Remarks by
The Honorable Leland A. Strom
Farm Credit Council Annual Meeting
San Francisco, CA
January 24, 2011

Thank you for that very nice introduction, and good morning to all of you. I appreciate the opportunity to be here again with you today. It's hard to believe that this is the third time I've appeared before you as FCA Chairman. Before I begin my remarks this morning, I want to recognize one of my two colleagues on the FCA Board who is also here today, Kenneth Spearman. Ken joined the Board just over a year ago, and he has provided significant contributions to the Board and FCA. Ken also serves as Board Chairman of the Farm Credit System Insurance Corporation. Although our newest colleague on the FCA Board, Dr. Jill Long Thompson, is not in attendance today, I also want to recognize her for the valuable contributions and insights she has brought to the Board.

Last year when I addressed you, I commented that the United States was slowly recovering from a deep global recession, that the unemployment rate remained high at 10 percent, and that agriculture continued to face a difficult economic environment. Today our country is still emerging from the longest recession since the Great Depression. The pace of recovery has been particularly slow for job growth, with unemployment still at 9.4 percent, and a housing sector that remains depressed. These factors have added economic uncertainty for consumers and businesses, including the agricultural sector. Fortunately, the Farm Credit System has for the most part weathered the financial crisis and continues to operate with strong earnings and capital.

This morning I'd like to share with you some information on FCA activities over the past year, the condition of the Farm Credit System, and our safety and soundness oversight. Then I'll conclude by discussing three challenges I see for the future – first, the importance of data and information for assessing systemic risk; second, the opportunities provided by diversity and inclusion; and third, my concerns about the future evolvement and structure of the System.

Key Policy and Regulatory Initiatives

During 2010, we focused our regulatory program on providing guidance on key safety, soundness, and mission service issues. We initiated policy and rulemaking projects to further enhance the regulatory capital framework; to improve liquidity investment requirements; and to strengthen loan pricing and structure, loan portfolio management, and investment asset management practices.

We published an advance notice of proposed rulemaking to solicit comments on amending FCA's regulations to replace the current core and total surplus capital standards with a "Tier 1/Tier 2" capital framework, which is more consistent with the Basel Accord and more closely aligned with the other financial regulators.

We also published an advance notice of proposed rulemaking to solicit comments on ways to clarify and enhance rules related to the disclosure of senior officer compensation, and the responsibilities and authorities of System institution compensation and audit committees. It is prudent and timely to review our regulatory guidance related to senior officer compensation to ensure that pay and benefits are aligned with the stakeholders' interests in a safe and sound institution. The turmoil within the financial industry and the ensuing decline in the economy highlight the need to ensure that shareholders and investors are informed of compensation policies and practices. Similar efforts are in process at other regulatory agencies. I know executive compensation is a sensitive issue and of much interest to you, so I encourage your written comments for our consideration on this matter.

Another significant initiative we undertook in late 2010 was to update the Agency's Strategic Plan. The FCA Board and senior management developed assumptions and discussed their implications for the planning horizon. We intend to complete our work on the Strategic Plan later this spring.

Other FCA Activities

We all know that the young, beginning, and small (YBS) farmer and rancher market segments are of vital importance to agriculture and rural America. This past year, the FCA Board had an opportunity to discuss with Gary Matteson of the Farm Credit Council the progress and challenges in serving YBS borrowers, which was very helpful. I also want to recognize the practices many of you are implementing to better serve YBS farmers in your territories. I know at least one institution has a board seat dedicated to a YBS farmer. Also, many of you have YBS advisory committees that provide input to help shape your institutions' YBS policies. Many of you also offer YBS-specific underwriting standards, concessionary interest rates, business planning and leadership training, and educational and outreach programs. All of these efforts are valuable in carrying out this special mission, and I encourage you to consider these and other best practices.

One recent highly publicized concern for agriculture is the rising price of farmland in many localities. This is not a new issue, as we have provided you with guidance on collateral risk on several occasions over the past few years. Most recently, during 2010, we issued an Informational Memorandum on our expectations regarding stress testing by System institutions. Among the risk factors to be stressed, we identified farmland and other collateral values. For our own part, we need to closely monitor this issue to ensure that System institutions can continue to operate safely and soundly if land values drop. We are looking to improve our data collection and management regarding real estate collateral values and overall risk evaluation. We are also communicating with other financial regulators to discuss the factors that have driven the increase in farmland prices, what risks they see in the future, and what actions they are taking regarding their regulated entities.

Increased Supervision

While the System's condition and performance remain satisfactory, the risk profile for many System institutions has weakened over the past two years, as reflected by downgrades in their FIRS ratings. Key performance measures at many institutions have weakened because of the difficult economic environment. Therefore, the System and its regulator must remain vigilant and respond quickly to changes in the risk environment. We now have five institutions under enforcement actions and a number of institutions under heightened supervision. We have found the boards of most of these institutions willing and able to take the necessary corrective actions.

We are continuing to focus the resources necessary to maintain appropriate oversight, take proactive measures to safeguard institutions, and identify emerging risks across institutions. Our Office of Examination recently issued its National Oversight Plan to ensure that all examinations have consistent priorities and focus squarely on material and emerging risks. As our new Chief Examiner, Robert Coleman, stressed in a recent Informational Memorandum, we are committed to providing guidance and oversight on relevant risk topics affecting System institutions and the continued importance of strong and consistent risk management practices in the current environment.

Given the weakened and fragile general economy and a volatile and uncertain agricultural economy, risk remains elevated for System institutions. Therefore, our Office of Examination will maintain a significant on-site presence and will focus on risk identification and risk management practices. Later today in one of the breakout sessions, Robert Coleman will more specifically discuss our National Oversight Plan, as well as his views and priorities as the Agency's new Chief Examiner.

Three Challenges

Now, as I said earlier, I want to briefly discuss three challenges I see for the future.

The first challenge is the importance of data to systemic risk assessment. Our ability to conduct strategic analysis and to assess systemic risks is critical to ensuring the safe and sound operations of the banks and to supporting FCA Board policy decisions. In 2008, FCA embarked on a project to consolidate the loan information FCA collects from System institutions for its examinations into a single data repository. Our objective in this project was to enable efficient access to borrower level information necessary to support our national examination program. It also gave us an opportunity to ensure a high standard of data management and security surrounding the data. This information is critical for assessing institution safety and soundness and maintaining an efficient and effective examination program.

The next phase of this project focuses on expanding the collection of essential data elements to facilitate our examination and analysis of risk from both an institution and System-wide perspective. We know that the System has embarked on its own project to explore collecting and housing uniform System data to enhance reporting and systemic analysis. We are coordinating with the System's workgroup and discussing potential efficiencies that may be obtained by collaborating on the adjacent initiatives. We are open to a coordinated approach with the System to collect loan information as a feasible alternative; however, we remain focused on our need to collect critical data elements for our examination and policy mission in a timely manner.

My second challenge relates to opportunities provided by diversity and inclusion. The pool of eligible and creditworthy agricultural borrowers is more diverse today than ever before. It consists of men and women from a variety of racial and ethnic backgrounds. It consists of young farmers, as well as older ones. It consists of producers with small, part-time operations, as well as producers with thousands of acres and millions of dollars in gross income. I understand that this diversity creates a marketing challenge for you because to reach some of these market segments, you may have to develop specific marketing strategies and outreach activities. But doing so is critical because the mission of the Farm Credit System as a Government-sponsored enterprise is to serve all eligible, creditworthy borrowers. Also, in addition to supporting diversity among your borrowers, I encourage you to ensure that your institutions, including your boards, reflect the diversity of your territories.

Diversity and inclusion are of key interest to FCA. For example, in approving a recent association merger, we required the continuing association to fully consider its market segments and geographic regions and to ensure its business plan includes strategies and outreach activities for serving the needs of eligible borrowers across the territory. We further required the business plan to address diversity within the association's workforce, management, and governance structure. We will continue to promote the principles of diversity and inclusion, not only because it's the right thing to do, but also because of the significant opportunities it provides the Farm Credit System in supporting the future of agriculture in America.

Finally, my third challenge relates to the continued evolution of the System. This year marks the 95th anniversary of the creation of the Farm Credit System. What amazing changes the System has seen since the first Federal Land Bank began operations in 1917! The System has gone from 12 districts with 37 banks and thousands of associations to the current structure today – with just five banks and 84 associations.

I know you have all heard the announcement about the proposed merger that would further reduce the number of banks to four.

We all recognize that a bank merger may provide opportunities for portfolio diversity and operational efficiencies. However, with so few banks remaining in the System, a merger of two or more banks could also result in an institution with size concentration risks, business model compatibility issues, and intra-System operational risks. Therefore, when reviewing a bank merger application, FCA must consider the implications of the merger not only for the merging banks, but also for the System and its remaining banks and associations. Our Office of Examination just last week sent a survey to all System institutions requesting their input and views on the risks, benefits, and other issues they consider pertinent to analyzing or considering a possible bank merger. We are also requesting individual meetings with the three banks not involved in the proposed merger to discuss in depth the impact of such a merger on their institutions and the System as a whole. In addition to helping us understand the possible ramifications of the proposed merger, the information we gain from these activities will assist us in determining what issues should be addressed if we amend our current regulations related to the procedures and requirements for bank merger submissions.

The financial crisis of 2008 resulted in the Dodd-Frank Bill which was enacted last July. For the most part it does not apply to FCA and the Farm Credit System. However, we will adhere to the spirit of the act, especially in carrying out our safety and soundness responsibilities. For example, the Agency will evaluate if it needs to set prudential capital and other requirements in connection with a merger to address the potential risks posed by a larger interconnected institution within the System. In addition, FCA will evaluate whether the proposed merger enhances service to all eligible customers and contributes to the overall long-term mission achievement of the System.

My final observation that I want to make this morning is one that has been important to me for a long time. We all have a responsibility to think about how the Farm Credit

System must continue to evolve so that it can successfully finance agriculture and the rural areas of this Nation for another century. Last year I challenged you to proactively prepare for potential future changes by having an open, thoughtful, and meaningful internal dialogue about the evolving structure of the System for its safe and sound long-term success. Frankly, I'm disappointed that the dialogue has not taken place on a broader stage, and I'm asking you again to discuss this important issue because I am concerned about the serious nature of System structure and related issues going forward. For example, what about joint and several liability? Should associations also be jointly and severally liable? What authorities should the remaining banks have? Should they have Title III authority? These and other complex issues require much thought and discussion, and I'm concerned that the System's historically ad-hoc approach to addressing such issues will not be sufficient in the future.

I am hopeful that the System's leadership, perhaps its new Coordinating Committee, will endeavor to address these important issues. I believe it is vital for the System to identify and address systemic and structure risk issues in a visionary, consistent, and coordinated manner. And I know the System has the ability to come together when there is a need to focus on an important issue. Just last week a System leadership group came to the Agency to present a very extensive report on its Systemic Risk Assessment Initiative. I applaud the System leaders who were able to come together to undertake a project so key to the future of the System. I believe this focus and coordination can and should be used to also assess the future evolvement of the Farm Credit System and the related impacts. You, the directors and managers of the cooperative Farm Credit System, have the ability and the responsibility to determine the future course of the System and whether it continues to be a tremendous benefit to agriculture and rural America in the decades to come.

In conclusion, as we face the challenges ahead, FCA renews its commitment to its mission: to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. Thanks to its experienced, hard-working staff, the Agency has made, and will continue to make, a positive difference. Together, we will strive to do what is best for agriculture, rural America, and the American people, whom we serve.