

P-97-11



Office of Thrift Supervision  
Department of the Treasury

Chief Counsel

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

October 14, 1997

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**RE: Authority to Purchase Farmer Mac Common Stock**

Dear [ ]:

This responds to your inquiry concerning the permissibility of a proposed investment by [ ] ("the Association"), of approximately \$[ ] in the common stock of the Federal Agricultural Mortgage Corporation ("Farmer Mac"). You indicate that the purchase of Farmer Mac common stock is required in order to sell agricultural loans to Farmer Mac and to participate in its programs for secondary marketing of such loans.

In brief, we conclude that the Association, pursuant to its incidental powers, may purchase Farmer Mac common stock in nominal amounts necessary to enable it to sell agricultural loans to Farmer Mac and to participate in Farmer Mac's secondary market programs.

**I. Background**

The Association is a federally-chartered savings bank serving the state of [ ]. You indicate that the Association has implemented loan programs for agricultural properties in the state, in addition to making residential and consumer loans. The Association relies on secondary market loan sales to fund a substantial portion of its lending operations.

Farmer Mac is a federally-chartered instrumentality, or Government-Sponsored Enterprise ("GSE"), of the United States and is regulated by the Farm Credit

Administration.<sup>1</sup> Farmer Mac's powers and duties include purchasing "qualified loans" and issuing securities representing interests in, or obligations backed by qualified loans, guaranteed by Farmer Mac for the timely repayment of principal and interest.<sup>2</sup> The term "qualified loans" generally refers to obligations that are secured by first liens on agricultural real estate and obligations on the portion of certain loans guaranteed by the Department of Agriculture.<sup>3</sup>

Farmer Mac purchases loans of "originators," which are defined to include savings and loan associations.<sup>4</sup> You indicate that in order to sell agricultural loans to Farmer Mac and participate in Farmer Mac's programs for secondary marketing of agricultural loans, Farmer Mac requires each originator to purchase shares of Farmer Mac's common stock.<sup>5</sup> The Association therefore wishes to purchase \$[ ] worth of Farmer Mac common stock.

## II. Discussion

While the Home Owners' Loan Act ("HOLA")<sup>6</sup> does not expressly authorize federal savings associations to purchase Farmer Mac common stock, the Office of Thrift Supervision ("OTS") and its predecessor agency, the Federal Home Loan Bank Board, have long recognized that federal savings associations possess "incidental" powers, *i.e.*, powers that are incident to the express powers of federal savings associations, as set forth in the HOLA.<sup>7</sup> The OTS employs a four-part test to identify activities that fall within the incidental powers of federal savings associations.<sup>8</sup> In brief, the four-part incidental powers test requires an examination of whether: (1) the

<sup>1</sup> 12 U.S.C.A. §§ 2279aa-1(a)(1) and 2002(a) (West 1989). Farmer Mac was established in 1988 by the Agricultural Credit Act of 1987, Pub. L. 100-233, 101 Stat. 1687 (Jan. 6, 1988).

<sup>2</sup> 12 U.S.C.A. §§ 2279aa-1(b)(4) and 2279aa-3(c)(13) (West Supp. 1997).

<sup>3</sup> See 12 U.S.C.A. § 2279aa(9) (West Supp. 1997).

<sup>4</sup> See 12 U.S.C.A. § 2279aa(7) (West 1989).

<sup>5</sup> The relevant statute provides that Farmer Mac "may" require each originator "to make, or commit, to make, such nonrefundable capital contributions to [Farmer Mac] as are reasonable and necessary to meet the administrative expenses of [Farmer Mac]." 12 U.S.C.A. § 2279aa-4(b)(1) (West 1989). Farmer Mac issues voting common stock evidencing any capital contributions made. 12 U.S.C.A. § 2279aa-4(b)(2) (West 1989). This stock may be held by insurance companies, banks, or other financial institutions or entities. 12 U.S.C.A. §§ 2279aa-2(a)(9)(B), 2279aa-2(b)(1) and (2)(A), and 2279aa-4(a)(1) (West 1989).

<sup>6</sup> 12 U.S.C.A. §§ 1461-1468c (West Supp. 1997).

<sup>7</sup> See OTS Op. Chief Counsel (Mar. 25, 1994) at 3 n.7.

<sup>8</sup> See, e.g., OTS Op. Chief Counsel (Mar. 25, 1994), OTS Op. Chief Counsel (Oct. 17, 1994), and OTS Op. Chief Counsel (Aug. 29, 1996).

activity is consistent with the purpose and function Congress envisioned for federal savings associations; (2) the activity is similar to, or facilitates the conduct of, expressly authorized activities for federal savings associations; (3) the activity relates to the financial intermediary role that all federal savings associations were intended to play; and (4) the activity is necessary to enable federal savings associations to remain competitive and relevant in the modern economy.

After reviewing a proposed activity under each of the four factors, a cumulative assessment must be made as to whether an activity has a sufficiently strong connection to the business of a federal savings association to be permissible. It is not critical that each factor be present for an activity to be permissible. In addition, the relative weight given to each factor may vary depending upon the type of activity in question; one factor may be given greater weight than another in appropriate circumstances.<sup>9</sup>

We will review, under this four-part test, the Association's proposed purchase of Farmer Mac common stock in nominal amounts necessary to be able to sell agricultural loans to Farmer Mac and to participate in Farmer Mac's secondary market programs (hereinafter, "the proposed activity").

First, the proposed activity is consistent with the purpose and function Congress envisioned for federal savings associations. Federal savings associations are expressly authorized by the HOLA to make loans for agricultural purposes and to make loans secured by agricultural real estate.<sup>10</sup> In fact, these authorities were recently expanded by Congress.<sup>11</sup> Thus, participation in Farmer Mac's secondary market programs is consistent with the role Congress envisioned for federal savings associations in agricultural lending.

In addition, as noted above, the statute that created Farmer Mac specifically includes savings and loan associations as one type of "originator" from which Farmer Mac may purchase loans and require a capital contribution evidenced by the issuance of its common stock.<sup>12</sup> This is consistent with the conclusion that the proposed activity falls within the statutory purpose and function Congress envisioned for federal savings associations.

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<sup>9</sup> OTS Op. Chief Counsel (Oct. 17, 1994) at 5.

<sup>10</sup> See 12 U.S.C.A. § 1464(c)(2)(A) and (B) (West 1997).

<sup>11</sup> See section 2303 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Title II of the Omnibus Consolidated Appropriations Act of 1997, Pub. L. 104-208, 110 Stat. 3009 (Sept. 30, 1996) (amending section 5(c) of the HOLA, 12 U.S.C. § 1464(c), to expand agricultural lending authorities).

<sup>12</sup> 12 U.S.C.A. §§ 2279aa(7) and 2279aa-4(b)(1)-(2) (West 1989). Since the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. 101-73, 103 Stat. 183 (Aug. 9, 1989), federal "savings and loan associations" are more commonly known as federal "savings associations" or "thrifts."

Second, the proposed activity facilitates, and is similar to, an expressly authorized activity. The ability of federal savings associations to make agricultural loans is enhanced and facilitated by the sale of such loans to Farmer Mac. Many federal savings associations, including the Association, rely on secondary market loan sales to fund a portion of their lending operations." Such sales free up capital which can then be used to make additional loans.

The purchase of Farmer Mac stock is also very similar to activities Congress has expressly authorized for federal savings associations. Federal savings associations have broad investment authority, including the authority to invest in other GSEs. A federal savings association may invest in the stock of a Federal home loan bank and the Federal National Mortgage Association ("Fannie Mae"), the securities or obligations of the Federal Home Loan Mortgage Corporation, and the securities or other instruments issued by, or fully guaranteed as to principal and interest by Fannie Mae, the Government National Mortgage Association, the Student Loan Marketing Association, or any agency of the United States.<sup>13</sup> Thus, the proposed activity is similar to activities that Congress has expressly authorized for federal savings associations.

Third, the proposed activity serves the financial intermediary role that federal savings associations were intended to play. The courts have recognized that depository institutions serve as financial intermediaries for the public to facilitate the flow of money and credit among different parts of the economy.<sup>14</sup> Farmer Mac's secondary market activities facilitate the channeling of available funds from points of surplus to points of demand by increasing the liquidity of agricultural mortgage loans, thereby making more funds available for lending,<sup>15</sup> and by improving the distribution of investment capital available for agricultural mortgage loans. Congress recognized that the potential benefits of a secondary market include access to additional capital and new sources of funds, integration into capital markets of institutions in isolated rural areas, increased mortgage availability, reduced lender costs, increased competition, and lower interest rates.<sup>16</sup>

By engaging in the proposed activity, the Association will not only support Farmer Mac's secondary market activities, but will also enhance the Association's

<sup>13</sup> 12 U.S.C.A. § 1464(c)(1)(D)-(F) (West Supp. 1997). See also 24 C.F.R. § 560.30 (1997).

<sup>14</sup> See Auten v. United States National Bank, 174 U.S. 125, 143 (1899).

<sup>15</sup> See H. Rep. No. 100-295(I), at 67 (1987), reprinted in 1987 U.S.C.C.A.N. 2723, 2738 ("Creation of a secondary market for agricultural mortgages will give lenders needed liquidity to continue to provide long-term agricultural credit at competitive rates to qualified borrowers . . . . By selling a mortgage, the lender 'reliquifies' and can use the proceeds for further lending.").

<sup>16</sup> See H. Rep. No. 100-295(I), at 68, reprinted in 1987 U.S.C.C.A.N. at 2739 (summarizing benefits of a secondary market in agricultural mortgage loans).

ability to make more loans. The proposed activity will thereby further the financial intermediary role that all federal savings associations were intended to play.

Fourth, the proposed activity will enable federal savings associations to remain competitive and relevant. National banks, pursuant to their incidental powers, may purchase Farmer Mac common stock in nominal amounts necessary to participate in the Farmer Mac programs.<sup>17</sup> The Federal Reserve Board ("FRB") has concluded with respect to State member banks and the Federal Deposit Insurance Corporation ("FDIC") has concluded with respect to insured state-chartered banks, that such entities are not prohibited by federal law from doing the same.<sup>18</sup> Federal savings associations must be able to engage in the same activity to remain competitive with other insured depository institutions and entities that provide agricultural loans.

As the foregoing indicates, each of the factors commonly considered in the incidental powers analysis supports a conclusion that the Association has the incidental authority to engage in the proposed activity. Accordingly, we conclude that this activity is permissible for federal savings associations under the incidental powers doctrine.

In reaching the foregoing conclusions, we have relied on the factual representations made in the materials you submitted to us. Our conclusions depend on the accuracy and completeness of those representations. Any material change in facts or circumstances from those described herein could result in a different conclusion.

If you have any questions regarding this matter, please feel free to contact Richard Bennett, Counsel (Banking and Finance), at (202) 906-7409.

Very truly yours,

/s/

Carolyn J. Buck  
Chief Counsel

cc: Regional Directors  
Regional Counsel

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<sup>17</sup> Office of the Comptroller of the Currency Interp. Letter No. 427 (May 9, 1988).

<sup>18</sup> See FRB Interp. Letter No. 88-20 (July 26, 1988) and FDIC Interp. Letter No. 93-51 (July 30, 1993).