

June 29, 2004



Director
Loan Making Division
Farm Service Agency
U.S. Department of Agriculture
1400 Independence Avenue, SW
Stop 0522
Washington, DC 20250-0522
Via facsimile: 202.720.6797

Dear Sir or Madam:

Re: Proposed Rule: Guaranteed Farm Ownership and Operating Loan Requirements
7 CFR Part 762, 69 Federal Register, No. 86, pp. 24537, May 4, 2004.

We are writing on behalf of the Illinois Bankers Association (“IBA”) and its Agricultural Advisory Committee (“Ag Committee”) to express our concerns regarding the proposed rule to revise the Farm Service Agency’s (“FSA” or “the Agency”) regulations about guaranteed loans and especially the acceptability of FSA guaranteed loans as collateral for Federal Home Loan Bank advances.

The IBA is a full-service bank trade association dedicated to creating a positive business climate that benefits the entire banking industry. It represents more than 1,700 banks and branches throughout Illinois, and it is the only banking trade association in the state that represents financial institutions of all sizes. Membership includes community, regional and money center banks, trust companies, holding companies, and thrifts. The Ag and rural member banks provide credit to agricultural producers across the state of Illinois.

In general, the IBA appreciates that FSA has taken into consideration many of the comments made by many program users over the years. This short regulation clears up many areas of confusion that users have brought to FSA’s attention, and some of the proposed changes will improve program delivery. Unfortunately, some changes included in the proposed rule will have a negative effect on the delivery of the program to farmers and ranchers. Our support and concerns are detailed below.

7 CFR Section 762.106 — Preferred and Certified Lender Programs

We applaud the removal of the requirement (in 7 CFR Section 762.106 (c) (8)) that institutions applying for Certified Lender Program (CLP) status send all of their forms to FSA for approval. We agree with FSA that field offices are familiar with these forms and that it is unnecessary for institutions applying for CLP status to have to apply to the FSA’s Washington office. We appreciate the removal of this regulatory burden.

Similarly, we applaud the removal of the requirement that FSA approve the designated person(s) to process and service guaranteed loans. Under the proposal (7 CFR Section 762.106 (c) (8)), the bank designates the person(s), without FSA prior consent. This is a determination properly left to the financial institution, and FSA is to be commended for removing the additional step previously required.

We also like revisions to 7 CFR Section 762.126 (e), which will help to resolve past confusion about proper lien positions for security on new guaranteed loans. Especially noteworthy is the increased flexibility afforded lenders that refinance chattel secured loans with a new real estate secured loan. By no longer requiring a lien on both loans, lenders will be better positioned to provide non-guaranteed credit to their customers for future borrowing needs.

7 CFR Section 762.124 — Interest Rates, Terms, Charges, and Fees

We applaud and agree with the Agency's concerns about unscrupulous fees being charged by certain bad lenders. We are, however, greatly concerned, and we oppose the Agency's proposal to limit fees on guaranteed loans to those that are no greater than those charged to un-guaranteed customers for similar transactions. We are concerned about the unintended consequences of the proposed rule. FSA should be trying to expand the number of private sector lenders that participate in the program. We believe that limiting loan fees will result in fewer banks and other lenders being willing to make guaranteed loans, because of the reduced income potential. FSA's intention to limit fees will likely lead to fewer banks participating in the guarantee program which, in turn, will result in producers having fewer credit choices, leading them to pay more for credit.

We oppose such a limitation because:

- Loans guaranteed by FSA under the Farm Ownership ("FO") and Operating Loan ("OL") programs are, by definition, impaired credits. Lenders still have to certify to FSA that the proposed loan could not be made to the customer without a guarantee from FSA. An impaired credit loan has unique characteristics that require more services from the lender. In addition, FSA requires more reporting, more careful collateral control, and more thorough financial analysis of guaranteed loans than are required by lenders for standard (unimpaired) loans. Banks, and their regulators, generally do not like impaired credits, and, as a result, they require more time and attention, all of which require greater expenditures from the bank.
- Guaranteed loans require greater financial analysis which, in turn, requires greater expenditures by the lender. FSA guaranteed loans require the bank to do an annual financial review, annual collateral inspection, and annual cash flow projection for the next crop season. All of this is important because the cash flow margins are generally much smaller. Again, the bank is dealing with an *impaired* credit. The extra effort creates additional expense, and, as a result, profitability on the asset is reduced.
- The Agency fails to provide the public with any documentation that excessive loan fees are a widespread problem. We believe that in the vast majority of cases, fees are appropriate, and, more importantly, set by the open market. Producers have many choices available to them when it comes to credit, and they have ample opportunity to vote with their feet. We believe that producers will continue to seek good loans on good terms from good lenders.
- While the Agency has done a good job over the last decade in improving the guaranteed loan program, there is more to be done. Loan fees charged by lenders are an example, we believe, of why there must be much more done to simplify and streamline the guaranteed loan program. We, and other users, have recommended additional changes that would increase program delivery efficiency and that would make it less likely that lenders would charge special fees in order to provide guaranteed loans. One example: We have strongly advocated that the Agency establish *de minimis* levels on collateral losses following loan liquidation. Current procedure requires the lender to account to the Agency for all collateral, even if the items in question are deceased, obsolete, junk, or abandoned. We have long advocated for a set dollar *de minimis* level that would allow lenders (and Agency staff) to settle loss claims quickly if the unaccounted dollar value of collateral fell below the established levels.

7 CFR Section 762.159 — Pledging of Guarantees

The banking industry has eagerly waited for this rule since 1999 when the Federal Housing Finance Board (“the Board” or “the Finance Board”) revised its own regulations to allow for the pledging of federally guaranteed loans for Federal Home Loan Bank advances. At that time, the Board made it explicitly clear that federally guaranteed loans were eligible collateral for the Federal Home Loan Banks and that such loans could be treated as unimpaired collateral. However, FSA regulations were not in sync with the Finance Board’s regulation and FSA guaranteed loans continue to be difficult, if not impossible, for Federal Home Loan Banks to accept as collateral. In the nearly five years that have passed since the Federal Housing Finance Board’s action, the FSA has had numerous discussions with bankers and Federal Home Loan Bank officials about the issue. Therefore, we had expected that the proposed rule would meet the needs of all parties. Unfortunately, that does not appear to be the case.

FSA has finally provided explicit language to allow banks to pledge the guaranteed loans to the Federal Home Loan Banks and Federal Reserve Banks. However, the Agency does not provide users with any information about how to make the pledge — there is no proposed format to be followed. While this seems like a rather simple matter to correct, it would be helpful for the agency to develop specific guidance on doing so.

Of far greater concern however, is the following language from the proposed rule:

*“the guarantee will **be unenforceable** until a new eligible lender is substituted.....The guarantee will not cover a loss that results...”*

The value of pledging a guaranteed loan to a Federal Home Loan Bank is negated by the proposed rule. FSA guarantees are full faith and credit guarantees made by the United States Treasury to the holder. As a full faith and credit guarantee, banks should be able to pledge these guarantees in exchange for nearly 100 percent par/collateral value. The Federal Home Loan Banks provide lendable funds to member banks that pledge collateral for advances. FSA guaranteed loans should be treated the same as Treasury certificates and other high value liquid assets because of the Federal full faith and credit guarantee. Under the proposal, the value of that guarantee is negated, and the Federal Home Loan Banks would be prudent to treat FSA guarantees the same as any other farm loan, and therefore their value as collateral for additional lendable funds would be significantly discounted.

The result is that smaller rural banks that are active FSA guaranteed lenders, will be denied additional lendable funds, and may be unable to make additional loans if funding tightens. USDA’s role should be to encourage private sector lenders to pledge their guaranteed loans for full value advances so they can continue to make credit available to rural America. The proposal does just the opposite.

Further, FSA is not the only USDA Agency that provides credit guarantees. We are greatly concerned about the impact the proposed rule will have when the Federal Home Loan Banks look at other USDA guarantees — especially in the areas of housing and business and industry lending. In addition, we are concerned that other federal agencies that provide credit guarantees may copy FSA’s lead. In short, this rule has the potential to negatively impact many other federal credit programs, to the detriment of rural America.

To avoid these negative consequences, the agency must re-write the rule in a way that provides for the guarantee to be enforceable at all times. Further, it is not clear to us where FSA has the authority, in law, to declare that a full faith and credit guaranty is unenforceable.

Conclusion

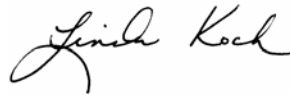
In conclusion, the IBA supports FSA's efforts to reduce the regulatory burden on guaranteed lenders. However, the Agency's efforts to address fees and pledging of guaranteed loans are seriously flawed and both must be reconsidered. We appreciate this opportunity to share our views with the Agency and hope that our concerns will assist the Agency in revising the proposal to ensure that the guaranteed program can serve rural America in meaningful ways for years to come.

Thank you for your consideration. If you have any questions or would like additional information, please contact the IBA's Gary McCants in Springfield at 217.789.9340.

Sincerely,



Hunt Bonan
IBA Chairman; and
Peoples National Bank of McLeansboro
Chairman



Linda Koch
Executive Vice President
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