

U.S. house of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn house Office Building
Washington, DC 20515

July 24, 1989

The Honorable Nicholas F. Brady
Secretary
Department of Treasury
1500 Pennsylvania Avenue, N. W.
Washington, D. C. 20220

Re: Book-Entry Regulations for Securities
Guaranteed by the Federal Mortgage
Agricultural Corporation (Farmer Mac)

Dear Secretary Brady:

Pursuant to our continuing oversight of the application, administration, execution, and effectiveness of the laws over securities and exchanges within the jurisdiction of this Committee under Rule X of the Rules of the House of Representatives, we have been following the progress of the Federal Agricultural Mortgage Corporation (Farmer Mac) with great interest. Farmer Mac recently submitted credit underwriting, loan repayment, security appraisal, and loan diversification standards to Congress for review. It has also adopted eligibility standards for certified loan poolers, and is actively working to complete work on pool diversification criteria. With Farmer Mac rapidly proceeding toward implementation of the secondary market for agricultural mortgage loans, we note that there is at least one issue involving the use of the bookentry system of the Federal Reserve System for Farmer Mac securities, that still needs resolution.

You may recall that the Farmer Mac titles were considered by Congress to be an integral part of the restructuring of the agricultural credit system during the development of the Agricultural Credit Act of 1987 (the Act). Throughout the legislative debate, careful attention was given to the role that Farmer Mac would play in attracting new sources of finance to the agricultural sector. Accordingly, on September 9, 1987, the Banking Committee and this Committee wrote to the Speaker requesting separate referral of Title III. On Wednesday, September 9, 1987, H.R. 3030 was sequentially referred to the Committee on Energy and Commerce, and the Committee on Banking, Finance and Urban Affairs until midnight, Monday, September 14, 1987. The package of amendments recommended by this Committee, and adopted by the House, included SEC registration for the mortgage-backed securities to be guaranteed by Farmer Mac (Sec. 2(a)) along with provision for the Treasury to authorize Farmer Mac to use the book-entry system of the Federal Reserve System (Sec. 8.3(e)).

During the conference on the House and Senate bills, the Senate agreed to accept the requirement for SEC registration on the basis of Treasury Department assertions that such registration was essential for investor protection. Treasury balanced its position with assurances that registration would not jeopardize the viability of Farmer Mac. This viability was accomplished through a legislative compromise giving Farmer Mac other agency "attributes," including the authority to use the book-entry system for the guaranteed securities.

The Treasury assurances, that this compromise approach would not adversely affect Farmer Mac's status in the agency market, were expressed to Members of Congress by letter dated December 16, 1987, from then Treasury Secretary James A. Baker (enclosure). The Secretary wrote the conferees on the Act that "it is the Department's seriously considered view that any resulting increased cost [from the SEC registration requirement] would be insubstantial and would certainly not jeopardize the overall viability of the secondary market." Secretary Baker went on to say "I understand very well that the essence of the House-Senate Conference, as well as of Congressional-Administration relations, is compromise. Our request here is very mindful of that essential characteristic . . . [and] of the six points" being considered by the conferees, one of which was the authority for the use of book-entry.

The Congress clearly intended that the authority for the use of the book-entry system would be granted by Treasury. This is critical, in our opinion, to achieving the objectives of the Act to establish a viable secondary market for the benefit of farmers and ranchers and we are aware of no reason the request should be denied.

We understand that on February 17, 1989, John R. Dahl, Chairman of the Farmer Mac Board of Directors wrote to then Acting Assistant Secretary David W. Mullins, to request the issuance of regulations which would authorize Farmer Mac to use the Fed's book-entry system for its guaranteed agricultural real estate mortgage-backed securities. We were advised that, to date, Chairman Dahl has not received a response to that request.

1 See, e.g., October 1, 1987 memorandum to Members of the Committee from the Subcommittee on Telecommunications and Finance regarding amendments to Title III of H.R. 3030 at Committee markup on Tuesday, October 2 at page 5:

The Federal Reserve Board operates what is known as the electronic book-entry system which provides the ability to process paperwork electronically. This is particularly valuable tool for mortgage-backed securities, which involve massive amounts of paperwork. Without this system, transfer of securities requires a physical delivery of an enormous amount of paper. The book-entry system also prevents the potential for collateral fraud by automatically and electronically transferring collateral control. The amendment is necessary because the Department of Treasury will not permit use of this system without such statutory authorization.

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As Mr. Dahl pointed out in his letter, the book-entry system of the Federal Reserve is used not only by the Treasury, but also by Export-Import Bank, Federal Home Loan Bank Board, Student Loan Marketing Association, Federal Home Loan Mortgage Corporation, and the Federal National Mortgage Association. The provision for Farmer Mac securities to be authorized for the book-entry system was an integral feature of our efforts to accord Farmer Mac the same status as an "agency" of the United States Government for purposes of the financial markets which deal in those securities as is the case with the other government sponsored agencies. Only in this way will Farmer Mac be able to offer a security that investors will accept at competitive prices. Competitive prices are the result of competitive yields, which are, in turn, essential for the secondary market to achieve its goal of benefiting the farmers and ranchers of this Nation through a new source of low-cost, fixed-rate agricultural real estate credit.

On the basis of the facts set forth in this letter, you are urged to promptly exercise the discretion granted to you by Congress to promulgate regulations authorizing Farmer Mac to use the book-entry system of the Federal Reserve System.

Sincerely,

JOHN D. DINGELL
CHAIRMAN

Enclosure

cc: The Honorable David W. Mullins
Assistant Secretary for Domestic Finance
Department of the Treasury

The Honorable Edward J. Markey
The Honorable Norman F. Lent
The Honorable Matthew J. Rinaldo

THE SECRETARY OF THE TREASURY

WASHINGTON

December 16, 1987

Dear Dick:

I understand that Chairman Dingell and the other Energy and Commerce conferees have issued or are about to issue a counteroffer to the "staff compromise" on those portions of the secondary market title of the farm credit legislation within the Energy and Commerce conferees' jurisdiction. I am writing to urge in strongest terms that you vote to accept the House conferees' offer.

Before discussing the reasons why the Department is so insistent on support of the House offer, I want to point out and express appreciation for how far both the Congress and the Administration have come in fashioning a viable secondary market for securitized farm mortgages. As you know, the Department opposes the creation of a federally subsidized secondary market for a variety of reasons; nonetheless, we pledged to you and others in Congress developing this legislation to work constructively to attainable provision. I am convinced not only that we in the Department have lived up to our pledge, but also that the resulting secondary market language is a vast improvement.

There remains, however, one very significant problem which arose in the "staff compromise" developed in the early hours of Tuesday, December 15: the designation of the securities as "government securities" for purposes of certain federal securities laws. This designation would be seriously detrimental not only to the interests of investor protection, but also to what I believe is our shared interest in minimizing federal budgetary exposure and liability. I have been informed that officials of the SEC have begun to communicate their concerns on the issue of investor protection, and that an SEC representative will be present when the Conference resumes. For our part, Assistant Secretary Gots will attend the Conference and be available to explain the Department's very grave concerns. We are well aware of the opposing arguments about reducing the cost of the securities and thereby ensuring a viable secondary market; let me respond simply by asserting that it is the Department's seriously considered view that any resulting increased cost would be substantial and would certainly not jeopardize the overall viability of the secondary market.

I will close by emphasizing that I understand very well that the essence of any House-Senate Conference, as well as of Congressional-Administration relations, is compromise. Our request here is very mindful of that essential characteristic; in fact, of the six points at issue within their jurisdiction, the House conferees' offer would recede outright to the Senate on two points, and would recede with amendment on two others.

Because we, but especially you, have come close to attaining a positive and workable provision, and in that spirit of compromise, I urge you most strongly to vote to accept the House offer.

Sincerely,

James A. Baker, III

The Honorable Richard G. Lugar
United States Senate
Washington, D.C. 20510