature search aimed at human health, some of these segments test positive for IgE which is a family of proteins from the immune system that activates the allergy response. Further screening to eliminate false positives show that the approved GMO is highly likely to be allergenic. This has lead Dr. Joe Cummins, a professor Emeritus of Genetics at Univ. of Western Ontario to conclude:

1. The APHIS review permitting commercial production of the GMO papaya did not look into the allergenicity of the protein from the ring spot virus transgene. However, published material indicates that the protein is a likely allergen (IgE epitope). APHIS was careless in ignoring the potential allergenicity and should withdraw the crop.

For me, my choice is to not eat a papaya which has genes from three viruses, several parts of E.coli and other bacteria and other non papaya genes as well that have tested positive for being a likely allergen. I would not like to plant that crop or its progeny on my land. I would also not like to unknowingly steal someone's property rights and be subject to legal penalties for doing so. For these reasons I support labeling.

The labeling I support is simple and cost effective. Take the list of genes added to the crop as described in the petition to the USDA and require it to be include it in every shipment of that GMO crop and be posted at the point of sale. For processed products merely require the inclusion of GMO designation and sufficient identification so that it can be looked up in the USDA data base.

STATEMENT OF NORA PEARL

To this panel: The following GMO resolution is included in the Hawaii State Democratic Platform.

GMO RESOLUTION PASSED AT THE STATE DEMOCRATIC CONVENTION, MAY 29, 2004

Whereas, Hawaii Senate Bill 726 (1993) stipulates that environmental assessment is a prerequisite for introduction of genetically modified organisms in the State of Hawaii, and

Whereas, genetically modified organisms and crops have been introduced to the State of Hawai'i through research at the Pacific Basin Agricultural Research Center as well as through seeds sold commercially without the stipulated environmental assessment, and,

Whereas, wind, birds and insects carry the pollen of genetically modified crops onto adjacent areas, altering non-modified crops, including certified organically grown crops and heirloom seed species, and

Whereas, farmers specializing in organic, non-GMO produce lose their certification if their crops are contaminated by genetically engineered organisms, and

Whereas, instead of being held liable for damages incurred by encroaching upon the neighboring crops, biotech companies are suing neighboring farmers for theft of intellectual property, thereby bankrupting the neighboring farmers, and

Whereas, citing risks to public health, the environment and the agricultural economy, many countries, including those in the Common Market, and Australia, prohibit the importation, cultivation and testing of biotech produce and food products, and other countries, including India, are now considering similar measures, and

Whereas, biotech genes are created by inserting genes from other species by means of viruses, creating, not only new species whose effect on the entire environment is unknown and in some instances has already been found to be detrimental, but, mutations in viruses that might never have occurred in billions of years, which could result in widespread epidemics involving enormous suffering and loss of life, and

Whereas, the U.S. Food and Drug Administration has recommended the formation of community review boards to monitor genetically modified crops and their impact, and

Whereas, the State of Hawaii has allowed more field testing of biotech crops than any other state in the nation, and

Whereas, Hawaii's native ecosystems are already challenged by invasive species to the point that many native plants and animals are close to extinction, and many are already extinct, and

Whereas, biotech breakthroughs of GMO plants are developing faster than studies can be done to confirm safety to health, agriculture and environment, and

Whereas, the great deal of uncertainty regarding long term, possibly irreversible effects of GMO crops mandates the use of the precautionary principle: All products are presumed to be ineffective and toxic until empirical data proves (on a case by case basis) otherwise, and

Whereas, regulatory agencies are not requiring adequate safety data from these industries prior to marketing or field trials and therefore there are no incentives for industry to sponsor safety studies and

Whereas, there is a serious potential for, and appearance of, conflict of interest among industry, regulatory agencies and university departments receiving industry research grants. Potential benefits may be overstated and potential risks downplayed, and

Whereas, there is an urgent need for coordination among Federal, state and county agencies (health, agriculture and environment) to examine, learn and agree on the truth about GM crops. One should not let industry set policy, and

Whereas, as in other areas of health, agriculture and environment local decisions pre-empt Federal ones if they are more conservative (following the precautionary principle), now therefore,

Be it resolved, that Regulatory agencies be established at both the state and county levels similar to federally mandated FDA Institutional Review Boards to evaluate the safety of each independent genetic modification. No member of the Review Board shall have conflict of interest in the technology being evaluated. This Review Board shall:

1) Establish guidelines for safety as related to health (occupational and community), environment and agriculture
2) Approve/reject all GM crops to be planted in communities
3) Establish a community monitoring board in each county (also with no conflict of interest) to monitor the impact of field grown genetically modified organisms.
4) Enforce regulations and required safety procedures.

Be it further resolved, that state and county agencies promote examination of GM product safety by:

1) Requiring permit and fees of the research organizations applying for approval that will fund the cost of safety studies,
2) Identifying institutions (including international agencies) without conflict of interest to conduct safety assessments,
3) Insuring that regulatory boards require adequate safety studies prior to marketing and open field testing,
4) Holding GM companies liable for negative impacts which should have been detected prior to field or market release,
5) Investigating post-marketing complaints of negative impacts associated with GM products (to facilitate these investigations, labeling of GM products should be required).

Be It Further Resolved that all open air testing of biotech crops be suspended in the State of Hawaii's until the review board described above is operational, and

Be It Further Resolved that biotech agriculture and manufacture be suspended in the State of Hawaii's to protect our farmers, our Hawaiian crops and native biota, and our people, and

Be It Further Resolved that in litigation arising from open air testing of biotech crops that the liability rest with the person or organization responsible for planting the biotech crops in question, as well as with the manufacturer of the biotech seeds, and

Be It Further Resolved, that a community review board (including representatives from environmental organizations and the Hawaii's Organic Farmers Association) be created in each county to monitor the impact of genetically modified organisms; and

Be It Further Resolved, that the Democratic Party requests the State of Hawaii's limit public funding of research on biotech crops to research conducted in the confines of enclosed laboratories until approved by the review board; and

Be It Further Resolved, that all genetically engineered foods and food products (such as leavening agents) be clearly marked as such so that consumers know what they are buying; and

Be It Further Resolved, that the Democratic Party of Hawaii's urge the state and counties to enact legislation that implements this resolution; and

Be It Further Resolved, that copies of this resolution be sent to all members of the Hawaii's State Legislature, the County Councils, the Governor of the State of Hawaii's, the County Mayors, and the Hawaii's Congressional Delegation.