

Bert Ely's FARM CREDIT WATCH®
Shedding Light on the Farm Credit System, America's Least Known GSE
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What is the FCA hiding, who is it protecting?

The November and December FCWs reported on enforcement orders the Farm Credit Administration (FCA) issued against two unnamed FCS institutions. The orders provided no insights into their problems and the corrective actions they were directed to take. As troubling as these non-disclosures were, a January 14 FCA news release included this most cryptic statement: "On January 12, the [FCA] Board approved Regulatory Enforcement Committee recommendation 10-01 to pursue a formal supervisory action concerning an FCS institution." What does that statement mean? Is the FCA going to take even stronger action against one of the two institutions against which it has issued an enforcement order or is a third institution about to get hit with an order? This lack of transparency raises these questions: What is the FCA hiding? Who is it protecting?

FCS associations are cooperative lenders owned by their borrowers. In this regard, they are comparable to credit unions and mutually owned banks and thrifts. However, while bank regulators routinely release to the public enforcement orders they have issued against mutual banks and thrifts, the same is not true for either the FCA or the National Credit Union Administration. If enforcement orders are not publicized, how can the owners of a mutual institution know that their institution is in trouble? How can these owners know that they need to take action, specifically by replacing directors and managers, if regulators do not tell them there are problems? In stockholder-owned institutions, a declining share price often will signal problems, but owners of cooperatives do not get such a signal.

Due to the joint-and-several liability of FCS Systemwide debt, owner-borrowers of every FCS association should be upset that the FCA is hiding problems. While the Farm Credit System Insurance Corporation (see below) provides a first line of defense against insolvent FCS institutions, if its resources are insufficient, then healthy FCS institutions are liable for the borrowings of failed FCS institutions. For this reason alone, the FCA should make public all of its enforcement orders, even if doing so costs some FCS executives and directors their jobs. The failure of the FCA to disclose its enforcement orders is one more reason why it should be merged into the Federal Housing Finance Agency, as I proposed in my most recent report on the FCS – see below for a link to this report.

Another FCS merger in the works?

As FCW has reported, two FCS association mergers have closed in recent months, reducing the FCS to 83 associations and five Farm Credit Banks. Earlier this month, four Federal Land Credit Associations (FLCAs), which can only do real estate-secured lending, converted to Agricultural Credit Associations (ACAs) so that they could also do non-real

estate lending, leaving the FCS with just three FLCAs and 80 ACAs. Reportedly merger talks are underway between Farm Credit of the Virginias, which serves most of West Virginia as well as western Virginia, and AgChoice, which serves 52 counties in central, western, and northern Pennsylvania as well as four counties in West Virginia.

Interestingly, both ACAs are about the same size – Farm Credit of the Virginias had \$1.51 billion of assets at September 30, 2009, while AgChoice had \$1.42 billion of assets on that date. While the amount of impaired loans at both ACAs at September 20, 2009, was more than triple the amount on the same date in 2008, the smaller AgChoice reported higher profits and less of a profit decline for the first nine months of 2009, compared to 2008, than did Farm Credit of the Virginias. A most interesting question is if this merger of equals does occur, who will be the new CEO – one of the two incumbent CEOs or a third person. If the two ACAs do merge, it also will be interesting to see the size of the retirement package for whoever does not become the CEO of the merged ACA.

FCS insurance premiums cut by half for 2010

FCS institutions will enjoy a \$200 million reduction in non-interest expense for 2010 due to a 50% cut in premiums they pay to the Farm Credit System Insurance Corporation (FCSIC), the FCS counterpart to the FDIC's Deposit Insurance Fund. This premium reduction equates to about a 7% increase in FCS pre-tax income. The FCSIC premium rate (20 basis points in 2009) is levied on an FCS institution's Secured Base Amount (SBA), the amount of its share of FCS Systemwide debt less 90% of the federally guaranteed loans and investments and 80% of state-guaranteed loans it owns.

The FCSIC premium rate was cut for two reasons. First, after five years of running below a statutory target equal to 2% of the SBA, the FCSIC fund balance finally reached 2%. Second, FCS debt outstanding shrank slightly during the first nine months of 2009 as FCS loans barely grew. Unless FCS lending grows dramatically in 2010 or unless the FCSIC experiences losses resolving insolvent FCS associations, the FCSIC premium rate will decline again in 2011, giving FCS lenders an additional cost advantage over their taxpaying competitors.

Availability of my latest FCS report

Bankers can obtain my new report on the FCS, "The Farm Credit System: Time for a New Regulator," by going to www.aba.com/aba/documents/press/ABA_TF2.pdf. This report, released last November, presents the case for merging the FCA with the Federal Housing Finance Agency, the other GSE regulator. This year will be an ideal time for Congress to consider creating a single GSE regulator as it begins to debate what the future will be for Fannie Mae and Freddie Mac.

Report FCS lending abuses to: green-acres@ely-co.com

Bankers are continuing to send FCW reports of FCS lending abuses, such as FCS loans for rural estates, weekend getaways, and hunting preserves. Email reports of similar lending abuses in your market to: green-acres@ely-co.com. Please provide as much detail as possible about any loan which violates the spirit, if not the law, governing FCS lending.

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