

Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FARM CREDIT ADMINISTRATION

12 CFR Part 614

RIN 3052-AB67

Loan Policies and Operations; Other Financing Institutions

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Farm Credit Administration (FCA) requests public comment through an Advance Notice of Proposed Rulemaking (ANPRM) concerning potential revisions to the regulations in subpart P of part 614 that govern the funding and discount relationship between Farm Credit System (Farm Credit, FCS, or System) banks that operate under title I of the Farm Credit Act of 1971, as amended (Act), and non-System other financing institutions (OFIs). Farm Credit Banks (FCBs) and agricultural credit banks (ACBs) are authorized to fund and discount certain short- and intermediate-term loans for non-System lenders, such as commercial banks, savings associations, credit unions, trust companies, agricultural credit corporations, and other agricultural and aquatic lenders as part of their mission to finance agriculture, aquaculture, and other specified rural credit needs. External developments, such as the consolidation of the commercial banking industry, the advent of interstate banking and branching, the gradual reduction of Federal assistance to agriculture and rural communities, and the increased interest of non-System financial institutions in additional sources of funding and liquidity may necessitate revisions to the regulations in subpart P of part 614 so that System banks can fulfill their obligation to meet demands in rural communities for short- and intermediate-term credit. The purpose of any future rulemaking would be to ensure that eligible and creditworthy farmers, ranchers, aquatic producers

and harvesters, processing and marketing operators, farm-related businesses, and rural homeowners will continue to have access to affordable, dependable, and stable short- and intermediate-term credit through both System and non-System lenders. Specifically, this ANPRM seeks comments regarding the FCA's OFI regulations and how they may be revised to better implement the statutory provisions.

DATES: Written comments should be received on or before July 16, 1996.

ADDRESSES: Comments may be mailed or delivered to Patricia W. DiMuzio, Associate Director, Regulation Development, Office of Examination, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or sent by facsimile transmission to the FAX number at (703) 734-5784. Copies of all communications received will be available for review by interested parties in the Office of Examination, Farm Credit Administration.

FOR FURTHER INFORMATION CONTACT:

Eric Howard, Policy Analyst, Regulation Development, Office of Examination, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, or Richard A. Katz, Senior Attorney, Regulatory Enforcement Division, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TDD (703) 883-4444.

SUPPLEMENTARY INFORMATION: The Agricultural Credit Act of 1923¹ created 12 Federal intermediate credit banks (FICBs) to discount agricultural production loans for national and State banks, trust companies, savings associations, credit unions, agricultural credit corporations, incorporated livestock loan companies, and other specified lenders. In 1930, Congress authorized the former FICBs to make secured loans and advances directly to such institutions (hereinafter OFIs).² As a result, OFIs could borrow from and discount production agricultural loans with System banks before the Farm Credit Act of 1933³ created production credit associations (PCAs) as an

alternative source of financing the operating needs of farmers and ranchers.

The legislative history to the Act reveals that Congress originally granted OFIs discount privileges at System banks in order to redress the scarcity of operating credit for farmers and ranchers.⁴ During the past 73 years, Congress has responded to the changing demands of agricultural producers and other rural residents for affordable short- and intermediate-term credit by updating the statutory authorities of the FICBs and their successor FCBs and ACBs⁵ to provide funding and financial assistance to both System and non-System lenders. Currently, section 1.7(b) of the Act authorizes OFIs to obtain funding from FCBs or ACBs for any loan that a PCA could make under section 2.4 of the Act to eligible farmers, ranchers, aquatic producers and harvesters, processing and marketing operators, farm-related businesses, and rural homeowners.

Section 1.7(b)(4) of the Act requires the FCA to enact regulations that assure that funding from Farm Credit banks operating under title I of the Act will be "available on a reasonable basis" to any national bank, State bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings association, credit union, association of agricultural producers engaged in making loans to farmers and ranchers, or corporation engaged in making loans to producers or harvesters of aquatic products that: (1) Is significantly involved in lending for agricultural or aquatic purposes; (2) demonstrates a continuing need for supplementary sources of funds to meet the credit requirements of its agricultural or aquatic borrowers; (3) has limited access to national or regional capital markets; and (4) does not use the services of System banks to extend

⁴ See H. R. Rep. No. 1712, 67th Cong., 1st. Sess. (Feb. 25, 1923), P. 17.

⁵ Section 410 of the Agricultural Credit Act of 1987 (1987 Act) created the FCBs through the mandatory merger of the Federal Land Bank and the FICB in each Farm Credit district. See Pub. L. No. 100-233, § 410, 101 Stat. 1568, 1637, (Jan. 6, 1988). Section 7.0 of the Act allows a FCB to merge with a bank for cooperatives in order to form an ACB. Section 7.0 of the Act derives from section 416 of the 1987 Act. Section 7.0 was further amended by section 408(b) of the Agricultural Credit Technical Corrections Act of 1988. See Pub. L. No. 100-233, § 416, 101 Stat. 1568, 1645, (Jan. 6, 1988); Pub. L. No. 100-399, § 408(b), 102 Stat. 989, 1001, (Aug. 17, 1988).

¹ Pub. L. No. 503, 42 Stat. 1454, (Mar. 4, 1923).

² Pub. L. No. 439, 46 Stat. 816, (June 26, 1930).

³ Pub. L. No. 75-73D, title II, 48 Stat. 257, 259, (June 16, 1933).

credit to persons and for purposes that cannot be financed by a PCA under title II of the Act. According to the legislative history to section 1.7(b)(4) of the Act,⁶ Congress intended that Farm Credit banks act as a primary funding and liquidity source for small, local OFIs so they in turn could meet certain short- and intermediate-term credit needs in their rural communities.⁷ However, the legislative history to section 1.7(b)(4) of the Act also indicates that Congress did not intend to exclude other agricultural creditors from funding or discounting loans with System banks,⁸ so long as they have a need for supplementary funds that cannot be met through access to national or regional capital markets.

Section 1.7(b) of the Act requires FCBs and ACBs to extend credit to qualified OFIs (within the confines of safety and soundness) as part of their mission to finance agriculture, aquaculture, and other specified rural credit needs. While many OFIs often compete directly with PCAs and agricultural credit associations (ACAs) that own voting stock in the FCB or ACB, the Act requires Farm Credit banks to extend funding on a safe and sound lending basis to any qualified OFI so that farmers, ranchers, aquatic producers and harvesters, farm-related businesses and rural homeowners have access to affordable and dependable credit.

The number of OFIs that fund or discount loans with System banks has declined from a peak of 327 in 1982 to 22 on December 31, 1995. Furthermore, the amount of credit that System banks have extended to OFIs has decreased from almost \$914 million in 1981 to \$230.8 million as of December 31, 1995. The farm crisis of the 1980s caused a decline in overall agricultural debt, which in turn, substantially reduced the number of OFIs and their demand for System financing. The FCS also experienced significant financial stress between 1984 and 1989, and many OFIs terminated their discounting relationship with System banks because:

(1) They sought to reduce their exposure to loss by retiring their investments in FCS banks; (2) the FCS no longer offered competitive rates; or (3) several OFIs ceased operations as a result of merger or closure. Many rural commercial banks, including some OFIs, merged with regional banks or bank holding company networks that did not qualify for OFI status because they were no longer significantly engaged in agricultural lending.

The financial strength of Farm Credit banks has significantly improved in the past several years. As a result, FCBs and ACBs are better positioned to help increase the availability of reasonably priced and dependable credit in many of America's rural communities. Efforts by Federal and State governments to balance their budgets may reduce direct assistance to agriculture and rural development in future years. As rural areas require greater private sector investment to sustain their economic viability, local financial institutions are seeking alternative means to provide affordable credit to their communities on a sustainable basis. Rural lenders also face liquidity problems from time-to-time. Loan-to-deposit ratios at rural depository institutions are now at historically high levels.⁹ As the commercial banking industry continues to consolidate into large national and regional networks it is unclear how the credit needs in rural communities will be affected.

Today, several non-System financial institutions are once again expressing interest in obtaining FCS funding for their short- and intermediate-term loans to agricultural and other rural borrowers. However, many of these non-System institutions perceive barriers that impede their access to System funding. Although a variety of factors may have contributed to the historical decline in the OFI lending program, the FCA wants to eliminate any regulatory restrictions that are not required by the Act and its legislative history or do not promote safety and soundness of the FCS.

The FCA wants to ensure that the relationship between Farm Credit banks and OFIs provides another means for meeting the short- and intermediate-term credit needs of agricultural producers and other rural borrowers, as Congress intended. The existing

regulations were enacted in 1981, after Congress amended the OFI provisions in the Act. See 46 FR 51886 (Oct. 22, 1981). As a result of external developments over the past 15 years, the FCA believes that it is now time to review these regulations in subpart P of part 614 to determine whether they are appropriately addressing the credit needs of non-System institutions that lend to agriculture and rural communities. An ANPRM will give all interested parties an opportunity to provide the FCA with information to assist it in developing proposed regulations that will be responsive to the credit needs of OFIs and their borrowers.¹⁰ Furthermore, the FCA seeks guidance about how new regulations can best promote equitable treatment of OFIs and System associations by FCBs and ACBs. Comments from non-System lenders are encouraged so that the FCA can consider the needs and concerns of eligible financial institutions that the Agency does not examine or regulate.

The Act establishes certain requirements that OFIs must meet in order to initiate and maintain a relationship with the FCS. For example, section 1.10(b) of the Act authorizes FCBs and ACBs to extend credit to OFIs so they can make short- and intermediate-term loans to persons who would be eligible to obtain credit from PCAs.¹¹ Additionally, each OFI is required by section 4.3A(c)(1)(D)(iii) of the Act to purchase non-voting equity in its funding FCB or ACB. Finally, the same borrower rights that PCAs must provide also apply to OFI loans that are funded by a Farm Credit bank.

Safety and soundness issues will also be addressed when the FCA proposes new OFI regulations. OFIs may pose different safety and soundness considerations for the FCA than direct lender associations. For example, OFIs may merit a different regulatory treatment than System associations for questions relating to collateral and lien perfection because, in contrast to System associations, OFIs can borrow

⁶ Current section 1.7(b)(4) derives from section 203 of the Farm Credit Act Amendments of 1980 (1980 Act). See Pub. L. No. 96-592, § 203, 94 Stat. 3437, 3441, (Dec. 24, 1980). Section 203 of the 1980 Act substantially revised former section 2.3 of the Act, which set forth the lending authorities of the FCBs. The new OFI eligibility criteria in section 203 of the 1980 Act were incorporated into former section 2.3(d) of the Act. Section 401 of the 1987 Act, which set forth the powers and obligations of the FCBs, recodified the requirements in former section 2.3(d) as section 1.7(b)(4) of the Act. See Pub. L. No. 100-233, § 401, 101 Stat. 1568, 1625 (Jan 6, 1988).

⁷ See H.R. 96-1287, 96th Cong., 2d. Sess., (1980), 21, 32-34. See also 126 Cong. Rec. H 10960-64 (daily ed. Nov. 19, 1980).

⁸ *Id.*

⁹ A recent study indicates that loan-to-deposit ratios at commercial banks of all sizes that substantially engage in agricultural lending have risen from 53.6 percent in 1987 to 86.2 percent as of June 30, 1995. See Economic Research Service, U.S. Dep't of Agriculture, (AIS-60), Agricultural Income and Finance Situation and Outlook Report, 11, 53. (Feb. 1996).

¹⁰ The FCA is aware that Congress is considering proposals that would provide non-System financial institutions greater access to funding and discount relationships with System banks. These legislative proposals go substantially beyond what the existing statute allows. Should any of these proposals be enacted, the FCA would review the regulations in light of the new statutory provisions.

¹¹ Section 1.10(b) of the Act allows FCBs and ACBs to extend financial services to PCAs, ACAs, and OFIs so they can make: (1) Aquatic loans that mature within 15 years; and (2) loans to farmers, ranchers, farm-related businesses, and non-farm rural homeowners that mature within 7 years, unless the bank's board, under the regulations of the FCA, approve loans that are repayable within 10 years.

from other lenders without the permission of their System funding banks. In contrast to the authorities vis-à-vis FCS institutions, the FCA lacks broad authority to: (1) Appoint a conservator or receiver for insolvent OFIs;¹² or (2) determine the priority of claims against OFIs in liquidation.¹³

The FCA requests comments and information that address the following questions:

I. Eligibility for OFI Status

A. Significant Involvement in Agricultural or Aquatic Lending

1. What criteria (such as assets, income, composition of the loan portfolio, or other factors) best determine whether an OFI is significantly involved in agricultural or aquatic lending as required by section 1.7(b)(4)(B)(i) of the Act and what specific threshold, if any, should new regulations use? Please explain your recommendation.

2. How should the FCA define an agricultural lender? Would the profiles of agricultural lenders established by other Federal agencies be useful? Please explain your recommendation.

B. An OFI's Need for Supplemental Sources of Funds

What criteria should be used to determine whether depository and non-depository OFIs demonstrate a continuing need for supplementary sources of funds to meet the credit requirements of their agricultural or aquatic borrowers, as required in section 1.7(b)(4)(B)(ii) of the Act? Please explain your recommendations.

C. OFI Access to National or Regional Capital Markets

1. Has the existing regulatory definition of "national or regional capital markets" in § 614.4540 become outmoded? If so, what factors in today's financial environment demonstrate that an OFI has limited access to "national or regional capital markets?"

2. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 will enable bank holding companies and their commercial bank affiliates to expand, over time, their interstate banking and branching networks. How will this law affect the concept of

limited access to "national or regional capital markets" in section 1.7(b)(4)(B)(iii) of the Act?

D. Mergers, Consolidations, and Acquisitions of OFIs

When an OFI merges, consolidates, or is acquired by another financial institution, the eligibility of the successor entity to borrow from an FCB or an ACB must be established anew. Under what conditions, if any, should a successor to an existing OFI be entitled to "grandfather" rights?

E. Parent and Affiliate Relationships

1. What factors should determine whether an OFI applicant is considered together with its parents and affiliates as a single entity?

2. Section 1.7(b)(4)(D) of the Act establishes specific criteria for FCA review of OFI application denials based on the OFI's subsidiary or affiliate relationships. Under §§ 614.4550 and 614.4555, the FCA creates a review procedure when an FCB or ACB rejects an OFI's request for financing for any reason. In the interest of eliminating unnecessary prior approvals and case-by-case reviews, the FCA requests comments on whether there is a compelling need for the regulations to continue to require an FCA review of all OFI applications that have been denied. Please explain your recommendation.

F. Eligibility of Major Financial Institutions

The statute and the legislative history indicate that agricultural lenders that do not meet the criteria of sections 1.7(b)(4)(B)(ii) and (iii) of the Act could still fund or discount certain loans with System banks. What restrictions, if any, should the regulations impose on System funding to these types of institutions?

II. Place of Discount

1. Should new regulations continue the territorial restrictions in existing § 614.4660 which require that an OFI must obtain financing from the FCB or ACB (designated System bank) in whose territory: (1) The OFI maintains its headquarters; or (2) more than 50 percent of the OFI's borrowers is concentrated? If not, what criteria should determine which Farm Credit bank should finance an OFI? Please explain your recommendation.

2. Under what circumstances, if any, should new regulations allow an FCB or ACB to extend financing to an OFI that does not operate in its chartered territory if the designated System bank does not approve the OFI's application?

3. Are there any aspects of the Riegle-Neal Interstate Banking and Branching

Efficiency Act of 1994 that the FCA should consider as it develops new regulatory provisions that determine the place of discount for commercial banks and nonbank affiliates of bank holding companies whose networks operate in the chartered territories of more than one Farm Credit bank? Please explain your recommendation.

III. Safety and Soundness

A. Supplemental Collateral

Under what circumstances, if any, should OFIs be required by the new regulations to pledge cash and readily marketable securities or other assets as additional collateral for their loans from System banks?

B. OFI Lending Limit

Current regulations at § 614.4565 impose a lending limit on OFIs. Is this limit appropriate? If not, what alternatives do you suggest and why? How should concentration risk be addressed in a general financing agreement between an OFI and a Farm Credit bank?

C. Insolvency of an OFI

How should new regulations safeguard the interests of an FCB or ACB when an OFI is liquidated?

IV. Fair Treatment Between OFIs and Direct Lender Associations

1. Do current regulations adequately and appropriately ensure that FCBs and ACBs accord impartial and equitable treatment to both FCS associations and OFIs? If not, what changes should be made and why?

2. The regulations currently require, with certain limited exceptions, that OFIs must be treated in a manner that is comparable to direct lender associations. To the extent feasible, the FCA seeks to ensure that OFIs and FCS associations are treated equitably by their funding banks. What circumstances, if any, justify different standards concerning equity investment in the funding bank, interest rate charges, and servicing fees?

V. Other Issues

Are there other regulatory changes, not addressed above, that would improve an FCS bank's ability to serve an OFI and its agricultural customers? Please explain your recommendations.

Dated: May 13, 1996.

Floyd Fithian,

Secretary, Farm Credit Administration Board.

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¹² Section 4.12(b) of the Act grants the FCA "exclusive power and jurisdiction to appoint a conservator or receiver" for FCS banks and associations.

¹³ For the past 65 years, the Federal courts have interpreted various Farm Credit Acts as authorizing the FCA to determine the priority of claims for System institutions in liquidation. See *Wheeler v. Greene*, 280 US 49 (1929); *Knox National Farm Loan Associations v. Phillips*, 300 US 194 (1937); *Little v. First South Production Credit Association*, CA No. J890021 (W) (S.D. Miss. May 16, 1990).