

### *E. Statutory Issues*

Many FCS and non-System commenters identified other factors that they view as impediments to the success of the OFI program. Several commenters believe that OFIs should be able to fund or discount long-term mortgage loans on agricultural land and rural homes with Farm Credit banks. Other commenters observed that OFIs cannot hold voting stock in their System funding banks and; therefore, they are not represented on the banks' boards of directors. One commenter opposed the prohibition on Farm Credit banks extending additional credit to OFIs when the aggregate of their liabilities exceeds ten times their paid-in and unimpaired capital and surplus. Several commenters expressed the view that the OFI program should be modeled after the Federal Home Loan Bank System. These restrictions on the OFI program are imposed by the Act, not FCA regulations.

### **III. Investments in Farmers' Notes**

Our public meeting notice asked interested parties for input on both OFIs and "other types of partnering relationships between System and non-System lending institutions that would increase the availability of funds to agriculture and rural America." See 66 FR 35428 (July 5, 2001). At the public meeting, many commenters encouraged us to promote other arrangements, in addition to the OFI program, that make it easier for Farm Credit banks and associations to provide funding and liquidity to non-System financial institutions and merchants that extend credit to agriculture. Many commenters expressed their desire for more flexible and informal arrangements between FCS and non-System institutions.

The FCA is exploring a variety of different options that could improve cooperation between FCS and non-System lenders that, in turn, would increase the flow of credit to agriculture and rural America. For example, we are currently reviewing the regulatory treatment of loan syndications. Future rulemakings may suggest other regulatory approaches for enhancing partnering arrangements between FCS and non-System lenders.

Our efforts in this rulemaking focus on the Farmers' notes program. The FCA originally approved this program in 1966. The purpose of the Farmers' notes program is to provide liquidity to private dealers and cooperatives that sell farm machinery, supplies, equipment, home appliances, and other items of a capital nature to eligible farmers and ranchers. The Farmers' notes regulation, § 615.5172, allows

PCAs and agricultural credit associations to purchase, as investments, notes, conditional sale contracts, and obligations that evidence the sale of the items, described above to farmers and ranchers.

The authority to purchase Farmers' notes derives from section 2.2(10) of the Act, which permits certain associations to invest their funds as may be approved by their funding bank under FCA regulations. Because Farmers' notes are investments, the regulation places a portfolio cap of 15 percent and a concentration limit of 50 percent of capital and surplus on association investments in Farmers' notes. Additionally, § 615.5172(d) requires participating dealers and cooperatives to endorse Farmers' notes that they sell to these associations with full recourse. The full recourse requirement is designed as a credit enhancement, which is consistent with the treatment of Farmers' notes as investments. Finally, the existing regulation requires associations to contact those notemakers who meet their credit underwriting standards, and encourage them to become FCS borrowers.

The Farmers' notes regulation has become outmoded. The FCA proposes substantial revisions to § 615.5172 that should reinvigorate this program. The proposed revisions should enable this program to evolve as agricultural credit markets continually change, so that FCS associations can help non-System lenders meet the credit needs of farmers. However, the purpose of this program remains the same, namely that FCS associations will continue to provide funding and liquidity to other agricultural creditors.

The FCA proposes four major changes to the Farmers' notes regulation so that this program will be more responsive to the needs of other creditors and their customers. First, all entities that routinely extend agricultural or aquatic credit in the normal course of their business may participate in this program. In the past, this program was restricted to private dealers and cooperatives. Now, merchants and all types of creditors will be able to sell Farmers' notes to FCS associations. Second, the FCA proposes to expand this program to long-term loans. Third, all FCS direct lenders may now invest in Farmers' notes, whereas this program was previously limited to FCS associations that had only short- and intermediate-term lending authorities. Fourth, FCS associations will be allowed to invest in notes from aquatic producers and harvesters and farm-related businesses. All these proposed

changes are reflected in proposed § 615.5172(a) and (b).

Other provisions of the proposed rule ensure that FCS direct lender associations continue to treat Farmers' notes as investments. Several provisions of the proposed rule contain various requirements that are designed to enhance the credit quality of Farmers' notes. For example, proposed § 615.5172(b) reaffirms that FCS associations may invest in Farmers' notes that are secured by specified collateral that the underlying debtor pledges to creditors. The FCA also proposes to retain the 15-percent portfolio cap and the 50-percent concentration limit in § 615.5172(c). All proposed revisions to § 615.5172(c) would either conform this provision to amendments in § 615.5172(a) and (b) or are stylistic changes that enhance the clarity of this regulation. Current § 615.5172(d) requires the seller to endorse all Farmers' notes with full recourse. The FCA proposes to update this requirement by allowing other types of credit enhancements, such as guarantees, insurance, reserves of cash or marketable securities, subordinated interests, or a combination of such credit enhancements that would adequately cover the principal amount of the association's investment in Farmers' notes.

The purpose of the portfolio cap, the concentration limit, and the credit enhancements in proposed § 615.5172(d) is to ensure that Farmers' notes are treated as investments. FCS associations are credit cooperatives, and the portfolio cap and concentration limit ensure that most assets in association portfolios are loans to members. The full recourse requirement and the other credit enhancements in § 615.5172(d) lessens the credit risk that FCS associations assume from Farmers' notes.

The FCA proposes to delete the provision in § 615.5172 that currently requires associations to contact the farmers or ranchers who are indebted on these Farmers' notes, and encourage them to become FCS borrowers. This requirement may be an impediment to the success of the Farmers' notes program. Other creditors may be reluctant to sell Farmers' notes to FCS associations as long as the regulation requires such associations to lure away their customers.

The proposed revisions to the Farmers' notes regulation would give the System a greater role in providing funding and liquidity to those who extend credit to agriculture during the normal course of business. The Farmers' notes program complements the OFI