May 19, 2016

Testimony of

Leonard Wolfe

On Behalf of the

AMERICAN BANKERS ASSOCIATION

before the

Agriculture, Nutrition and Forestry Committee

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Chairman Roberts, Ranking Member Stabenow, and members of the Committee, 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 $585 million bank with fifteen branches serving Marshall, Nemaha, Brown, Clay, Washington, Cloud, and Riley counties in Kansas. We have over $233 million in agricultural real estate and production loans in our portfolio – over 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 Past Chairman of the Kansas Bankers Association and I serve as 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 $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 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 5,000 banks – over 82 percent of all banks – reported agricultural loans on their books at year end 2015 with a total outstanding portfolio of over $171 billion.

The topic of today's hearing is very timely. The agricultural economy has been slowing, with farm sector profitability expected to decline further in 2016 for the third consecutive year. However, 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 manage through any turbulence in the agricultural economy.

Banks continue to be one of the first places that farmers and ranchers turn when looking for agricultural loans. My bank's 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 and the ability to repay.

In 2015, farm banks – banks with more than 15.5 percent of their loans made to farmers or ranchers – increased agricultural lending 7.9 percent to meet these rising credit needs of farmers and ranchers, and now provide over $100 billion in total farm loans. Farm banks are an essential resource for small farmers, holding $48 billion in small farm loans, with $11.5 billion in micro-small farm loans (loans with origination values less than $100,000). 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.

However, we remain concerned with certain areas of the agricultural credit market. In particular, we are worried that the Farm Credit System – a government sponsored enterprise – 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. However, today's Farm Credit System provides many of the same products and services as the banking industry, and often neglects the young, beginning and small U.S. famers and ranches. Since the Farm Credit System's inception 100 years ago, it has grown into an enormous $304 billion system offering complex financial services. To put this size into perspective, ***if the Farm Credit System were a bank it would be the ninth largest in the United States, and larger than 99.9 percent of the banks in the country***.

This system operates as a Government Sponsored Enterprise 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 2015 – 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 moved dramatically away 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 does not need subsidized credit.

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 credit availability is to oversee and closely examine entities such as the Farm Credit System and ensure that they stick to their charter of helping young, beginning and small farmers.

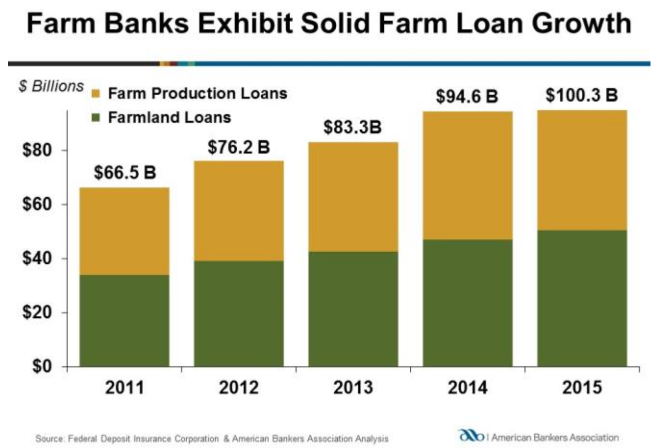
In my testimony today I would like to elaborate on the following points:

- Banks are a 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 a Primary Source of Credit to Farmers and Ranchers in the U.S.

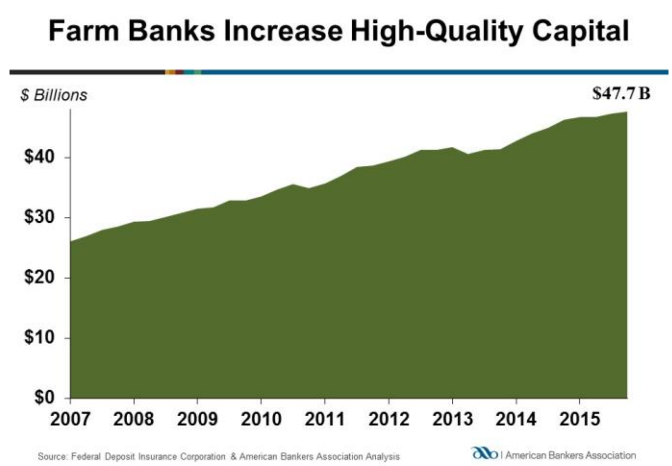
For my bank and for many of ABA's members, agricultural lending is a significant component of their business activities. ABA has studied and reported on the performance of "farm banks" for decades, and we are pleased to report that the performance of these highly specialized agricultural lending banks continues to be strong. ABA defines a farm bank as one with more than 15.5 percent farm or ranch loans (to all loans).

At the end of 2015, there were 1,976 banks that met this definition. Farm lending posted solid growth during 2015. Total farm loans at farm banks increased by 7.9 percent to $100.3 billion in 2015 up from $94.6 billion in 2014. Approximately one in every three dollars lent by a farm bank is an agricultural loan.



Farm real estate loans grew at a faster rate than farm production loans. Outstanding farm real estate loans grew at a pace of 9.1 percent, or $4.2 billion, to a total of $50.6 billion. Farm production loans rose by 6.6 percent, or $3.1 billion, to $49.8 billion.

Farm banks are a major source of credit to small farmers – holding more than $47.8 billion in small farm loans (origination value less than $500,000) with $11.5 billion in micro-small farm loans (origination value less than $100,000) at the end of 2015. The number of outstanding small farm loans at farm banks totaled 761,192 with the vast majority – over 496,200 loans – with origination values less than $100,000. Farm banks are healthy and well capitalized and stand ready to meet the credit demands of our nation's farmers large and small.



Equity capital — often thought of as the strongest form of capital — at farm banks increased 4.9 percent to $47.7 billion in 2015. Since the end of 2007, farm banks have added $19.5 billion in equity capital, building strong high-quality capital reserves. These capital reserves give farm banks flexibility as the agricultural sector adjusts to lower commodity prices — allowing bankers to work with and serve the needs of our nation's famers and acting as a buffer from the risks associated with any downturn in the agricultural sector.

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 has not been a credit driven event. 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 for the third consecutive year in 2016 seem to have modestly cooled off the demand for farm real estate. We watch the farm real estate market very closely, as do my customers. USDA estimates a 1.2 percent decline in the value of farm real estate in 2016. In recent years, over four-fifths of the agriculture sector's asset values were held in real estate. 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. At my bank, to further manage risk, we regularly stress test our loan portfolios to judge repayment capacity under different scenarios.

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 would not have been 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. Some farmers have more than one guaranteed loan, so this number does not match one-to-one with the number of individual farmers and ranchers; nonetheless 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 $480,969 and the average outstanding guaranteed non real estate secured loan is $309,700. 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 0.5 percent in FY11 to a low of 0.2 percent in FY15. 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, 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 100 years, the FCS has received numerous charter enhancements, and has ventured into areas that are not appropriate for a farmer-owned farm lending business. In fact, today's FCS provides many of the same services and products as a commercial bank, while benefiting from a special tax-treatment status.

Today, ***the FCS is a large and complex financial services business with $304 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 2015 of only 4.0 percent (a significant decrease from the effective tax rate of 4.5 percent in 2014). Despite Congress's intentions, the FCS's tax subsidy has not been passed onto its customers. The tax advantages enjoyed by the FCS in 2015 was worth $1.296 billion or 28 percent of the Farm Credit System's net income in 2015[1].

The Farm Credit System is a Government Sponsored Enterprise

The Farm Credit System presents the same kind of potential threat 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. 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."[2] The line of credit has been extended annually, for 12-month periods, and now expires on September 30, 2016.

We believe the farmers who own stock of the Farm Credit System — and the American taxpayers who back it — deserve a better understanding of the deep financial commitment

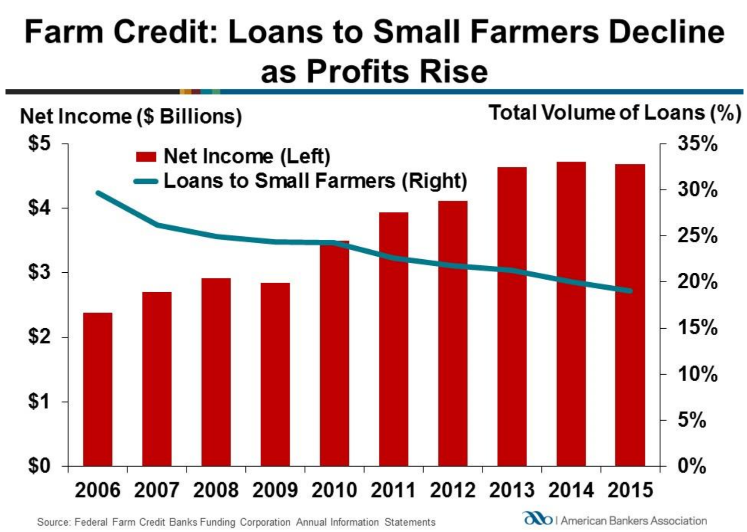
[1] Federal Farm Credit Banks Funding Corporation; 2015 Annual Information Statement of the Farm Credit System; March 7, 2016. Page F-3
[2] Federal Farm Credit Banks Funding Corporation; 2013 Annual Information Statement of the Farm Credit System; February 28, 2014, page 23

between the Farm Credit System and the U.S. Treasury, 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 U.S. Treasury.

Large Borrowers Benefit Most from Farm Credit System Subsidy

The Farm Credit System's tax subsidy benefits have not been passed along to those Congress intended to benefit from the taxpayer subsidized loans — young, beginning and small famers and ranchers. Instead, a review of the 2015 Annual Information Statement from the Federal Farm Credit Banks Funding Corporation indicates that 45.5 percent of all Farm Credit System outstanding loans at the end of 2015 were in ***excess of five million dollars***. At December 31, 2015, just 4,458 persons or entities – less than one percent of the FCS's 527,462 borrowers – had each borrowed at least $5 million from the FCS for a total of $107.3 billion in lending. Further analysis shows that the FCS has one loan outstanding of <u>$1 to $1.5 billion</u>, and five loans of <u>$750 million to $1 billion</u> outstanding.

The Farm Credit System does not provide the public with aggregated data by borrower; if it 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, nearly half of the entire Farm Credit System's portfolio at the end of 2015 was to individuals who owed it much more than a million dollars. Any farmer able to take on over $1 million in debt does not need taxpayer subsidized credit.



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 to have a government assisted, tax advantaged lender providing credit to customers who could easily borrow from taxpaying institutions like mine.

In fact, ***the heavily subsidized credit that FCS provides goes to those who need it least***. Despite amendments to the Farm Credit Act of 1980 requiring each FCS 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 be dismal—even as the assets of the system have expanded enormously. Loans to small farmers have steadily dropped over the past several years with small farm loans declining from a high of 30 percent of total new loan volume in 2003[3] to just 14.1 percent in 2015. 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.

Farm Credit System Lending Outside of Mission

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 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

[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

services like a rural telephone cooperative, the loan is a legal for a Farm Credit System lender to make. This clearly stretches any reasonable interpretation of the FCS charter.

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. As with the Verizon loan, this too stretches the chartered purpose.

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, U.S. taxpayer supported money was transferred to European investors. All taxpayers should be concerned that the Farm Credit System can be involved in these deals and that its regulator is working to aid and abet these activities which are clearly beyond the scope envisioned by Congress.

Conclusion

The banking industry is well positioned to meet the needs of U.S. farmers and ranchers. U.S. agriculture has begun to adjust to lower commodity prices after enjoying one of the longest periods of financial prosperity in history. While it is true that debt-to-asset and debt-to-equity ratios have risen some — to 13.23 and 15.25 percent, respectively — each remains low relative to historical levels. During the past few years, while farmers experiences unprecedented high commodity prices and rising farm profits, farmers used their excess cash profits to retire debt and to acquire additional equipment and 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.

Bankers remain concerned that the Farm Credit System now represents an unwarranted risk to taxpayers. In addition, the Farm Credit System does not pass the benefits of its tax subsidy onto those intended by Congress. Nearly half of the entire Farm Credit System's portfolio at the end of 2015 was to individuals who owed it much more than a million dollars. Borrowers who can amass over $1 million in credit do not need taxpayers to subsidize their debt. The Farm Credit System's regulator has expanded the authorities of the Farm Credit System, to the point today where the Farm Credit System provides similar products and services as a typical tax-paying commercial bank. All taxpayers should be concerned about where the Farm Credit System is choosing to lend taxpayer subsidized credit and that its regulator is working to aid and abet these activities.

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.