TESTIMONY OF

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on behalf of

THE AMERICAN BANKERS ASSOCIATION

presented to the

COMMITTEE ON AGRICULTURE

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Mr. Chairman, and members of the committee, I am pleased to appear before you to discuss the future of the farmer-owned cooperative movement and to discuss ways that cooperatives can access more capital to better compete in the global economy. My name is Roger Monson and I am President of the Citizens State Bank in Finley, North Dakota and I am the Chairman of the American Bankers Association's Agricultural and Rural Bankers Committee ("ABA"). For those of you who are not familiar with Finley, it is located about an hour and a half north of Fargo. Approximately 550 people call Finley home. Citizens State Bank of Finley has $ 38 million in assets and makes credit available to individuals, businesses (including farmers) and to cooperatives.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership -- which includes community, regional and money center banks holding companies, as well as savings associations, trust companies and savings banks -- makes ABA the largest banking trade association in the country.

Today, I would like to express the banking industry's concerns about a proposal that would fundamentally change the charter of CoBank, and to discuss a number of public/private partnerships that exist, have been authorized, or that could be further enhanced to help all rural businesses gain better access to capital.

The farmer-owned cooperative movement deserves a great deal of credit for helping to develop the infrastructure, markets, and services in rural America that many farmers, ranchers, and rural residents continue to depend upon to this day. ABA members have assisted the farmer-owned cooperative movement since the very beginning by providing credit, other financial services, and talented people to serve on boards and advisory committees to help farmer-owned cooperatives strengthen their financial management skills.

The American Bankers Association Is Opposed to a Fundamental Revision of CoBank's Charter

We are aware that the Farm Credit System's CoBank is actively pursuing legislation that would fundamentally alter their charter. The $27 billion Denver based Government Sponsored Enterprise ("GSE") has a unique mission in rural America; principally it is chartered to serve **farmer-owned**, and **farmer-controlled** cooperatives.

Recent legislation passed in Wyoming and Minnesota has changed the definition of a cooperative in those states with the intention of attracting additional capital investment by giving outside investors a stake in the decision making of the business, and by providing a framework for a return on investment that exceeds the traditional cooperative model. These state laws will allow businesses to continue to be defined as farmer-owned cooperatives, when they appear to be only farmer-content businesses--- businesses that are neither owned by a majority of farmers or farmer-controlled. These efforts to change the cooperative model are interesting and may meet the needs of some institutions that

organize in Wyoming or Minnesota. Personally, they do not look like the cooperatives that I know.

The larger question of what they are must be decided by leaders of the cooperative movement and ultimately by Congressional action. We do know that well-managed and well-capitalized businesses that organize under these state laws will have no problem accessing additional debt and investment capital from private sector banks, insurance companies, industrial credit corporations, and individuals.

CoBank is asking Congress to consider very broad legislative language to re-write their charter to allow them to finance these hybrid businesses. Our belief is that their proposal would dilute their existing obligations to farmer-owned and farmer-controlled cooperatives and would allow them to finance organizations that merely have some farmer content. CoBank's proposal is a very broad and fundamental re-write of their charter.

We are very concerned that CoBank is asking Congress to sign away a major part of their jurisdiction over their activities by proposing language that would allow CoBank to lend to any entity that is defined as a "cooperative" by state law, not federal law. We believe this would create a situation that would be impossible to regulate, as it would require their regulator, the Farm Credit Administration, to become familiar with different laws in all 50 states to determine if CoBank was making loans to eligible borrowers. As a Government Sponsored Enterprise ("GSE"), they should continue to be governed by federal law, not state law. If CoBank wishes to be governed by state laws, they should surrender their federal charter, and the funding advantages they receive as a taxpayer-supported and subsidized GSE.

Finally, CoBank's proposal would allow them to continue to lend to businesses that are no longer cooperatives (farmer-owned or even farmer-content) for up to five years so the businesses can "transition" to other forms of credit. This proposal should not even be considered. If a farmer-owned cooperative disbands, it is no longer a farmer-owned cooperative, and it is no longer eligible to borrow from CoBank. Under the proposal, taxpayer subsidized credit would be extended to a fortunate few businesses, while others would not be able to access the same taxpayer-subsidized benefits.

Over the years CoBank has grown into a $27 billion institution that, in addition to providing financing to farmer-owned cooperatives, provides export financing for agricultural products, finances rural telephone and other infrastructure, operates a nationwide leasing company, wholesales FCS funding to a large number of FCS associations, and provides cash management services to its borrowers. They are a formidable government sponsored institution when compared to the vast majority of banks and other financial institutions that serve rural America. We believe that granting them authority to lend to farmer-content companies would be a great mistake.

Banks Finance Cooperatives

While we oppose CoBank's proposal, we support farmer-owned cooperatives. Cooperatives are very important in North Dakota, and in all of rural America. In my state, cooperatives provide electricity, telecommunications, and other information technologies. They supply markets, and help develop new uses for agricultural production. Our bank finances cooperatives because they are good business for the bank, and because they provide many services that we need in Finley. I am a member of the Town and Country Cooperative, which has farmers and townspeople as members. I would like to share with you how Town and Country Cooperative came about because it is a great example of how we leveraged an important USDA program to provide the capital the cooperative needed to grow.

The cooperative had been affiliated with Cenex. However, financial trends were not good, and the patron/owners decided to close the business. The company sold farm supplies, fuels, clothing, tires, and hardware. All of us in town recognized what an important asset the cooperative was to Finley, so when some of the former patrons and people in town got together to see what could be done to keep the business open, the Citizens State Bank got involved immediately. Ultimately, a new cooperative was formed, Town and Country Cooperative. The patron/owners are farmers, local businesses (including our bank), and people that live in Finley. The new cooperative has added a convenience store with a deli and has started agronomy services for area farmers.

In order for Town and Country Cooperative to remain viable, they had to build their business base to increase cash flow. A cooperative in a neighboring town of 1,100 people closed, and Town and Country Cooperative bought their convenience store. Our bank financed $650,000 for the acquisition. By providing the capital the cooperative needed, we helped save 10 jobs and today, the cooperative has increased their payroll to 13 employees in that town. In addition to providing credit, we provide the cooperative with deposit services and will soon have automatic teller machines in each store.

Another local cooperative that we finance is the Finley Farmers Grain and Elevator Cooperative, a business that has been in the community since 1911. This cooperative, which is farmer owned, buys grain from area farmers. It is also a significant employer in town with 20 people on the payroll. In order to remain competitive and to be able to have the new unit trains stop in Finley to pick up grain, the cooperative had to finance the acquisition of a new 372,000 bushel grain bin, lay two miles of new railroad track, and acquire a locomotive. My bank was the lead lender in the $2.2 million package. We participated some of the loan with another local bank. Without the loan, the cooperative might have lost its access to the railroad. At a minimum, they would have been at a price disadvantage if they could not load unit trains, which have become the norm in grain transportation in my state.

USDA Business and Industry Guaranteed Loan Program

I was able to finance Town and Country Cooperative's acquisition of the new store with a combination of direct bank loans and with a USDA Business and Industry loan guarantee ("B&I"). Our bank was able to provide the loan to the cooperative because the USDA guarantee helps us manage credit risk and allowed us to exceed our loan limit because the guaranteed portion of the loan does not count against our legal lending limit.

As this committee looks for new ways to help cooperatives access more capital, please remember that the B&I guaranteed loan program works well for private sector lenders like us and for quasi-government lenders like the Farm Credit System ("FCS"). The biggest obstacle lenders confront using the B&I is funding. Annual demand for funding frequently exceeds annual allocations. In my state, B&I demand usually exceeds the North Dakota state allocation and the state is dependent upon national pooling to meet all of our B&I requests. Some years, not all requests get funded. Cooperatives are well represented in North Dakota, and the rest of the country, as recipients of these loans.

In the case of Finley Farmers Grain and Elevator Cooperative we were not able to utilize the B&I program because the regulations do not allow lenders to finance revolving credit, which was the type of credit that best fit the cooperative's needs. I recommend that the B&I regulations be revised to allow USDA to guarantee revolving credits, including revolving lines for short term working capital and longer term lines for capital asset finance. A revolving loan guarantee would have helped us in Finley, and I am sure that it would help businesses and cooperatives access capital in other states as well.

USDA Cooperative Stock Purchase Guaranteed Loan Program

Several years ago USDA announced a new guaranteed loan program that was specifically targeted to help farmer-owned cooperatives. This program, the Cooperative Stock Purchase Guaranteed Loan Program, was intended to allow institutions like mine to make loans to farmers to enable them to buy cooperative equity. To encourage banks and FCS institutions to make more loans for these purposes, USDA was supposed to provide up to 90% guarantees on these loans. The program was launched with much fanfare, and many of us thought that it was a great idea.

Many times small farmer-owned cooperatives do not have much of an asset base, so when I get a request to finance a cooperative equity purchase from a customer, I have to look at securing that loan against other assets owned by the customer. When we do this we take away from the customer's ability to borrow additional funds in the future for other business needs. The USDA cooperative equity purchase loan guarantee would allow my bank to make loans to finance cooperative equity purchases without always having to be cross collateralized by other assets. Typically these are small loan requests; a loan for $100,000 to purchase cooperative equity would be a very large loan.

Despite the promise of this program, USDA has had limited success. First, the program was given to the Rural Business-Cooperative Service ("RBCS") the agency that handles the B&I program in a very capable manner; however they do not have the experience with small loan requests, or with farmer-generated financial statements. Their area of expertise is with large complex credit requests. To date, very few loans have been written under this program.

Last year Congress again attempted to resolve some of the operational problems when it authorized B&I guaranteed loans to individual farmers to buy cooperative stock. Section 6017 of the *Farm Security and Rural Investment Act of 2002* ("2002 Farm Bill") allows USDA to guarantee such loans, and further allows farmers to provide financial information in a manner that is generally accepted by area agricultural lenders. We have yet to see if this additional clarification will result in any comprehensive change in USDA's lending for cooperative stock purchases. We hope that USDA will be able to promulgate regulations soon.

I am very fortunate to live in a state that has a willing partner to help us finance cooperative stock purchases for individual farmers and ranchers. The Bank of North Dakota, the only state owned bank in America, has a cooperative stock purchase loan participation program that works quite well. If my bank originates a loan to an individual to purchase stock in a cooperative, the Bank of North Dakota will participate up to 70 percent of the loan. I make my part of the loan at our normal bank interest rate, and Bank of North Dakota makes their part at prime minus one, thus providing the customer with a very favorable blended rate. We have made lots of loans under this program and they are good business for us, and good for farmer-owned cooperatives. I encourage USDA to contact the Bank of North Dakota to learn how they have been so successful with this program.

In addition, we believe that USDA should undertake a comprehensive review of all of the credit programs intended to help individuals make cooperative equity purchases to create a streamlined loan program that works for farmers, ranchers, and the credit community. Further, we believe that administration of the resulting program should be turned over to the Farm Service Agency ("FSA"). FSA has the expertise with small loan requests, understands farmer financial statements, knows the lenders that are likely to be making loans under this program, and has done an outstanding job of streamlining all of their existing guaranteed loan programs over the past five years. Making this program work for farmers and their lenders would go a long way in helping cooperative members capitalize their enterprises.

Rural Business Investment Companies

Section 6029 of the 2002 Farm Bill authorized a very innovative program, the Rural Business Investment Company ("RBIC"). Patterned after the successful Small Business Investment Companies administered by the Small Business Administration, RBICs would allow banks and FCS institutions to charter institutions that would promote economic development in rural areas by making equity investments in rural businesses and

cooperatives that generally have annual sales of less than $2 million and a net worth of $6 million or less.

The Secretary of Agriculture is authorized to guarantee debentures issued by some RBICs to allow them to leverage their capital to make additional equity capital available to rural businesses. The Secretary is authorized to guarantee a total of $280,000,000 in debentures. Finally, the Secretary has been authorized to make grants of up to $44,000,000 to RBICs for the purpose of helping them administer their investment programs. This new program is highly targeted since RBICs would be required to make at least 75% of their capital investments in rural America. The balance of their investments could be made in non-rural areas, but the resulting investments must benefit rural residents.

We supported the creation of RBICs during the debate on the 2002 Farm Bill, and we have been anxiously awaiting USDA's rule making process. Once USDA promulgates the regulations, we call upon Congress to appropriate full funding for this important program to help generate more equity capital in rural America.

I live, work, and invest in Finley because it is my home and every day I have the opportunity to help my fellow citizens with their financial service needs. Above all, however, my bank remains in Finley because we can produce a return on investment that satisfies the needs of those that own the bank. If you allow CoBank to expand their lending to broadly defined farmer-content businesses, we may one day have a hearing about why there is no bank, and maybe no real farmer-owned cooperatives left in Finley, North Dakota.

Thank you for the opportunity to share our thoughts about the future of the farmer-owned cooperative movement. Our members have been meeting the financial needs of farmer-owned cooperatives, rural businesses, farmers, ranchers, and all rural Americans for a very long time. We support farmer-owned cooperatives because they provide many of the essential services farmers and ranchers need to succeed in their businesses. Our support is substantial; we provide credit, financial expertise, and other financial services every day to all of our customers--- cooperatives, for profit enterprises, municipalities, and individuals.

I am happy to answer any questions you may have at this time.