

# History of the Farm Credit System

## Early history

As discussed in detail in a 1928 thesis by Arthur Francis Pottle, “The History of the Federal Farm Loan Act,” Iowa State College Library, and in a book by W. N. Stokes, Jr., *Credit to Farmers: The Story of Federal Intermediate Credit Banks and Production Credit Associations*, pp. 2-4, the Farm Loan Act of 1916 provided for 12 Land Banks. The Banks were authorized to make long-term loans on farm real estate. As stated by Stokes□

As early as 1908, President Theodore Roosevelt’s “Country Life Commission” had recommended a cooperative credit system that would provide agricultural credit *on fair terms*. By 1912 politicians found it universally popular to promise that strong measures would be taken by Government itself. In that year all three political parties, Republican, Democratic and Progressive, adopted platform planks calling for strong rural credit legislation.

The Federal Reserve Act passage during this same period did not appease these demands. Agitation increased as impressions gathered strength that *business* now had its banking system and agriculture must have one also.

Congress responded to these pressures by authorizing creation of a Commission with a mandate to examine in depth the problems and potentials of rural credits. A study of the credit facilities on the European continent was to be undertaken for experience and precedent which might serve as guidelines for bold new legislative approaches.

Threats of war already were on the European horizons. Commission members, however, managed to tour 14 countries. They obviously were impressed with the systems they observed, for their recommendations followed generally the European pattern. The Commission proposed creation by Congress of a system of privately-owned and operated banks. These institutions, the Commission recommended, would make long-term loans to farmers on the security of farm real estate. While farmers alone would be the patrons, they would have neither ownership nor vote. The Commission did not envision cooperative operation. Plans called for the banks to sell bonds to the public. Bank capital would come from private sources, and investors would profit in proportion to financial success of the organizations.

These recommendations were placed in a bill which was duly introduced into Congress.

Agricultural leaders in Congress manifested interest in this approach, but also had more expansive ideas. A joint Committee for both houses was created and hearings were held which probed all problems of rural credits. This Committee eventually prepared a second bill creating a system of Government-sponsored banks and embodying many of the fundamentals which were later to be adopted as the Federal Land Bank System.

Congress thus had before it two proposals, each designed to provide long-term loans to agriculture. One would create a privately-owned system of “Joint-Stock” Land Banks; the other would create a Government-sponsored and supervised system of Land Banks which hopefully would be owned eventually by its patron stockholders.

Compromises or reconciliation of such polarized concepts—the one system private, the other public—proved difficult. The easy way out was to tie both plans together and adopt them into a single enactment. Congress did just that with the Farm Loan Act of 1916. President Woodrow Wilson signed the bill into law on July 17, 1916.

Neither precedent nor experience was available to guide Congress in its development of this pattern for the American Farm Credit System. European credit unions and similar organizations were examples, but departures from their patterns were radical. The long Congressional debates, extended deliberations and massive studies all had been rewarded with creation of a well rounded system of Banks. Of utmost importance, the Farm Loan Act was creating the basic formats which Farm Credit institutions later were to adopt to fill the needs which knowingly were left unsatisfied in the 1916 legislative effort.

Hoag, in his book, *The Farm Credit System: A History of Financial Self-Help*, pp. 1,2 (1976), wrote

The various parts of the cooperative Farm Credit System were authorized by Congress over a 17-year period—1916 to 1933—to meet extremely pressing needs of farmers, ranchers, and their cooperatives. In overly simplified terms, these needs can be summed up as having a dependable source of adequate credit, on terms suited to the particular needs of agriculture, from lenders who understood their problems.

The Land Banks and their affiliated associations came into being by Congressional law in 1916,<sup>1</sup> because farmers had an urgent need for more and better long-term mortgage financing. Money was scarce in most rural areas, and when lenders could be found, costs usually were high. Every few years mortgages had to be renewed or refinanced. There was the ever-present danger that renewals or a new lender would not be available.

Congress established the Federal Intermediate Credit Banks in 1923<sup>2</sup> as wholesalers of funds from investment centers in recognition of farmers' and ranchers' needs for operating credit for periods of more than 30, 60, or 90 days and the frequent shortage of funds in rural America. The need had become acute as a result of the 1921 general business recession which triggered the farm depression of the mid-1920s that merged into the general depression of the 1930s. The Intermediate Credit Banks were authorized to discount farmers' notes for commercial banks, agricultural credit corporations, and livestock loan companies. They were also authorized to make credit available to cooperatives, but only on farm products they held in storage.

In the financial crisis, climaxing in 1933, the Government came to the assistance of the Land Banks<sup>3</sup>—along with many other financial and business organizations through such organizations as the Reconstruction Finance Corporation—and requested them to take on the responsibility of stemming the tide of farm foreclosures sweeping the country. At the same time the Production Credit Associations and the Banks for Cooperatives were organized.<sup>4</sup> Even the former inadequate supply of short-term credit had dried up. Financial organizations of all kinds were stocked with frozen assets. Hundreds of commercial banks, especially in rural areas, had gone bankrupt and closed their doors. Many others were faced with that possibility. Insurance companies that normally made loans to farmers were loaded with loans of all kinds that could not be repaid. All types of lenders were making frantic efforts to collect loans to pay their own expenses rather than making new loans. Merchants, dealers, and individuals were trying to collect credit advanced to farmers in order to pay their bills. Farms were being sold for unpaid taxes in an effort to pay teachers and provide other local services.

In such circumstances, the organizations making up the Farm Credit System played a vital role in the lives of farmers and the economy as a whole. Under varying conditions in the years that have followed, the System has had changing but increasingly significant roles in the agricultural and general economies of the Nation.

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<sup>1</sup> Federal Farm Loan Act.

<sup>2</sup> Agricultural Credits Act.

<sup>3</sup> Emergency Farm Mortgage Act.

<sup>4</sup> Farm Credit Act of 1933.

After the war-time prosperity of 1918-1920, American agriculture fell into a deep depression and the Federal land program, and its private counterpart, the joint stock land banks, fell into disuse and deterioration.

In the early 1920s, the War Finance Corporation endeavored to establish a program for short-term agricultural credit. Congress, responding to the nation's depressed rural economy, enacted the Agricultural Credits Acts of 1923,<sup>5</sup> which established the Federal Intermediate Credit Banks to finance and discount the paper of agricultural credit organizations, commercial banks, savings institutions and cooperatives, in order to channel funds to individual farmers for their operating needs.

## **The Great Depression**

The nationwide depression that deepened in 1929, and continued into the 1930s, accelerated the problems of rural America. Upon assuming office, President Roosevelt acted quickly to establish a means to revive financially the farm economy. By Executive Order, the President created the Farm Credit Administration, thereby concentrating the supervision and authority over the floundering rural assistance programs.<sup>6</sup>

Thereafter, Congress enacted the Farm Credit Act of 1933, establishing a system of production credit corporations and associations, with financing from the Federal intermediate credit banks, to provide operating loans to farmers on a short-term credit basis.<sup>7</sup> That legislation also brought into the Farm Credit Administration the banks for cooperatives. In the same year, the Emergency Farm Mortgage Act provided for refunding and revising the operations of the Federal land bank associations to meet the problems of farm foreclosures and debt defaults.<sup>8</sup>

In 1939, the Farm Credit Administration, since 1933 an independent agency, was transferred to the supervision of the United States Department of Agriculture where it remained, until reestablished by statute as an independent agency by the Farm Credit Act of 1953.<sup>9</sup>

During the ensuing years, the Farm Credit System fully realized one of its early objectives—the complete farmer ownership, through stock purchase, of the entire farm credit banks, retiring all government capital.<sup>10</sup>

In the late 1960s, it became increasingly apparent that the system, which was based on several underlying statutes, should be recodified, updated, and made ready for the years ahead.

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<sup>5</sup> 42 Stat. 1454 (1923).

<sup>6</sup> Exec. Ord. No. 6084, March 27, 1933. That Executive Order renamed the Federal Farm Board as the Farm Credit Administration and consolidated within it the existing Federal agencies dealing primarily with agricultural credit.

<sup>7</sup> 48 Stat. 51 (1933). The major impact of this legislation was to round out a more comprehensive system of agricultural credit by establishing a system through the production credit associations, of channeling funds directly to farmers and by bringing cooperatives into the Farm Credit Administration's credit program.

<sup>8</sup> *Id.* This legislation, of which the Farm Credit Act was a part, addressed itself to the problems of farm foreclosures and bankruptcies by refinancing loans at lower interest rates, together with infusing additional government funds and loan guarantees into the land bank associations.

<sup>9</sup> 67 Stat. 390 (1953). For legislative history and purposes of the 1953 Act, see 1953 U.S. Code Cong. & Adm. News 2008 *et seq.*

<sup>10</sup> In 1968, upon the repayment of Government capital invested in the Banks for Cooperatives, the banks in the Farm Credit System were fully capitalized by retained earnings and stock held by its users.

Accordingly, the Farm Credit Act of 1971 was proposed and adopted to modernize the Farm Credit System. It eliminated duplication and repealed a variety of enabling statutes. It coordinated the activities of the banks within the system, changed various qualifications and descriptions of authority, and expanded the operations of the system's banks.<sup>11</sup>

The 1971 recodification tended to give permanency and clarity to the Farm Credit Administration, and its structure and functions, culminating fifty-five years of Congressional response to the credit needs of rural America.<sup>12</sup>

The Farm Credit Act Amendments of 1980,<sup>13</sup> among other things, broadened the Farm Credit System's role in serving the credit needs of member-borrowers. The Amendments broadened access to the banks' funds, added purposes for which loans could be made, increased lending limits, authorized new services and changes in the banks' capital structure, expanded the opportunity for FCS financial planning, and permitted Federal Land Banks to participate in commercial bank loans if such loans are of a type that a Federal Land Bank is authorized to make under the Farm Credit Act.

In 1985, in the midst of a deepening farm depression characterized by low commodity prices, high farm debt to asset ratios and steeply falling land values, the Farm Credit System banks held some \$6 billion in loans in which the face amount exceeded the value of the collateral.<sup>14</sup> Increasing amounts of nonaccrual and other high risk loans (\$10 billion in September 1985), record losses and increasing acquisition of property through foreclosure or liquidation severely strained the resources of the system, with individual banks and associations in danger of collapse.<sup>15</sup> In response to the growing crisis, Congress passed the Farm Credit Act Amendments of 1985<sup>16</sup> which (1) reorganized the central administration of the system to make the Farm Credit Administration a more independent, arm's-length regulator of the system, (2) increased the FCA's enforcement powers, and (3) created the Farm Credit System Capital Corporation to assist the system as a ready source of financial assistance. Although the Act did not appropriate additional funds for the FCA, it did provide the Department of the Treasury with discretionary authority to provide financial assistance after certification of need from the FCA.

The Agricultural Credit Act of 1987 provided for reorganization of the Farm Credit System in terms of powers and capitalization.<sup>17</sup> Federal Land Banks and Federal Intermediate Credit Banks within each district were to be merged. Not later than six months after the

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<sup>11</sup> Pub. L. 92-181, 85 Stat. 583 *et seq.* Dec. 10, 1971; 12 U.S.C. §§ 2001-2259. For legislative history and purpose of the 1971 Act, see 1971 U.S. Code Cong. & Adm. News 2091 *et seq.*

<sup>12</sup> See 1971 U.S. Code Cong. & Adm. News 2091-2092. For an informed commentary on the Farm Credit System, with emphasis on its historical development, see Hoag, *The Farm Credit System—A History of Financial Self-help* (Interstate Printers and Publishers, Inc., Danville, Ill. 1976).

<sup>13</sup> Pub. L. 96-592, 94 Stat. 3437 (1980).

<sup>14</sup> H. Rep. 99-425, 99th Cong., 1st Sess., p. 7 (1985).

<sup>15</sup> H. Rep. 99-425, 99th Cong., 1st Sess., p. 8 (1985).

<sup>16</sup> Pub. L. 99-205, 99 Stat. 1678 (1985).

<sup>17</sup> Pub. L. No. 100-233, § 410, 101 Stat. 1637 (1988). Production Credit Associations were to be merged with Federal Land Banks within the same geographic area. Pub. L. No. 100-233, § 411, 101 Stat. 1637 (1988). See *First South Prod. Credit Ass'n v. Farm Credit Admin.*, 729 F. Supp. 1559 (E.D. Va. 1990) (merger of Jackson Federal Intermediate Credit Bank and Farm Credit Bank of Texas upheld as within reasonable exercise of F.C.S. authority and mandate to merge banks).

F.C.B./FIC.B. merger, voting shareholders of each association were to vote on merger of the associations. Within six months after enactment of the legislation, a special committee was to be selected for the purpose of developing a proposal for the consolidation of Farm Credit System districts into no less than six financially viable farm credit banks.<sup>18</sup> The consolidation proposal was to be subject to vote by the voting shareholders of each bank.

Under the Agricultural Credit Act of 1987, not later than 15 days after January 6, 1988, a special committee was to be formed for the purpose of developing a proposal for the voluntary merger of the banks for cooperatives and the Central Bank for Cooperatives into a single National Bank for Cooperatives.<sup>19</sup> Merger required a majority vote of stockholders of each district bank for cooperatives. The result was the Co-Bank plus the St. Paul District Bank for Cooperatives.

The cooperative banking system was the last component of the Farm Credit System to assume an identity and obtain recognition as an integral part of the Farm Credit Administration.<sup>20</sup> The Banks for Cooperatives (BCs), which made up the third major branch of the Farm Credit System, were charged with furnishing a dependable and continuing source of funds to more than 3,000 agricultural cooperatives nationwide.<sup>21</sup> The banks for cooperatives, one in each Farm Credit district and a National Bank for Cooperatives, extended credit to certain cooperatives.<sup>22</sup> The National Bank for Cooperatives served district banks for cooperatives by making direct loans to them and participating in loans that exceed their respective lending limits.<sup>23</sup>

The Agricultural Credit Act of 1987 assured that Farm Credit System borrower stock would be retired at par value even though the stock value was impaired.<sup>24</sup> The legislation also provided for protection of stock that was frozen for institutions that were liquidated after January 1, 1983 and before January 6, 1988.<sup>25</sup>

While the United States was freed from any liability in connection with the obligations of the System's banks, provision had been made with respect to the individual and collective liability of the banks.<sup>26</sup>

Under the Agricultural Credit Act of 1987, on consolidated or System-wide obligations, each bank was responsible for obligations issued on its own behalf and jointly and severally liable on other obligations as called upon by the Farm Credit Administration.<sup>27</sup> After five years

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<sup>18</sup> Pub. L. No. 100-233, § 412, 101 Stat. 1637 (1988).

<sup>19</sup> Pub. L. No. 100-233, § 413, 101 Stat. 1639 (1988). See 12 C.F.R. Pt. 611, Subpart J.

<sup>20</sup> Farm Credit Act of 1933, 48 Stat. 257.

<sup>21</sup> The importance of the banking system for cooperatives is evidenced by the fact that five out of six American farmers are members of agricultural cooperatives. Thus, a special system was needed to facilitate credit flows to these farmer-owned organizations.

<sup>22</sup> For cooperatives eligible to review loans and financial services, see § 100.03[3][a] *infra*. For discussion of district borders for cooperatives, see § 100.03[3][a] *infra*.

<sup>23</sup> 12 C.F.R. § 600.60. For discussion of the Central Bank for Cooperatives, see § 100.03[3][b] *infra*.

<sup>24</sup> Pub. L. No. 100-233, § 101, 101 Stat. 1572 (1988), *adding* 12 U.S.C. § 2162.

<sup>25</sup> Pub. L. No. 100-233, § 101(d), 101 Stat. 1572 (1988), *adding* 12 U.S.C. § 2162(d).

<sup>26</sup> 12 U.S.C. § 2155, *as amended by* Pub. L. 99-205, Sec. 101, 99 Stat. 1679 (1985), *as amended by* Pub. L. No. 100-233, § 303, 101 Stat. 1620 (1988).

<sup>27</sup> Pub. L. No. 100-233, § 303, 101 Stat. 1620 (1988), *amending* 12 U.S.C. § 2155.

enactment, the F.C.S.I.C. fund<sup>28</sup> was to be exhausted before a bank was asked to be liable for other banks' obligations.<sup>29</sup>

The Agricultural Credit Act of 1987 created an F.D.I.C.-type fund for the Farm Credit System.<sup>30</sup> The new fund was designated the Farm Credit Insurance Corporation (F.C.S.I.C.). Beginning five years after enactment of the legislation, the F.C.S.I.C. was to insure the timely payment of principal and interest on obligations issued on behalf of System banks.<sup>31</sup> The F.C.S.I.C. was to be managed by a board consisting of the Farm Credit Administration Board.<sup>32</sup>

Each System bank, beginning in 1989, paid an annual premium on the average principal outstanding of 0.15 percent on loans in accrual status and 0.25 percent on nonaccrual loans.<sup>33</sup> The premiums were to be scaled back when the F.C.S.I.C. balance reached 2 percent of all outstanding obligations or whatever amount otherwise was considered an actuarially sound amount.<sup>34</sup>

As part of the long-term management of agricultural credit, the Agricultural Credit Act of 1987 created a Federal Agricultural Mortgage Corporation (Farmer Mac) as part of the Farm Credit System.<sup>35</sup> Eligible institutions (Farm Credit System institutions, bank, insurance company, business and industrial development company, savings and loan association, commercial finance company, trust company, credit union "or other entity that originates and services agricultural mortgage loans") could originate loans secured by agricultural real estate and sell the loans into the FAMC secondary market. FAMC provides guarantees for the timely payment of principal and interest on pools of qualified loans.<sup>36</sup>

To assist financially troubled Farm Credit System districts, the 1987 legislation established the Farm Credit System Assistance Board (F.C.S.A.B.).<sup>37</sup>

The purpose of the F.C.S.A.B. was to "carry out a program to provide assistance to, and protect the stock of borrowers of, the institution of the Farm Credit System, and to assist in restoring System institutions to economic viability and permitting such institutions to continue to provide credit to farmers, ranchers and the cooperatives of such, at reasonable and competitive rates."<sup>38</sup>

If the book value of stock and other equities of a System institution based on generally accepted accounting principles was less than par value, the Farm Credit Administration was to request assistance from F.C.S.A.B.<sup>39</sup> The F.C.S.A.B. is to monitor the financial condition,

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<sup>28</sup> See § 100.03[4][a] *infra*.

<sup>29</sup> Pub. L. No. 100-233, § 303, 101 Stat. 1620 (1988), *adding* 12 U.S.C. § 2155(d).

<sup>30</sup> Pub. L. No. 100-233, § 303, 101 Stat. 1620 (1988), *adding* 12 U.S.C. § 2277a *et seq.*

<sup>31</sup> *Id.*, *adding* 12 U.S.C. § 2277a-3.

<sup>32</sup> *Id.*, *adding* 12 U.S.C. § 2277a-2.

<sup>33</sup> *Id.*, *adding* 12 U.S.C. § 2277a-4.

<sup>34</sup> *Id.*

<sup>35</sup> Pub. L. No. 100-233, § 702, 101 Stat. 1686 (1988), *adding* 12 U.S.C. § 2279aa *et seq.*

<sup>36</sup> *Id.*, *adding* 12 U.S.C. § 2279aa-6.

<sup>37</sup> Pub. L. No. 100-233, § 201, 101 Stat. 1585 (1988), *adding* 12 U.S.C. § 2278a *et seq.*

<sup>38</sup> *Id.* *adding* 12 U.S.C. § 2278a-1.

<sup>39</sup> *Id.* *adding* 12 U.S.C. § 2278a-4.

business plans and operations of the institution and to issue preferred stock in amounts necessary to maintain the book value of the stock.<sup>40</sup> The F.C.S.A.B. could also issue preferred stock in an amount equal to the premium to retire high cost debt at current market value. On request by the institution, F.C. S.A.B. could facilitate merger by the issuance of preferred stock.

The 1987 legislation also created the Farm Credit System Financial Assistance Corporation (F.C.S.F.A.C.) to provide capital to F.C.S. institutions experiencing financial difficulty.<sup>41</sup> The F.C.S.F.A.C. had the authority to issue obligations (up to \$2.8 billion initially with \$1.2 billion more after 1988).<sup>42</sup> The interest during the first five years was paid by F.C.S.F.A.C.; during the second five years, one-half of the interest was paid by System institutions and the other half was paid by F.C.S.F.A.C. In the third five-year period, System institutions were to pay all of the interest. Institutions of the Farm Credit System were to repay the Federal government for interest not paid by the System on a “fair and equitable” basis.<sup>43</sup>

The 1987 legislation created the Federal Farm Credit Banks Funding Corporation to handle issuance of obligations of the System.<sup>44</sup> The Funding Corporation determines the amount, maturities, rate of interest and conditions of participation of the banks in issues of joint, consolidated or System-wide obligations.<sup>45</sup>

*Source of above: Harl, Agricultural Law, vol. 1, Ch. 100 (2004).*

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<sup>40</sup> *Id.* See 12 C.F.R. Pt. 615, Subparts A, B. O.

<sup>41</sup> *Id.* adding 12 U.S.C. § 2278b *et seq.*.

<sup>42</sup> *Id.* adding 12 U.S.C. § 2278b-6.

<sup>43</sup> *Id.* adding 12 U.S.C. § 2278b-8.

<sup>44</sup> Pub. L. No. 100-233, § 204, 101 Stat. 1605 (1988), *amending* 12 U.S.C. § 2160(a).

<sup>45</sup> *Id.* adding 12 U.S.C. § 2160(b).