SPEECH
BEFORE THE
AMERICAN AGRICULTURAL ECONOMICS ASSOCIATION
SYMPOSIUM ON FARMER MAC
BY
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Good afternoon. My name is Bill Oliva and I am a Director of Salomon Brothers responsible for Financial Institutions Capital Markets. As you may be aware, Salomon Brothers is a major participant in the capital markets, with 1987 trading volume of about $5 trillion. The Firm is a primary dealer in United States Government securities; a member of the long term selling groups of and senior investment banker to those Government Sponsored Enterprises which finance in the capital markets; the leading underwriter of taxable securities for the past 3 years; and a continuing innovator in the securitization of assets.

The secondary market for securitized assets has developed to the point where it is a truly global market. In the past two years investors have purchased securities backed by fixed rate Australian dollar mortgages; floating rate sterling mortgages; automobile receivables issued by a U.S. commercial bank; credit card receivables issued by a U.S. savings institution; international trade receivables issued by a private U.S. conduit; a mortgage on an office building in New York City; a mortgage on a hotel and casino in Atlantic City. The innovations go on and on.

While the types of issuers, underlying assets, structures and currencies are different there are three major factors which are necessary for a successful secondary market program. These are credit, liquidity, and information and technology. These are very broad categories and contain a number of important sub-categories which I will discuss.

Prior to this discussion, however, let me mention a few of the advantages which a secondary market can provide to both borrowers and lenders in agriculture.

I. Advantages to a Secondary Market

As with the secondary market for single family residential mortgages, liquidity — the comfort of an institution in knowing that it is not locked in — adds considerable value to a portfolio. A liquid secondary market would provide the seller or buyer the ability to manage its agricultural loan portfolio in the same way it manages its equity, bond and mortgage portfolios. For example, "ag securities" could be used as vehicles for raising cash, taking tax losses or gains, taking book profits or losses, and performing asset restructuring to enhance yield or better match assets and liabilities. It also gives the agricultural lender the ability to diversify its loans by location, property type, industry, borrower and maturity. This diversification can help meet portfolio management goals while reducing exposure to credit losses. In addition, issuers pass through interest rate risk to investors which are better able to manage it. Lower credit risk and less interest rate risk mean a lesser need for capital.
Non-traditional agricultural lenders e.g. pension funds or foreign institutions could find investment in liquid "ag securities" beneficial, especially if they provide attractive yields in relation to their credit quality. This likely would be the case initially as we have seen historically in the development of the mortgage and receivables secondary markets. This may be especially true today as financial institutions worldwide are "asset starved", i.e. unable to originate or purchase sufficient high quality assets at spreads above their cost of funds to provide adequate compensation for risk and appropriate profit levels. As a result of and in conjunction with advances in the technology of cash flow analysis and structuring, financial institutions have begun creating "synthetic assets". Synthetic assets are created by combining two or more very different instruments to obtain the desired cash flow pattern and yield in a more cost-effective way than purchasing the asset itself, e.g., combining a fixed rate bond with an interest rate swap to create a floating rate bond.

What this means is the potential to bring new investors into the agricultural lending business via the capital markets. New investors assure a consistent supply of "ag credit" in good and bad markets; provide opportunities to be responsive to the needs of agricultural borrowers by providing new loan structures where applicable; and ultimately lower the cost of agricultural borrowing to the more creditworthy borrowers. A secondary market also brings the discipline of market pricing to borrowers and lenders. Tradeoffs between risks (e.g. credit, interest rate and prepayment) and yield are made by the marketplace. Lenders and, therefore, borrowers have the ability to give up flexibility such as prepayment for a lower rate and, in the alternative, can obtain maximum flexibility for a price.

We all have seen this play out in the residential housing market, and also have witnessed excellent starts in the securitization of commercial mortgages and consumer receivables. While the knowledge and experience gained in these areas are transferable to the agricultural sector, there are a number of issues which must be addressed in designing and implementing a program for the issuance of "ag securities".

II. Keys to a Secondary Market

As I stated before the three keys to a successful secondary market are credit, liquidity, and information and technology. A successful or true secondary market is one which is always available for sellers and buyers at a price commensurate with market conditions and the quality and structure of the assets being sold or purchased. A secondary market should be a planned, consistent program with regular issuances, not a series of "one-off" private placement transactions.
1. Credit

Obviously, the most important and, in fact, overriding consideration in any investment is credit. The credit issue goes beyond the guarantor or issuer of the security (whether a public or private entity) and beyond the rating, even if a high investment grade. The fundamental underlying asset needs to be strong currently in relation to its past performance and its reasonably expected future performance. This does not mean that the underlying asset must be guaranteed going forward to be completely free of any chance of default or delinquency, but that it must have structural safeguards against these.

The starting point for assuring the quality of the underlying asset is underwriting standards. Underwriting standards encompass the wherewithal of the borrower to pay, the value of the underlying collateral, the definition and level of the maximum exposure to be taken by the lender, and the provisions to assure collection of payments in a timely manner. To the extent that a loan does not fall within these standards it might not be eligible for funding in the secondary market program. In the alternative, the originator of the loan might take on additional credit risk, thus making the loan eligible for inclusion. Or, the originator may choose to hold the loan in portfolio and thus charge the borrower a higher yield.

Once individual loans meet the underwriting criteria designed to make each loan a sound investment, the pool of loans must be aggregated and packaged so as to enhance the credit of the total pool beyond that of the individual loans. Geographical or industry diversity is one way to reduce the risk of the pool. The use of pool insurance policies, surety, letters of credit, government guarantees, market value overcollateralization, cash flow overcollateralization or subordination, and reserve funds assure the investor of receiving full and timely payments of principal and interest from the pool of loans. The Freddie Mac and Fannie Mae programs use combinations of these, as do the major private conduit programs. The nature (i.e. private vs. government) and magnitude of these enhancements, as well as the rating by the statistical rating agencies where applicable, will determine the credit premium required by investors.

2. Liquidity

Liquidity, the ability to buy and sell assets at a market level in reasonable size in all types of markets, has taken on increasing importance. The past five to ten years have been characterized by increasingly volatile market, increased deregulation, and advances in financial sophistication and technology, all of which have put an extremely high premium on capital, particularly for financial institutions. The ability to buy and sell assets and thereby restructure portfolios in the capital markets has become an important tool to preserve and even increase capital for many financial institutions.
A secondary market for "ag loans" needs to be liquid. Liquidity is created through a market's issuance size, volume, consistency and homogeneity. Size is an obvious requisite - bigger markets imply more and larger participants who are comfortable that they can buy and sell large blocks of securities. However, size is a necessary but not sufficient condition.

A good example of this is the Title XI program administered by the U.S. Maritime Administration. Title XI bonds carry the full faith and credit of the United States government with more than $7 billion outstanding at the peak of the program. Yet, given its credit and total size, the Title XI market cannot be considered liquid because each issue is relatively small with a different structure, a series of "one-off" private placements sold to a few investors rather than a large liquid program. This is not a criticism of the Title XI program which has been most effective in providing funds to the shipbuilding industry, but rather an example of what is not a true secondary market.

However, homogeneity does not preclude a secondary market for a number of different types of agricultural loans. Intermediate equipment loans and short term working capital loans may be funded using the existing models for automobile receivables and credit cards. Longer term real estate loans have substantial precedent in the programs of Freddie Mac, Fannie Mae and private conduits. Besides a consistent structure within each type of asset, these markets also are characterized by large public offerings and distribution to a wide variety of investors worldwide.

3. Information and Technology

Critical to optimizing the structuring and pricing is the ability of investors and issuers to project future delinquency, default and prepayment behavior by analyzing past data where appropriate. For example, the residential mortgage market developed based upon statistics maintained by the Federal Housing Administration ("FHA") as to prepayments. Historical data provided by major credit card companies and automobile finance companies have been used in the receivables areas, while statistics published by trade groups such as the Mortgage Bankers Association are being utilized in the non-conforming mortgage markets. Finally, monthly prepayment information is provided to the markets by Ginnie Mae, Freddie Mac and Fannie Mae.

However, in the securitized commercial mortgage market statistics of prepayments, default and delinquency histories are not always available. As a result securities often are structured to the most conservative prepayment assumptions (usually assuming no prepayments) with potential credit losses covered by substantial cash flow subordination and private surety or letters of credit. The FmHA rural loan asset sale lead managed by Salomon Brothers utilized all of these. The message here is that better historical information permits structuring and marketing securities to obtain the most optimal results.
It also permits better integration of the technology currently utilized in the mortgage and receivables backed securities markets. By utilizing this technology issuers and investors are able to further enhance the value of their securities by, for example, stratifying cash flows as to maturity (as in Collateralized Mortgage Obligation ("CMO")) or as to coupon (as in interest only/principal only strips ("IO/PO")). Designing secondary market securities within the context of this technology will permit this value enhancement to begin at an early stage in the development of an agricultural secondary market.

III. Conclusion

There is little question that prudently underwritten and properly structured liquid agricultural assets have real value and will be well received by the capital markets. The ability of issuers and investors to trade-off credit and interest rate risks for yield provides flexibility to agricultural lenders and a market pricing discipline to all agricultural sectors.
FARMER MAC GUARANTEED SECURITIES
STRUCTURE, PRICING AND CASH FLOW ANALYSIS

Agenda

- Generic Mortgage Pass-Through Security Structure
- Farmer Mac 90/10 Pass-Through Security Structure
- Farmer Mac 90/10 Pass-Through Pricing Determinants
- Possible Security Structure and Indicative Pricing
- Cash Flow Analysis
- Benefits of Farmer Mac Securitization to Originators
FARMER MAC GUARANTEED SECURITIES
SECURITY STRUCTURE

Generic Mortgage Pass-Through Security

- Mortgage Pass-Through Certificate Represents An Undivided Interest In The Mortgage Pool Underlying The Security
- Cash Flow From Underlying Mortgages Is "Passed Through" To The Holders of Securities In Form Of Semi-Annual Or Annual Payments Of Principal, Interest And Prepayments
FARMER MAC GUARANTEED SECURITIES
SECURITY STRUCTURE

Generic Mortgage Pass-Through Security

Mortgagors Make Semi-Annual Or Annual Principal And Interest Payments To Originators

Originators (Primary Services) Forward Principal And Interest Payments, Less Primary Servicing Fees To Master Servicer

MASTER SERVICER
Collects P & I From Primary Servicers And Disburses P & I Payments To Investors Semi-Annually Or Annual Receives A Master Servicing Fee And Performs Investor Reporting

Investor

Investor
CASH FLOW FOR FARMER MAC GUARANTEED SECURITIES

Mortgagors

Servicer (Originator A)

Servicer (Originator B)

Master Servicer

Payments from Mortgages & Advances of Master Servicer

Required Guarantee Payments (after subordinate certificate absorbs initial shortfall)

Trustee (Payment + Investment Earnings)

Subordinate Certificate

Senior Certificates

Senior Certificates

Senior Certificates

1) Senior Certificateholders have priority over Subordinate Certificateholder to distributions.
2) Absorbs all shortfalls and is paid only after Senior Certificateholder is paid.
FARMER MAC GUARANTEED SECURITIES

SECURITY STRUCTURE

Farmer Mac 90/10 Pass-Through Security

- In Senior/Subordinated Structure The Subordinated Class Is A Form of Credit Enhancement Which Covers Losses And Guarantees Cash Flows Of The Senior Class

- Structure Creates Two Classes Of Certificate Holders: Senior Class And Subordinated Class, Each Representing A Percentage Of The Original Outstanding Balance

- 90% Senior And 10% Subordinated With The 10% Subordinated Piece Initially Retained By The Originator Or Pooling Facility
FARMER MAC GUARANTEED SECURITIES

SECURITY STRUCTURE

Farmer Mac 90/10 Pass-Through Security

* Rights Of The 10% Class Certificate Holders Are Subordinated To The Rights Of 90% Class Certificate Holders

* Cash Flow Normally Due Subordinated Certificate Holders Diverted To Senior Certificate Holders To Cover Losses From Foreclosures Or A Shortfall In Cash Flows Due To Delinquencies

* If Losses Or Shortfall Significant Enough To Exhaust Subordinated Class, Farmer Mac Guaranty Drawn Upon To Cover Remaining Losses

* When No Shortfall Or Losses, Subordinated Class Cash Flows Paid To Certificate Holder Or May Be Used To Set Up And Maintain Reserve Account
FARMER MAC GUARANTEED SECURITIES
SECURITY STRUCTURE
Farmer Mac 90/10 Pass-Through Security

Cash Flows Received
Semi-Annually At Originator Level
- Scheduled Principal
- Scheduled Interest
- Prepayments
- Liquidation Proceeds
- Insurance Proceeds
- Condemnation Awards
- Investment Proceeds

Are There Delinquencies Or Losses On Property Disposition?

Is 10% Interest's Share Of Cash Flow Insufficient?
- 90% of Cash Flow To 90% Piece
- 10% Of Cash Flow To 10%

Farmer Mac Guarantee Used To Cover Shortfall Of Cash Flow Payments To 90% Piece
FARMER MAC GUARANTEED SECURITIES

SECURITY PRICING

Mortgage Pass-Through Securities Involve Five Basic Forms Of Risk To Investors

- Market Risk
- Credit Risk
- Liquidity Risk
- Prepayment Risk
- Reinvestment Risk
Market Risk:

- **Market Price Of Pass-Through Security May Change Adversely Over Time**

- **Embodies The Volatility Of The Security's Price And Yield Relationship To Other Issues**

- **Pass-Through Prices Influenced By Traditional Factors In Fixed-Income Market Plus Mortgage Market Factors**
Credit Risk:

- Loan Underwriting Standards Of Originators

Mortgage Pool Characteristics:

- Type Of Property (Agricultural Real Estate)
- Loan-To-Value Ratio (LTV's Less Than 80%)
- Purpose Of Loan (Finance Agricultural Real Estate)
- Principal Balance Of Loan (Limit = $2.5 Million)
- Location Of Property Securing The Loan
- Anticipated Cash Flow From Property
Credit Risk:

- Delinquency And Default Experience
- Severity Of Default Losses
- 90/10 Structure Limits Investor Credit Risk
- Farmer Mac Guaranty ($1.5 Billion Line Of Credit With Treasury) Further Mitigates Risk Of Loss To Investors
- Credit Risk Is A Minor Factor In Price Determination
FARMER MAC GUARANTEED SECURITIES
SECURITY PRICING

Liquidity Risk:

- Secondary Market Liquidity Impacts Pricing
- Market Liquidity Based On Several Factors:
  - Dollar Size Of Outstanding Issues
  - Types Of Investors And Security Maturities
  - Number Of Dealers Trading The Security
  - Existence Of Repo Market

- As Secondary Market For Farmer Mac Securities
  Expands/Improves Yields Should Tighten To Comparable
  Treasuries

- Evolution Of Secondary Market For 10% Class Is Foreseeable
  Influenced Over Time To Reflect Actual Default And
  Delinquency Experience
Prepayment Risk:

- Mortgage Pass-Throughs Exhibit Prepayment Uncertainty Which Leads To Prepayment Risk

- Actual Prepayment Experience May Differ Greatly From Prepayment Assumption Used By Investor To Initially Value Pass-Through Security

- For Discount Securities, Faster Actual Prepayments Are Advantageous To Investor Since They Receive Their Principal Back Over Shorter Time Period Than Expected

- For Premium Securities, Slower Actual Prepayments Are Advantageous To Investor Since They Receive The Higher Rate Of Interest On Their Investment For A Longer Time Period Than Expected
Reinvestment Risk:

- Investor's Uncertainty In Being Able To Invest Incoming Semi-Annual Cash Flows At Favorable Rates
- Pass-Throughs Tend To Have High Prepayment Risk
- Pass-Throughs Can Prepay Early Which Is Desirable Only When Prepayments Can Be Reinvested At Favorable Rates
- Prepayments Negatively Correlated To Interest Rates (Prepayments Increase In Falling Rate Environments And Decrease In Rising Rate Environments)
FARMER MAC GUARANTEED SECURITIES
SECURITY PRICING

Farmer Mac 90/10 Pass-Through Indicative Pricing

- Pass-Through Market Compensates Investors For Complexity And Risks Of Pass-Throughs
- Relatively High Yields In Comparison To Comparable-Quality Corporate Or Government Issue
- Initially, Farmer Mac Senior/Sub Mortgage Pass-Through Securities Should Trade Around 150 bps Over The Comparable Average Life Treasury
- Based On March 11, 1988 Market Conditions, The Senior Class Certificates Would Yield 9.792% With A Price Of $100.359
# FARMER MAC GUARANTEED SECURITIES

## SECURITY PRICING

Farmer Mac 90/10 Security Structure And Indicative Pricing

<table>
<thead>
<tr>
<th>MORTGAGE POOL</th>
<th>$100,000,000 Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>GROSS WAC = 10.425%</td>
<td>90% CLASS</td>
</tr>
<tr>
<td>WAM = 30 Years</td>
<td>PASS-THROUGH</td>
</tr>
<tr>
<td>MINIMUM NUMBER OF MORTGAGE LOANS = 50</td>
<td>RATE = 9.75</td>
</tr>
<tr>
<td>MAXIMUM LOAN BALANCE = $2.5 MM</td>
<td>TO INVESTOR</td>
</tr>
<tr>
<td>PRIMARY SERVICING FEE = 20 bps</td>
<td>MARKET PRICE =</td>
</tr>
<tr>
<td>MASTER SERVICING = 20 bps</td>
<td>$100.359</td>
</tr>
<tr>
<td>GUARANTY FEE = 25 bps</td>
<td>YIELD TO INVESTOR = 9.792%</td>
</tr>
<tr>
<td>TRUSTEE FEE = 2.5 bps</td>
<td></td>
</tr>
<tr>
<td>PREPAYMENT = 10% ASSUMPTION (CPR)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>10% CLASS</th>
</tr>
</thead>
<tbody>
<tr>
<td>PASS-THROUGH</td>
</tr>
<tr>
<td>RATE = 9.75</td>
</tr>
<tr>
<td>MARKET PRICE =</td>
</tr>
<tr>
<td>$77.185</td>
</tr>
<tr>
<td>YIELD = 16.00%</td>
</tr>
</tbody>
</table>
Based Upon The Indicative Structure And Pricing Presented, The Initial Cash Flow From The Security Sale Would Be As Follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Proceeds From Sale Of 90% Class</td>
<td>$100.259</td>
</tr>
<tr>
<td>Less: Underwriting Fees</td>
<td>$0.625</td>
</tr>
<tr>
<td>Issue Costs</td>
<td>$1.510</td>
</tr>
<tr>
<td>Net Sales Proceeds</td>
<td>$98.224</td>
</tr>
</tbody>
</table>
FARMER MAC GUARANTEED SECURITIES
CASH FLOW ANALYSIS

Semi-Annual Cash Flow Allocation

- Gross Weighted Average Coupon of Mortgage Pool: 10.425%
- Primary Servicing Fee to Originator: 20 bps
- Master Servicing Fee to Pooling Facility: 20 bps
- Guaranty Fee to Farmer MAC: 25 bps
- Trustee Fee to Trustee: 2.5 bps
- Pass-Through Rate to Investors: 9.75%
FARMER MAC GUARANTEED SECURITIES

BENEFITS TO ORIGINATORS

- Program Provides Originators With Means To Sell Mortgages In Organized Secondary Market
- Provides Originators With Important Degree Of Liquidity And Interest Rate Gap Management
- Originators May Retain Profitable Primary Servicing Function
- Pricing Obtained In Formalized Secondary Market With Pass-Through Structure Superior To Pricing Attainable In Whole Loan Market
- 90/10 Structure, Coupled With Farmer Mac Guaranty Virtually Eliminates Investor's Credit Risk, Thereby Reducing Their Required Yield And Increasing Sale Proceeds To Originators
HOW FARMER MAC WILL CHANGE THE AGRICULTURAL
LENDING AND INVESTMENT ACTIVITIES OF LIFE
INSURANCE COMPANIES

THE LIFE INSURANCE INDUSTRY HAS LONG BEEN A PROVIDER OF MORTGAGE
FINANCING OF AGRICULTURE. MANY OF THE COMPANIES PROVIDING CAPITAL TO
AGRICULTURE TODAY HAVE BEEN DOING SO FOR MORE THAN A CENTURY. THESE
COMPANIES RECOGNIZED THAT FARM MORTGAGES MADE A POSITIVE CONTRIBUTION TO
A WELL BALANCED INVESTMENT PORTFOLIO. THE AMERICAN COUNCIL OF LIFE
INSURANCE ("ACLI"), A LIFE COMPANY TRADE ASSOCIATION, REPORTS THAT THE
LIFE INSURANCE INDUSTRY CURRENTLY HAS APPROXIMATELY $10 BILLION IN
MORTGAGES SECURED BY FARM LAND. THIS REPRESENTS LESS THAN 15% OF THE
TOTAL REAL ESTATE LOANS OUTSTANDING.

AT ONE TIME THERE WERE DOZENS OF LIFE COMPANIES ACTIVELY INVOLVED
IN THE FARM MORTGAGE MARKET. TODAY, ONLY A FRACTION OF THOSE REMAIN.
THIS DECLINE CAN BE ATTRIBUTED, FOR THE MOST PART, TO THREE CAUSES:

1. INSURANCE COMPANY FUNDS AVAILABLE FOR AGRICULTURAL LENDING ARE
LIMITED BY A COMPANY'S TOTAL ASSET SIZE, AND THE PROPORTION OF
THOSE ASSETS THAT CAN BE ALLOCATED TO ANY PARTICULAR
INVESTMENT. IN ADDITION, FARM MORTGAGES ARE ILLIQUID MAKING
PORTFOLIO REPOSITIONING IMPOSSIBLE.

2. AVAILABILITY OF FUNDS AND RATE STRUCTURE OF THE COMPETITION
PLACED INSURANCE COMPANIES AT A DISADVANTAGE. READY ACCESS TO
THE NATIONS CAPITAL MARKETS, COMBINED WITH PRICING BASED ON
AVERAGE COST OF FUNDS, COULD NOT BE MATCHED BY THE INSURANCE COMPANIES DURING THE VOLATILE RATE ENVIRONMENT OF THE LATTER 70'S AND EARLY 80'S.

3. THE COST OF ORIGINATING AND SERVICING A PORTFOLIO OF SMALL AGRICULTURAL LOANS HAS INCREASED TO THE POINT THAT MOST INSURANCE COMPANIES FIND IT UNPROFITABLE.

IT WAS PRIMARILY A COMBINATION OF THESE CONCERNS THAT PROMPTED A GROUP OF INSURANCE COMPANIES INVOLVED IN FARM LENDING TO JOIN FORCES WITH OTHER CONCERNS TO DEVELOP AND IMPLEMENT A SECONDARY MARKET FOR FARM LOANS. AND THE REST AS THEY SAY IS "HISTORY".

FROM THE EARLIEST DISCUSSIONS OF THE SECONDARY MARKET THERE HAS BEEN A GOOD DEAL OF SPECULATION AS TO HOW IT MIGHT IMPACT THE FARM MORTGAGE MARKET AND THE ASSOCIATED LENDERS. I WOULD LIKE TO ADDRESS THIS SUBJECT AS IT RELATES TO THE FARM LENDING ACTIVITIES BY INSURANCE COMPANIES.

THE SECONDARY MARKET WILL OFFER THE INSURANCE INDUSTRY THE OPPORTUNITY TO PLAY A MORE ACTIVE ROLE IN AGRICULTURAL REAL ESTATE LENDING. THIS OPPORTUNITY WILL MANIFEST ITSELF IN TWO BASIC FORMS.

1. INSURANCE COMPANIES MAY BE ABLE TO BECOME MORE ACTIVE AND FLEXIBLE LOAN ORIGINATORS.
2. INSURANCE COMPANIES MAY BECOME MORE ACTIVE AS PURCHASERS OF LOANS ORIGINATED BY AGRICULTURAL BANKS AND OTHER LENDERS, AND AS PURCHASERS OF MORTGAGE-BACKED SECURITIES.

NOW LET'S TAKE A CLOSER LOOK AT EACH OF THESE OPPORTUNITIES. INSURANCE COMPANIES MAY BECOME MORE ACTIVE ORIGINATORS FOR THE FOLLOWING REASONS:

COMPANIES WILL HAVE ACCESS TO A SOURCE OF FUNDS THAT IS LARGE, COMPETITIVELY PRICED, AND CONSISTENTLY AVAILABLE: THE NATION'S CAPITAL MARKETS.

THEY SHOULD BE ABLE TO USE THIS SOURCE OF FUNDS TO ORIGINATE LOANS ON A MORE CONTINUOUS BASIS AND AT LOWER INTEREST RATES THAN MIGHT OTHERWISE BE THE CASE.

DRAWING ON AN ADDITIONAL SOURCE OF FUNDS MAY PERMIT COMPANIES TO OFFER A WIDER VARIETY OF LOAN PROGRAMS TO BORROWERS.

COMPANIES SHOULD BE BETTER ABLE TO MANAGE THE RISK AND UNCERTAINTY INTEREST IN ANY LENDING PROGRAM, BY GAINING THE FLEXIBILITY TO HOLD SECURITIZED LOANS IN PORTFOLIO OR TO SELL THEM IN A LIQUID MARKETPLACE.

THE SECOND OPPORTUNITY, PURCHASE OF LOANS AND MORTGAGE-BACK SECURITIES, IS SUPPORTED BY THE FOLLOWING ASSUMPTIONS:
Loans generally would be purchased for the purpose of forming pools for securitization, although the securities might be held in the portfolio indefinitely rather than immediately sold.

Purchase of mortgage-backed securities typically would be for investment purposes, although securities might be resold for portfolio management reasons.

Acquisition of loans and mortgage-backed securities might, in time, constitute an increasing share of insurance companies credit activities.

Lastly, the purchase of loans and securities would permit insurance companies to utilize their limited staff resources more effectively, allowing them to channel credit regions they might otherwise be unable to service.

It is clear that the secondary market will provide opportunities for the agricultural lending activities of life insurance companies. What is not so clear is how the life companies view these opportunities and how they will make use of them. Of those companies currently active in agricultural lending, opinion on the use of secondary market cover the entire spectrum. Some see no application to their program, while others have very definite ideas on how to utilize the program's opportunities. Since it is impossible to speculate on how the industry will react to the secondary market, I would like to focus on how one company, Prudential, sees its role.
As a direct result of bottom line pressure, Prudential has slowly withdrawn from being an originator of small agriculture loans. Current activities are targeted to more specific areas, and to the larger farm and agri/business loans. As a result, we view our opportunity in the secondary market as a purchaser and pooler of loans from other lenders. These pools of loans would be sold, or depending on internal demand for fixed income securities, could be retained.

As a purchaser and pooler of loans, some change would be inevitable. However, it would be comprised primarily of a tighter focus and a leveraging up of existing staff skills. For example, instead of originating loans directly with borrowers, staff would call on banks and other lenders to purchase loans. Instead of servicing one loan at a time, staff would be master servicing many loan originators.

In summary, I would suggest that the secondary market does offer increased opportunities for all lenders. These opportunities if acted upon will inevitably promote change. However, the change will not be dramatic or instantaneous, especially for insurance companies. Rather, the change will be gradual as the companies focus on which role or roles best suit their needs. The role of originator, pooler, or holder of the mortgaged-backed security.
C.G. KELLY HOLTHUS, PRESIDENT-ELECT DESIGNEE
AMERICAN BANKERS ASSOCIATION &
PRESIDENT & CHIEF EXECUTIVE OFFICER
FIRST NATIONAL BANK
YORK, NEBRASKA

AMERICAN AG ECONOMIC ASSOCIATION
PANEL
KNOXVILLE, TENNESSEE
AUGUST 2, 1988

OTHER PANELISTS:
  MODERATOR - MARVIN DUNCAN, FCA
  WILLIAM LERA, SALOMON BROTHERS
  JIM MURRAY, FORMER ABA CONSULTANT
  JOHN MENEELY, PRUDENTIAL
I. The idea of an agricultural secondary market is not new to ABA.

A. How Farmer Mac will be used by the farmers/bankers.

B. 1981 ABA study cited need for fixed-rate agricultural credit source.

C. ABA formed presidential task force (1986).

D. Put together inter-industry coalition:
   1. American Bankers Association
   2. Independent Bankers Association of America
   3. American Council of Life Insurance

Secondary market task force worked with Jim Murray.
II. What's Farmer Mac mean to a banker from York, Nebraska?

A. Couldn't offer farm customers fixed-rate loans.

B. Farm Credit System and major insurance companies were the only lenders.

C. Only credit was adjustable-rate.

D. Why was that? (Some background)

E. We learned a valuable lesson back then.

1. Borrowing short to lend long is bad.

2. Thrifts used short-term deposits to make 30-year mortgages for their portfolios.

3. Rising interest rates brought disintermediation.
4. Strict federal regulations saved commercial banks.

5. Secondary market then might have helped avoid deep trough of early 1980's.

III. Farmer Mac is a good credit alternative.

A. Long-term loans without disintermediation.
   1. Permits lending on earning power rather than on assets.
   2. A hedge against downturns.

B. Long-term liquidity to agriculture.

C. Land could have been sold in early 1980's if adequate financing would have been available.

D. Less volatility in ag finance (ABA study).

E. More competition.

F. Similarities to Fannie Mae, Freddie Mac (chart).

G. Farmer Mac has no direct effect on agricultural production loans today.
   1. These are short-term loans.
   2. Banks make those from short-term deposits.
IV. How will banks participate?

A. Smaller community banks will originate loans.

B. Mid-sized and regionals will originate and pool loans.

C. Larger banks will pool for sale into the secondary market.

D. What will my bank in York, Nebraska do?

E. What do I expect in Nebraska generally?

F. We will be able to supply short-term, intermediate-term and long-term financing.
V. Real beneficiary is the farmer.

A. He likes fixed-rate, set-term mortgages.

1. For cost control.

2. For income projections.

3. Farmer Mac may also include ARM's.

4. One lender borrows, not borrowing from different sources.

B. Farmer Mac won't answer every farmer's needs.

1. Tough underwriting standards and conservative asset-to-loan ratios.

2. Narrow range of credit availability at first.

3. But investors will like soundness of the investment.

4. Farm collateral is an earning asset not an asset that depreciates rapidly.
VI. Conclusion

A. ABA played major role in creating Farmer Mac.

B. Nine members on interim board include:
   1. Randy Killibrew of ABA.
   2. Tom Olson of IBAA (also ABA member).
   3. Both deeply involved in whole process.
   4. They received endorsement of coalition.

C. Farmer Mac is a good step forward for ag credit.
   1. In part a private sector solution.
   2. But doesn't ignore government's role.
3. Permits other players, such as Farm Credit System.

4. We welcome the competition.

5. ABA is prepared to help make it work.

6. My bank, for one, plans to make good use of it.