June 3rd, 2013

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Director
Loan Making Division
Farm Loan Programs (FLP)
FSA, U.S. Department of Agriculture
1400 Independence Avenue SW.
Stop 0522
Washington, DC 20250-0522

RE: RIN 0560-AH66; Maximum Interest Rates on Guaranteed Loans; Volume 78; Issue 42; Monday, March 4, 2013; pgs 13999-14005

Dear Director:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the interim final rule *Maximum Interest Rates on Guaranteed Loans*.

Background

USDA has begun to implement a regulation as an interim final rule on the maximum interest rate allowed to be charged on FSA guaranteed farm loans. The existing regulations in 7 CFR 762.124(a)(3) ties the maximum rate to the rate charged an "average agricultural loan customer." The new regulation ties the maximum interest rate to nationally published indices, specifically the 3-month London Interbank Offered Rate (LIBOR) or the 5-year Treasury note rate, unless the lender uses a formal written risk-based pricing practice for loans, in which case the rate must be at least one risk tier lower than the borrower would receive without the guarantee.

[1] The Independent Community Bankers of America (ICBA), the Nation's voice of more than 7,000 community banks of all sizes and charter types, is dedicated to serving exclusively the interests of the community banking industry through effective advocacy, best-in-class education, and high-quality products and services. With more than 5,000 members, representing more than 24,000 locations nationwide, and employing 300,000 Americans, ICBA members hold more than $1.2 trillion in assets, $1 trillion in deposits, and $750 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

This rule uses the 3-month LIBOR and the 5-year Treasury note rate setting maximum spreads:

1) 6.5 % above the 3-month LIBOR for variable rate loans and those fixed under five years;
2) 5.5% above the 5-year Treasury for loans fixed for five years or more;
3) 1% additional if the 3-month LIBOR falls below 2%, causing the maximum allowable spreads to be 7.5% above the 3-month LIBOR rate for variable-rate loans and 6.5% above the 5-year Treasury note rate for loans fixed for terms of 5 or more years,

The interim final rule differs from the proposed rule in that the proposed rule based maximum interest rates on the New York Prime and the 10-year Treasury note indices. The proposed rule also set the maximum interest rate 3% below the percentages specified in the interim final rule. While not stated in the rule, USDA believes the 3-month LIBOR rate and the 5-year Treasury note are the two indices that best reflect lenders' costs of funds for short term and longer term (over 5 years) loans.

The interim rule also explains the interest rate maximums will be applicable only at loan closing or restructuring, but then rates may fluctuate according to the bank's policy that applies to other, non-guaranteed loans, without being restricted by any maximums. The rate on variable rate loans will not need to be within the maximum percentages over the loan's duration.

USDA notes that, based on past data, most guaranteed loans made between 1999 and 2010 would have met the requirements in the proposed rule. However, USDA concedes this is not true for all loans and some producers may be denied access to credit as a result of this rule. While USDA suggests these producers would be best served by using the direct loan programs, it should be noted that the direct loan programs are underfunded as demand far outstrips supply of money available annually for direct loans. This means some producers will likely be forced to give up their farming careers as a result of this rule.

USDA's general views are that specific maximum rates will simplify compliance because it will be easier to demonstrate a rate was below the maximum on the date of loan origination or refinancing than to demonstrate the rate was at or below a rate charged an average agricultural loan customer. USDA believes the regulation will increase clarity and specificity by using the maximum rate requirements, while at the same time setting rates that will work in current credit market conditions. Finally, USDA believes all borrowers should receive lower interest rates and thus share in the benefits of the guarantee which USDA believes lowers risks to lenders.

ICBA Views

ICBA appreciates USDA's efforts to provide greater clarity and simplicity in setting interest rates and understands why USDA is seeking to set maximum interest rates instead of continuing with vague criteria tied to lenders' so-called "average farmers."

However, ICBA has concerns with the proposal as written. First, there may be some confusion among lenders in terms of how loans of varying terms are to be treated and more clarification on this issue may be needed going forward. Second, USDA should allow lenders to choose their own indices. Many lenders and farmers are not familiar with the LIBOR rate, for example. Many lenders may currently base their lending off of the Prime rate.

ICBA has concerns about limiting the choice of indices to only two, particularly since the LIBOR rate was revealed to have been manipulated in recent years and significant changes will be made to LIBOR in the future.

While the Prime rate, for example, may be under the umbrella of the banks' lending policies from USDA's perspective, bankers will feel considerable pressure to conform their lending to the two indices specified in the rule regardless of their current loan policies or face potential review by USDA and potential ineligibility for further use of the program. Therefore, it would be useful to allow a broader array of indices bankers can use based on their familiarity with a given index and the specific needs of their customers.

ICBA disagrees with USDA's philosophy that there are fewer risks for lenders using the guaranteed loan program and therefore all guaranteed loan borrowers should share in the benefits of these lower risks by capping interest rates. This philosophy assumes all guaranteed loan borrowers' risk profiles are similar. In other words, USDA is suggesting that all guaranteed loans are made to "average guaranteed borrowers" or specifically the type of philosophical approach the regulation is intending to avoid.

To the contrary, the riskiness of lending to guaranteed borrowers can vary greatly. Some guaranteed borrowers may be extremely risky depending on the borrowers' type of farming enterprise, their business and marketing expertise and many other factors. Other guaranteed borrowers may be only slightly more risky than the lender's typical non-guaranteed borrowers.

Therefore, ICBA believes a more appropriate philosophy for USDA to embrace is to acknowledge the benefit all guaranteed loan borrowers obtain – access to credit which they would not otherwise receive – which is the purpose of the guaranteed loan programs in the first place. Trying to establish parameters in which borrowers receive an interest rate benefit is an inappropriate role for the government as ultimately it will lead to some borrowers not receiving access to credit, as the rule acknowledges. The marketplace is better capable of setting interest rates through competitive forces and careful underwriting and risk analysis performed by lenders.

Several bankers have suggested USDA's maximum interest rate parameters should ensure a higher rate for longer term credits. Further, if USDA finalizes this rule, ICBA strongly agrees the maximum rates should apply only at loan closing or refinancing.

ICBA asked its Agriculture-Rural America Committee to respond to questions regarding this proposal and these questions and responses are attached for USDA's review and consideration. If you have any questions on these comments, please contact Mark Scanlan at 202-659-8111 or mark.scanlan@icba.org. Thank you for your consideration of these comments.

Sincerely,

Signed

Mark Scanlan
Sr. V.P. Agriculture and Rural Policy, ICBA

Attachment

ICBA Banker Survey Responses

Questions Asked

- **Would this rule cause problems for your bank and if so what type of problems specifically?**
- **Do you believe the maximum rate on loans over 5 years should be lower than the maximum rate on loans with a maturity of less than 5 years?**
- **Do longer-term guaranteed farm loans have greater risk than shorter term loans?**
- **Do you have recommendations for USDA?**

Banker Responses

- Does the 1 percent increase if LIBOR falls below 2% also apply to loans tied to the 5-yr treasury or are those tied to a floor on the treasury itself? Tying the increase only to LIBOR could be a problem if we have an inverted yield curve.

- As long as the index the rate is tied to has a term similar to the term of the note I don't see a problem with the rule change. What could be a major issue is having the automatic margin increase on both indexes tied to the 3-month LIBOR rate. In times when you have a flat or an inverted yield curve you wouldn't be able to offer a long term fixed rate loan due to your borrowing costs being higher than your loan yield.

- Our bank would be forced to use USDA's pricing matrix. There would be too much risk to do otherwise in my view. It may also force us to consider making all such loans adjustable rate with a schedule of adjusting each 3 or 5 years, for example, presuming that would meet the definition of a variable loan, in order to remain in tune with current rate levels and avoid the issue that created the S & L debacle early in my banking career. The other apparent option is what we currently do with long term fixed rate loans - fund them with a specific FHLB advance to lock in an acceptable spread as long as the pricing matrix allowed us to get such a spread. It seems the rate should be determined by the quality of the borrower (i.e. character, risk of default, etc.), the type and quality of the collateral, the cost of funds to fund the loan, and the ability to match the source and use of the funds. Other methods are arbitrary.

- The 5.5% margin over the 5 year Treasury would be higher than 6.5% above 3 month LIBOR at least most of the time. The long term rate should be higher than the short term rate.

- Loans over 5 years would have more credit risk and if the rate were fixed for over 5 years there is also market or interest rate risk which is likely the greater risk.

- We have not found that complying with FSA interest rate guidelines was a problem, and I do not think these parameters would bother us. The larger concern is finding guaranty availability when we need it. We would also like to see the maximum loan amounts increased.

- We tie all loans to prime that would float, and give a fixed rate for terms up to five years. As long as the rate was defensible relative to other similar credits we don't see a problem.

- There is generally less spread opportunity on longer terms, thus higher rates are needed because if you match the liability you will have less spread than on floating rate loans.

- We would begin pricing using USDA's matrix to assure compliance.

- I personally think the longer term loans should not be less than the short term loans as there is more inherent interest rate risk as well as credit risk in longer term loans.

- The rule would be a problem. First, it's far too complicated and needs simplified. We don't use any LIBOR based pricing models and won't. The LIBOR rigging case in the UK last year should be but one indication of why it shouldn't be used. Secondly, farmers and ranchers don't understand LIBOR and don't want to understand LIBOR. We price everything off our internal cost of funds and/or the base rate indicator of Prime Rate.

- The rate on loans over 5 years should NOT be lower than loans with a maturity of less than 5 years. For very obvious reasons, rates are indeed going to increase and in so doing, so will the bank's overall funding and operating costs.

- Yes, rates on loans over 5 years should be higher due to the obvious future increase in funding costs, operating costs and pricing in the "unknowns" of a longer term maturity loan, particularly in the ever changing ag commodity sector.

- A simple pricing model rule, that ag banks large and small can understand and deal with, could easily be drafted vs. the proposed plan, using either Prime Rate or a chosen Treasury Bill rate; take out anything related to LIBOR and limit all the variables and, quite frankly, even the discussion on individual bank internal pricing matrix's.

- Would this rule cause problems for our bank? Yes. We do not use LIBOR, so we would need to set up additional system parameters for a small number of guaranteed loans. The WSJ prime rate is our variable rate of choice. We also use an internally-generated variable rate risk rating system for our higher-risk customers. For guaranteed loans, the potential problems are the reasons the higher risk customer is assigned the WSJ prime plus a margin. This rule provides the guaranteed loan customer a lower interest rate than our risk rating system would normally allow.
- The rate on loans over 5 years should be higher. The loan composition (primarily renewal

operating or refinanced M&E and/or land debt) would indicate a larger risk of default and should be priced accordingly.

- Not a big problem, but I believe interest rates on loans over 5 years should have a higher fixed rate than those that run less than 5 years, simply because of the interest rate risk on longer maturity, fixed rate loans. Longer maturity fixed rate loans create a higher interest rate risk for the bank, and the rate should be higher to offset that risk. Interest rate risk is certainly higher with longer term loans, therefore higher rates should be allowed to offset that risk.

- The rule may cause smaller banks to sell the guaranteed portion of FSA loans to Farmer Mac or others. Most longer term rates are lower currently but this could change. Competition should set how far above LIBOR or a Treasury rate the interest rate should be.

- A rate tied to New York Prime should be an option to have as most customers understand that better than the LIBOR rate.

- Yes, this could be a problem as it would open up potential legal issues in the cases dealing with a foreclosure action and collection of guarantee.

- FSA operating loans require maintenance and record keeping of the specifics of advances and repayments, details of recorded operating expenses and repayment sources. FSA guaranteed farm ownership land and chattel loans usually have annual payments and are amortized over longer periods of time and are less "labor intensive" to the banks. I believe the rate charged on the loans should be "risk rated" by credit quality risk, i.e. higher risk, higher rate charged. Loans should be "risk rated" by credit quality, potential repayment ability and collateral coverage.

- I think tying to a "bench mark" like LIBOR or Treasury is fine, but they need to expand on the criteria for risk rating using loan-to-value guidelines and ratio analysis as most banks have outlined in their Loan Policies.

- Specific future problems we would foresee is LIBOR or the 5-year treasury being manipulated or artificially held down. If this were to occur we would be in a compromised position to keep up with actual market rates in a rising rate environment.

- We are anticipating a rising rate environment, and therefore are pricing our longer term loans at a higher rate than our short term loans. The pricing of this proposal is 180 degree opposite of our current pricing models.

- For the most part all of our loans are priced below those 2 standards, however we do a lot of fixed for 3 years and at times with a steeper yield curve tying those loans to a 3 month LIBOR rate may not be adequate. A ten year fixed option may sometimes be made and tying it to a 5 year index again may not be appropriate. There may be times when the cost of servicing a small loan makes the loan unprofitable at the USDA stated rates.

- We have not recently closed any loans with a wider spread than that, however times could change. Steep yield curve conditions would put lenders and borrowers in a position where banks are unwilling to lend at those margins.

- I think more appropriate would be a standard spread over a similar term treasury. 6.5% fixed over a 1 year treasury on annual adjustable, 6.5% fixed over the 3 year treasury for 3 year adjustment notes and so on all the way up the maturity ladder. Then if yield curve conditions change, the regulation would not have to be redone or lending stop until rates are equitable for the lender.

- One thing to remember is that loans that float every 5 years but that amortize over 20 or 30 years have a much longer average life than the 5 year treasury does. It will take much longer than the 5 years to get your money back to reinvest and a much longer period for adverse conditions to affect the loan.

- I think the 2 safe harbors given are not enough. Better would be to set a margin, say 6.5% over any similar maturity range treasury. Simpler and more effective.

- I don't like the "at least one tier" language used in the regulation. It leaves it up to litigation to determine if one tier was adequate or not.

- The longer a rate is fixed, the higher the inherent interest rate risk; therefore, we would price a loan over five years with a higher rate. We will make a lower rate loan when the maturity is shorter than 5 years, because of the reduced inherent rate risk.

- As the government becomes more involved in the pricing and fees associated with guaranteed loans, I think you will see a decline in the use of this program.

INDEPENDENT COMMUNITY BANKERS *of* AMERICA *The Nation's Voice for Community Banks.®*
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