

## I. Background

This proposed rule is intended to make affordable credit more available to agriculture and rural America by increasing cooperation between System and non-System lenders. This rulemaking began on April 20, 2000, with an advance notice of proposed rulemaking (ANPRM) that asked the public questions about ways to improve the funding and discount relationship between Farm Credit banks and OFIs. See 65 FR 21151. FCA staff subsequently conducted telephone and field interviews with interested parties. On August 3, 2001, we held a public meeting in Des Moines, Iowa, where interested parties offered suggestions on how we could facilitate greater cooperation between System and non-System lenders in providing credit to agriculture and rural America. The public meeting addressed both the OFI program and other arrangements where the FCS and non-System lenders could help each other in extending credit to farmers, ranchers, and other eligible borrowers in rural America.

Many of the comments and suggestions that we received from the ANPRM, interviews, and at the public meeting are incorporated in this proposed rule, which would revise both our OFI and Farmers' notes regulations. This preamble also explains other actions that we are taking to facilitate greater cooperation between System and non-System lenders that will ultimately benefit agriculture and other eligible rural residents. OFIs and Farmers' notes are two separate and distinct programs that arise under different provisions of the Farm Credit Act of 1971, as amended (Act). In the first program, Farm Credit Banks (FCBs) and the agricultural credit bank (ACB) (collectively Farm Credit banks) fund and discount short- and intermediate-term loans that OFIs make to eligible farmers, ranchers, aquatic producers and harvesters, farm-related businesses, and non-farm rural homeowners. The Farmers' notes program currently authorizes certain FCS associations to invest in notes, contracts, and other obligations that eligible farmers and ranchers enter into with suppliers. Changes to the OFI and Farmers' notes regulations require conforming amendments to our capital regulations.

This rule complements other efforts by the FCA to increase the flow of credit to agriculture and rural America by promoting greater cooperation between FCS and non-System lenders. System banks and associations have many different powers that enable them to act as a funding source for a wide array of

credit products that non-System lenders offer their customers. For example, Farm Credit banks fund and discount short- and intermediate-term loans that OFIs make to eligible borrowers. Separately, Farm Credit banks and associations can provide non-System lenders with long-term funding, in addition to short- and intermediate-term funding, by buying participations up to 100 percent of the principal amount of the loan. Syndications are another method that FCS institutions use to help non-System institutions extend credit, particularly to larger borrowers. As part of its effort to promote partnering arrangements between FCS and non-System lenders, the FCA is currently exploring methods for the System's use of syndications originated by non-System lenders. Today, the FCA is proposing substantial revisions to its Farmers' notes regulations, which if adopted, will expand this program to more non-System lenders, and allow all FCS associations to invest, for the first time, in both long- and short-term loans between these other lenders and eligible farmers and ranchers.

These different authorities give the FCS many powers to meet the varied funding needs of a wide variety of non-System lenders that finance agriculture. These authorities allow non-System lenders to access any one or a combination of FCS funding programs, depending on individual needs. The System fulfills its mission to finance agriculture and other specified credit needs in rural America by serving as a steady source of funding and liquidity for other lenders. This should result in lower credit costs and more credit options for farmers, ranchers, aquatic producers and harvesters, and other eligible rural residents.

## II. Other Financing Institutions

### A. History of OFIs

Farm Credit banks have discounted production agricultural loans for OFIs since 1923.<sup>1</sup> Since 1930, Farm Credit banks also have made secured loans and advances directly to OFIs.<sup>2</sup> Thus, OFIs could borrow from, and discount production agricultural loans with, Farm Credit banks before Congress created production credit associations (PCAs) as an alternative source of financing the operating needs of farmers and ranchers.<sup>3</sup> Since 1980, the Act has authorized Farm Credit banks to fund

and discount for OFIs any loan that PCAs could make. As a result, OFI loans to eligible processing and marketing, farm-related businesses, and non-farm rural homeowners may also be funded or discounted by a Farm Credit bank.

The legislative history of the various Farm Credit Acts reveals that the primary purpose of the OFI program is to address the scarcity of operating credit for farmers and ranchers.<sup>4</sup> Over the years, Congress has responded to the changing credit needs of farmers, ranchers, and other rural residents by expanding the lending authority of the FCS, and giving Farm Credit banks more authority to fund OFIs.<sup>5</sup> These statutory changes have ensured that the FCS could continue as a source of affordable and reliable credit to agriculture and rural America on both a wholesale and retail level.

OFIs, historically, have established funding or discount relationships with Farm Credit banks when the cost of FCS funds is significantly lower than other funding sources. The OFI program reached its peak in the 1970s and early 1980, when market interest rates were at historically high levels. In 1982, approximately 300 OFIs borrowed approximately \$914 million from various Farm Credit banks. By December 31, 2002, Farm Credit banks lent only \$291 million to 31 OFIs.

Much of the decline in the OFI program can be attributed to the farm crisis of the mid and late 1980s. Declining land values and commodity prices meant that many farmers were unable to repay their loans, which caused the FCS to experience significant financial stress between 1984 and 1989. During this time, many OFIs terminated their funding and discount relationships with Farm Credit banks for a variety of reasons. One reason for the decline of the OFI program was that Farm Credit banks were in a weakened financial position and, therefore, could no longer offer OFIs competitive rates. Additionally, the merger or consolidation among many commercial bank OFIs improved their liquidity and

<sup>4</sup> See H. R. Rep. No. 1712, 67th Cong., 1st. Sess. (February 25, 1923), p. 17; H.R. Rep. No. 96-1287, 96th Cong., 2nd Sess. (September 4, 1980), p.21.

<sup>5</sup> From 1923 until 1988, OFIs funded and discounted short- and intermediate-term loans with the former Federal Intermediate Credit Banks. Section 410 of the Agricultural Credit Act of 1987 (1987 Act) created the FCBs through the mandatory merger of the Federal Land Bank and the Federal Intermediate Credit Bank in each Farm Credit district. See Pub. L. 100-233, section 410, 101 Stat. 1568, 1637 (January 6, 1988). Section 7.0 of the Act authorizes FCBs to merge with banks for cooperatives to form an ACB. According to section 7.2 of the Act, an ACB has all of the powers and obligations of its constituent banks.

<sup>1</sup> See The Agricultural Credits Act of 1923, Pub. L. 503, 42 Stat. 1454 (March 4, 1923).

<sup>2</sup> See Federal Farm Loan Act Amendments, Pub. L. 439, 46 Stat. 816 (June 26, 1930).

<sup>3</sup> See Farm Credit Act of 1933, Pub. L. 75-73D, title II, 48 Stat. 257, 259 (June 16, 1933).