

**Remarks by
The Honorable Nancy C. Pellett
Farm Credit Council Annual Meeting
Palm Desert, CA
January 15, 2007**

Thank you so much for the kind introduction and the opportunity to be here. It is always such a pleasure to attend this annual meeting and to have the opportunity for discussion and interaction with so many of you. It is a time to reflect on our shared commitment to this country's farmers, ranchers, and rural communities.

Before I begin my remarks, I want to acknowledge my colleagues on the Board—two outstanding gentlemen with whom I am so pleased to work.

Dallas Tonsager has been at FCA now for a little over two years and is no longer “the new guy.” He continues to be such a tremendous addition to this Board and I really appreciate the opportunity to work alongside him.

And, of course, many of you know our newest Board member, Lee Strom. I have enjoyed getting to know him and am so pleased that President Bush nominated a producer who understands agriculture and rural America and who wants to see it remain healthy. I foresee this Board being as unified and working together as well as the previous Board, so I'm anticipating a great year with Lee as a colleague. Dallas and Lee, will you please stand up so that you may be recognized?

Even though he is not in attendance, I want to recognize Doug Flory, who means so much to me and has been such a great friend and colleague since I arrived at FCA. We will truly miss his leadership as a Board member and as the Chairman of the Insurance Corporation. He has contributed greatly to the good communication among the Board and with the System, and it has indeed been a privilege to serve with this outstanding gentleman.

Finally, I would like to acknowledge the professional staff. They are very creative and competent and do a great job implementing the decisions the Board makes.

Review of 2006

As we look back at 2006, I am pleased to report that the System has continued its outstanding service to agriculture and rural America. As the arm's-length regulator, our primary mission remains the same—to make sure the System is safe and sound—and it is. All institutions were rated either 1 or 2 in the FIRS rating system. We saw unprecedented loan and asset growth last year as the total System assets grew during the year ending September 30, 2006, by \$19.3 billion to \$154.7 billion—14.3 percent. Capital grew by \$1.5 billion to \$24.2 billion—6.7 percent. Although increasing less than assets, System capital remained strong at 15.7 percent of assets at September 30. The System's combined net income was \$1.8 billion year to date as of September 30 and will again exceed \$2 billion this year. Credit quality also remained strong with adversely classified loans of only 2 percent.

With regard to young, beginning, and small farmers, it is clear that the System is making a strong effort to serve and address the needs of young, beginning, and small farmers and ranchers. Serving the needs of YBS farmers must continue to be a high priority, and FCA will focus on YBS lending programs to ensure that the System meets the needs of these groups who are so critical to the future of agriculture and rural America. In particular, the System should consider ways it can continue to be involved in rural infrastructure and quality of life amenities that motivate individuals, particularly these young people, to return to rural areas and agriculture.

In this regard and in looking back on the Investments in Rural America pilot program, we continue to receive requests for participation by System institutions. It is encouraging to see the System use the investment authority of the Act to improve rural communities. We all know the important role rural communities play in keeping agriculture prosperous and economically vibrant. Under these pilot programs, you are creating solutions for meeting the financing needs of agriculture, rural infrastructure, facilities, housing, businesses, renewable energy, supply systems, and value-added agribusiness. For example, several System institutions have created the "FarmStart" program. This program provides investments for working capital purposes of up to \$50,000 for young and/or beginning farmers and start-up cooperatives. Other institutions have purchased debt securities that provide critical medical and sanitation services needed in rural communities. We continue to encourage System institutions to use these programs to make appropriate and helpful investments that support rural communities' success in keeping agriculture vibrant and young, beginning, and small farmers involved.

Also in 2006, I'm particularly proud of the work the Agency did in finalizing the governance and disclosure and reporting rules. The implementation has gone very smoothly, which is a tribute to good communication between our staff and you in the System. We realize many System boards are still in the process of implementing these new rules, but examiners tell me that you are making excellent progress. This commitment to strong governance and self-determination by System boards is key to the integrity of your GSE mission. We believe both the governance and disclosure rules help you achieve this necessary transparency to your investors and the public, as the scrutiny on GSEs will only increase in the future. More importantly, it recognizes that it is the responsibility of each institution's board to fulfill its mission of serving agriculture and its borrower-shareholders in a comprehensive, complete, and safe and sound manner.

One other area that merits comment is the System's resolve to function and operate in the spirit of the cooperative body as a unified entity. I would suggest that through the Horizons project you have demonstrated your ability and intention to focus on shared goals and speak with a unified voice more than you ever have in the System's 90-year history. The result of your internal communications and common objectives is obvious. As a matter of fact, I would offer that the criticism and concerns voiced by some of your competitors in the marketplace are more of a reaction to 95 associations and 5 banks with over \$150 billion in assets operating as a unified and effective financial entity rather than to possible small changes to the Farm Credit Act or changes in regulations. The real significance of the Horizons project is the realization of the potential for real cohesiveness within the Farm Credit System.

For me this has been highlighted even more as I have reflected on Theodore Roosevelt's letter accompanying the Report of the Country Life Commission, which stated and I quote, "The cooperative plan is the best plan of organization wherever men

have the right spirit to carry it out.... It develops individual responsibility that has a moral as well as financial value over any other plan.” The Horizons project has shown the value of a cooperative plan acting in the cooperative spirit, and I would encourage you to continue to work together in this manner so that the System can continue to thrive.

Looking toward the new year

And so, looking forward, I want to offer three points. First, you have been hearing about the changes in the way we examine and have begun to experience this, but I want to revisit it again. Our primary mission is to ensure safety and soundness, so I am pleased to report that we continue to enhance our examination program, and we are now doing it differently and better. We are relying on your good governance and your internal systems of controls more and more. We have organized our staff so that we have the appropriate skills and knowledge for the different levels of institution size and scope, risk, and use of technology. Our examination focus is more risk based. Our examiners will interact with the Board, the committees of the Board, and management to ensure proper controls and practices are in place and that desired goals are achieved.

We will also continue to encourage your boards of directors to take more responsibility. Specifically, I want to emphasize the importance of boards setting the appropriate “tone at the top,” which as you know has been a problem with other GSEs—indeed, with many large corporations all across America. As the System continues to increase its sophistication, modernization, and advances in technology, FCA is committed to keeping our staff on the cutting edge of these trends so that as your regulator we can continue to effectively ensure safety and soundness.

Second, as we at FCA look toward our 2007 policy agenda, we are committed to continue making sound policy decisions that address System mission accomplishment. This past year we have worked to provide appropriate flexibility while holding System institutions responsible for making the right decisions in financing borrowers within the System’s charter. You should use this flexibility with care to finance operations consistent with your GSE mission.

Going forward, as we evaluate our regulations to make sure they are consistent with the System’s mandate to serve the full range of agriculture in this country, it will require a continued dialogue with you as we keep the farmer, the all-important end user, in mind as policy decisions are made. But also, we must be mindful of the statutory and regulatory limitations; and as Congress begins reauthorization of the Farm Bill this year and considers possible changes to the Act, we look forward to participating in that process.

Regarding our specific regulatory plans for this year, staff will begin reviewing regulations on disclosure and reporting requirements to shareholders and investors for any needed changes. We will also continue to look at lending program requirements, and will conclude our review of other Federal banking agencies’ Basel proposals on capital adequacy and consider appropriate changes to FCA capital adequacy requirements for the System. You will also likely see a proposed rule on priority of claims and completion of a final rule sometime this year on eligibility for processing and marketing operations. The proposed rule on processing and marketing is focused on allowing agricultural producers to capture more of the value-added dollar. It also recognizes the evolving sophisticated legal structures that farmers now use when

engaging in processing and marketing business activities. We are not focused on expanding the System's authority to lend to businesses that only have a tangential relationship to agricultural or producers' operations. Instead, the proposal is focused on assisting, through System financing, only those agricultural or producer operations that are truly integrated and are a logical extension of bona fide farmer and rancher operations. We are reopening the comment period for 45 days and after it closes, our staff will work to complete a balanced final rule.

My third point for you to consider is that for a GSE and for the Farm Credit System in particular, the bottom line must always be mission accomplishment. We, as the regulator, must do our part to ensure that the System continues to accomplish the mission set out for it by Congress, and you must also do the same. I have been impressed as I have read the Horizons research and other reports from the Farm Bureau and the National Corn Growers on how agriculture and rural America are changing—this kind of self-evaluation is essential for staying relevant to your farmer-borrowers and staying true to your mission.

Specifically, within proper safety and soundness limits, this means growth with a purpose and not just growth for growth's sake. It means using the authorities you have to serve all of agriculture, not just the most creditworthy or largest entities. Given the GSE stature and public policy focus of the System, you must continually push for balance in your mission accomplishment to ensure that all segments of the agricultural marketplace receive constructive and needed credit. Along those lines, I continue to encourage you to do all you can to reach minority, young, beginning, and small agricultural producers that have difficulty in obtaining credit. But I also want to commend your efforts to bring more diversity into the System—whether it is actively looking for more diversity on your boards, in your staff, or in how you are marketing yourselves to potential borrowers. I want to acknowledge your efforts on this and encourage you to continue to focus on this important issue.

Finally, on this point of mission fulfillment, I want to encourage you to continue to develop affiliations with commercial banks, Farmer Mac, and other financial institutions that are mutually beneficial. While we see significant efforts in working with bankers on similar entity and other loan participations and syndications that meet the needs of larger agricultural producers, there seems to be an opportunity to work with commercial banks and other commercial financial providers to more broadly meet the needs of all agricultural producers. I encourage you to continue to explore these opportunities to partner.

Closing

In closing, many of you know that one of my goals as Chairman has been to improve communication, as appropriate for an arm's-length regulator, between the Agency and the System. I am encouraged to see the progress that has been made over the past few years and I hope to see it further improve in 2007. We will continue our commitment to an open dialogue with the System and the public. Whether the issue is examination or policy, good communication is a major factor in maintaining a healthy arm's-length regulator and a healthy Farm Credit System.

I have also continued to emphasize efficiency and effectiveness in how we conduct our business at the Agency. We are committed to spending wisely the funds we receive from

assessments. We will continue to implement initiatives designed to streamline and improve operations, and to strategically develop and enhance staff expertise so that FCA is well positioned to meet all future challenges and opportunities.

As we at FCA look toward this new year, it is with great anticipation as I see the opportunities out there for the Farm Credit System to continue to serve a changing agriculture and rural America. The importance of biofuels, including the growth of ethanol, cannot be underestimated. President Bush and Congress have focused significant attention on alternative energy sources as they begin to craft a new farm bill, and there is now emphasis on cellulose ethanol from switchgrass, wood, sorghum, and other farm products. These developments present new opportunities for the System but also opportunities that must be properly managed.

2007 promises to be an eventful and important year for FCA and the Farm Credit System. We at the Agency will continue our commitment to excellence as an arm's-length regulator and in keeping the System safe and sound. At the same time, the System has never been in better shape, and thus your responsibility to monitor your mission accomplishment has never been more important. I know I speak for not only myself but also my colleagues on the Board when I say that we look forward to seeing the Farm Credit System continue to serve agriculture and rural America in 2007, and it is a privilege to be a part of it at this time in history. Thank you very much.