June 25, 2014

Testimony of

Leonard Wolfe

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

before the

Subcommittee on Livestock, Rural Development, and Credit

of the

House Committee on Agriculture

United States House of Representatives

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Chairman Crawford, Ranking Member Costa, and members of the Subcommittee, my name is Leonard Wolfe, and I am the President, CEO and Chairman of the Board of United Bank and Trust in Marysville, Kansas. United Bank is a $570 million bank with fifteen branches serving Marshall, Nemaha, Brown, Clay, Washington, Cloud, and Riley counties in Kansas. We have over $176 million in agricultural real estate and production loans in our portfolio – nearly half of all of our loans are to farmers and ranchers. In addition, we finance businesses that support, in some way, the needs of farmers and ranchers in our part of the state.

I am also the Chairman of the Kansas Bankers Association and I serve as Vice Chairman of the American Bankers Association's Agricultural Credit Task Force. I appreciate the opportunity to present the views of the ABA on credit conditions and credit availability in rural America.

The American Bankers Association is the voice of the nation's $14 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend nearly $8 trillion in loans. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to agriculture since the founding of our country. Over 5,470 banks – nearly 81% of all banks – reported agricultural loans on their books at year end 2013 with a total outstanding portfolio of over $149 billion.

The topic of today's hearing is very timely. The agricultural economy has been performing extremely well. Farm and ranch incomes for the past five years have been some of the best in history. With the new Farm Bill in place, farmers, ranchers, and their bankers have certainty from Washington about future agricultural policy. Interest rates continue to be at or near record lows, and the banking industry has the people, capital, and liquidity to help American farmers and ranchers sustain this excellent agricultural economy.

Banks continue to be the first place that farmers and ranchers turn when looking for agricultural loans. In fact, more farmers and ranchers receive credit from the banking industry than from any other source. Our agricultural credit portfolio is very diverse – we finance large and small farms, urban farmers, beginning farmers, women farmers, and minority farmers. To bankers, agricultural lending is good business and we make credit available to all who can demonstrate they have a sound business plan, the experience, and the ability to repay.

In 2013, farm banks – banks with more than 14% of their loans made to farmers or ranchers – increased agricultural lending 9.1 percent to meet these rising credit needs, and now provide nearly $90 billion in total farm loans. Farm banks are an essential resource for small farmers, holding $45 billion in small farm loans, and $12 billion in micro-small farm loans. These farm banks are healthy and well capitalized and stand ready to meet the credit demands of our nation's farmers large and small.

In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses – food processors, retailers, transportation companies, storage facilities, manufacturers, etc. – receive financing from the banking industry as well. Agriculture is a vital industry to our country, and financing it is an essential business for many banks, mine included.

Banks work closely with the USDA's Farm Service Agency to make additional credit available by utilizing the Guaranteed Farm Loan Programs. The repeal of borrower limits on USDA's Farm Service Agency guaranteed loans has allowed farmers to continue to access credit from banks like mine as they grow, ensuring credit access for farmers across the country.

We remain concerned with certain areas of the agricultural credit market. In particular, we are worried that the Farm Credit System – a government sponsored entity – has veered away from its intended mission and now represents an unwarranted risk to taxpayers. The Farm Credit

System was founded in 1916 to ensure that young, beginning, and small farmers and ranchers had access to credit. It has since grown into a $261 billion behemoth offering complex financial services. To put this in perspective, ***if the Farm Credit System were a bank it would be the ninth largest in the United States, and larger than 99.9% of the banks in the country***.

This system operates as a Government Sponsored Entity and represents a risk to taxpayers in the same way that Fannie Mae and Freddie Mac do. It benefits from significant tax breaks – valued at $1.3 billion in 2013 – giving it a significant edge over private sector competitors. Moreover, the Farm Credit System enjoys a government backing, formalized by the creation of a $10 billion line of credit with the U.S. treasury in 2013.

The Farm Credit System has veered significantly from its charter to serve young, beginning, and small farmers and ranchers, and now primarily serves large established farms, who could easily obtain credit from the private sector. In fact, the majority of Farm Credit System loans outstanding are in excess of $1 million. Any farmer able to take on over $1 million in debt is not a small farmer. Moreover, small borrowers accounted for less than 16% of all new Farm Credit System Loans in 2013.

Our nation's farmers and ranchers are a critical resource to our economy. Ensuring that they continue to have access to adequate credit to thrive is essential for the wellbeing of our whole nation. America's banks remain well equipped to serve the borrowing needs of farmers of all sizes. An important step in ensuring that credit availability is to review entities such as the Farm Credit System and ensure that they stick to their charter of helping young, beginning and small farmers.

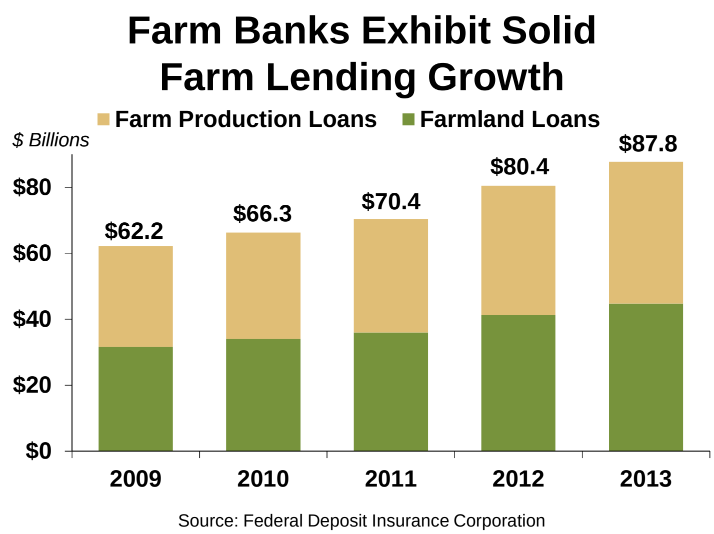
In my testimony today I would like to elaborate on the following points:

- Banks are the primary source of credit to farmers and ranchers in the United States;
- Banks work closely with the USDA to make additional credit available via the Guaranteed Farm Loan Program
- The Farm Credit System has become too large and unfocused, using taxpayer dollars to subsidize large borrowers.

I. Banks Are the Primary Source of Credit to Farmers and Ranchers in the United States

For my bank and for many of our members, agricultural lending is a significant component of their business activities. ABA has studied and reported on the performance of "farm banks" for decades and, we are pleased to report that the performance of these highly specialized agricultural lending banks continues to be strong. ABA defines a farm bank as one with more than fourteen percent farm or ranch loans (to all loans).

At the end of 2013, there were 2,152 banks that met this definition. Farm lending posted solid growth during 2013. Total farm loans at farm banks increased by 9.1 percent to $87.8 billion in 2013 up from $80.4 billion in 2012. Approximately one in every three dollars lent by a farm bank is an agricultural loan.



Farm production loans grew at a faster rate than farm real estate loans. Outstanding farm production loans grew at a pace of 9.7 percent, or $3.8 billion, to a total of $43.0 billion. Farmland loans rose by 8.6 percent, or $3.5 billion, to $44.7 billion.

Farm banks are a major source of credit to small farmers – holding approximately $45.2 billion in small farm loans (less than $500,000) with $11.5 billion in micro-small farm loans (less than $100,000) at the end of 2013. The number of outstanding small farm loans at farm banks totaled 778,545 with the vast majority – over 513,000 loans – under $100,000.

One area of concern for farm bankers and their customers has been the rapid appreciation in farmland values in some areas of the country. The run up in farmland values so far has not been a credit driven event. Farm banks are actively managing the risks associated with agricultural lending and underwriting standards on farm real estate loans are very conservative. The key consideration in underwriting any loan is the ability of the customer to repay regardless of the collateral position in the loan. To further manage risk, we regularly stress test our loan portfolios to judge repayment capacity under different scenarios.

After several years of large increases in farmland values, the consensus view among bankers I know is that the increase in cropland values has slowed. USDA estimates of lower commodity prices in 2014 seem to have cooled off the demand for farm real estate somewhat. We watch the farm real estate market very closely, as do my customers. Eighty-two percent of farmer and rancher wealth is tied up in their real estate.

II. Banks Work Closely With the USDA's Farm Service Agency to Make Additional Credit Available by Utilizing the Guaranteed Farm Loan Programs

I would like to thank Congress, especially the Agricultural Committees, for repealing borrower term limits on USDA Farm Service Agency guaranteed loans. Term limits restricted farmer access to capital, and with the expansion of the farm economy over the past ten years, there are some farmers who are not able to obtain credit from banks like mine without a guaranty from USDA. The USDA's Farm Service Agency guaranteed loan program has been a remarkable success. Today, nearly $12 billion in farm and ranch loans are made by private sector lenders like my bank and are guaranteed by the USDA. There are nearly 43,000 loans outstanding – of course some farmers have more than one guaranteed loan, so this number is not to be confused with the number of individual farmers and ranchers, but the numbers of individuals accessing credit under this program is very significant.

This program has grown over the past five years, with less than $9 billion outstanding at the close of FY 08 to nearly $12 billion today. The loans made by banks like mine under this program are modest in size. The average outstanding guaranteed real estate loan is $439,000 and the average outstanding guaranteed non real estate secured loan is $250,000. Clearly, we are reaching customers who have modest-sized operations, who are in the process of starting their farm or ranch operation, or who are recovering from some sort of financial set-back. Despite the fact that these customers do not have either the earnings or collateral to qualify for conventional credit, losses in the program have been extremely small. Over the last five fiscal years losses have ranged from a high of 0.6% in FY10 to a low of 0.3% in FY13. These are extremely low losses – especially for customers who are perceived to be a higher risk than other customers, hence the need for the USDA credit enhancement. Bankers who utilize the guaranteed farm loan programs offered by USDA know what they are doing and work very closely with their farm and ranch customers to properly service these loans. The Farm Service Agency deserves a great deal of credit for administering such a successful public/private partnership. We urge you to continue to support this very worthwhile program.

III. The Farm Credit System is a Large Government Sponsored Entity That Primarily Serves Large Borrowers at the Expense of Taxpayers

I mentioned earlier in my testimony that the market for agricultural credit is very competitive. I compete with several other banks in my service area, finance companies from all of the major farm equipment manufacturers, several international banks, credit unions, life insurance companies, and finance companies owned by seed and other supply companies to name a few. The most troublesome competitor I face is the taxpayer-backed and tax-advantaged federal Farm Credit System (FCS). The FCS was chartered by Congress in 1916 as a borrower-owned cooperative farm lender at a time when banks did not have the legal authority to make long-term farm real estate loans. Over the ensuing 98 years the FCS has received numerous charter enhancements, and has ventured into areas that are not appropriate for a farmer-owned farm lending business.

Today ***the FCS is a large and complex financial services business with $261 billion in assets.*** If it were a bank, it would be the ninth largest bank in the United States. It is tax-advantaged and enjoyed a combined local, state, and federal tax rate in 2013 of only 4.5%. According to the Federal Farm Credit Banks Funding Corporation, ***the tax advantages enjoyed by the FCS in 2013 were worth $1.348 billion*** or 29% of the Farm Credit System's net income in 2013[1].

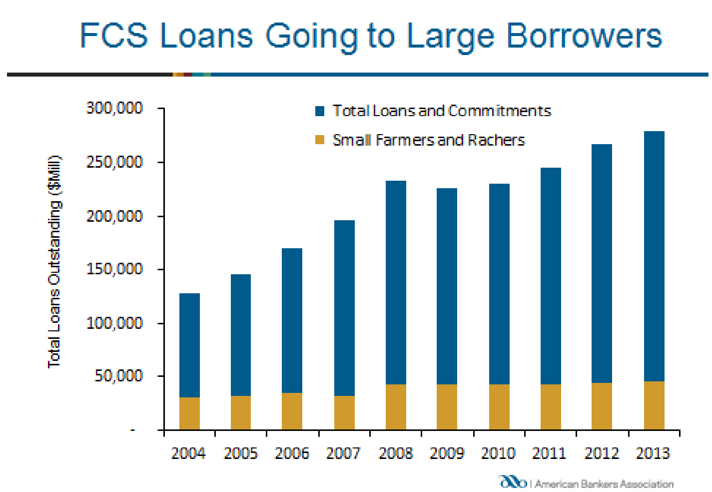
The Farm Credit System is a Government Sponsored Entity

In spite of their size, profitability, and tax advantages the Farm Credit System presents the same kind of potential threat to the American taxpayer as Fannie Mae and Freddie Mac. As a

[1] Federal Farm Credit Banks Funding Corporation; 2013 Annual Information Statement of the Farm Credit System; February 28, 2014. Page F-52

Government Sponsored Enterprise (GSE) like Fannie Mae and Freddie Mac, the American taxpayer is the ultimate back stop should the Farm Credit System develop financial problems. This reality was formalized in 2013 when the Farm Credit System Insurance Corporation arranged a $10 billion line of credit “with the Federal Financing Bank, a federal instrumentality subject to the supervision and direction of the U.S. Treasury – to which the Federal Financing Bank would advance funds to the [Farm Credit System] Insurance Corporation. Under its existing statutory authority, the [Farm Credit System] Insurance Corporation will use these funds to provide assistance to the System Banks in exigent market circumstances which threaten the Banks’ ability to pay maturing debt obligations. The agreement provides for advances of up to $10 billion and terminates on September 30, 2014, unless otherwise extended.”[2]

We believe the farmers who own stock of the Farm Credit System—and the American taxpayers who back it—deserve a better understanding of what transpired between the Farm Credit System and the US Treasury last September, but very little information is available to the public. Unlike the housing GSEs which are subject to reform efforts to lessen the taxpayer’s exposure, the Farm Credit System seems to be increasing its dependence upon the US Treasury.



Source: FCA's Annual Report on the Farm Credit System's Young, Beginning, and Small Farmer Mission Performance

Congress created the Farm Credit System as a public option for farm finance when farmers were having trouble getting the credit they needed from non-government sources. The conditions that led to the creation of the Farm Credit System nearly 100 years ago no longer exist, and yet we continue have a government assisted, tax advantaged farm lender providing credit to customers who would be able to easily borrow from taxpaying institutions like mine. In fact, the heavily subsidized credit that FCS lends goes to those who need it least. Despite amendments to the Farm Credit Act of 1980 requiring each FCS

[2] Federal Farm Credit Banks Funding Corporation; 2013 Annual Information Statement of the Farm Credit System; February 28, 2014, page 23

lender to have a program for furnishing credit to young, beginning and small farmers and ranchers (YBS), the share of new YBS loans to total new FCS loans continues to ***decline—***even as the assets of the system have expanded enormously. In all categories of YBS lending, new young, beginning, and small farm loans continues to steadily drop with small farm loans declining the most – from a high of 30% of total new loan volume in 2003 to just 15.4% in 2013.[3] Clearly, those who would benefit the most from the highly subsidized credit made available by the FCS are not receiving the benefits that Congress intended them to receive.

Large Borrows Benefit Most from Farm Credit System Subsidy

A review of the 2013 Annual Information Statement from the Federal Farm Credit Banks Funding Corporation indicates that 51.3% of all Farm Credit System outstanding loans at the end of 2013 were in ***excess of one million dollars***. The Farm Credit System does not provide the public with aggregated data by borrower; if they did, we would see a much higher percentage of borrowers with debt in excess of one million dollars. In addition, the Farm Credit System does not disclose approved, but unfunded commitments. If it did, the numbers would be even higher. In short, well more than half of the entire Farm Credit System's portfolio at the end of 2013 was to individuals who owed it much more than a million dollars.

We do not believe this is the highest and best use of the Farm Credit System's government sponsorship. Borrowers who can amass over $1 million in credit from the FCS do not need taxpayers to subsidize their debt. Again, small farm borrowers, according to data supplied by the Farm Credit Administration, accounted for less than 16% of all new FCS loans in 2013.

Moreover, the Farm Credit System has wandered dangerously off course into areas of finance that have nothing to do with agriculture, or rural America for that matter. Two recent Farm Credit System loans demonstrate this point:

In 2013, Denver based CoBank, the largest Farm Credit System bank, approved a $750 million loan to Verizon. CoBank's loan was part of a financing package that totaled over $6 billion. Financial institutions from all over the world shared a portion of the loan. CoBank was

[3] "FCA's Annual Report on the Farm Credit System's Young, Beginning, and Small Farmer Mission Performance: 2013 Results". Office of Regulatory Policy, June 12, 2014 Board Meeting

the only government sponsored enterprise to be a participant in the loan. CoBank's share of the loan was the largest single piece of the credit package. The purpose of the loan was to enable Verizon to purchase the portion of Verizon Wireless that it did not already own. The proceeds of the loan, which closed in 2014, went to London based Vodafone, the corporate entity that owned the rest of Verizon Wireless. The Farm Credit Administration, the regulator of the FCS, has publicly stated that the loan is perfectly legal because Verizon is a "similar entity" to a rural cooperatively owned telephone company. In other words, since Verizon provides telephone services like a rural telephone cooperative, the loan is a legal for a Farm Credit System lender to make.

On June 2, 2014, CoBank entered into a $350 million "credit agreement" with Connecticut based Frontier Communications Corporation to help finance a $2 billion acquisition by Frontier Communications from AT&T. Frontier Communications is a $16 billion publicly traded company. CoBank played a major role in this financing package in that they are credited with being the "administrative agent and lead arranger" by Frontier. While we have not seen a finding from the Farm Credit Administration about the eligibility of Frontier Communications to borrow from CoBank, we suspect that the regulator will again cite the notion that $16 billion Frontier Communications Corporation is "similar" to a rural cooperatively owned telephone company.

What new benefit has accrued to rural America as a result? These loans facilitated corporate deals designed to maximize shareholder returns. In the case of the Vodafone buyout, US taxpayer supported money was transferred to European investors. As a banker, I understand the concept of maximizing shareholder wealth, but as a taxpayer I have a hard time understanding how the Farm Credit System can be involved in these deals and how the regulator of the Farm Credit System seems to be working to aid and abet their activities.

Conclusion

The banking industry is well positioned to meet the needs of U.S. farmers and ranchers. U.S. agriculture has enjoyed one of the longest periods of financial prosperity in history; financially, American agriculture has never been stronger. USDA projected that at year-end 2013, farm and ranch net worth was nearly $2.7 trillion. This unprecedented high net worth is due in part to a robust increase in farm asset values (mainly farm real estate), but is equally due to solid *earned* net worth as farmers used their excess cash profits to retire debt and to acquire additional equipment and additional land. As a result, farmers and ranchers today have the capacity to tap their equity should there be a decline in farm profitability resulting in diminished cash flows. While no farmer or rancher wants to take on additional debt, the strength of the U.S. farm and ranch balance sheet gives producers options to do so if the need arises.

When the agricultural economy collapsed in the middle 1980s, the banking industry worked closely with farmers and ranchers to restructure their businesses and to rebuild the agricultural economy. Since that time banks have provided the majority of agricultural credit to farmers and ranchers. While other lenders, including the Farm Credit System, shrank their portfolios of agricultural loans or exited the business altogether, banks expanded agricultural lending. Bankers saw opportunity where others did not. Bankers still see great opportunities in agriculture.

Thank you for the opportunity to express the views of the American Bankers Association. I would be happy to answer any questions that you may have.