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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Interim Report On The Implementation Of The Farm Credit Act Amendments Of 1980

The Farm Credit System's basic authorizing legislation was amended in 1980 to provide additional authorities to the System so it could more effectively serve the needs of agriculture in the 1980s. GAO conducted this review pursuant to provisions of the amendments which require that GAO evaluate their implementation during the first 2 years of the program.

When GAO completed its field work, most of the regulations to implement the regulations to implement the amendments had been finalized; however, program policies and implementing procedures were still evolving. Consequently, few amendments were fully operational and it was too early to assess whether farmers, ranchers, and fishermen--the target populations--had materially benefited from the amendments.

This report discusses the general implementation process. In addition, it focuses in detail on three specific amendments which program officials view as among the most important.

UNITED STATES GENERAL ACCOUNTING OFFICE

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This is the first of two reports on the programs and activities which were authorized by the Farm Credit Act Amendments of 1980. It discusses the process used to implement the amendments and suggests ways to improve three of the programs which were authorized by the amendments. Our review was made pursuant to the Farm Credit Act of 1971, as amended (12 U.S.C. 2260).

Copies of this report are being sent to the Governor of the Farm Credit Administration, the Director of the Office of Management and Budget, and interested Members and committees of the Congress.

Charles A. Bowsher
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

INTERIM REPORT ON THE IMPLEMENTATION OF THE FARM CREDIT ACT AMENDMENTS OF 1980

D I G E S T

The Farm Credit Act Amendments of 1980 (Public Law 96-592, 94 Stat. 3437) were signed into law on December 24, 1980. The main purpose of the amendments was to give the Farm Credit System new authorities to fulfill its mission of serving agriculture in the 1980s. (See pp. 1 and 4.)

The Farm Credit System is composed of 12 districts throughout the United States. In each district, there is a Federal Land Bank, a Federal Intermediate Credit Bank, and a Bank for Cooperatives. The System also has a Central Bank for Cooperatives, located in Denver, Colorado, that participates with the district Banks for Cooperatives in larger loans. The Farm Credit Administration supervises, regulates, and examines the various banks in the Farm Credit System. (See pp. 1 and 2.)

GAO undertook this review pursuant to the provisions of the Farm Credit Act Amendments of 1980 which require GAO to conduct evaluations of the programs and activities authorized by the amendments and to make an interim report to the Congress. (See p. 4.)

Regulations to implement most of the major provisions of the Farm Credit Act Amendments of 1980 were finalized during the period August 1981 to April 1982. For many amendments, implementing policies and procedures were still evolving when GAO finished its field work; consequently, program implementation had not been fully completed. (See p. 7.)

GAO selected 13 programs, included in the Farm Credit Act Amendments of 1980, for review. In GAO's judgment, the programs selected were the more important and had the greatest potential to increase lending and therefore were used to analyze the implementation process. Three of the 13 programs were selected for more detailed analysis because Farm Credit System

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officials and other interested parties regarded them as being among the most important. (See p. 4.)

INTERNATIONAL BANKING SERVICES PROGRAM

The 1980 amendments authorized the Banks for Cooperatives to offer financial services related to exporting and importing agricultural commodities. They began providing limited services in February 1982. Initially, most services are being provided by the Central Bank for Cooperatives; the district Banks' for Cooperatives primary role is to market the Central Bank's services. Ultimately, after some operating experience is developed, some district banks may be authorized to directly offer the Central Bank's services. (See pp. 17 and 18.)

The Farm Credit Administration and the Banks for Cooperatives encountered a number of problems in implementing the international banking services program. These problems related to the decision to centralize services, the Central Bank's capability to start offering the services, and the division of duties and responsibilities between the Central and district banks. GAO does not know what impact, if any, these problems may have had in implementing the international banking services program. In view of the complexities of providing international banking services, however, GAO believes that before any district bank is authorized to offer these services, it should be required to justify its ability to undertake such a program. (See pp. 22 to 26.)

At the time of GAO's review, the Farm Credit Administration did not have the capability to independently evaluate country risk associated with the extensions of credit by the Central Bank for Cooperatives under the international banking services program. GAO believes that the Farm Credit Administration, as the supervising Federal agency of the Farm Credit System, needs this capability to adequately examine the Central Bank and to assure its financial soundness and integrity. GAO also believes that the Farm Credit System should either determine if it can use the country risk studies of the Federal bank regulatory agencies, or it should develop such studies on its own. (See pp. 26 and 27.)

OTHER FINANCING INSTITUTIONS

The 1980 amendments sought to enhance the opportunity for commercial banks and other agricultural lenders, referred to as other financing institutions, to obtain funds by discounting agricultural loans with the Federal Intermediate Credit Banks. The new provisions in the law and the implementing regulations should help assure that qualifying institutions gain access to the Federal Intermediate Credit Banks' discounting services. (See p. 29.)

Several new regulations contain waiver or other provisions that require the Farm Credit Administration to exercise discretion in making case by case eligibility determinations for access to discounting services. Also, certain aspects of some regulations lack specificity in defining eligibility. The manner in which these provisions are applied ultimately will determine whether the new policies will operate in a less restrictive manner than the policies in force before enactment of the amendments. (See p. 29.)

GAO believes that the Farm Credit Administration, in reviewing all denials of applications for access to discounting services, should closely monitor the implementation and application of certain regulations and district policies to ensure that other financing institutions are given the opportunity to better utilize the services of Federal Intermediate Credit Banks in order to serve the needs of agriculture. (See p. 29.)

YOUNG, BEGINNING, AND SMALL FARMER AND RANCHER PROGRAM

The 1980 amendments require that each association in the Farm Credit System prepare a program for furnishing sound and constructive credit and related services to young, beginning, and small farmers and ranchers. However, the Farm Credit Administration has not given district banks specific guidance on various types of qualifying programs. It is uncertain, therefore, what the System will do to help young, beginning, and small farmers and ranchers enter and remain in agriculture. (See p. 41.)

The amendments also require that the results of this program be reported on an annual basis. Even though the reporting guidelines were not finalized at the time of GAO's review, it does not appear that a reporting system will be developed to show only those borrowers who received credit or services under the new program. Therefore, program results may be difficult to measure. (See pp. 52 and 53.)

RECOMMENDATIONS TO THE GOVERNOR, FARM CREDIT ADMINISTRATION

GAO recommends that minimum requirements be established which district banks must meet before they are allowed to make loans under the international banking services program, and that the Farm Credit Administration establish a system for evaluating foreign credit. (See p. 28.)

GAO recommends that the Farm Credit Administration closely monitor the implementation of the program which authorizes Federal Intermediate Credit Banks to purchase or discount agricultural loans made by banks and other financing institutions. (See p. 40.)

GAO is making a number of recommendations intended to assist district banks and associations in developing programs designed to meet the credit needs of young, beginning, and small farmers and ranchers. (See p. 55.)

AGENCY COMMENTS

The Farm Credit Administration believed that the draft report was too critical of the implementation process and failed to consider the implementation process in the context of the agency's operating environment. GAO did not make any suggestions for improving the implementation process. GAO is sympathetic to the magnitude of the problems facing the Farm Credit Administration in implementing the amendments and therefore has made some revisions, where appropriate, to recognize its comments. (See p. 16.)

The Farm Credit Administration did not comment on the recommendation to establish minimum requirements that district banks must meet before they are allowed to undertake an international banking services program. The agency did concur on the need to strengthen its ability to evaluate country risk and is taking steps to achieve this goal. (See p. 28.)

The Farm Credit Administration believes that since the passage of the 1980 amendments, the Farm Credit System has demonstrated its acceptance of the expressed intent of the Congress that the System be more responsive to other financing institutions' needs. It maintains that the regulation and policies will assure that no financing institution is wrongfully denied access to the discount function. (See p. 40.)

The Farm Credit Administration maintained that programs to meet the needs of young, beginning, and small farmers and ranchers must be developed locally to be successful. There are over 900 associations that individually must develop a program to meet the needs of their area. GAO believes that a concerted effort, under the leadership of the Farm Credit Administration, is a more realistic approach in attempting to at least determine what options are available to the associations rather than have a fragmented approach. (See p. 54.)

Contents

ABBREVIATIONS

BC	Bank For Cooperatives - makes loans of all kinds to agricultural and aquatic cooperatives
CBC	Central Bank For Cooperatives - participates with the district BCs on larger loans
FCA	Farm Credit Administration - an independent Federal agency responsible for supervising, examining, and coordinating the activities of the banks and associations of the Farm Credit System

FCS — Farm Credit System - encompasses the Federal Farm Credit Board, the Farm Credit Administration, the Federal Land Banks and associations, the Federal Intermediate Credit Banks and associations, and the Banks for Cooperatives

FFCB — Federal Farm Credit Board - establishes policies and approves regulations to implement the Farm Credit Act and assist the Farm Credit Administration in carrying out its responsibilities

FICB — Federal Intermediate Credit Bank - provides loan funds for Production Credit Associations and Other Financing Institutions

FLB — Federal Land Bank - makes long-term mortgage loans through Federal Land Bank Associations

FLBA — Federal Land Bank Association - the local office through which a Federal Land Bank loan is made

FmHA — Farmers Home Administration - an agency within the Department of Agriculture which provides credit for those in rural areas who are unable to get credit from other sources at reasonable rates and terms

GAO — General Accounting Office

OFI — Other Financing Institution - commercial banks and other institutional lenders that qualify for access to the Federal Intermediate Credit Banks' discount facilities

PCA — Production Credit Association - provides short- and intermediate-term production or operating loans with funds obtained from the Federal Intermediate Credit Bank

YBS — Young, Beginning, and Small Farmer and Rancher Program - describes a program designed to help this group get started and stay in farming and ranching

CHAPTER 1

INTRODUCTION

The Farm Credit Administration (FCA), an independent Federal Government agency, supervises and regulates the activities of the member-owned Farm Credit System (FCS). The Farm Credit Act of 1971 (Public Law 92-181, 85 Stat. 583) gives FCA broad authority over the banks and associations which make up the FCS. In 1980 this act was amended (Public Law 96-592, 94 Stat. 3437) to give FCS institutions new authorities. This is an interim report which discusses some changes brought about by the Farm Credit Act Amendments of 1980, the effect of these changes on agricultural lending, and their current status. A final report on the amendments will be issued by December 31, 1984.

The FCS is the largest supplier of agricultural credit in the United States today. It is organized as a cooperative and is entirely borrower owned. It obtains funds through the sale of bonds and discount notes. In 1981 the FCS made loans totaling $73.9 billion, a 6.6-percent increase over the $69.3 billion in loans made during 1980.

Total loans outstanding on December 31, 1981, were $78.7 billion. This represents a 15.2-percent increase from the $68.3 billion outstanding a year earlier. Loans made and outstanding have increased at a lower rate since 1978, reflecting the current depressed economic conditions in agriculture.

ORGANIZATION OF THE FARM CREDIT SYSTEM

The Federal Farm Credit Board (FFCB) is the policymaking body for FCA and the cooperative FCS. There are 13 board members--one from each of the 12 farm credit districts and one who is appointed by and serves as a representative of the Secretary of Agriculture. The 12 district board members are appointed by the President of the United States, confirmed by the Senate, and serve a single 6-year term.

At the same location in each of the 12 farm credit districts is a Federal Land Bank (FLB), a Federal Intermediate Credit Bank (FICB), and a Bank for Cooperatives (BC). There is also a Central Bank for Cooperatives (CBC) in Denver, Colorado, making 37 banks in all.

The FLBs, through a national network of 488 Federal Land Bank Associations (FLBAs), make long-term loans secured by first mortgages on farm or rural real estate. Loans are made for aquatic needs; purchasing farms, farm land, machinery, and livestock; refinancing and paying debts; repair and construction of property; and other family needs.

The FLBs were the dominant farm real estate lender in 1981. At December 31, 1981, the FLBs held 42 percent of all farm debt secured by real estate. The FLBs accounted for about two-thirds of the net increase in farm real estate debt in 1981. Commercial banks now hold only 8 percent of the outstanding farm debt secured by real estate. The FLBs made 99,699 loans during 1981. This was 8 percent more than in 1980. At the end of 1981, 646,372 loans amounting to $48 billion were outstanding.

The FICBs provide loan funds to Production Credit Associations (PCAs) and to other financing institutions (OFIs) which finance the credit needs of agricultural and aquatic producers. OFIs include national banks, State banks, trust companies, agricultural credit corporations, incorporated livestock loan companies, savings institutions, credit unions, or any association of agricultural producers engaged in the making of loans to farmers and ranchers; and any corporation engaged in the making of loans to producers and harvesters of aquatic products. There are 423 PCAs which make short- and intermediate-term loans to farmers, farm-related businesses, producers and harvesters of aquatic products, and rural homeowners. These loans may be for the production of agricultural products; the purchase, repair, or maintenance of rural homes; and the other needs of the farmer-borrower. In addition to the PCAs, there were 184 OFIs using the FICB in financing agricultural and aquatic producers as of December 31, 1981.

The FICBs had $21.2 billion in loans and discounts outstanding to PCAs and had $914 million in discounts outstanding to OFIs as of December 31, 1981. The share of non-real estate farm debt held by PCAs remained almost the same during 1981. They ended the year with about 25 percent of the total outstanding non-real estate farm debt. At the end of 1981, 380,186 PCA borrowers had loans amounting to $21.7 billion outstanding.

The BCs provide term and seasonal credit to farmer cooperatives for virtually any purpose that will enable the cooperative to better carry out its marketing, purchasing, or business service functions. The CBC's primary function is to purchase loans that exceed the lending limits of district BCs. Thus, the CBC participates in the large lines of credit extended by the district BCs.

On December 31, 1981, the BCs had $9.5 billion in loans outstanding. This was 3 percent less than the $9.8 billion outstanding at the end of 1980, the first decrease in 10 years. Loans made during the year amounted to $24.8 billion. At the end of 1981, 3,493 cooperatives had loans outstanding. This is virtually the same as the previous year.

A fiscal agency, under contract with the FCS, arranges for the issuance, sale, and handling of consolidated bonds and discount notes to investors. The principal and interest on these bonds and notes are not guaranteed by the U.S. Government. During 1981, the fiscal agency sold $95.9 billion of consolidated bonds and discount notes for the FCS.

DEVELOPMENT OF THE FARM CREDIT SYSTEM

The FCS began (originated) with the passage of the Federal Farm Loan Act in 1916 (Public Law 64-158, 39 Stat. 360) which authorized 12 FLBs. The act also authorized local National Farm Loan Associations, now called FLBAs, for a permanent and dependable source of long-term agricultural credit. FLBAs service FLB loans.

The depression of the 1920s led to the passage of the Agricultural Credits Act in 1923 (Public Law 67-503, 42 Stat. 1454) which authorized 12 district FICBs. FICBs were set up to make loans to farmer cooperatives and to discount farmers' short- and intermediate-term loans made by OFIs. However, OFIs did not use FICB services to the extent expected. As a result, the Congress passed the Farm Credit Act of 1933 (Public Law 73-75, 48 Stat. 257) which authorized local PCAs. PCAs could discount farmers' short- and intermediate-term notes and, in effect, became the retail outlets for wholesale credit available from the FICBs.

The Farm Credit Act of 1933 also authorized 13 BCs to provide complete loan services for farmers' marketing, supply, and business service cooperatives. Twelve BCs serve the needs of cooperatives in their respective districts. The thirteenth, the CBC, helps the other 12 on larger loans. Also, in March 1933, an Executive Order created FCA and placed all FCS institutions under its supervision.

FLBs, FICBs, and BCs were initially capitalized by the Federal Government and remained largely owned by the Government until the Congress passed the Farm Credit Act of 1953 (Public Law 83-202, 67 Stat. 390). This act, which farmers and cooperatives endorsed, provided users a means of controlling the FCS and allowed for the ultimate retirement of all Government capital invested in it. Additional legislation enacted in 1955, 1966, and 1968 further emphasized user ownership, a goal which was fully realized on December 31, 1968, when the last of the Government capital was repaid.

The Farm Credit Act of 1971 recodified all the prior laws governing the FCS, modernized its functions, broadened its lending authority, and brought decisionmaking closer to the borrowers. The act provides the authority for the present activities of the FCS banks and associations.

Public Law 94-184 (89 Stat. 1060) amended the 1971 act on December 31, 1975. It lowered the percentage of voting control required to be held by farmers, producers, or harvesters of aquatic products, or eligible cooperative associations from 80 to 70 percent in the case of rural electric, telephone, and public utility cooperatives. Another amendment to the 1971 act was passed on October 10, 1978. Public Law 95-443 (92 Stat. 1066) authorized PCAs to extend the terms of loans to commercial fishermen from 7 to 15 years.

The FFCB, in 1978, requested each of the 12 farm credit district boards to determine if the FCS had the legal authorities required to fulfill its mission in the 1980s. The FFCB also asked each district board to come up with recommendations for amending the Farm Credit Act to provide for greater efficiency in the internal operations of the FCS. In response, the 12 district boards and the CBC submitted 81 proposals to amend the 1971 act. After considering these proposals, a policy coordinating committee recommended that 28 proposed amendments be drafted into a single legislative package. The recommendation was approved by each of the 12 district boards and the board of the CBC. On April 4, 1979, the FFCB unanimously concluded that the interests of agriculture would be well served by the 28 proposed amendments and recommended that they be considered by the Congress. During the remainder of 1979 and throughout 1980, the Congress held hearings on the 28 proposed amendments, adding some new amendments and deleting some proposed amendments. The Farm Credit Act Amendments of 1980 (Public Law 96-592, 94 Stat. 3437), which further modernized and expanded the authority of FCS institutions, were enacted into law on December 24, 1980.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were twofold. First, we wanted to evaluate the progress made to date in implementing the major provisions of the Farm Credit Act Amendments of 1980. Second, we wanted to determine, to the extent feasible, the effect that these amendments will have on agricultural credit services. This review was made pursuant to the provisions of the 1980 amendments which required GAO to conduct evaluations of the programs and activities authorized by the amendments and to make an interim report to the Congress by December 31, 1982. In early January 1983 we informally provided information on the results of this review to the Senate Committee on Agriculture, Nutrition, and Forestry, and to the House Committee on Agriculture. The review was conducted in accordance with generally accepted Government auditing standards.

We selected 13 programs, included in the 1980 amendments, for review. We selected those programs which, in our judgment, were the more important and had the potential to increase lending the most. The 13 programs we reviewed are highlighted in Chapter 2. We reviewed these programs in order to make some determination of the reasonableness of the time it took FCA and the districts to implement them.

FCA officials began implementing those programs which they concluded were the most important. Our review focused largely on three of those programs which represented the biggest change from the programs in existence prior to the 1980 amendments. The three programs are:

--International banking services (ch. 3).

--Other financing institutions (ch. 4).

--Young, beginning, and small farmers and ranchers (ch. 5).

Our work was performed primarily at FCA in Washington, D.C.; at the Farm Credit Banks in St. Paul, Minnesota; and at the CBC in Denver, Colorado. We interviewed FCA officials to obtain information relating to the procedures followed in drafting and finalizing regulations and the impact of the amendments once they were implemented. To obtain some insight into the impact that these amendments could have on agricultural credit services, we reviewed the public comments submitted to FCA in response to its proposed regulations and interviewed several economists who are substantially involved in education and research activities in agricultural finance. We also interviewed officials from nationally recognized farmer and cooperative organizations to obtain information on how the amendments would affect agricultural lending. We talked to officials from two nationally recognized organizations representing commercial banks for the same reasons. We discussed the amendments with Government officials at the Washington, D.C., offices of the Farmers Home Administration and the Small Business Administration.

At the CBC, we interviewed senior staff to obtain information on planning, directing, and managing international banking services. In addition, we interviewed the staff of the International Services Division for additional information and gathered and analyzed appropriate documentation. We also discussed international credit services with an official from a large commercial bank in Denver, Colorado, to determine if the CBC's staffing and level of international credit services were similar and appropriate.

The St. Paul Farm Credit District was chosen for extensive audit work because this district is foremost in granting credit for agricultural purposes. This district has a large number of farmer cooperatives and a large number of OFIs eligible to use the FICB in comparison to the other districts. In order to evaluate the implementation of the amendments in this district, we interviewed officials at all three banks as well as officials at several FLBAs and PCAs in Minnesota and Wisconsin. We also interviewed rural bankers in Minnesota and Wisconsin about programs to serve the needs of young, beginning, and small farmers and ranchers and about discounting relationships with the St. Paul FICB. To obtain a broader perspective on programs to serve the needs of young, beginning, and small farmers and ranchers, we interviewed some young and small farmers in Minnesota. We also interviewed Minnesota Department of Agriculture officials and officials at the Minnesota State offices of the Farmers Home Administration and the Small Business Administration.

Although the 1980 amendments were in effect when we completed our field work in July 1982, most provisions of the amendments were not fully operational at that time since FCA and the district banks had not finished issuing regulations or policies. Our review, therefore, was primarily limited to the efforts made by the FCS to implement the amendments.

CHAPTER 2

THE IMPLEMENTATION PROCESS

Regulations to implement most of the major provisions of the Farm Credit Act Amendments of 1980 were finalized during the period August 1981 to April 1982. Once that was completed, each district bank had to develop and approve policies and each association had to develop and approve procedures to implement the policies in the district. Overall, implementation had not been fully completed when we finished our field work in July 1982.

STATUS OF FCA'S REGULATIONS AND DISTRICTS' POLICIES

We reviewed 13 programs authorized by the amendments which we identified as having the most potential to increase lending. One program would have authorized the extension of credit and other services in the Virgin Islands if determined to be feasible by FCA. FCA subsequently concluded it was not feasible to provide credit to the Virgin Islands and therefore will not implement this program. It based its decision on, among other things, the poor land quality, the high cost of land, the difficulties of obtaining farm labor, and the little demand for agricultural credit. The following schedule describes each of the remaining 12 programs and shows its status as of June 30, 1982.

Status of selected FCA regulations and district policies as of June 30, 1982

Program/Description	FCA regulation in effect	No. of districts with an FCA approved policy
International banking services/provide BCs authority to finance cooperatives' exports and imports	yes	none
Other financing institutions/ revised existing program so that OFIs can discount the same loans as PCAs	yes	10
Young, beginning, small farmer/ directed FLBAs and PCAs to prepare programs for furnishing sound and constructive credit	yes	8
Processing and marketing/allowed FLBAs and PCAs to make loans directly related to the applicant's operation	yes	7
10 year PCA loans/extended the terms of nonaquatic loans from 7 to 10 years	yes	10
97 percent FLB loans/authorized loans up to 97 percent of appraised value if guaranteed by a Federal, State, or other government agency	yes	approval by FCA not required

Status of selected FCA regulations and district policies as of June 30, 1982

Program/Description	FCA regulation in effect	No. of districts with an FCA approved policy
60 percent cooperative eligibility/reduced from 70 to 60 percent the required voting control that must be held by farmers in certain cooperatives to borrow from the BC	yes	approval by FCA not required
Aquatic loans/broadened aquatic lending beyond the PCA operating loan	yes	approval by FCA not required
Systemwide loss sharing/authorized all FCS institutions to share loan or other losses with each other	yes	12
Usury law exemptions/required that interest rates be determined notwithstanding any limitation imposed by any State constitution, statute, or other law	yes	approval by FCA not required
Insurance/authorized the sale of certain types of insurance on an optional basis	no	none
Participation loans/authorized FCS institutions to participate in loans with each other and other non-FCS institutions	no	none

Two of the programs--60 percent cooperative eligibility and usury law exemptions--were implemented by FCA without regulations or interim guidelines because the requirements of the legislation were self-explanatory. FCA had not developed or finalized a regulation as of June 30, 1982, to implement the participation loan program. Draft regulations to implement the insurance program also had not been finalized. One FCA official said, however, that the participation loan program was a top priority project and that the insurance regulation was almost finalized.

At the time of our review, none of the districts had an approved policy for an international banking services program because FCA decided to provide all international banking services centrally through the CBC and the fiscal agency. Most of the districts had approved policies for at least the major programs (the first five programs listed in the table). FCA said no approved policy was required for four of the other programs. FCA did not know the level of activity for the programs listed in the table, except for international banking services and OFIs.

DEVELOPMENT OF IMPLEMENTING REGULATIONS

The various segments of the FCS apparently worked independently from one another in implementing the amendments. FCA's Office of Supervision was responsible for drafting all the regulations to implement the amendments. The Office of Supervision was also responsible for reviewing and approving each district's policy to implement the regulations. FCA officials said they let each district formulate its own policy without providing general guidance or direction other than the regulations. The officials said that although they thought the regulations were self-explanatory, they did respond to specific questions that the districts raised.

FCA's implementation process began with the preparation of a draft regulation. The draft regulation was presented to the FFCB for its review and approval. After the draft regulation was approved by the FFCB, it was reviewed by an FCA task force and given to interested parties both within and outside the FCS for comment. The comment period was limited to 30 days. After FCA reviewed the comments and made changes it deemed necessary, it submitted the draft regulation to the FFCB for tentative approval as a proposed regulation. Once approved by the FFCB as a proposed regulation, it was sent to the House and Senate agriculture committees for a 30 day comment period in accordance with provisions of the 1980 amendments. After that 30 day comment period, which could not include periods of congressional recess, the proposed regulations were published in the Federal Register and the public had 60 days in which to submit comments to FCA.

FCA evaluated the comments it received on the proposed regulations, made changes it believed appropriate, and prepared final regulations. The final regulations, together with a summary of all comments received on the proposed regulations, were then submitted to the FFCB for its consideration. Once approved, copies of final regulations again were sent to the House and Senate agriculture committees prior to publication in the Federal Register. Final regulations were then published in the Federal Register and became effective after a 30 day waiting period.

The only additional steps to this process involved the international banking services and the OFI programs. The 1980 amendments required that, if there were any unresolved differences between FCA and the Board of Governors of the Federal Reserve System as to whether the regulations implementing these two programs conformed to national banking policies, objectives, and limitations, then FCA had to send the regulation to the Secretary of the Senate and the Clerk of the House of Representatives. According to the amendments, the regulation would not become effective if both Houses of the Congress adopted a concurrent resolution disapproving the regulation within 90 calendar days of continuous session of Congress. If no committee of either House of the Congress acted at the end of 60 calendar days of continuous session, the regulation would then go into effect immediately.

Once FCA's regulations were finalized, the boards of directors in each of the 12 farm credit districts had to approve most of the policies developed or adopted by the respective banks. Each FLBA and PCA also developed policies and procedures to implement bank policies to the extent that the program affected them. FCA was responsible for reviewing and approving each district's policies. According to FCA officials, district policies were sent to a regional staff officer in FCA. The regional staff officer was responsible for reviewing the policy and discussing the results of his review with Office of Supervision management. Office of Supervision management reviewed each policy for consistency among all the districts and compliance with the FCA regulation and either approved or rejected the policy. According to FCA officials, each district was notified whether or not its policy was approved or rejected. If a policy was rejected, FCA officials said they sent the district a detailed letter describing exactly what needed to be done to get the policy approved.

FCA was involved in varying degrees in getting policies implemented for some of the more complex and controversial programs. For example, on the OFI program the FICB presidents appointed a FCS task force to implement FCA's regulation by drafting model policies, a general financing agreement, and an application form. One FCA official said he worked on the task force and was involved in

- --meetings with FICB presidents,
- --a meeting with FICB managers to discuss the OFI regulations and stress the need for FICBs to start working on policies and procedures,
- --preparing correspondence to FICBs stressing the need to expedite implementation,
- --encouraging the FICBs to appear at meetings of State banking commissions to discuss the OFI amendment,
- --showing a slide presentation to explain the OFI amendment to bankers,
- --presenting training sessions on the OFI amendment for FCA staff,
- --preparing a paper on OFIs,
- --speaking on the OFI amendment before banking special interest groups and to 12 State banking groups, and
- --preparing a paper on bank holding company access to the FICB discount window.

FCA participated in an FCS task force established to draft model policies for the young, beginning, and small farmer program. Most districts were planning to adopt the model policies as drafted by the task force. The FCS also used the task force approach to draft model policies and procedures for the international banking services program.

The FFCB was only involved in approving FCA's regulations. According to FCA officials, the FFCB had previously agreed to the philosophy and the approach behind the regulations implementing each program. The FFCB, however, held FCA accountable for supervising the district banks' preparation of policies and procedures.

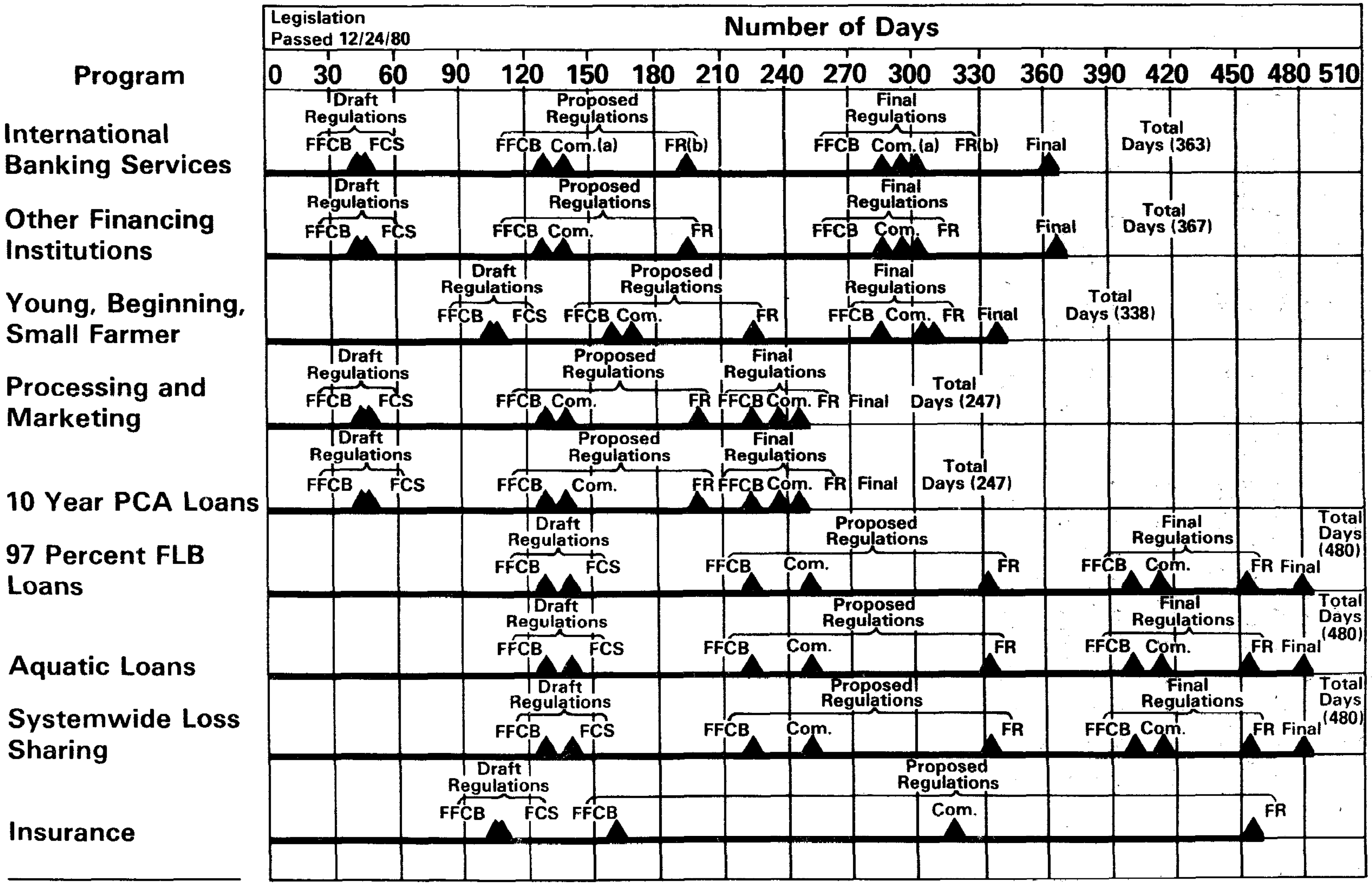
According to FCA, the staff involved in the development of the regulations at the FCA level and the development of policies and procedures at the district bank level also had major line responsibilities for supervising a multibillion dollar credit system facing an extremely difficult economic environment. In FCA, the line divisions on which most of the implementation burden fell had staff vacancy rates approaching 25 percent and were operating under an administrative hiring freeze that precluded filling essential vacancies. The Farm

Credit Act Amendments of 1980 required the creation or revision of over 100 regulations implementing substantial and controversial legislation. According to FCA, in spite of these obstacles, the most significant aspects of the legislation were implemented as rapidly as permitted by the Administrative Procedures Act and the requirements for congressional clearance contained in the 1980 amendments.

Implementation time frames

For nine programs that we reviewed, where regulations had been finalized or were in process, the following table shows the number of days between each major event in the implementation process from the time the legislation was passed to the time final regulations became effective.

The Number of Days Between Major Events in the Implementation Process



a/ Committee
b/ Federal Register

The three phases of the regulation process that took the longest amount of time included

--drafting the regulation the first time (44 to 128 days),

--analyzing comments and revising the regulation (53 to 83 days the first time and 25 to 91 days the second time), and

--reviewing the proposed regulations by the agriculture committees (56 to 139 days).

FCA had limited or no control over the time it took the public to comment on the proposed regulations within stipulated time frames and the length of time proposed regulations were with the agriculture committees for review.

In discussing how the implementation process could have been hastened, one FCA official pointed out that FCA had limited the public comment period to 20 days, down from 60 days, for three of the programs without too much adverse reaction. This approach was not used for other programs. Also, the FFCB held special board meetings in order to speed up the approval process. FCA's General Counsel identified eight programs which he concluded could be implemented without the promulgation of regulations or interim guidelines. Therefore, FCA was able to implement these programs at once. Finally, for two of the programs, the FFCB waived the 30 day delay period applicable to final regulations and implemented the regulations for these two programs at once.

Another FCA official told us that FCA had serious doubts about when the legislation would pass and therefore not much preparatory work was done. The official also said that preparatory work was delayed because FCA did not know soon enough the format of the final version of the legislation. The official said the law itself imposes certain requirements which make it impossible to issue regulations in under a year's time. Finally, the official said, in the future, he would encourage the banks to start working on their policies and procedures as early as possible in order to speed up the implementation process.

Implementation planning

FCA did not have a formal plan for implementing the amendments which identified each task to be performed, roles and responsibilities of organizations or staff involved in performing the tasks, and alternative ways of performing the tasks. FCA advised us, however, that the sequence in which the regulations were developed was based on its assessment of the relative potential impact of each of the authorities contained in the 1980 amendments on the ultimate beneficiaries of the legislation and its ability to implement related changes. Detailed time schedules for the implementation process were developed for each phase of the regulation process. Copies of the schedule were provided to all district banks for their use in planning their implementation processes. According to FCA, the procedures within FCA for approving district bank policies were modified to assure that approval actions would be consistent from bank to bank and that actions were taken as promptly as practical.

District and association policies and procedures were not developed concurrently with the development of implementing regulations but rather each district waited until FCA had implemented a final regulation before developing and approving district policies and procedures. FCA's time schedules did not indicate when the district and associations should start or complete their policies and procedures.

The St. Paul FICB and BC did not develop their first plans for preparing policies and procedures until November 1981. The Senior Vice President for Administration told us that corporate planning for other 1981 activities had been finalized before the amendments became law and that these planning efforts consumed all available resources. No attempt was made to determine if preparing policies and procedures should have had greater priority than the ongoing planning efforts. In addition, he and another senior vice president said that they normally wait until FCA's regulations are finalized in order to determine if FCA is interpreting the regulation in the same manner that they are.

AGENCY COMMENTS

In our draft report we did not make any suggestions in this chapter for improving the implementation process. FCA believed that our draft report was too critical of its implementation process and that the draft report failed to consider the implementation process in the context of FCA's operating environment. FCA pointed out that the line divisions on which most of the implementation burden fell had staff vacancy rates approaching 25 percent and were operating under an administrative hiring freeze that precluded filling essential vacancies. We are sympathetic to the magnitude of the problems facing FCA in implementing the amendments and therfore have made some revisions where appropriate to recognize its comments.

CHAPTER 3

THE IMPLEMENTATION OF THE INTERNATIONAL BANKING SERVICES PROGRAM

The BC system began providing limited international banking services in February 1982. Initially, most of the international banking services are being provided by the CBC in Denver, Colorado, and at the fiscal agency in New York City. The primary role of the district BCs is to provide the domestic marketing function. Ultimately, some districts will offer some of the services that are now concentrated at the CBC.

The CBC had $19.6 million in outstanding loans at July 31, 1982. This consisted entirely of guaranteed letters of credit. In addition to letters of credit, other services currently authorized include bankers acceptances, currency exchange, collections, financing third parties, wire transfers, and credit reports. The 1980 amendments also authorize other activities relating to international banking for the BCs. Some of these services will not be offered right away. However, they will be made available as the implementation process proceeds or as cooperatives request such services.

FCA and the BC system encountered a number of problems in implementing the international banking services program. The problems relate to FCA's decision to centralize international banking services, the CBC's capability to start offering the services, and the division of duties and responsibilities between the CBC and district banks. We were unable to determine what impact, if any, these problems had in implementing the international banking services program. In addition to the problems in implementing the program, FCA has not developed a system for identifying countries with actual or potential debt-serving problems which is needed by FCA to evaluate the Central Bank's country exposure on international lending.

INTERNATIONAL BANKING SERVICES

FCA approved the BCs' entry in international banking services in February 1982. Under the plan approved by FCA, the CBC will make decisions regarding extending credit to cooperatives and other eligible parties, maintaining correspondent banking relationships, and marketing BC services to foreign banks and other parties. Rediscounting bankers acceptances and foreign exchange operations will be handled by the fiscal agency with coordination from the CBC. The role of district banks is to publicize the new services to cooperatives in their districts through meetings and educational programs.

Services authorized by the amendments

The 1980 amendments provide explicit authority for the BC system to offer services related to exporting and importing agricultural commodities. These services should help cooperatives expand their capacity to manage and expedite direct sales of agricultural products to overseas buyers. This is an essential role for the BC system as agricultural cooperatives are emerging as a more important factor in the world market for U.S. farm products.

The amendments allow the BC system to engage in a wide array of activities to facilitate international banking services. Besides the basic services, such as letters of credit, bankers acceptances, and currency exchange, the BCs can invest in ownership interests in foreign business entities which provide credit information and loan servicing. The amendments further allow the BCs to offer technical and financial assistance to other parties to facilitate a transaction which substantially benefits a voting stockholder of the BC. These other parties may be domestic or foreign. Also, to facilitate its business of financing exports and imports, the BCs can maintain credit balances with correspondent banks and pay or receive fees or interest in the transfer of funds to or from parties to a transaction.

All of the services authorized by the amendments are not currently being offered because of insufficient demand. During the very early stages of program implementation, a senior CBC official told us that he did not envision that cooperatives would request such authorized services as investing in capital facilities abroad. As of the date of our review, the CBC had not yet published policies and procedures relating to capital investments abroad. In addition, the CBC official said that they have no immediate plans to invest in ownership interests in foreign business entities for credit information and loan servicing functions. Again, policies and procedures for transactions of this sort have not been developed by the CBC staff.

FCA's regulations require that the BCs avail themselves of insurance plans to limit risk to the BC system on international banking services. The Export Credit Guarantee program (GSM-102) has been used often by the CBC to protect its outstanding loans. It is sponsored by the Department of Agriculture's Commodity Credit Corporation and its guarantee will cover most of the amount owed to the U.S. bank in case the foreign bank defaults. However, in all cases, banks providing the financing under the program will be expected to assume a small portion of the risk. Some international banking service transactions may not be insured or guaranteed. In these cases, CBC officials told us, risk is minimal. A typical transaction that is uninsured and not guaranteed is one with a foreign government agency wherein the foreign government and the commercial correspondent bank have credibility in the eyes of the CBC.

It is likely that the bulk of the bank's first-year business will be limited to GSM-102 arrangements. A senior CBC official told us that private insurance is very expensive--thus limiting potential profits. This official stated that the CBC, therefore, is no longer trying to obtain insurance through private companies. Also, obtaining blanket insurance coverage through the Foreign Credit Insurance Association is still unsettled after many months of consideration. This association generally does not issue blanket insurance contracts for agricultural products. However, the association agreed to work with the CBC on such blanket coverage. At the time of our review, a negotiated policy between the CBC and the association was pending approval by the Export-Import Bank, which oversees the operation of the association.

Services offered by the system

At the time of our review, the FCS was offering letters of credit, bankers acceptances, third party financing, foreign exchange, and collections, wire transfers, and credit reports. These services are described below.

Letters of credit

A letter of credit is an arrangement by which the buyer instructs a bank to make payment to the seller, providing the seller complies with stated terms and conditions. The CBC will be able to process import, export, and standby letters of credit. As of July 31, 1982, there were $19.6 million in outstanding export letters of credit. This consisted of only eight transactions. In addition, there were four standby letters of credit totaling $7.3 million. These standby letters of credit are bid bonds used to secure a cooperative's bid and may not result in an actual sale.

Bankers acceptances

A bankers acceptance is a negotiable time draft drawn primarily to finance the import, export, transfer, or storage of goods. It is termed accepted when a bank guarantees payment at maturity. The bankers acceptance program is not making much progress because the collateral requirements imposed on the CBC by the Federal Reserve are more stringent than those for commercial banks. An FCA official told us that the Federal Reserve requires that the amount of the collateral be in inventory for the CBC's bankers acceptance. Commercial banks, on the other hand, are treated much more leniently in terms of having collateral in inventory. As a result, the CBC incurs additional costs, thus reducing its competitiveness with commercial banks.

Third party financing

Third party financing is made available to foreign importers provided the transaction meets the following two tests:

--The party is purchasing from a U.S. farmer cooperative.

--The merchandise must be for export.

Foreign exchange

Although foreign exchange transactions are authorized, the CBC is not actively involved in them. The fiscal agency for the FCS plans to use commercial banks to assist cooperatives in buying or selling foreign currencies to enable them to compete for sales if foreign currencies are involved.

Collections, wire transfers, and credit reports

The CBC has established international correspondent banking relationships with many banks around the world. The correspondent banking network enables the CBC to receive funds directly through wire transfers, thus avoiding costly delays. Foreign correspondent banks are also used to obtain credit information on foreign buyers which in turn will enable cooperatives to determine the best method of payment and the best business arrangement with foreign buyers.

REASONS WHY THE BCS WANTED AUTHORITY TO PROVIDE INTERNATIONAL BANKING SERVICES

The international banking services being offered by the CBC allow farmer cooperatives to finance the sale of agricultural commodities directly to the foreign importer. The ability to finance direct exports enables cooperatives to follow their products further through the marketing channel, thus avoiding middlemen, and obtain a higher profit margin on the sale. In addition to the potential to make higher profits, these new credit services offer farmer cooperatives a new market potential abroad by making credit available for exports and imports.

Direct exporting enables cooperatives to earn higher profits

Cooperatives and farmers and ranchers will benefit in the long run if the cooperative develops direct exporting capability and uses the new international banking services offered by the BCs. These services will enable eligible cooperatives to obtain BC financing to export agricultural products directly. Direct exporting, however, does require more expertise on the part of the cooperative since it must contract with the importer and then obtain BC financing. If exports increase, farm income also should increase. Farm income is becoming greatly influenced by world markets and the efficiency with which farm products are exported. In 1980, about $1 out of every $3.50 in total farm income came from farm exports.

Numerous large-volume sales to foreign countries have demonstrated the economic benefits of exports to farmers. According to the President of the CBC, large amounts of grain and other agricultural products were marketed or supplied by cooperatives but exported by dealers and brokers in the mid-1970s. The cooperatives which marketed or supplied these products for export made some profits. However, the profits realized by grain brokers and other middlemen were very large in comparison to profits made by cooperatives. Direct exporting enables a cooperative to control its agricultural commodity for a longer period of time in the export marketing channel. By using direct exporting, the middleman is eliminated and the cooperative is able to obtain a larger share of the sales revenue for its farmer owners. Thus, to meet these changing needs, the BCs wanted authority to develop an international banking services program to support cooperatives as they directly market farm products overseas.

It was events such as those discussed above that caused the BCs to decide that they needed a more direct role in serving cooperatives by financing exports. The development of the international banking services program began in 1976 when a task force, established by the Presidents of the BCs, set out to determine the need for BCs to finance cooperatives' agricultural exports. After the task force established that the need did exist, FCA introduced legislation to authorize the financing of exports. On December 24, 1980, the legislation was signed into law giving BCs a legal basis to offer international banking services to eligible cooperatives and associated parties.

New market potential abroad

Despite the fact that the value of agricultural exports is high, the number of cooperatives directly exporting is low. For fiscal year 1982, the value of agricultural exports is estimated to be $42.5 billion. Recent surveys indicate that cooperatives handle less than 10 percent of agricultural exports. Only about half of this is direct exports; the remainder is sold through brokers, private trading companies, and other intermediaries.

Of the approximately 3,600 domestic farmer cooperatives, CBC officials estimate that roughly 100, or about 3 percent, are exporters. Even a smaller number of cooperatives are direct exporters involved in international markets on a regular basis.

Farmers have expressed the desire to see their cooperatives participate more in direct exporting. However, most agricultural cooperatives are not familiar with the procedures necessary for entering into sound contracts for the sale of farm products to other countries. CBC officials anticipate that more cooperatives will take advantage of direct exporting now that they are offering international banking services. Some cooperatives that are now exporting may look to the CBC for assistance rather than using other sources. Other cooperatives that are presently not exporting will probably tap into the export market now that the CBC can provide financing and technical assistance.

The CBC has announced its services to banks and importers in many foreign countries that buy large quantities of agricultural products. The CBC hopes to persuade importers to use its services and its correspondent banks in future transactions. If this occurs, the share of agricultural products exported by cooperatives will increase.

LACK OF COORDINATION DURING PROGRAM IMPLEMENTATION

The most significant event recently for the BC system was the implementation of the international banking services program. After months of legislative activity, policies and procedures development, building up a staff, and working with FCA, implementation actually began. This undertaking, because of its complexity, encountered some coordination problems. According to CBC officials, coordination with FCA was at times difficult primarily because FCA did not provide timely guidance. We do not know, however, what impact this had in implementing the international banking services program.

Centralization of international banking services

According to senior CBC officials, one problem was the timing of FCA's announcement to centralize most of the operations at the CBC. In June 1981, the FFCB decided to centralize international banking services and FCA advised the BCs of the FFCB's decision in August 1981.

The following international operations were centralized:

--Correspondent bank relationships.

--Credit extensions to foreign and domestic parties other than eligible U.S. cooperatives.

--Foreign exchange operations.

--Letters of credit processing.

--Rediscounting bankers acceptances.

FCA gave the following reasons for centralization of international banking services:

--The foreign business community does not perceive the BC system as 13 separate entities. To avoid costly and confusing duplication, FCA should establish a focal point for foreign contacts and business arrangements.

--The BC system needs a reasonably large fixed investment in staff and training. Duplication of this at several locations does not seem to be in the best interest of the BC system's borrowers.

--Centralization of certain services provides the most cost-effective service and minimizes risk exposure.

Marketing CBC services to domestic cooperatives is the district BCs' primary role for at least the next 3 years.

Development of resources necessary to start international banking services

FCA has monitored the progress of the international banking services program since the establishment of the 1976 task force. Through its efforts, a lot was done to put the

BCs' new authority on line. However, it appears that problems did exist. These problems were mentioned in FCA's October 1981 letter to the President of the CBC. FCA's letter stated that the CBC had not made adequate progress in developing the international banking services program despite earlier reviews of the program's status. The letter listed the following problem areas:

--Policies for most services had not been developed.

--Procedures had not been developed for working with district banks and internal procedures and controls were lacking.

--Little progress had been made in developing a country risk unit.

--No work had begun on credit policies and a credit manual.

--Extensive work remained to be done in the area of correspondent bank relationships.

--Serious concerns remained regarding the bank staff's managerial and technical capability to implement the program on a sound basis.

In discussions with a senior CBC official regarding FCA's letter, he said that the findings were not supported by factual evidence. We were told by an official in FCA's Office of Supervision that the CBC later submitted a plan which showed how these problem areas would be resolved. Subsequently, FCA approved the CBC's plan to correct deficiencies and international banking services commenced soon thereafter.

THE DISTRICT BCS' INVOLVEMENT IN INTERNATIONAL BANKING SERVICES

The role of district BCs is primarily to market the international banking services to cooperatives in their district. Most district BCs will probably carry out this marketing function for 3 years before being allowed to take on more responsibility in international banking.

General role of district banks

The district banks have front-line responsibility for marketing international banking services domestically for cooperatives. The CBC is coordinating and supporting this effort. The domestic marketing plan is in three phases. First, the BCs are announcing and explaining the new services through meetings and individual calls on cooperatives. Second, the district banks will initiate a continuing educational program to help strengthen the expertise of cooperatives in international banking service transactions. Finally, the BCs and the CBC will assist cooperatives with foreign market development to help increase cooperative exports.

Although the district banks are primarily responsible for domestic marketing of international banking services, questions remain regarding their role. For example, FCA officials are still not sure what the division of duties is between the CBC and the district BCs in specific transactions regarding international banking services. This problem was brought up at the August 1982 FFCB meeting and FCA agreed to:

--Press district banks to define their role in providing international banking services.

--Obtain clear definition of the relationship and division of responsibilities between CBC and district BCs.

FCA also stated that there are coordination problems between the CBC and the district BCs. For example, the CBC asked the BCs to call on cooperatives in their districts to determine their interest in exporting. Only a few BCs surveyed cooperatives in their district at the CBC's request. As a result, the CBC does not know the current market potential and the plans of cooperatives regarding exporting in all districts.

District banks' reactions differ with centralized services

Prior to the announcement that most of the international banking services would be centralized, district BCs were making preparations to offer international banking services to cooperatives in their districts. After the announcement to centralize most international banking services, the role of district BCs changed from one of offering full services to cooperatives to that of domestically marketing the services offered by the CBC.

The Sacramento BC has expressed interest in assuming a more independent role in international banking services. According to a senior CBC official, this district wants authority in areas such as handling and accounting for its own transactions. A memorandum of understanding has been negotiated between the CBC and the Sacramento BC. This agreement will allow the CBC to offer a 25-percent participation to the Sacramento BC for loans originating in that district.

Other districts also would rather be more involved in handling international banking services directly than just providing marketing services. According to a CBC official, some district BC officials' attitudes are becoming less enthusiastic about international banking services since they will not be able to offer such services for several years. A St. Paul BC vice president stated that they do not want to be dependent on the CBC every time they have an opportunity to market the program to a district cooperative.

It appears, however, that most of the district BCs are accepting the reality of centralization. The costs for a district BC to gear up to handle export transactions can be high. We were advised by FCA officials that, with the possible exception of the Sacramento BC, FCA does not anticipate authorizing any district BC to participate with the CBC in any aspect of international trade financing at this time. In view of some of the problems that faced the FCS in getting this program underway, we believe that before any district BC is authorized to engage directly in international banking services, it should be required to justify to FCA that it is ready to undertake these services.

FCA'S CAPABILITY TO MONITOR CBC'S COUNTRY RISK UNIT IS LIMITED AND SHOULD BE IMPROVED

FCA cannot adequately monitor the quality of loans made by the CBC since it has no way to independently evaluate country risk. If FCA plans to effectively supervise and regulate the CBC's international banking services program, steps must be taken to correct this deficiency.

FCA needs to develop a method to evaluate country risk

FCA, as regulator of the CBC, needs to be able to assess the international loans being made by the CBC. Reviewing the loan portfolio is a regular part of a bank examiner's audit. Yet, FCA has not developed a methodology to examine and classify the CBC's international loans and other outstandings with regard to country risk. A country risk assessment takes into consideration the possibility that adverse economic, social, or political circumstances may prevent a country's borrowers from making timely (or in the extreme, any) repayment of interest or principal.

Currently, the CBC contracts with a private consultant for country risk analysis. The consultant's reports are used in making credit decisions. Typically, a large commercial bank will do a similar analysis by either in-house capabilities or through contracts.

The three major Federal bank regulators have a joint committee on country risk which evaluates and classifies countries and loans made to these countries by banks under their supervision. These bank regulatory agencies have adopted uniform examination procedures for evaluating and commenting on country risk to U.S. banks with relatively large foreign lending. These examination procedures take into account a bank's own analysis of a country's economic, social, and political developments, whether dollar limits are set for exposures, and the extent that country exposures are monitored and controlled against the assigned limits. FCA's role is similar to that of the Federal bank regulators as supervisor and examiner of the CBC. Yet, FCA has no means of independently evaluating the credit decisions made by CBC staff with regard to loans and other outstandings made to foreign countries. In order for FCA to be able to fully and independently examine the activities of the CBC's international banking services program, it must be able to review and classify loans based on some independent assessment of risk.

We understand that commercial risk can be minimized by stated contract terms and by insurance and guarantees. However, country risk remains. Although country risk is difficult to totally eliminate, it can be minimized by basing loan decisions on country risk studies. As a regulatory agency like the bank regulatory agencies, FCA should determine if it could use the information developed by the joint task force on country risk for supervisory and regulatory purposes. If permission is granted, FCA could use this information to evaluate credit decisions being made by the CBC staff as well as to assess the CBC's outstanding loans for country risk. The alternative is to assess country risk itself.

CONCLUSIONS

International banking services is a new program available to cooperatives through the CBC. Although the program has been operational since February 1982, a number of problems were encountered during the development process. They included FCA's decision to centralize international banking services at the CBC, some BCs' lack of enthusiasm about marketing international banking services because of their noninvolvement, and differences of opinion between FCA and the CBC over the readiness of both to start an international banking services program. We were unable, however, to determine what impact these problems had in implementing the program. In any event, we believe that before any district BC is authorized to engage directly in international banking services, FCA should require it to justify its readiness to undertake such a program.

At the present time, FCA's capability to evaluate and monitor country risk is limited due to the lack of a methodology to assess country risk. If FCA is to effectively regulate the CBC's international banking services program, it will have to improve in this area.

RECOMMENDATIONS TO THE GOVERNOR, FCA

We recommend that the Governor, FCA:

--Establish minimum requirements which district Banks for Cooperatives must meet before they are allowed to undertake an international banking services program.

--Determine the feasibility of using the results of the Federal bank regulatory agencies' country risk studies or have FCA develop such studies on its own.

AGENCY COMMENTS

FCA did not comment on the recommendation to establish minimum requirements that district BCs must meet before they are allowed to undertake an international banking services program. FCA did concur on the need to strengthen its ability to evaluate country risk and is taking steps to achieve this goal.

The agency apparently misinterpreted our comments about the international banking services program. We did not intend to imply in this chapter that finalizing the regulations was untimely. Rather, the chapter discusses problems attributable to FCA and to CBC and BC management in implementing an international banking services program. To clarify that timeliness was not our concern, we have deleted all references to it in this chapter.

CHAPTER 4

FCA NEEDS TO CLOSELY MONITOR THE IMPLEMENTATION OF CERTAIN OFI REGULATIONS

FICBs were originally established to discount agricultural loans made by OFIs; however, most activity has been with PCAs. For example, 95 percent of FICB loan and discount volume during 1981 was with PCAs. Commercial bankers cite (1) competition between OFIs and PCAs, (2) greater capital and surplus restrictions on OFIs, and (3) the extensive paperwork involved as the reasons OFIs have made limited use of the FICBs' discounting services.

The 1980 Farm Credit Act Amendments attempted to correct this situation by authorizing FICBs to discount the same types of loans for qualifying OFIs as for PCAs and by assuring qualifying OFIs reasonable access to the FICBs' discounting services. The objectives are to:

--Extend the FICBs' discounting services to a large number of OFIs which need this service to more adequately serve agricultural and aquatic borrowers.

--Enhance the opportunity of OFIs to utilize the FICBs' discounting services.

--Provide more equal treatment for qualifying OFIs and PCAs in borrowing and discounting loans.

The new provisions in the law and the implementing regulations should help assure that qualifying OFIs gain access to the FICBs' discounting services. Several new regulations contain waiver or other provisions that require FCA to exercise discretion in making case by case OFI eligibility determinations. Also, certain aspects of some regulations lack specificity in defining OFI eligibility. The manner in which these provisions are applied ultimately will determine whether the new policies will operate in a less restrictive manner than the policies in force before enactment of the amendments. We believe that FCA, in reviewing all denials of applications for access to the FICBs' discounting services, should closely monitor the implementation and application of certain FCA regulations and district policies to ensure that OFIs are given the opportunity to better utilize the services of FICBs in order to serve the needs of agriculture.

DISCOUNTING BEFORE THE 1980 AMENDMENTS

FICBs were created in 1923 to discount for or purchase from any agricultural credit corporation, National or State bank, savings and loan association, or credit union any loan made for any agricultural purpose. To participate in the program immediately prior to the 1980 amendments, loans had to be secured by agricultural notes on collateral approved by FCA; the OFIs' liabilities could not exceed capital and unimpaired surplus by a ratio of more than 10:1 if a corporation or by more than 2:1 if a bank, association, or credit union; and the loan could not exceed a 7-year term or carry an interest rate more than 4 percent above the FICB discount rate. The Farm Credit Act of 1971 required FICBs to charge OFIs and PCAs the same interest rate.

While some implementing FCA regulations and FICB policies were specific, others were not as clear or varied widely from one district to another. For example, FCA required OFIs to present persuasive evidence they could not serve the needs of agriculture without access to the FICB; submit proof there was a continuing need to maintain a loan volume at least equal to the last 3-year average; and establish sufficient capital, loan volume, and institutional capability.

The FICBs' policies varied widely from one district to another. For example, required minimum OFI capital varied from $250,000 in one district to $1,000,000 in another district. The OFI investment in the FICB also varied from one district to another in the amount required and the method of computation. For example, two districts computed the investment on the basis of the line of credit and required 5 and 6 percent respectively. Another district used the same investment as required for PCAs. The remaining districts either did not state the amount of the required investment or computed the investment differently. Four districts had a minimum investment ranging from $25,000 to $120,000. The minimum loan volume that the OFI had to achieve ranged from $2,000,000 to $5,000,000 where stated. Two districts required that the minimum loan volume be achieved within 12 months. The required liabilities-to-capital ratio ranged from 4:1 to 8:1. Other districts used different ratios based on total discounts to capital. Some of the district policies did not specify all of their OFI discounting requirements. For example, one district said its capital, investment, and loan volume had to be "sufficient." Some districts did not state requirements for things such as the investment, loan volume, or liability-to-capital ratio.

Discounting has been limited

OFI discounting with FICBs over the years has been limited. Since 1960, FICB loans and discounts made with PCAs ranged from 92 to 96 percent of total FICB loans and discounts while loans and discounts made with OFIs ranged from 4 to 8 percent. In this same period, however, the number of PCAs discounting with FICBs has declined due to consolidations while the number of OFIs discounting has steadily grown. The following table shows discounting activity for PCAs and OFIs for selected years.

PCA and OFI loan and discount activity

Year	Loans and discounts made ($000 omitted)		Number of PCAs and OFIs	
	PCA	OFI	PCA	OFI
1960	$ 2,607,399 92%	$ 228,528 8%	490 85%	87 15%
1965	4,135,519 93%	295,518 7%	474 82%	105 18%
1970	8,276,660 93%	621,431 7%	442 77%	135 23%
1975	16,062,551 96%	735,901 4%	431 77%	128 23%
1980	32,674,199 95%	1,767,616 5%	424 72%	167 28%
1981	35,007,079 95%	1,856,393 5%	423 70%	184 30%

Over the past 20 years FICB loan and discount volume has increased substantially; however, the OFIs' share of this increase has not kept pace with the PCAs' share. In 1960 OFIs accounted for 8 percent of the FICBs' total loans and discounts and this percentage dropped to 5 percent in 1981. This occurred even though the number of OFIs relative to PCAs has increased from 15 to 30 percent.

The FCS has not evaluated OFI use of the FICBs' discount services, and information about why OFIs have not made greater use of FICBs' discounting services was not available. FCA's Deputy Governor, Office of Supervision, advised us that the attitude of FICB management could play some role in the extent of a district's discounting activity. He said that the agricultural characteristics and the commercial banking structure of each district could also play some role in the extent of a district's discounting activity. Commercial bankers, however, cited three reasons why OFIs make limited use of an FICB's discounting services. They said that (1) competition between OFIs and PCAs, (2) greater capital and surplus restrictions on OFIs, and (3) the extensive paperwork involved all accounted for the limited use of the FICBs' discounting services.

We noted some variations in discounting by district. In 1981, for example, the Springfield district had no discounting activity, while the Baltimore, Columbia, Louisville, St. Louis, and Spokane districts had less than $100 million in discounts. At the other end of the spectrum, the New Orleans, St. Paul, Omaha, Wichita, Texas, and Sacramento districts had more than $100 million in discounts. Some of these differences may be attributed to the characteristics of each district. For example, most OFIs eligible to use the FICB are located in the central United States, which is heavily agricultural. Other differences may be attributed to the parties involved. The Deputy Governor for Supervision told us that while FICBs have not always been receptive toward OFIs, which they view as competitors, OFIs also have been reluctant to make a continuing committment to use the FICBs. He attributes this to OFIs' funding and lending needs which, at times, conflict with the FICBs' ability to fund and lend to the OFI. Also, the FICB is only one of several alternative sources of funds to many OFIs, and the attractiveness of discounting with the FICB can vary over time relative to other alternatives.

OFI applications for discount services

During the period 1979 through 1981, 115 OFIs applied to establish a discounting relationship with an FICB. Of that number, 80 (70 percent) were approved, 20 (17 percent) were rejected, 7 (6 percent) were withdrawn, and 8 (7 percent) were pending at the time we completed our review in July 1982. Of the 20 applications that the FICBs rejected, 6 (30 percent) were because of a low percentage of agricultural loans to total loans, 3 (15 percent) were because of access to capital markets, 4 (20 percent) were because of insufficient loan volume, 4 (20 percent) were because of inadequate needs demonstration, and 3 (15 percent) were because of inadequate credit quality, procedures, or management.

FCA was unable to tell us how many OFI applications had been rejected over the years. Information available from the St. Paul and Sacramento FICBs indicates that most OFIs inquiring have not subsequently applied because they either were discouraged by the information received or were not serious to begin with. For example, of 47 inquiries in 1980 and 1981 in the Sacramento district, the FICB had only received two applications for discounting, and both were approved. In 1980 and 1981, the St. Paul FICB reported that 100 inquiries resulted in 29 applications. The FICB approved 14, rejected 11, and 4 were withdrawn.

EFFECT OF THE FARM CREDIT ACT AMENDMENTS OF 1980 ON DISCOUNTING

Our review of the Farm Credit Act Amendments of 1980, FCA regulations, and St. Paul district policies indicates that some aspects of the new OFI discounting program should provide more reasonable access and more equal treatment for qualifying OFIs. However, some of the FCA regulations and some of the

St. Paul district policies still favor PCAs. Therefore, it may cost the OFI more to discount with the FICB than it will cost the PCA, at least in the St. Paul district. It also is too early to tell whether the new program will result in an increase in the number of OFIs discounting and in the volume of loans discounted. Therefore, the regulations and policies should be closely monitored to ensure that otherwise eligible OFIs, who are making a significant contribution to agricultural lending needs, are given the opportunity to better utilize the services of the FICBs.

The legislation provides OFIs more equity

The 1980 Farm Credit Act Amendments were an attempt to correct many of the problems that existed under the 1971 act. For example, the amendments authorized FICBs to discount the same types of loans for qualifying OFIs as for PCAs and assured eligible OFIs reasonable access to the FICBs' discounting services. The objectives were to extend the FICBs' discounting services to a large number of OFIs which need this service to more adequately serve agricultural and aquatic borrowers, enhance the opportunity of OFIs to utilize the FICBs' discounting services, and provide more equal treatment for OFIs and PCAs in borrowing and discounting loans. In our opinion, the amendments should benefit OFIs.

The Farm Credit Act Amendments of 1980 include four criteria which OFIs are required to meet to be eligible to discount with an FICB. To be eligible, an OFI must (1) be significantly involved in lending for agricultural or aquatic purposes, (2) show a continuing need for supplementary sources of funds to meet its agricultural or aquatic borrowers' credit needs, (3) have limited access to national or regional credit markets, and (4) not use the FICBs' services to extend credit to borrowers not covered by the act. Clearly, the general nature of several of these eligibility criteria provided FCA a degree of latitude in formulating implementing regulations. The eligibility requirements set forth in the 1980 amendments are similar to those which were in FCA's regulations and in St. Paul's district policy before enactment of the 1980 amendments.

The amendments would help OFIs in several ways. Prior to the 1980 amendments, OFIs could not discount with the FICB loans to farm related businesses, rural residents, aquatic producers, and loans for processing and marketing activities and for the other needs of agricultural and aquatic producers. Now OFIs can discount the same types of loans that PCAs can discount. The amendments also benefit OFIs by increasing the ratio of total liabilities-to-unimpaired capital for certain types of OFIs so that the ratio for all OFIs is the same as it is for PCAs.

Some FCA regulations and St. Paul district policies may not increase discounting

FCA's implementing regulations are more specific than the previous regulations and generally provide for more equal treatment of PCAs and OFIs. However, some regulations may operate in a more restrictive manner than the policies in force before enactment of the amendments. The regulations have been in effect since December 1981. FCA's Deputy Governor for Supervision told us that he believed the Congress wanted to make OFI and PCA discounting more equal. He said the regulations accomplish equality and provide a mechanism for FCA to review FICB proposals to deny OFI access. Under FCA regulations, all rejections of OFI applications to have access to the banks' discount facilities must be reviewed by FCA before they become final.

The St. Paul FICB implemented a revised discounting program in June 1982. Some of the new eligibility criteria in the amendments, however, were being used before this date. FICB staff said that any application received since FCA's regulation became effective in December 1981 was processed in accordance with the eligibility requirements set forth in the regulations even though the district did not finalize its procedures until June 1982.

In the St. Paul district, senior FICB officials believe that the number of OFIs and the volume discounted will increase but not because of the amendments. They believe the increases will be related more to a changing environment resulting from bank deregulation. In our view, the changes to OFI policies in the St. Paul district could have both positive and negative aspects for OFIs. The positive aspects of the program should facilitate growth in OFI discounting. The negative aspects of the program could diminish the potential for growth in OFI discounting. FCA needs to closely monitor the following regulations and policies to ensure that they are no more stringent than necessary.

Agricultural loan volume

In order to satisfy the requirement in the 1980 amendments that an OFI be significantly involved in lending for agricultural or aquatic purposes, FCA prepared a regulation requiring an OFI to have at least 15 percent of its loan volume at the seasonal peak in agricultural and/or aquatic loans. The regulation required the FICB to consider requests with a lesser percent if the OFI demonstrated that it was making a special and sustained effort to serve agricultural or aquatic producers and the 15 percent would be attained in a reasonably short period. The St. Paul FICB defined the period in which the 15 percent had to be achieved as 18 months.

FCA's former regulation required at least 25 percent agricultural loans, but it could waive the minimum percentage if the OFI demonstrated that it was making special efforts to serve the credit needs of the rural area. For example, an OFI with 10 percent agricultural loans could have discounted those loans at the FICB if it was making special efforts to serve the credit needs of the rural area. Under the revised criteria, an OFI with 10 percent agricultural loans would not be eligible to discount those loans with the St. Paul FICB unless it could increase its loan volume to 15 percent of its portfolio within 18 months.

Lowering the required agricultural loan volume from 25 to 15 percent could increase the number of eligible OFIs by 1,661 nationally, according to a 1980 FCA estimate. However, the revised regulation has a less flexible waiver provision than before. This could mean that OFIs, able to demonstrate special efforts to serve agricultural needs, and otherwise eligible, may be ruled ineligible for failure to meet the required 15 percent agricultural loan volume.

In this regard, an OFI president told us it had received a waiver from the old requirement that 25 percent of its total loans be for agricultural purposes. Although they had only 10 percent agricultural loans, the waiver was granted because they could effectively demonstrate special efforts to serve agricultural needs. Although their agricultural loan volume has generally fluctuated between 10 to 15 percent since approval, the State government has formally recognized this OFI's agricultural expertise and commitment. Also, its discount volume with the FICB was among the highest in the St. Paul district. Under grandfathering provisions of the 1980 amendments, this OFI will retain its eligibility to discount with the FICB; but if the OFI had to apply for discounting privileges and could not bring its loan portfolio up to the 15 percent level within a reasonable period of time, it would not qualify under the revised criteria and would be denied discounting privileges. Under the new program, however, before an FICB can deny an OFI discounting services, its decision must be reviewed and approved by FCA.

In addition, the waiver provisions, both before and after the 1980 amendments, have not been communicated very well to OFI applicants in the St. Paul district. Between January 1, 1979, and September 30, 1981, the St. Paul FICB rejected two OFIs that had at least 20 percent agricultural loans but less than the required 25 percent. The denial letter sent to these OFI applicants did not disclose the waiver provision, nor did the program eligibility information they requested disclose the waiver provision. The revised information brochure developed by the St. Paul FICB again does not inform applicants of the waiver provision associated with the 15-percent requirement. Although these waiver provisions are intended to provide some flexibility, they are of little use if not communicated to applicant OFIs.

Debt-to-capital ratio

The 1980 Farm Credit Act Amendments authorize the same maximum total liabilities-to-paid-in and unimpaired capital and surplus ratio of 10:1 for all OFIs and PCAs. FCA regulations now require FICBs to permit OFIs the same debt-to-capital ratio that PCAs are allowed, after a satisfactory relationship has been established. FCA's regulations prohibit FICBs from purchasing or discounting obligations from, and making or extending loans and financial assistance to, an OFI under certain conditions. For example, the FICB cannot provide assistance if the amount of the obligation added to the OFIs' aggregate liabilities, whether direct or contingent, exceeds 10 times the paid-in and unimpaired capital and surplus of the OFI or the amount of the liabilities permitted under the laws of the jurisdiction creating the OFI, whichever is less. The regulation states that a debt-to-capital ratio less than that permitted by statute may be imposed to assure that the OFI maintains its eligibility to borrow and provides adequate capital from a credit standpoint. Any lesser ratio imposed initially shall not be less than one ratio point below the district average for PCAs. Once the OFI has established and maintained a satisfactory access relationship with an FICB, the debt-to-capital standard shall be the same as that used in evaluating PCAs.

We believe the above changes could facilitate discounting by commercial banks which had been limited to a debt-to-unimpaired capital and surplus ratio of 2:1. However, in St. Paul, an FICB senior vice president sees little or no interest in commercial banks discounting with the FICB and thus he concluded the change would have a negligible impact on discounting volume in the district. An FCA official explained that commercial banks may be precluded from taking advantage of the increase in this ratio because of capital requirements that regulatory agencies place on banks.

The FCA regulation will not help OFIs in the St. Paul district. This is because the FICB is not increasing the amount of leverage OFIs are currently allowed to the higher ratio that PCAs were previously allowed. Formerly, PCAs were allowed a ratio of 8:1 and OFIs 7:1. Currently, the district is limiting new OFIs to a 6:1 ratio during a probationary period and then allowing them to graduate to the 7:1 ratio they formerly were allowed. After determining that PCAs in the district were not exceeding a 7:1 ratio, the FICB lowered the ratio PCAs were allowed to the OFI limit. The impact of the revised FCA regulation, as implemented in the St. Paul district, is to disadvantage new OFIs relative to PCAs and established OFIs for some initial period of time.

Access to capital markets

FCA's regulation requires that, in order to discount with an FICB, OFIs have limited access to national or regional money markets as an alternate source of funds and fully utilize locally generated funds to finance local needs. The regulations also state that evidence of money market access shall be determined by the extent to which the OFI, or entity of similar size and circumstances, have the ability to utilize, on a regular basis, bankers acceptances, commercial paper, negotiable certificates of deposit, or other similar liability instruments as a source of funds.

The Senior Vice President responsible for the OFI program in the St. Paul district stated that the amendment provisions, which restrict OFIs from discounting if they have access to capital markets, essentially accomplish the same purpose as FCA's former regulations. In that regard, he thought that the revised rules do not change the FICBs' approach toward considering OFI applications and that OFI access will not be more restrictive. In the past, one of the factors used by the St. Paul FICB to determine if an OFI had a continuing need to discount with the FICB was whether or not the OFI had access to national or regional money markets. The reasoning was that access to such markets was not compatible with continuing need.

FCA's regulations do not clearly define the nature of such access. This has resulted in some different interpretations among staff in the St. Paul district over whether or not an OFI had access to national or regional money markets. For example, the St. Paul FICB rejected two OFI applications in 1982 because it concluded the OFIs had access to national or regional money markets. In both cases there was considerable internal disagreement within the FICB as to the proper access determination. Also, one of the application files included an FICB staff note that said other FICBs planned to approve similar applications.

We believe that the regulation, because it lacks specificity, may result in some confusion in determining eligibility requirements and may lead to different application decisions in different FICBs.

Investment in FICB

Before the 1980 amendments, the Farm Credit Act required FICBs to charge OFIs the same interest rate as they charged PCAs. However, the FCA regulations did not address the effect of other costs such as the OFI investment in the FICB relative to the PCA investment, an element in determining the effective interest rate. In the St. Paul district, OFI investments as a percentage of average loan volume discounted with the FICB were 33 to 60 percent greater than PCA investments during the 1977 to 1981 period. St. Paul FICB staff analysts noted that, without this greater OFI investment, the FICB's lending rate would have to be increased to maintain the same amount of FICB income. The effect of all this is that OFIs' effective interest rates exceeded the PCA effective interest rates at least during 1980 and 1981 by about one half of one percent each year.

The revised FCA regulations state that the OFIs' investment shall be no greater than the PCAs' actual average investment. The regulations, however, still do not address the method of computing the respective investments. St. Paul FICB policies require OFIs to invest with the FICB, to the nearest quarter percentage of year-end average PCA investment, an amount based on its projected credit line while the PCAs' investment is based on its actual notes discounted with the FICB. If the OFIs' projected credit line and the PCAs' amount discounted are equal and if the OFI is fully utilizing its projected credit line, the amount invested in the FICB would be the same for both OFIs and PCAs. Past experience, however, indicates that this is not the case in the St. Paul district where OFIs generally have not fully utilized their projected credit line. The result is that the effective interest rate is higher for OFIs than it is for PCAs in the St. Paul district. We believe this policy needs to be monitored by FCA.

Loan-to-deposit ratio

FCA's regulations state that in order for an OFI to demonstrate a continuing need for supplementary sources of funds to meet the credit requirements of its agricultural or aquatic borrowers, its gross loan-to-deposit ratio shall be not less than 60 percent at the seasonal peak for the last 3 consecutive years. Where failure to meet this criterion in one of the last 3 consecutive years is the result of a general decrease in borrowings caused by an economic decline, the FICB may make an exception in applying this criterion to a request for access where the OFI has otherwise maintained ratios equivalent to depository institutions of comparable size in the district.

FCA's eligibility requirement that an OFI have a gross loan-to-deposit ratio of at least 60 percent at the seasonal peak was not changed by the 1980 amendments. A requirement was added that to be eligible an OFI must have maintained the ratio over the past 3 consecutive years. The St. Paul FICB's policy provided that an exception could be made when an OFI applicant did not maintain the minimum gross loan-to-deposit ratio of 60 percent. The policy allowed the FICB to make exceptions for any of the last 3 years down to 55 percent if the reason for not maintaining the percentage was due to a general economic decline and the OFI provided sufficient evidence to show it was making a special and sustained effort to serve agricultural and aquatic producers. The St. Paul FICB's prior policy only called for an FCA waiver and did not limit it to 55 percent of gross loans-to-deposits.

In general, the average agricultural bank in the Seventh Federal Reserve District (Illinois, Indiana, Iowa, Michigan, and Wisconsin) has operated with a loan-to-deposit ratio in excess of the 60 percent requirement, but since the fourth quarter of 1981, the ratio has been less than 60 percent. Even though only one applicant was rejected for not meeting this requirement in the St. Paul district between January 1, 1979, and September 30, 1981, the average agricultural bank could have difficulty meeting FCA's requirement for at least the next few years, if this trend continues. We believe this policy needs to be closely monitored by FCA.

CONCLUSIONS

We believe the Farm Credit Act Amendments of 1980 go a long way towards correcting many of the problems that existed with the FICBs' discounting program. The amendments do this by allowing FICBs to discount the same types of loans for eligible OFIs as for PCAs and by establishing criteria in order to assure that a qualifying OFI has reasonable access to the FICBs' discounting services. The new provisions in the law should help OFIs.

We recognize that FCA is charged by statute with the responsibility of establishing OFI eligibility under rather general statutory criteria. The guidance described on pages 34 through 39 is directed toward a definition of OFI eligibility and provides criteria for ascertaining when an OFI qualifies for participation or continued participation in the discounting and related FCS programs. We are not suggesting that the present guidance is inconsistent with the general criteria established by the Congress for establishing OFI eligibility.

Several new regulations, however, contain waivers or other provisions that require FCA to exercise discretion in making case by case OFI eligibility determinations. Also, certain aspects of some other regulations lack specificity in defining OFI eligibility. The manner in which these provisions are applied ultimately will determine whether the new policies will operate in a less restrictive manner than the policies in force before enactment of the amendments. We believe, therefore, that FCA needs to closely monitor the implementation and application of its regulations and district policies to ensure that they (1) best meet the needs of agriculture; (2) enhance opportunities for participation in the program by eligible OFIs; and (3) effectively measure what constitutes significant involvement in agricultural lending by an OFI.

AGENCY COMMENTS

FCA maintained that since passage of the 1980 amendments, the Farm Credit System has demonstrated its acceptance of the expressed intent of the Congress that it be more responsive to OFI needs. It maintained that the regulations and policies will assure that no OFI is wrongfully denied access to the discount function. FCA pointed out the effort that it has made to promote the OFI program. It maintained that the lack of applications by other financing institutions to participate in the discounting program is attributable to the significant changes in the operating environment of commercial banks, including the generally improved liquidity caused by economic conditions.

RECOMMENDATIONS TO THE GOVERNOR, FCA

We recommend that the Governor, FCA, as part of his responsibilities to supervise and examine the FCS, closely monitor the implementation of the OFI program in each Farm Credit district to assure that OFIs, who are significantly involved in agricultural lending and are otherwise eligible, are given the opportunity to enhance their utilization of the financial services of the FICBs and better serve the needs of agriculture. The monitoring should specifically include application of the regulations and policies dealing with agricultural loan volume, debt-to-capital ratio, access to national and regional money markets, investment in the FICB, and gross loan-to-deposit requirements.

CHAPTER 5

THE YOUNG, BEGINNING, AND SMALL FARMER AND RANCHER PROGRAM MAY NOT RESULT IN MUCH ADDITIONAL HELP FOR THAT GROUP

The Farm Credit Act Amendments of 1980 require that each FLBA and each PCA prepare a program for furnishing sound and constructive credit and related services to young, beginning, and small (YBS) farmers and ranchers. FCA's leadership role in identifying meaningful programs for furnishing sound and constructive credit and related services for YBS farmers and ranchers has been limited and needs to be strengthened. Responsibility for developing and implementing such programs lies with the more than 900 land bank and production credit associations. In the absence of effective leadership and guidance by FCA, however, the programs developed pursuant to the provisions of the 1980 amendments are likely to continue to lack consistency and overall direction as did the voluntary young farmer and rancher programs that existed prior to the 1980 amendments.

The act requires that the results of this program be reported to FCA on an annual basis. Even though FCA's reporting guidelines were not finalized at the time of our review, preliminary planning indicates that its reporting system will capture information on YBS farmers and ranchers who receive credit and services from FLBAs and PCAs but will not indicate the extent to which the credit and services provided were the direct result of programs specifically designed to meet the credit needs of this group of borrowers. Therefore, program results may be difficult to measure.

FORMER EFFORTS TO HELP YBS FARMERS AND RANCHERS

In 1974, FCA authorized programs for district banks and their associations which would be responsive to the needs of young farmers. Based on our review of these programs in the St. Paul district, we observed the following:

--The programs were voluntary and many banks and associations did not develop programs.

--There was a high degree of variability in the extent to which normal credit standards were relaxed by associations with programs.

--Relatively few loans were made by those associations which had programs.

--FCA and district banks provided little encouragement, supervision, or analyses of the programs.

FCA's regulation lacked specificity

FCA's 1974 regulation did not require that district banks and associations implement programs. Additionally, the regulation did not provide guidance as to how young and beginning farmers might be aided. The regulation stated:

> "Young farmers. Consideration can be given to special lending programs for young farmers placing emphasis upon sound credit service to those entering farming in a low-equity, high-risk position but demonstrating high management ability and earning capacity, thereby providing service to high potential persons within the broad category of young farmers who might otherwise not have an opportunity to enter into farming. Programs shall limit total lending by a Federal land bank or production credit association to an amount not exceeding five percent of their preceding year's peak loans outstanding. This same limitation will generally be applied by Federal land banks when authorizing Federal land bank association programs."

This regulation states a general policy regarding young farmer programs but does not require that districts implement such programs. This limited guidance lead to high variability among district policies.

District young farmer policies varied widely

Four districts--Baltimore, St. Louis, Wichita, and Texas--had no young farmer policies. The remaining districts had policies in either one bank or in both. However, guidance to the associations varied widely between districts with policies. For example, the Louisville district policy stated that the FLB and the PCAs would not establish any special programs to help young farmers but would work toward this objective within its regular lending programs. Springfield's policy was one of providing sound and constructive credit through a mix of long- and short-term credit tailored to the needs of the beginning farmer. The policy stated that land bank repayments, including deferment of principal and interest, and PCA loan plans should be tailored to the cash flow capacity of the farmer within sound loan concepts. Columbia's policy was for financing young farmers who could not meet the bank's or associations' usual credit requirements. Under this policy, PCAs could charge loan applicants a higher interest rate, subject to authorization by its board and approval by the FICB. The higher rate was based on increased analyzing, counseling, and servicing which would be required in connection with making loans to these young farmers.

St. Paul district policy

The St. Paul FLB did not adopt a policy for young farmers, pursuant to FCA's 1974 regulation, because it was not mandatory. FLB management felt they already were making an adequate endeavor to meet the special credit needs of young farmers. An FLB vice president noted that about 20 percent of their loans were made to farmers less than 35 years old. However, the FLB Director of Credit Standards did not know how many of these loans were made to individuals entering farming in a low-equity, high-risk position.

The policy for the St. Paul FICB stated that its program for financing high risk, young farmers was intended to make adequate loan funds available to young farmers who, on the basis of credit standards, were not normally eligible for PCA financing. The objective was to provide an opportunity for young people to enter farming. We noted, however, that only 17 of the 46 district PCAs had policies for financing young farmers and the policies varied from one PCA to another. For example, the maximum loan amount, when specified, ranged from $50,000 to $100,000. Loan repayment provisions also varied and were addressed by only nine of the PCAs. Of these, only six specified repayment terms more liberal than normal standards.

The St. Paul district had 71 young farmer loans outstanding in 1979, 141 in 1980, and 560 in 1981. These loans represented about 0.7 percent, 0.8 percent, and 2.5 percent of the PCAs' outstanding loans for the respective years. Actually, these statistics are overstated because one PCA reported all the loans it made to farmers under 35 years old with less than 10 years experience, including those made under regular lending provisions. Loans reported by that PCA accounted for the majority of the district's young farmer loans in 1979 and 1981.

One way the St. Paul district tried to help young farmers was to modify loan repayment provisions. We noted that the credit quality of young farmer loans without modified loan repayment provisions was as good as the PCAs' overall loan portfolio. On the other hand, the credit quality of young farmer loans with liberal repayment standards was generally poorer than the PCAs' overall loan portfolio. Overall, the percentage of young farmer loans rated acceptable varied widely between associations. This suggests that an analysis of the lending techniques employed by associations with young farmer loans rated acceptable would be useful in structuring new programs.

A senior vice president of the St. Paul FICB told us that little emphasis was placed on the young farmer program by the district board or by bank management. He said bank management did not get very involved because they thought that a small program with high risk could better be handled at the PCA level.

NEW EFFORTS TO HELP YBS FARMERS AND RANCHERS

The Congress expressed specific concern about the adequacy of FCS's programs to serve YBS farmers and ranchers by inserting a provision in the amendments that requires each FLBA and PCA, under policies of the district board, to prepare a program for furnishing sound and constructive credit and related services to YBS farmers and ranchers. However, FCA has not identified or given district banks specific guidance on the types of alternative programs that will benefit YBS farmers and ranchers. It is not clear, therefore, what will be done to help YBS farmers and ranchers enter and remain in agriculture.

Unlike the previous voluntary programs to serve young farmers, the 1980 amendments require that district bank boards adopt policies to guide the FLBAs and the PCAs in the preparation of their programs. Under the 1980 amendments, there is considerable latitude and discretion in establishing programs to serve the YBS farmer and rancher. The extent and nature of the programs that would be established, other than loan guarantee programs, is not spelled out in the amendments or their legislative history.

The Senior Deputy Governor of FCA told us that the 1980 amendments did not require FCS to do anything different from what they were presently doing in extending special credit to YBS farmers and ranchers. He said that special credit means supervised and coordinated credit. Supervised credit refers to making credit services such as financial analysis and planning available to farmers and ranchers. Coordinated credit means making all credit sources available to farmers and ranchers. This includes FCS institutions, Federal, State, and local government agencies as well as private sources of credit.

The official also said the FCS has been adequately serving YBS farmers and ranchers. Other officials believe that little more can be done to help YBS farmers and ranchers in the present environment of high interest rates and low commodity prices. Therefore, FCA has not studied the needs of the YBS farmer and rancher and has not examined its past young farmer program to identify what worked well and what did not work well. We believe FCA has considerable latitude and discretion under the 1980 amendments to establish YBS programs beyond the previous loan guarantee programs.

We believe that a more systematic and comprehensive approach to implementing the legislation is required. To achieve this, FCA needs to be more specific in guiding district banks in developing their programs to meet the special credit needs of YBS farmers and ranchers. The district policies FCA approved, however, are very general. As a result, bank guidance to associations, which will ultimately extend credit to YBS farmers and ranchers, may also be very general and lack specific direction as to how program objectives might be achieved. Our view was shared by two trade associations in their objections to FCA's draft regulations on the YBS farmer and rancher program. One trade association said that the regulation was so vague and insubstantial as to preclude the creation of an effective credit program for YBS farmers and ranchers. It said that while the regulations state that consideration shall be given to special credit needs, they do not spell out concrete programs or establish goals. It said failure to do this means that there is no effective way to measure whether or not the program is successful. The second trade association suggested that FCA develop a list of specific types of program devices that could benefit YBS farmers and ranchers. The FFCB rejected these proposals to avoid any limiting effect on FCS institutions.

One of FCA's responsiblities, according to the act, is to coordinate the activities of the banks in making studies of lending standards. Yet, FCA has not conducted any recent studies to determine the needs of the YBS farmer and rancher or identified any programs which worked well in the past for the YBS farmer and rancher. There are over 900 FLBAs and PCAs in the FCS and each must prepare a program for furnishing sound and constructive credit and related services to YBS farmers and ranchers. We believe it would be more logical if specific guidance came from a single authority in order to provide some frame of reference in which associations can develop their programs. We also believe that FCA has the authority and the responsibility to promote the efforts of the associations in providing responsive programs.

IMPLEMENTATION OF THE YBS FARMER AND RANCHER PROGRAM HAS BEEN SLOW IN THE ST. PAUL DISTRICT

The St. Paul district has not moved very quickly to develop a YBS farmer and rancher program. The FLB prepared association program guidelines in July 1982. However, FCA approval was required prior to implementation by the FLBAs. The FICB Senior Vice President for Association Administration estimated that PCAs would have their program implemented 6 months after FCA provided a definition of "small farmer." While FCA has accepted a definition of "small farmer", it had not been approved by the FCS as of July 31, 1982. The program, when eventually implemented, may fall short of expectations in that little new will be available to these borrowers that the FCS was not formerly providing. St. Paul officials believe that little more can be done in the present environment of high interest rates and low commodity prices.

The district policy does not contain specific objectives designed to promote the provision of a greater level of service to YBS farmers and ranchers. District implementation plans have not adequately addressed important factors, such as special credit needs, programs to meet those needs, alternate loan plans, and coordination with other lenders.

Even after implementation, much remains to be done such as structuring alternative loan plans and workable coordination agreements with other lenders. In any event, it does not appear that there will be much additional help for YBS farmers and ranchers as a result of this program. There may be a curtailment of credit to this group by agricultural lenders because of high interest rates and more restrictive credit policies caused by depressed prices and earnings in the agricultural sector.

District policy provides little additional guidance

The St. Paul FICB and FLB adopted a joint policy which essentially follows the proposed policy developed by the National FICB/FLB Task Force for financing YBS farmers and ranchers. The policy is, for the most part, a restatement of FCA's regulation. It defines "young" as one who is under the age of 35; "beginning" as one who is in the process of establishing an agricultural operation and who has not assumed the full control and risk of such an operation for longer than 5 years; and "small" as one having sustained gross sales from agricultural or aquatic production and a net worth as prescribed by FCA. At the time of our review, FCA had accepted $40,000 and $100,000 as a gross sales and net worth figure, respectively. An applicant that meets the definition of either "young," "beginning," or "small" would be eligible. The policy was approved by FCA on February 17, 1982.

The policy, while providing a framework in which to structure meaningful programs for this specialized group, provides little that is new which the associations could not do in varying degrees before. We believe that FCA and the National FICB/FLB Task Force should have provided more guidance on acceptable risk and alternative loan programs which could have been offered to these borrowers. In this way the associations would have had some frame of reference for developing acceptable YBS loan programs.

Little progress has been made developing alternative loan programs

The FICB has not developed alternative loan programs for consideration and possible adoption by the PCAs; however, they are coordinating with the FLB, which has made some progress in this area. The district board in consort with the bank presidents has considered what might be done to better serve this group. It has considered options, such as acceptance of greater risk, establishing special reserve funds at the banks, and seeking legislative changes that would lower interest rates.

The FLB had planned to develop alternative loan plans for YBS farmers and ranchers. This task terminated after bank officials developed 15 ideas to help YBS farmers and ranchers. The ideas were forwarded to their research department for evaluation and possible inclusion in an ongoing research study. The objective of the ongoing study is to develop at least one alternative loan plan which will aid in providing initial cash flow relief to loan applicants. While the alternative plan would be available to all borrowers, it also should benefit the YBS farmer and rancher. Leasing is one example of an alternative loan plan currently being used by PCAs. It is the type of program that FICBs could have included in developing alternative loan programs.

Leasing

Leasing rather than purchasing capital equipment is one alternative being used in six PCAs in the St. Paul district which can help YBS farmers and ranchers. Leasing can help YBS farmers and ranchers by making equipment available to them at less than the cost of ownership. Although leasing has benefits, it is not used extensively in the St. Paul district. Leasing is advantageous where tax payments are offset by investment tax credits and depreciation allowances. The FLBs, however, have no tax liability and tax liabilities of PCAs are small.

Leasing from a PCA reduces the farmer's annual interest rate. For example, one farmer in the St. Paul district leased a tractor through a PCA at an annual percentage rate of 10.1 percent. The rate for a conventional loan at that time was 15.8 percent. A bank vice president estimated that, at present, the PCA's tax liability, about $270,000, can accommodate only 29 leases a year. This PCA serves over 2,000 members; therefore, leasing has a limited potential to aid the YBS farmer and rancher. Expanding the leasing program to all PCAs and targeting the program for YBS farmers and ranchers appears to be an effective way to satisfy some of this group's needs.

Coordination efforts have not resulted in anything new

Coordination efforts between the St. Paul FLB and FICB, as of July 1982, produced little that is new which would provide increased funding or better credit terms for the YBS farmer and rancher. However, there have been numerous conferences and written communications with lenders serving similar populations, and a number of memorandums of agreement have been structured. Progress has been made in the areas of planning, guiding, and controlling the total financial needs of YBS farmers and ranchers. Coordination within the district includes units of the FCS, and Federal, State, and commercial agricultural lenders.

FLB and FICB have a coordinated program

Coordination efforts between the St. Paul FLB and FICB call for an exchange of information in areas such as State programs and alternative loan plans. Another effort is to better align PCA and FLBA territorial boundaries. The FLB and FICB are also coordinating their programs to provide a better service to YBS farmer and rancher borrowers. For example, PCAs will make services such as income tax preparation and farm record keeping available to FLBA borrowers. Similarly, FLBAs will extend estate planning service to PCA borrowers. In addition, the coordination policy will be documented in the borrower's file and both PCA and FLBA representatives will be present at the annual review held with the YBS farmer and rancher borrower.

FmHA programs have had reduced potential to aid YBS farmers and ranchers

Coordination efforts to date with Federal agencies have focused on the Farmers Home Administration (FmHA). The St. Paul FICB and FLB have executed memorandums of agreement with the FmHA in all four States within the district. The memorandums of agreement contain little that is new, but they do accelerate the process for approving loan participations and guarantees. Agreements have not been formalized with other Federal agricultural lenders such as the Small Business Administration, the Commodity Credit Corporation, and the Agricultural Stabilization and Conservation Service.

FmHA channels credit to farmers, rural residents, and communities through a number of direct lending programs. They also guarantee the agricultural loans of other lenders. The FCS's use of FmHA in the YBS farmer and rancher programs focuses on loan participations in FmHA's farm ownership and operating loans as well as being a source of loan guarantees. FLB and FICB have participated in these loans in the past and have had loans guaranteed by FmHA.

Participation in FmHA farm ownership loans has been advantageous to the borrower and to the FLB. A few years ago, the FmHA loan had a 5 percent interest rate while FLB loans were priced at about 8 percent. FLB participation with FmHA resulted in a favorable melded interest rate for the borrower. Secondly, the FLB held a first lien on the acquired property. This essentially gave the FLB a 100-percent guarantee on its portion of the loan in case of default.

Starting in 1982, FmHA farm ownership loans have had reduced potential for aiding the YBS farmers and ranchers because loanable funds were reduced about 10 percent from 1981 and the FmHA interest rate had increased to over 13 percent as of March 1982. FmHA does provide farm ownership loans at a lower interest rate to borrowers with limited resources; however, other lenders cannot participate in these loans.

The FLB can obtain a 90 percent FmHA guarantee on its real estate loans; however, this program has disadvantages to the borrower as well as to the FLB. The guarantee does not increase the borrower's ability to repay the loan and he must pay a 1 percent placement fee. Secondly, the guarantee does not materially reduce the FLBs' risk because 90 percent of the loan balance has normally been recovered in cases of loan default. The FLB holds about $15 million of FmHA guaranteed loans.

Funding for FmHA farm operating loans significantly increased in fiscal year 1982, but the interest rate had reached 14.25 percent by April 1982. An FICB vice president told us he believes it is difficult to participate in an operating loan with FmHA due to the form of the collateral. Therefore, he believes that future cooperation with FmHA will probably be mostly in the area of loan guarantees. A PCA president noted, however, that FmHA guarantees have also become less useful. Formerly, PCAs used the guarantees when the borrower's repayment capability was somewhat marginal. Now FmHA insists on demonstrated repayment ability before it will guarantee the loan.

The Department of Agriculture has launched a YBS farmer and rancher pilot program in 81 counties and in 10 States. The objective is to help part-time and beginning farmers and ranchers become full-time and successful. The St. Paul district has limited its participation in this program to giving technical assistance. PCAs, however, may provide some loans, subject to a FmHA loan guarantee.

In summary, coordination efforts with FmHA to date have led to more formalized agreements and more efficient procedures for loan participations and guarantees; however, there is little new that the FCS was not formerly doing to aid YBS farmers and ranchers. In fact, FmHA programs have less potential for providing assistance to the FCS than they formerly had.

State programs are few and usefulness to FCA programs is limited

The St. Paul district has made some efforts to complement the YBS farmer and rancher program with the farm credit programs of State agencies. However, little has materialized as a result of these efforts which would substantially benefit YBS farmers and ranchers. Coordination with States is not new to the St. Paul district, but efforts have intensified as a result of the 1980 amendments. In the St. Paul district, only Minnesota and North Dakota have State programs. Nationally, only seven States had such programs as of August 1981.

Minnesota family farm security program

The objective of the Minnesota family farm security program is to deal with the credit problems encountered by beginning farmers. Such credit problems are the result of the high price of farm real estate, high interest rates, and the unavailability of credit. The State's role is one of guaranteeing the real estate loan and providing interest relief.

To be eligible for assistance, applicants must have a net worth of less than $75,000 and meet State standards demonstrating creditworthiness. In addition, the applicant must obtain a source of both long- and short-term agricultural credit.

The program provides two types of assistance to eligible farmers purchasing farm real estate. First, the State will pay lenders 90 percent of the sums due and payable under a real estate mortgage or seller-sponsored loan in the event of a loan default by a program participant. Second, the State can pay the lender an adjustment equal to 4 percent interest on the principal balance of the real estate loan. This adjustment is to be returned to the State by the borrower after the loan has run for 10 years, or the borrower may petition for one 10-year extension. As a part of the application process, a program applicant must present a 1 year commitment letter from a short-term lender for operating expenses.

Despite the fact that many efforts have been made to reach necessary agreements enabling the St. Paul FLB to participate in the Minnesota family farm security program, problems remain. One major problem centers over who has first lien on the financed property. The Farm Credit Act of 1971 requires that the FLBs have first lien. Yet, Minnesota law requires the State to recover interest adjustment payments and other costs after its guaranteed portion of the financing has been satisfied. This agreement is not legally satisfactory for FLBs according to FCA's General Counsel.

North Dakota beginning farmer program

The North Dakota beginning farmer loan program, which started in July 1978, is a combined effort by a State-owned bank and the FmHA to provide 100-percent financing for purchases of real estate by beginning farmers. North Dakota defines a beginning farmer as one who has a family net worth of less than $100,000 and receives more than one-half his income from farming. Under the program, a beginning farmer can purchase farmland with no down payment by borrowing up to 65 percent of the appraised value from the State-owned bank, which holds a first lien. The balance of the appraised value will be provided by FmHA. For the first 5 years of the loan, the State-owned bank may lend its portion of the money at 2 percent below the market interest rate and defer principal repayment for the first 2 years of the loan.

The FLB cannot participate with the State-owned bank because North Dakota law requires the bank to hold a first lien on financed property. Similarly, the Farm Credit Act of 1971 requires the FLBs to hold a first lien on financed property. The North Dakota legislature is considering enacting changes allowing FLBs to secure first liens. Thus, the State-owned bank generally would be able to participate with FLBs in loans to beginning farmers. According to an FICB official, PCAs in the St. Paul district are not expected to become involved much in this program.

In summary, two States within the district have programs to help meet the financial needs of YBS farmers. It appears that the St. Paul district will have minimal participation in these programs, at least in the near term, because the two States require first liens on the financed property as does the FCS.

Commercial lenders do not appear to have complementary programs

The rural bankers that we talked to did not have any special lending programs for YBS farmers and ranchers. However, they are interested in getting young people into agriculture and attempt to get one or two started each year. Because a beginning farmer has no past record, income projections are normally scaled down and expenses are scaled up, according to one rural loan officer. If the applicant then meets credit standards, the loan is approved with the thought that there will probably be little principal repayment during the first 2 or 3 years.

Officials of the St. Paul FLB said that loan participations with commercial lenders are not contemplated in the early stages of the YBS farmer and rancher program. However, such participation may occur if FCA provides guidance on participations with other lenders.

REPORTS OF ACHIEVEMENTS MAY BE MISLEADING

According to the 1980 amendments, the banks in each district are required to provide FCA with a joint report on that districts' progress toward meeting program objectives. Such a report is to be based on the activities of associations in each district. Essentially, the report should summarize the operations and achievements in each district under programs developed to meet the special credit needs of YBS farmers and ranchers. FCA is required by the act to provide district banks with guidelines to assure that the reporting is uniform. However, despite guidance from FCA, the statistics the banks plan to report may be misleading.

An FCA official told us that the reporting format will include all loans made to farmers and ranchers which meet the definition of young, beginning, or small. The report might also include some specific examples to illustrate how FCS is serving this group. The report will not show whether or not the loan would have been made without the program. In any event, the reporting format may not be ready until December 1982.

Although formulation of the program reporting system is still in its infancy, officials in the St. Paul district have reservations as to the adequacy of the uniform reporting system. An FICB vice president pointed out that a borrower may never graduate out of the small category by choice. However, he believes the program must concentrate on the beginning and small categories because age is not a meaningful category in determining the need for special consideration. The FLB director of credit standards said that these programs will focus on the beginning category for similar reasons. The small category also gave him problems because he said gross farm income can vary widely by type of farm and net worth may be little more than an indicator of the leverage position of the borrowers. A FLB senior vice president noted that the definition of a small farmer was too broad and might include 70 percent of FLB borrowers.

We believe that if the FCS counts every loan to a farmer under 35 years old as being a loan to a young farmer under the new program, actual program accomplishments will be difficult to assess. The same is true for loans to beginning and small farmers. We believe that only those loans to farmers under 35 years old which are granted under a program designed to meet the special credit needs of young farmers should be counted and reported as program results. Similarly, we believe that loans to small and beginning farmers should be reported as loans under those programs only if they were in fact made to fulfill special credit needs, and not loans the FCS would have made anyway.

CONCLUSIONS

FCA, in drafting a regulation, and the St. Paul district, in developing a policy to deal with the young, beginning, and small farmer and rancher, did not identify the various types of programs and credit devices which could help this group of farmers and ranchers. As a result, neither the regulation nor the policy provides guidance on specific programs or on terms and conditions which the FLBAs and PCAs should consider in developing their young, beginning, and small farmer and rancher programs. It is uncertain, therefore, whether the programs being established will provide much additional help for this type of borrower.

At the time of our review, FCA was in the process of developing reporting guidelines for associations to use to report activities under programs developed and progress toward accomplishing program objectives. Under the procedures being developed, however, the reporting system will not disclose the extent that credit and services have been provided as a direct result of programs specifically designed to meet the needs of young, beginning, and small farmers and ranchers. As a result, meaningful information on the programs' progress will not be collected.

AGENCY COMMENTS

FCA pointed out the difficulties of providing constructive credit to meet the needs of young, beginning, and small farmers and ranchers and the extent to which the FCS is already providing credit to this group of borrowers. FCA said that meetings have been held with the staff of FmHA to improve coordination between the two agencies and to explore ways of being of greater assistance to young and beginning farmers.

FCA did not agree with our recommendations. It stated that

> "* * * FCA has not provided direction to the System on the types of programs that might be developed for young, beginning, and small farmers. Such programs must be tailored to the type of agriculture in an area, economic conditions existing at a given time, and the capacity of individual associations. If programs to provide special credit to these groups are to be successful, they must be developed locally.* * *"

We agree that programs should be tailored to the needs and conditions in an area and the capacity of individual associations. We believe, however, that FCA should provide guidance to the associations on such matters as the types of options that the associations should be considering in order to meet their unique needs.

There are over 900 associations that individually must develop a program to meet their needs in their area. We believe that a concerted effort, under the leadership of FCA, is a more realistic approach in attempting to at least determine what options are available to the associations rather than have a fragmented approach.

RECOMMENDATIONS TO THE GOVERNOR, FCA

We recommend that the Governor, FCA:

--Evaluate past young farmer programs and identify what programs were successful.

--Study the current needs of young, beginning, and small farmers and ranchers and identify what programs would meet these needs.

--Disseminate information to district banks and associations on the types of programs they should consider in developing individual young, beginning, and small farmer programs.

--Establish specific program goals so that progress toward meeting these goals can be measured and reported.

Farm Credit Administration

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December 8, 1982

Mr. William J. Anderson, Director
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

We appreciate the opportunity to comment on the draft of a U.S. General Accounting Office (GAO) report entitled Interim Report on the Implementation of the Farm Credit Act Amendments of 1980 (hereinafter referred to as the Report), transmitted by your letter of November 9, 1982. Our comments on the four major chapters of the draft Report follow.

Chapter 2--FCA Could Have Expedited the Implementation Process

We acknowledge that an implementation process can always be validly criticized with the benefit of hindsight. However, we were disappointed at the lack of specificity in the draft Report and the failure of the audit team to consider the implementation in the context of the Farm Credit Administration's (FCA) operating environment. The staff involved in the development of the regulations at the FCA level and the development of policies and procedures at the Farm Credit bank level also had major line responsibilities for supervising a multibillion dollar credit system facing an extremely difficult economic environment. In FCA, the line divisions on which most of the implementation burden fell had staff vacancy rates approaching 25 percent and were operating under an administrative hiring freeze that precluded filling essential vacancies. The Farm Credit Act Amendments of 1980 (1980 Amendments) required the creation or revision of over 100 regulations implementing substantial and controversial legislation. In spite of these obstacles, the most significant aspects of the legislation were implemented as rapidly as permitted by the Administrative Procedures Act, 5 U.S.C. § 551, et seq., and the requirements for congressional clearance contained in the 1980 Amendments. In our judgment, the failure to consider such matters causes the draft Report to be seriously misleading.

This section of the draft Report further comments on the lack of a plan to implement the 1980 Amendments. Although GAO may disagree with the implementation plan, the contention that no implementation plan existed is not supportable. The sequence in which the regulations were developed was based on FCA's assessment of the relative potential impact of each of the authorities contained in the 1980 Amendments on the ultimate beneficiaries of the legislation and the ability of FCA and the Farm Credit System (System) to implement related changes. Detailed time schedules for the implementation process were developed for each phase of the regulation process. Copies of the schedule were provided to all System banks for their use in planning their implementation processes. The procedures within FCA for approving System bank policies were modified to assure that approval actions would be consistent from bank to bank and that actions were taken as promptly as practical.

Chapter 3--Problems Slowed the Implementation of International Banking Services Programs

We believe that the analysis contained on pages 19 - 26 of the draft Report cannot be supported by the facts surrounding implementation of the subject authority. Final regulations were approved by the Federal Farm Credit Board in December 1981. This represented the minimum practical time lapse to comply with notice and publication requirements of the Administrative Procedures Act and the congressional clearance requirements contained in the 1980 Amendments. FCA approval of policies and procedures authorizing the Central Bank for Cooperatives to implement such authorities was obtained immediately following their approval by the Board of Directors of the Central Bank for Cooperatives in February 1982. This cannot reasonably be construed as representing a significant delay in implementation on the part of FCA or the Central Bank.

As to the balance of this section of the draft Report, we concur that the Agency needs to strengthen its ability to evaluate country risk. In September 1982, FCA hired an additional staff member with experience in this area. Additional staff will be added as required. In October, contact was established with other bank regulatory agencies. Discussions are being held to determine whether these agencies' country risk analysis practices are suitable for adoption by FCA and whether they can make information available to assist FCA in the analysis of country risk.

Chapter 4--FCA Needs to Closely Monitor the Implementation of Certain OFI Regulations

In our view, FCA regulations and the policies of the Federal intermediate credit banks (FICBs) will not preclude otherwise eligible OFIs from using the discounting services of the FICBs. The regulations governing eligibility are more liberal in every respect than any previous FCA regulations on the subject. In addition, the regulations go considerably beyond the requirements of the law in requiring that any adverse decision by an FICB on the eligibility of any OFI applicant be automatically reviewed by FCA prior to notifying the applicant. This additional requirement has been imposed to assure that no OFI applicant is wrongfully denied access to the discount function.

As was true in Chapter 2, the analysis reflected in Chapter 4 fails to include significant facts necessary to an objective evaluation of the implementation process. Since passage of the 1980 Amendments, the System has demonstrated its acceptance of the expressed intent of Congress that the System be more responsive to OFI needs. Major revisions have been made in FICB policies to assure more national standardization. The financial requirements for forming an OFI have been reduced significantly, and the attitude of the FICBs has been changed from one of resistance to relationships with OFIs to one of acceptance of congressional direction. To promote the program, the FICBs have met with nearly every state banking association. In addition, FCA has participated in conference seminars at the American Bankers Association (ABA) and the Independent Bankers Association for several consecutive years to provide information and guidance on how to organize an OFI and establish a discount relationship with an FICB. FCA senior staff members have cooperated in writing magazine articles in trade publications and assisted ABA in developing a paper on how to organize an OFI. These efforts have produced only 29 applications by OFIs in the first 9 months of 1982. Factually, commercial bankers have simply not responded to the need they testified existed during the 1980 legislative process. This is partly attributable to the significant changes in the operating environment of commercial banks, including the generally improved liquidity caused by general economic conditions.

Chapter 5--The Young, Beginning, and Small Farmer and Rancher Program May Not Result in Much Additional Help for That Group

For reasons that are not developed in the draft Report, GAO may well be correct in its statement that the 1980 Amendments may not result in much additional help for young, beginning, and small farmers. System banks and associations have a multiplicity of loan structuring and repayment programs at their disposal to meet the needs of any credit worthy borrower. The difficulty in applying these programs is that they do not provide a substitute for net income. Young, beginning, and small farmers and ranchers are particularly sensitive to fluctuations in the agricultural economy and to the effects of adverse weather conditions because they generally are more highly leveraged due to the high cost of agricultural inputs (most notably land and machinery) and the relatively low return on investment. In attempting to provide "supervised" credit, a lender that is required to operate on a self-sustaining basis walks a very thin legal line between providing constructive credit of benefit to a borrower and forcing the borrower to make business decisions that may result in the involvement of the lender in the management of the borrower's business. Where it becomes necessary to resort to legal action in order to collect a loan, a lender that deliberately or accidentally crosses that line typically confronts an unsympathetic court.

For the System's Federal land banks, 32 percent of the loans made in 1981 were to farmers with net farm incomes under $10,000; 20.6 percent of these loans were to borrowers under 35 years of age. The most recent data available indicates that on December 31, 1980, production credit associations (PCAs) had in excess of 20,000 loans to farmers under the age of 25 and nearly 60,000 loans to farmers ages 25 to 34. More than 23 percent of all PCA loans made in 1980 were made to farmers below age 35. In 1980, more than 40 percent of all new PCA borrowers were under 35 years of age. These facts in themselves will make significant additional market penetration difficult.

Since passage of the 1980 Amendments, FCA and the System banks and associations have been meeting with corresponding staff levels in the Farmers Home

Administration (FmHA) to improve coordination between FmHA and Farm Credit System lending programs to enable both groups to provide credit more effectively. Particular emphasis has been placed on how the System and FmHA can be of greater assistance to young and beginning farmers and to borrowers experiencing financial difficulties. FCA and the System banks have evaluated a number of the state-sponsored lending programs to determine their compatibility with Farm Credit System authorities. FCA is also working with the Federal intermediate credit banks to improve the production credit association data base so that more complete information on borrower characteristics will be available. FCA has not provided direction to the System on the types of programs that might be developed for young, beginning, and small farmers. Such programs must be tailored to the type of agriculture in an area, economic conditions existing at a given time, and the capacity of individual associations. If programs to provide special credit to these groups are to be successful, they must be developed locally. FCA will continue to work with the System in developing locally responsive programs.

Sincerely,

Donald E. Wilkinson
Governor

Note: Page references have been changed to conform to the final report.

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