April 14, 2011

Testimony of

Matthew H. Williams

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

before the

Subcommittee on Department Operations, Oversight, and Credit

of the

House Committee on Agriculture

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Chairman Fortenberry, Ranking Member Fudge, and members of the Subcommittee, my name is Matt Williams, and I am the Chairman and President of Gothenburg State Bank in Gothenburg, Nebraska. My great grandfather founded the bank in 1902 and our family has operated it since then. My grandfather served as president of the bank and my father followed him in the job. Since it was founded, Gothenburg State Bank and my family have survived many economic catastrophes including the farm crisis of the 1920s, the Great Depression, the farm crisis of the 1980s, and the Great Recession of 2008/2009. We plan to continue to serve the citizens of central Nebraska for the next 100 years or more. Our bank's tag line is "Still Pioneering" and it is a core value of our company. Today, Gothenburg State Bank has two office locations, assets of $115 million, and employs 27 people. Our loans total nearly $80 million with about 75% of our portfolio connected to agriculture in a direct or indirect way.

I also serve as the Vice Chairman of the American Bankers Association (ABA), and I appreciate the opportunity to present the views of the ABA on credit conditions in rural America. The ABA represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its two million employees. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to agriculture since the founding of our country. Over 5,700 banks --- nearly 75% of all banks --- reported agricultural loans on their books at year end 2010 with a total outstanding portfolio of over $127 billion. More farmers and ranchers receive credit from the banking industry than from any other source. 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.

The topic of today's hearing is extremely important and timely. Our nation is facing difficult economic conditions which are affecting all businesses, including banks. The core business of banking is lending. That is what banks do. Banks will continue to be the source of financial strength in their communities by meeting the financial needs of farms, businesses and individuals. Banks in every state in the country are actively looking for good farm and ranch loans. Since the financial crisis, the banking industry stepped up and ***increased*** their share of farm and ranch lending from year end 2007 to year end 2010 by over $13 billion. During the same period farmers and ranchers have ***reduced*** their total indebtedness by nearly $6 billion.

The Impact of Dodd-Frank on the Banking Industry

Our communities and our country cannot reach their full potential without the presence of a local bank – a bank that understands the financial and credit needs of its citizens, farmers, businesses, and government. I am concerned that this model may be in jeopardy given the massive weight of new rules and regulations that will result from the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank). The vast majority of banks in our country had nothing to do with the events that led to the financial crisis and are as much victims of the devastation as the rest of the economy. While most banks are far removed from Wall Street and banks on Main Street are the ones that are paying the price for the mess that others created.

Banks work every day to make credit and financial services available to their customers. Those efforts, however, are made more difficult by regulatory costs and second-guessing by bank examiners. Combined with hundreds of new regulations expected from the Dodd-Frank Act, these pressures are slowly but surely strangling our traditional community banks, handicapping our ability to meet the credit needs of our communities.

Managing this mountain of regulation will be a significant challenge for a bank of any size. The median-sized bank has only 37 employees – for them, and for banks like mine that have even fewer employees, this burden will be overwhelming. Historically, the cost of regulatory compliance as a share of operating expenses is two and a half times greater for small banks than for large banks. Moreover, it creates more pressure to hire additional compliance staff, not front line customer service staff. It means more money spent on outside lawyers to manage the risk of compliance errors and greater risk of litigation. It means more money to hire consulting firms to assist with the implementation of all of the changes, and more money hiring outside auditors to make sure there are no compliance errors. It means more risk of regulatory scrutiny, which can include penalties and fines. All of these expenditures take away precious resources that could be better used serving the bank's community.

The consequences of these new burdens from the government are real. New regulatory pressures will have a negative impact on the number of banks that survive in our country. Costs are rising, access to additional capital is limited, and revenue sources have been severely cut. It means that fewer loans will get made. It means a weaker economy. It means slower job growth. With regulatory over-reaction, new laws, and uncertainty about government's role in the day-to-day business of banking, meeting the financial needs of our local community seems to have become secondary, and yet our success in Gothenburg demands that we focus on our customers and our community.

The Impact of Dodd-Frank on Agricultural Credit

The increased regulatory burden brought about by the passage of Dodd-Frank that I have spoken about will impact agricultural credit. Dodd-Frank will require that we supply the regulators with additional data about our lending activities to farmers and ranchers. Dodd-Frank may require us to justify the "suitability" of the credit products we make available to our farm and ranch customers.

Of particular concern is the additional regulatory and compliance burden expected once the Bureau of Consumer Financial Protection (CFPB) becomes fully operational. This new bureaucracy – expected to hire over 1,200 new staff – will certainly impose new obligations on

community banks – banks that had nothing to do with the financial crisis and already have a long history of serving farmers, ranchers and all consumers fairly in a competitive environment.

Small banks like mine are not exempt from the CFPB. All banks – large and small – will be required to comply with rules and regulations set by the CFPB, including rules that identify what the CFPB considers to be "unfair, deceptive, or abusive." Moreover, the CFPB can require community banks to submit whatever information it decides it "needs." There are also many other new regulatory burdens flowing from the Dodd-Frank Act empowerment of the CFPB which will add considerable compliance costs to every bank's bottom line. Increased compliance costs increase the cost of borrowing money for our customers; this will not help us revive our local and national economy.

In response to what we know lies ahead, ABA and our members have been telling farmers and ranchers that they have to improve their business practices including their marketing plans, their capital expenditure planning, and their risk management practices to name a few. Overall, many producers have responded positively to these messages, and they have stepped up their game to meet the challenges of this period. Proven cash flow, and being able to demonstrate the ability to repay a loan, continues to be a bedrock principle of agricultural lending by banks. If a producer cannot show adequate repayment ability, it will be hard to obtain credit. Again, the regulators have made it very clear to the bankers that they expect bankers to stick to the basics and that demand is being followed by the bankers I know.

Agricultural Real Estate Values Have Increased Due to Farm Prosperity, Not Leveraged Speculation

In the past six months we have all heard and read a great deal about the increase in farm land prices. The question most asked by the press, and increasingly the banking regulators is, "Are we looking at another bubble?" A little more than a month ago the FDIC held a symposium on this issue. In early December the FDIC issued guidance (the Office of the Comptroller of the Currency issued similar guidance to all western banks) to all FDIC insured banks warning them about the dangers of asset bubbles and also warning agricultural banks --- those banks with a concentration in agricultural lending --- like mine, to consider the dangers of credit concentration. We appreciate the guidance of the regulatory community.

I was the only banker invited to share my views at the FDIC Symposium. While it is clear in some areas of the country --- including most of Nebraska --- farm land prices have escalated, there is no evidence that this is being fueled by credit. Farmers are responding to market signals, and those signals are extremely positive. Farmers and ranchers have accumulated cash thanks to a healthy agricultural economy, and they have a positive outlook. As a result of these factors, what land that has gone on the market (in my area, very few parcels have come up for sale) has generated intense interest, and as a result, prices have risen. At the same time, demand for credit to finance these new land acquisitions has been relatively flat. A recent survey of bankers in three Federal Reserve Districts supports this point. In all three districts, the overwhelming majority of bankers reported that farm and ranch loan demand in the third quarter of 2010 was essentially the same as it was in the third quarter of 2009. In the districts that reported an increase in demand, the increase was very modest. This data strengthens my belief that the increase in farm land sales values that we have seen over the past few years has largely been the result of farmer prosperity, not excessive lending.

I made it clear to the participants at the FDIC Symposium last month that managing agricultural loan risk is what we do at Gothenburg State Bank, and what bankers at banks all over the country do. To give you a sense of our posture towards farm real estate lending, please consider some of the standards at our bank:

- We have very conservative underwriting standards for real estate lending and these have not changed for a decade or more.
- Repayment-ability is the primary driver of our underwriting --- if the request does not cash flow, we do not do it --- regardless of the collateral position of the customer.
- We only lend a maximum of 60% of the appraised value of the land (loan-to-value).
- In our current farm land loan portfolio, our average loan-to-value is about 40%
- Even though land values have increased to $5,000 per acre in our service area, we use $3,500 per acre for credit analysis purposes when calculating net worth position, debt to assets, and other key ratios.
- Technology is available that allows us to stress test our farm loan portfolio to see what would happen if real estate values dropped by as much as 40%.

- I cannot overstate the value of the technology that my bank and that most banks have invested in that allows us to do credit analysis and run "what if" scenarios almost instantaneously. In our bank exercise, a 40% drop in real estate values did reduce the balance sheet net worth of our customers, but it had very little or no effect on the quality of our loan portfolio. Our bank's risk to the FDIC insurance fund would not change.

I believe the concerns about what is happening in farm land values are overstated at this time. Our farm and ranch customers, and the farm and ranch customers of many other banks, have enormous skin in the game in their operations. Many are paying cash for real estate. Leverage levels are at or near a historic low- a recent paper published by the Kansas City Federal Reserve indicates that only 30% of all farmers and ranchers had ***any*** debt in 2008 (the most recent data available). Prosperity is driving the demand for farm land and retained earnings are providing the cash to purchase it.

Recommendation to Congress to Help Farmers and Ranchers Access Credit from Banks and Other Private Sector Lenders

I have spoken at length about the prosperity that many farmers and ranchers have enjoyed over the past ten years. However, for many reasons, that prosperity has not benefited all sectors of the agricultural economy. For over forty years the banking industry and the USDA have worked cooperatively to provide access to credit to those farmers and ranchers who have some deficiency in their operation that makes them ineligible for bank credit. Many of these farmers and ranchers who borrow are young and are still acquiring the asset base they need to be able to qualify for bank loans. Most of these farmers operate small farms because the average loan is $187,000 which is not a large farm loan given the capital that modern agriculture demands. Despite the challenges these young and small farmers and ranchers face, they are conscientious customers who handle their credit obligations very well.

I am referring to the farmers and ranchers who borrow money from banks through the guaranteed farm loan programs offered by the USDA's Farm Service Agency (FSA). Since it is a credit guaranty, banks like mine underwrite and fund the loan and the USDA provides the bank

with a guaranty against loss on the loan. At the end of FY10, over 55,000 farmers and ranchers accessed credit through this program. Banks are not the only participants as Farm Credit System lenders, credit unions, state agricultural credit programs, and others have worked with USDA to provide credit to these farmers and ranchers.

The program has been a resounding success. Each year a limited appropriation is leveraged into a significant program that, in many cases, is the only way these farmers and ranchers can access credit. At the end of FY10, the portfolio of guaranteed farm and ranch loans exceeded $10 billion, or about 4% of the total agricultural credit market. Even though these customers have some financial statement or operating deficiency, they are very conscientious borrowers. FY10 year-end loan delinquencies were 1.69% and losses in the program in FY10 were .581% of outstanding loans. From a delinquency and loan loss perspective, this is a very sound portfolio of loans.

In the early 1990s, Congress inserted “term limits” into the program that only allowed farmers and ranchers a limited period of eligibility for the program. While the goal of term limits was understandable, it has created uncertainty for many farmers and ranchers. I should also note that I do not know of any comparable eligibility limitation in other federal loan guaranty programs. Given the volatile nature of the agricultural economy, the practical application of FSA term limits has caused hardship to those farmers and ranchers who can least weather a financial setback.

For this reason, the American Bankers Association (and many farm organizations) has endorsed HR 1422 introduced by Representative Leonard Boswell, and co-sponsored by Representative Bruce Braley, Representative G.K. Butterfield, Representative Tom Latham, and Representative David Loebsack. Congressman Boswell’s bill would extend the deadline on FSA guaranteed loan term limits to December 2013. We urge this committee to support and pass HR 1422.

The Banking Industry is Concerned About the Risk a Government Sponsored Enterprise Creates in the Rural Economy

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. However, 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 farm real estate loans. Over the ensuing 95 years the FCS has received numerous charter enhancements, and it continues to pursue increased authorities from Congress and from its regulator.

Today the FCS is a large and complex financial services business with $229 billion in assets. It is profitable --- it earned $3.495 billion in net income in 2010. It is tax-advantaged and enjoyed a combined local, state, and federal tax rate in 2010 of 5.9%. In spite of their size, profitability, and tax advantages the Farm Credit System presents the same kind of potential liability to the American taxpayer as Fannie Mae and Freddie Mac. As a 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. The potential liability that GSEs pose to taxpayers became very real in 2008 when the federal government seized Fannie Mae and Freddie Mac. An earlier near collapse of the federal Farm Credit System in the late 1980s as a result of their irresponsible farm lending foreshadowed what taxpayers would confront more than twenty years later with the housing GSEs. Congress will take up the question about what to do with the housing GSEs in an effort to restructure home mortgage finance in the United States. I urge this committee to include the federal Farm Credit System in those discussions as there is no difference between the risk the housing GSEs pose to our economy and the risk the Farm Credit System poses to our rural economy.

As an example of the risk the Farm Credit System poses to the rural economy, I would like to bring to your attention the **investment bond pilot program**, a program created by the

Farm Credit Administration (FCA), the regulator of the Farm Credit System. Under the "pilot" program FCS institutions are authorized to finance almost any kind of commercial and municipal activity in rural America. Often called "mission-related investments", "Rural Investment Bonds", or "Agriculture and Rural Community (ARC) bonds", this program allows FCS to finance "independent or assisted living facilities, waste water or water treatment facilities, rural business facilities, rural drainage district projects, fire station facilities or major equipment purchases, municipal, township or county facilities, health care facilities such as outpatient surgery centers, physician and dental facilities, multi-family housing, community buildings, processing or manufacturing facilities, hotel/convention facilities, industrial development parks, agribusiness facilities or major equipment purchases" (Source: Badgerland Financial website March, 2011. Badgerland Financial is an FCS lender based in Wisconsin).

To finance a project under this program, an FCS lender helps the borrower issue a "bond" which is then purchased by FCS as an "investment". In this way, FCS is able to characterize otherwise prohibited commercial lending activity as an investment instead of a loan. The pilot program has been running since 2005. The Farm Credit Administration has been considering a proposed rule to expand and permanently authorize the program for several years. Thousands of bankers and others wrote comment letters opposing the program, and yet the FCA continues to allow the pilot project to operate, and to continue to acquire assets.

The pilot program and proposed rule allows unrestricted commercial financing that redirects the FCS away from its mission to serve family farmers and ranchers. Hotels, dental clinics, and other financing projects already undertaken have moved the FCS directly into commercial finance. The FCS was specifically chartered by Congress to leverage its special GSE privileges in support of farmers, ranchers, and farmer-owned cooperatives, not commercial businesses. The diversion of the capital owned by farmers and ranchers into commercial projects that have no direct connection to the farmer-owners of the FCS puts farmer-owned capital in jeopardy. Interestingly, since these are "investments" the bond issuers (the borrowers) are not eligible to participate in the benefits of cooperative ownership so they do not receive patronage dividends. Congress should be additionally concerned that the FCS is quickly devolving into a two tiered system of "owners" who share the benefits of cooperative ownership, and those who do not receive any benefits.

If Congress intended the FCS to finance hotels, dental clinics, and general manufacturing, it would have provided that authority to the FCS. The FCA's attempt to broadly reinterpret the investment portion of the statute as a way to expand lending oversteps its authority and undermines the express intent of Congress. It is a gross example of regulatory over-reach. A pilot project by definition is conducted in a limited area for a limited time. FCA has allowed the "Investments in Rural America" pilot program to operate since 2005. A nationwide program operating indefinitely is clearly not a pilot program and should be terminated.

We urge this committee to stop the Farm Credit System's investment bond pilot project.

The Banking Industry is Well Positioned to Meet Their Customer's Needs

For the past decade, US agriculture has enjoyed one of the longest periods of financial prosperity in history. Financially, American agriculture has never been stronger. In 2010, many American farmers and ranchers enjoyed their most profitable year ever, and USDA projects that 2011 will exceed 2010. The balance sheet for US agriculture at the end of 2010 (according to USDA) is the strongest it has ever been with a debt to asset ratio of less than ten percent. USDA projected that at year end 2010 farm and ranch net worth was in excess of $2 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 significant decline in farm profitability resulting in diminished cash flows. While no farmer or rancher wants to take on additional debt, the strength of the US 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 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 shrank their portfolios of agricultural loans or exited the business

altogether, banks expanded agricultural lending, just as they did following the economic crisis of 2008/2009. Bankers saw opportunity where others did not.

In 1902 my great grandfather saw great possibilities in Gothenburg, Nebraska. We are still pioneering in Gothenburg. Do not allow the opportunities for banks like mine working with our farm, ranch and rural customers to become overshadowed by excessive regulation and unfair competition from government backed entities.

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.