

Farm Credit Administration

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INFORMATIONAL MEMORANDUM



June 25, 2004

To: Chairman, Board of Directors
Chief Executive Officer
Farm Credit System Institutions

From: Nancy C. Pellett
Chairman and Chief Executive Officer

Subject: Investments in Rural America

The Farm Credit Administration (FCA) is committed to helping ensure a dependable source of credit for agriculture and rural America so that farmers, ranchers, and their rural communities can flourish. Rural America and agriculture currently face new and unique challenges. These challenges require innovative solutions. In our Spring 2004 Unified Agenda, we indicated that the FCA is exploring opportunities for the Farm Credit System (FCS) to further the availability of funds to agriculture and rural areas through partnerships and investment opportunities.

This initiative aims to provide FCS banks, associations, and service corporations (collectively, FCS institutions) greater flexibility and new tools to help meet the growing financing needs of agriculture and rural America in the 21st century. As part of this initiative, we are evaluating how FCS institutions can:

- More fully achieve their statutory mission to finance agriculture and related activities in rural areas by making greater use of their statutory investment authorities;
- Safely and soundly invest in debt and equity securities that support agricultural producers, agribusinesses, and rural communities, such as rural economic development bonds and Rural Business Investment Companies (RBICs); and
- Form strategic alliances and partnerships that would increase funding for young, beginning, and small farmers and ranchers and start-up agribusinesses, and help provide growth and job opportunities in rural communities.

As we continue to evaluate new methods for FCS institutions to invest in and partner with their agricultural and rural communities, we would like to highlight several options that FCS institutions can currently pursue to make mission-related investments.

Rural Business Investment Program

On June 8, 2004, USDA published, and requested comments on, an interim final rule to implement its Rural Business Investment Program.¹ Under the program, which is authorized by the Farm Security and Rural Investment Act (Pub. L. 107-171) (FSRIA), USDA may license RBICs and provide guarantees and grants to promote rural economic development and job opportunities and meet equity capital investment needs of small rural enterprises.² This program provides FCS institutions an opportunity to help rural areas by forming or investing in RBICs in accordance with law and safe and sound practices.

FSRIA authorizes an FCS institution described in section 1.2(a) of the Farm Credit Act of 1971 (Act) to establish and invest in RBICs or entities established to invest solely in RBICs, provided that such investments are not greater than 5 percent of the capital and surplus of the FCS institution. If an FCS institution holds more than 15 percent of the shares of a RBIC, either alone or in conjunction with other FCS institutions (or affiliates), the RBIC shall not provide equity investments in, or provide other financial assistance to, entities that are not otherwise eligible to receive financing from the FCS under the Act.

Eligible Investments Under § 615.5140

Under our current investment regulations, some flexibility and opportunity already exists for FCS institutions to further their mission to serve agriculture and rural areas through investments in high quality and liquid assets.

More specifically, under § 615.5140(a)(1), FCS institutions have broad authority to invest in obligations (including loans) that are “fully insured or guaranteed by the United States, its agencies, instrumentalities, or corporations.” The United States often guarantees or insures loans or other obligations which are made by private lenders to meet specific needs. FCS institution may use this authority to make investments that support their mission objectives. For example, FCS institutions may invest in guaranteed agricultural, rural housing, rural utility, or rural economic development loans and other obligations made under various USDA programs.³

Under 615.5140(a)(2), FCS institutions may invest in general obligation and revenue bonds of State or local governments that meet certain eligibility criteria, including credit rating and maturity standards. FCS institutions can use this authority to help advance rural communities by participating in the financing of their growth and economic development. For example, FCS institutions may invest in revenue bonds where the proceeds are used to support young, beginning, and small farmers, rural businesses and entrepreneurs, rural infrastructure, and rural utilities.

FCS institutions can use their current authorities under § 615.5140(a)(1) and (5) to help provide funding to low- and moderate-income residents in rural areas. Under these authorities, FCS institutions may invest in rural residential mortgage loans and securities that government-sponsored enterprises, such as Fannie Mae or Farmer Mac, guarantee. Lastly, under § 615.5140(a)(6), FCS institution may invest in highly rated asset-backed securities backed by agricultural equipment loans that meet our investment eligibility criteria.

The investments described above can help increase the availability of long-term credit to farmers, ranchers, agribusiness, and other rural residents at stable interest rates. They can also help improve the liquidity of agricultural lenders, provide new capital for agricultural investments, and enhance the ability of individuals in rural communities to obtain financing for farmland and moderately priced homes. Further, such investments can also provide FCS institutions an additional tool to diversify the credit risk exposures in their agricultural loan portfolios.

Pursuant to § 615.5142, FCS associations must obtain the prior approval of their funding bank prior to making eligible investments under § 615.5140. Further, FCS banks and associations must establish investment management policies and practices that are appropriate for the nature and risk characteristics of their investment activities in accordance with § 615.5133.

Prior Approval of Mission-Related Investments

The Act explicitly states that the mission of the farmer-owned FCS is "to provide for an adequate and flexible flow of money into rural areas." In section 1.1(a) of the Act, Congress also recognized the "growing need for credit in rural areas" and declared that the objective of the FCS is to improve the income and well being of America's farmers and ranchers. To ensure that FCS institutions can continue to meet this mandate in the future, the FCA continually evaluates and updates its regulations. In doing so, the FCA seeks to ensure the efficient credit delivery and flow of capital to agriculture and rural areas and ensure the System's continued safe and sound operations.

As we evaluate how to best modernize and update our investment regulations, we will consider, on a case-by-case basis, your requests to make other mission-related investments or to conduct pilot investment programs. Specifically, § 615.5140(e) states that "You may purchase and hold other investments that we approve. Your request for our approval must explain the risk characteristics of the investment and your purpose and objectives for making the investment." We plan use this authority to approve new investments that fund the needs of agriculture or rural America under certain conditions.

As we indicated in our Informational Memorandum dated August 2, 1999, your request for our approval to make investments that are not specifically identified under FCA regulations or statute should be accompanied by:

- A detailed description of the proposed investment or pilot investment program.
- Your purpose and objectives for making the investment or program. Your discussion should address how your proposal supports the mission of the FCS.
- A balanced discussion of market, credit, liquidity, business, financial, reputation, and legal risks that may arise.
- An assessment of the effect on your institution.
- Other information you consider relevant.

Please submit your requests to Michael V. Dunn, Director, Office of Policy and Analysis. For further information or questions, please contact Mr. Dunn at (703) 883-4183 or by e-mail at dunnm@fca.gov.

¹ In addition to outlining the criteria that will be used to select and license RBICs, the interim rule includes a request for comments. We encourage FCS institutions to comment on all aspects of the interim rule. The deadline for submitting comments on the rule is 4:00 p.m. on July 8, 2004. (See 69 FR 32200, June 8, 2004.)

² All applications for RBIC licenses must be received by the Associate Administrator for Investments at the Small Business Administration (SBA) by 4:00 p.m. on September 17, 2004. For information on the application process or to request copies of the required forms, you should contact the Investment Division at SBA at (202) 205-6510.

³ In addition to the Farm Service Agency, which provides guarantees and direct credit for farm ownership and operating loans, USDA has several other rural development programs. These rural development programs are delivered through three of its agencies: (1) the Rural Utilities Service addresses rural America's need for basic services, such as clean water, sewers and waste disposal, electricity, and telecommunications; (2) the Rural Housing Service addresses rural America's need for single-family and multi-family housing as well as health facilities, fire and police stations, and other community facilities; and (3) the Rural Business Cooperative Service provides help to rural areas that need to develop new job opportunities, allowing businesses and cooperatives to remain viable in a changing economy.