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Farm Credit Services of America Ends Attempt to Leave the Farm Credit System

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

Summary

In an unprecedented move, an institution of the Farm Credit System (FCS) — a government-sponsored enterprise — initiated procedures on July 30, 2004, to leave the FCS and be purchased by a private company. But after much controversy, including congressional hearings, the board of directors of Farm Credit Services of America (FCSA) voted on October 19, 2004, to terminate its agreement with Rabobank before seeking approval from the Farm Credit Administration, the System's federal regulator.

FCSA is the FCS lending association serving Iowa, Nebraska, South Dakota, and Wyoming. Rabobank is a private Dutch banking company with extensive experience in agriculture and a growing global network. Under the plan, the loans, facilities, and employees of FCSA would have become part of Rabobank, and new FCS charters would have been issued to reestablish a System presence in the four-state region.

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. Although Congress had no direct statutory role in the approval process, the House held hearings on the implications of the deal, and Senators Daschle and Johnson introduced S. 2851 to require public hearings and a longer approval process. This report will not be updated.

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 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.
- **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.

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[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].

The timeline for the above steps requires at least seven months. From the date the resolution is submitted, the association must wait at least 30 days to submit the termination plan. Once submitted, FCA has 60 days to consider the plan. If FCA approves, stockholders have 30 days to review the information statement before voting. If a majority approve, a 35-day period is allowed for a petition to re-vote. Termination can occur no sooner than 90 days after stockholder approval. Pending a termination, FCA would issue new lending charters so that the System could maintain a presence in the affected region. In this case, FCSA's plan did not proceed beyond the commencement resolution. After releasing its resolution on July 30, 2004, FCSA never submitted its termination plan before the board canceled the agreement on October 19, 2004.

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 earned from the benefits of being in the System, and is defined as capital exceeding 6% of assets over a multiyear period. FCA may review the association's records and make adjustments in calculating the final exit fee. This prevents an association from manipulating its capital to reduce the exit fee.

FCSA's attempt to leave the Farm Credit System was unprecedented in two ways: size, and purchase by an outside entity. Only one System institution has used the termination provisions. In 1991, the California Livestock Production Credit Association ($14 million in loans) became Stockmans Bank after becoming dissatisfied about making payments to prop up failing System institutions. Congress approved that termination in the 1990 farm bill and waived some fees (P.L. 101-624, Sec. 1838). It is not clear that Congress intended for a System institution to be purchased by an outside company.

The Offer

On October 19, 2004, the board of directors of Farm Credit Services of America (FCSA) voted to terminate its July 30, 2004, agreement with Rabobank to be purchased for $600 million payable to stockholders and a projected $800 million "exit fee" payable to the Farm Credit System Insurance Corporation. The board also voted on October 19 to reject a merger within FCS, and to initiate a patronage payment plan for its borrowers.

The offer generated significant controversy and congressional hearings over the financial terms and future of FCS. Rabobank had increased the stock offer to $750 million, following a $650 million offer from a neighboring FCS institution (see next section).

FCSA would have given 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. Shareholders would have owed capital gains taxes on the stock payment, and FCSA may have owed taxes on the exit fee attributed to the tax-exempt real estate portfolio.

Background on FCSA. As the second-largest of the System's 97 lending associations, FCSA is headquartered in Omaha, Nebraska, and has 43 offices and 51,000 shareholders. 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 Wyoming.[2]

Within the Farm Credit System, FCSA is one of the 18 lending associations in the AgriBank Farm Credit district, one of the System's five large regional banks. In March 2004, FCSA represented 6.3% of total combined System assets of $120.5 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.[3]

Historically, FCSA's four-state territory was the Omaha district, one of the twelve original Farm Credit districts. 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 into 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 in the U.S. 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.

Alternative Offer Within the System

Before the FCSA board accepted Rabobank's offer on July 30, AgStar Financial Services, an FCS association in Minnesota, made an undisclosed offer to merge with FCSA and keep it in the System. On August 18, 2004, AgStar submitted another offer to purchase FCSA for $650 million, $50 million more than Rabobank's initial offer. 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.

The AgStar offer was meant to be competitive with Rabobank in terms of the stockholder payment. But rather than a buyout, the AgStar offer was a merger of two System institutions. The $650 million payment would be more of a patronage or dividend distribution rather than a stock buyout, and shareholders would continue to be owners in the merged association. AgStar stated that it would make patronage payments to FCSA shareholders, something that current FCSA management had not done. No exit fee would be required with an AgStar merger, allowing $800 million in capital to remain in the association, rather than being transferred to the nationwide FCS Insurance Corporation.[4]

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[2] FCSA, *2003 Annual Report,* [http://www.fcsamerica.com/company/AR99FCSA.pdf].

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

[4] For more analysis, see "FCS of America's Organizational Choices" by Peter Barry (University of Illinois) [http://www.farmdoc.uiuc.edu/finance/publications/FCSA%20Rabobank%20Agstar%20choices.pdf] and "Understanding the Proposed Sale of Farm Credit Services of America" by (continued...)

Implications for the Future of the Farm Credit System

Regional Implications. With FCSA terminating its bid to exit the System, service to FCS customers in the region should continue uninterrupted through FCSA.

However, if FCSA had been purchased by Rabobank, FCA would have issued new charters and the Farm Credit System would have needed to rebuild a physical infrastructure of offices and employees, as well as its portfolio of loans and customers. Thus, even though issuing new charters could have maintained a System presence in the region, the magnitude of that presence could have been significantly smaller for some time, depending on employee and customer loyalties.

National Implications. Although the Rabobank agreement directly affected service to only a fraction of the System, the implications for the entire System have been greater. FCSA's acceptance of Rabobank's offer has given opponents of the System additional reasons to question the rationale supporting the System's existence.

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.[5]

Thus, the attempt by Farm Credit Services of America to voluntarily become private is being seen by some as an indicator that the System may no longer need its government sponsorship. The American Bankers Association has asserted for many years that the FCS no longer warrants its GSE status and is now citing this buyout offer as further evidence for that position.[6] Such commercial lenders are among the only groups that did not express opposition to the sale, provided that taxpayer interests were adequately addressed.

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[4] (...continued)
Neil Harl, et al. (Iowa State University) [http://www.econ.iastate.edu/rabobankbuyout].

[5] 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].

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

The System counters arguments over its GSE status by asserting its statutory mandate to serve agriculture through both good times and bad. The Farm Credit Council, the System's lobbying arm, was opposed to the Rabobank purchase, and contended that farmer borrowers would be better served under the status quo or under the AgStar merger.[7] Most farm groups expressed concern over the proposed sale to a private, and foreign, company.

Issues for Congress

Congress had no statutory role in the termination process. However, some Members of Congress took 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 received constituent mail about the future of their loans, and whether the rest of the System "is for sale."

A House Agriculture Subcommittee on Conservation, Credit, Rural Development, and Research held a hearing on the issue on September 29, 2004. The Farm Credit System asked Congress to remove the statutory language allowing institutions to leave the System. Commercial bankers asked for better access to FCS funding, and testified that institutions should be allowed to exit the System if they want more lending authorities than allowed under the Farm Credit Act.

In the Senate, Senators Daschle and Johnson of South Dakota introduced S. 2851 to require FCA to hold public hearings on the implications of the proposed purchase, and to increase FCA's review period from a maximum 60-day period to a minimum six-month period.

In conclusion, the option for FCS institutions to terminate their status in the System is allowed in statute and regulation. Despite aborting its attempt to leave the System, Farm Credit Services of America's decision to be bought by a private firm may affect the agricultural and lending industry's view of the Farm Credit System into the future. The agreement served to highlight certain provisions in the Farm Credit Act that both proponents and opponents of the System say need attention. Future efforts to address these issues may be affected by these recent events.

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