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Leaving the Farm Credit System: The Future of Farm Credit Services of America

Jim Monke
Analyst in Agricultural Policy
Resources, Science, and Industry Division

Summary

In an unprecedented move, an institution of the Farm Credit System (FCS or System) — a government-sponsored enterprise (GSE) — has initiated procedures to terminate its status in the System and be purchased by a private company. On July 30, 2004, the board of directors of Farm Credit Services of America (FCSA) accepted an offer to be purchased by Rabobank for $600 million in borrower-owned stock, and a projected $800 million "exit fee" payable to the Farm Credit System Insurance Corporation. FCSA is the System lending association that serves farmers in Iowa, Nebraska, South Dakota, and Wyoming. Rabobank is a private banking company from the Netherlands with extensive lending experience in agriculture. The option to leave the System is allowed by statute under the Farm Credit Act of 1971, as amended, but has been exercised only once, and did not involve an outside purchaser.

The acquisition needs to be approved by the Farm Credit Administration, the federal regulator of the Farm Credit System, and by the farmer-borrower shareholders in the four-state region. If approved, the loans, facilities, and employees of FCSA would become part of Rabobank. New charters would need to be issued to allow new or existing FCS associations to begin lending in the four-state region. The approval process is expected to proceed through the fall of 2004 and possibly be completed in the spring of 2005. Although Congress has no direct statutory role in the approval process, several members of Congress have stated that they will seek congressional hearings on the purchase, and its implications for System borrowers. This report will be updated as events warrant.

Background on the Farm Credit System

The Farm Credit System (FCS or System) is a national network of cooperatively owned lending institutions that provide credit and other services to farmers and ranchers. The FCS is a federally chartered institution, created in 1916 by Congress in the Federal Farm Loan Act. It has a statutory mandate to serve agriculture as a permanent, reliable source of credit. Current statutory authority is in the Farm Credit Act of 1971, as amended. The most comprehensive recent changes were enacted in the Agricultural Credit Act of 1987 (P.L. 100-233). Federal oversight by the House and Senate Agriculture Committees in conjunction with regulations and examinations by the Farm Credit Administration (FCA) are designed to provide for the safety and soundness of System institutions. As a government-sponsored enterprise (GSE), the System has been given by Congress certain exemptions from taxation, and other benefits that presumably allow it to overcome barriers that might prevent purely private lenders from serving agriculture in the manner Congress envisioned. Unlike the housing GSEs, which are secondary markets, the FCS is a direct lender.

The System is a composed of four regional Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), each of which has chartered territory for serving farmers nationwide.[1] Funds from the sale of bonds flow through these five regional banks to 97 FCS lending associations, the second-largest of which in terms of assets is Farm Credit Services of America. FCS lending associations are cooperatives governed by directors elected from the borrowers who are also cooperative stockholders. They lend to farmers either directly or through their subsidiaries. For more information on the structure of the Farm Credit System, see CRS Report RS21278, *Farm Credit System*.

The Ability to Leave the Farm Credit System

Section 416 of the Agricultural Credit Act of 1987 (P.L. 100-233) amended the Farm Credit Act of 1971 to allow institutions to leave the Farm Credit System. These provisions originated in the Senate bill and were adopted by the conference committee (H.Rept. 100-490). The statute (12 U.S.C. 2279d) is implemented through detailed FCA regulations (12 C.F.R. 611.1200-1290) that specify the types of information that must be provided to FCA and the institution's shareholders throughout the termination process. By law, FCA must approve the plan before shareholders can vote to leave the System.

The main requirements of the termination procedure are as follows:

- **Commencement Resolution.** The association notifies FCA and stockholders of the plan to terminate and its effect on stockholders.
- **Plan of Termination.** The association submits a detailed plan to FCA including a proposed stockholder information statement, evidence of a new charter to be granted if FCS status is revoked, and an estimate of the exit fee. The exit fee is capital exceeding 6% of the association's assets.
- **FCA Approval or Disapproval.** If FCA disapproves, it must explain. One reason mentioned in the regulations is an "adverse effect on the ability of remaining System institutions to fulfill their statutory purpose."
- **Stockholder vote.** If FCA approves the plan, a majority of stockholders in the association who vote must approve the plan.
- **Reconsideration petition.** If the plan is approved by stockholders, a petition by 15% of stockholders may force a second and binding vote.

[1] For a directory of institutions in the Farm Credit System, and a map of the five regional banks, see the Farm Credit Administration website at [http://www.fca.gov/apps/instit.nsf].

- **Termination.** If approved by stockholders, the association pays its debts and deposits the exit fee in escrow. FCA revokes the charter.
- **Post-termination.** FCA determines the exact exit fee.

The timeline for the above steps is likely to take at least seven months. From the date the resolution was submitted (July 30, 2004), the association must wait at least 30 days to submit the Plan of Termination. FCA has 60 days to review the plan. If FCA approves the plan, stockholders are given 30 days to review the information statement before voting. If a majority approve, a 35-day period is allowed for the petition to re-vote. Termination may occur no sooner than 90 days after the stockholders approve the plan.

Pending termination, FCA would issue new lending charters so that the Farm Credit System could maintain a presence in the affected region, and thus national coverage.

The Offer

On July 30, 2004, the board of directors of Farm Credit Services of America (FCSA) accepted an offer to be purchased by Rabobank for $600 million in borrower-owned stock, and a projected $800 million "exit fee" payable to the Farm Credit System Insurance Corporation.[2] This action to leave the Farm Credit System is unprecedented in size and in that it involves purchase by an outside company. Only once has a System institution used the termination provisions. In 1991, the California Livestock Production Credit Association ($14 million in loans) became Stockmans Bank. Congress approved that termination in the 1990 farm bill and waived the exit fee (P.L. 101-624, sec. 1838).

Under the current agreement, Rabobank would purchase all of the outstanding stock of the 51,000 stockholders in FCSA, and distribute the $600 million on a patronage basis based on each stockholder's outstanding loan balance over a specified period. The exit fee is a payment required in statute by the Farm Credit Act. The exit fee serves to reimburse the System for the capital (equity, or retained earnings) accumulated due to the benefits of membership in the System, and is defined as the excess of capital exceeding 6% of assets over a multiyear period. If the Farm Credit Administration and the stockholders approve the deal, FCA has authority to review the association's accounting records and make adjustments as deemed necessary in calculating the final exit fee.

FCSA would give up the benefits of membership in the Farm Credit System, including the tax exemption on its real estate loan portfolio and access to System funds. Consequently, local and state governments could see greater tax revenues depending on how future rural loan portfolios are distributed between FCS and Rabobank. Shareholders might owe capital gains or income taxes on the stock payment.

Background on FCSA. As the second-largest of the System's 97 lending associations, FCSA has 43 offices in the four-state region including Iowa, Nebraska, South Dakota and Wyoming. In 2003, its $7.3 billion loan portfolio was distributed geographically with 42% in Iowa, 39% in Nebraska, 16% in South Dakota, and 3% in

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[2] Farm Credit Services of America, press release, July 30, 2004, [http://www.fcsamerica.com/transaction.htm].

Wyoming.[3] FCSA's headquarters is in Omaha, Nebraska. Lending authorities in the western Wyoming counties of Teton and Lincoln are shared with an Idaho association.

Within the Farm Credit System, FCSA is one of the 18 lending associations in the AgriBank Farm Credit district. AgriBank is one of the five large regional banks in the System. In March 2004, FCSA represented 6.3% of total combined System assets of $120.5 billion, and 6.8% of total System capital of $19.4 billion. In terms of loans to customers, FCSA held 8% of the System's $91 billion loan portfolio, and about 25% of the AgriBank district's loan portfolio.[4]

Historically, the four-state territory of Farm Credit Services of America made up the Omaha district of the Farm Credit System, which was one of the twelve original districts in the System. In 1994, the Farm Credit Bank of Omaha merged with the Farm Credit Bank of Spokane to become AgAmerica Farm Credit Bank, and the Omaha district consolidated to become the current FCSA. On January 1, 2003, AgAmerica dissolved into two parts, and Farm Credit Services of America became part of the AgriBank district.

Background on Rabobank. Rabobank is a private Dutch banking cooperative with a long history of agricultural lending in the Netherlands. Rabobank has $500 billion in assets with operations in 35 countries. Rabobank has a 25-year history in the United States, generally financing larger agribusinesses and cooperatives. In recent years, Rabobank has moved into farm-level lending with the purchases of Valley Independent Bank (California) in 2002, Lend Lease Agri-Business (St. Louis) for $45 million in 2003, and Ag Services of America (Cedar Falls, Iowa) for $47 million in 2003.

FCSA and Rabobank have said that all current loans held by the association will continue, and that no staff reductions or office closures are anticipated.

Alternative Offer Within the System. Before the FCSA board accepted the Rabobank offer, AgStar Financial Services association in Minnesota made an undisclosed offer to buy FCSA and keep it in the System, which FCSA rejected. AgStar and FCSA are both in the AgriBank Farm Credit district. AgStar's territory is adjacent to FCSA, and includes the southern and eastern halves of Minnesota, and the northwestern portion of Wisconsin. With 12,000 stockholders and $2.4 billion in loans, AgStar is smaller than FCSA. On August 18, 2004, AgStar submitted another offer to purchase FCSA for $650 million, an amount $50 million above the Rabobank offer. FCSA management currently is reviewing the offer.[5]

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[3] Farm Credit Services of America, *2003 Annual Report*, [http://www.fcsamerica.com/company/AR99FCSA.pdf].

[4] AgriBank, FCB, *2003 Annual Report*, [http://www.agribank.com/Docs/03-Annual-bank.pdf].

[5] See AgStar press release, "AgStar Announces Five-Point Proposal to Preserve and Strengthen Farm Credit Services of America," August 18, 2004, at [http://www.agstar.com/Default.aspx?pageid=268].

The Future of the Farm Credit System

Regional Implications. Pending termination of FCSA, the Farm Credit Administration may issue new lending charters so that the Farm Credit System maintains a presence in the affected region. Such charters could be issued to one or more existing FCS associations in neighboring states, or to new associations created for all or part of the four-state region.

If FCSA is purchased by Rabobank, the Farm Credit System likely will need to rebuild a physical infrastructure of offices and hire new employees, because those assets would go with FCSA to Rabobank. FCSA would also take its current portfolio of loans and customers to Rabobank. Thus, even though the System could maintain a presence in the region, it is possible that the magnitude of that presence could be significantly smaller for some time, depending on employee and customer loyalties to the institutions involved.

National Implications. Although the Rabobank offer directly affects only a small portion of the System, the implications for the entire System's mission could be greater. Whether or not FCSA ultimately is allowed to leave the System, the acceptance of the Rabobank offer by the FCSA board has caused opponents of the System to further question the rationale supporting the System's existence. For example, the American Bankers Association has asserted that the buyout offer weakens the System's mission.[6]

When Congress passed the Federal Farm Loan Act in 1916, credit was frequently unavailable or unaffordable in rural areas. Many lenders avoided agricultural loans due to the inherent risks. Thus, Congress created the Farm Credit System and provided certain financial benefits to assure a permanent, reliable source of credit to American agriculture.

For more than a decade, credit has been available to most farmers from a variety of sources, including commercial banks, life insurance companies, farm input suppliers, the U.S. Department of Agriculture (USDA), and the Farm Credit System. Furthermore, the reliability of government commodity payment programs has given agricultural lenders extra assurance that most farm borrowers will be able to repay their loans.

These factors have caused some observers to question whether the same need exists today for FCS as in the early part of the 20th century. Such critics of FCS say preferential treatment is not warranted since agriculture no longer faces a credit constraint and other industries do not receive such treatment.[7] Thus, the decision by Farm Credit Services of America to voluntarily choose to become private is being seen by some as an indicator that the System may no longer need its government sponsorship.

The System counters these arguments by asserting that its statutory mandate to serve agriculture in good times and bad will serve the industry better than commercial lenders. The Farm Credit Council, the System's lobbying arm, is opposed to the Rabobank

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[6] See American Bankers Association, press release, July 30, 2004, at [http://www.aba.com/Press+Room/073004statement.htm].

[7] For example, see Bert Ely, "The Farm Credit System: Reinvented and Mission-Challenged," November 2002, at [http://www.aba.com/Industry+Issues/issues_ag_menu.htm].

purchase, and contends that farmer borrowers would be better served if FCSA were purchased by another System association such as AgStar. [8]

Issues for Congress

Congress is not required to take any action in the pending transaction, nor does it have any direct statutory role in the approval process. However, some members of Congress have taken an interest, especially given concerns by some farmers over the future of the Farm Credit System generally and more specifically in the four-state region. Some members' offices in states outside the affected region have received constituent requests about the future of their loans, and whether the rest of the System "is for sale." Senators Daschle and Johnson of South Dakota have stated that the Senate should conduct hearings on the implications of the proposed purchase.

In conclusion, the option for FCS institutions to terminate their status in the System is allowed in statute and regulation. The process is now underway for a large association serving a four-state region. Within the next several months, the Farm Credit Administration will react to the proposal and, if it is approved, stockholders may vote. Regardless of the outcome, the decision by a large FCS association to be bought by a private firm may affect the agricultural industry's view of the System into the future.

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[8] See Farm Credit Council, press release, July 30, 2004, at [http://www.fccouncil.com/press/fcsofamerica.pdf].