Remarks by
The Honorable Leland A. Strom
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Thank you for that very nice introduction, and good morning to all of you. I appreciate the opportunity to be with you here today in New Orleans. 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 a couple of key issues that we are giving much attention. Then I'll conclude by discussing some challenges I see for the future.

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. The comment period recently closed, and we will be reviewing the comments we received as we determine how to further address this issue.

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 next month.

I also want to mention that FCA is doing its part to reduce our carbon footprint and support the President's initiative to curb Green House Gas emissions by the Federal Government. Most notably, we are leveraging our videoconferencing capabilities to reduce inter-office travel. We have already increased our recycling efforts and committed to purchasing “green” products when available. We will also be evaluating methods of reducing the amount of energy spent by agency employees in commuting to work. I encourage you to also look at efficiencies you can gain, both short and long term, in this area and share any best practices you develop with your colleagues as well as your fellow stockholders.

Rising Farmland Values

There has been much press in recent months on the rapid rise in farmland prices, especially in the Midwest, where reports of double-digit annual gains are common. Given the importance of farmland values to the agricultural economy and the lenders we regulate, it is important that we consider the underlying collateral risk associated with the loans that are backed by farmland. Farmland accounts for about 85 percent of all farm assets. We know that substantial downward adjustments to the value of farmland can occur. History has shown us that. We witnessed a severe correction in the 1980s that reshaped farming and agricultural lending alike. While conditions are quite different today, and we have learned many valuable lessons from the past, we need to be ever diligent about the effect of changes in the farm economy and farmland markets on the financial institutions we oversee. We also need to think carefully about how conditions today could change the drivers that have propelled farmland prices upwards.

The associations of the Farm Credit System are the largest source of farm mortgages in the U.S. with a market share estimated by USDA at about 44 percent. Farm real estate debt held by the Farm Credit System has increased by almost 80 percent since the beginning of 2003, and the average Farm Credit association has over 55 percent of its loan portfolio in farmland mortgages.

Farm commodity markets have become more volatile in the last five years and are whipsawed by economic, political, and weather events. The volatility we now experience is no more evident than in the single biggest U.S. crop – corn – which, because of its size, has a significant influence on the pricing of U.S. farmland. In just the last eight months the spot price of corn has doubled in value, driving the latest surge in cropland prices. But just over two years ago we also experienced volatility on the downside as corn plunged from record highs.

We are now in an optimistic period for U.S. agriculture in spite of the sluggish general economy. There have been good reasons to be optimistic about the value of agricultural real estate, as world and domestic demand for commodities has been coupled with very low interest rates. Not surprisingly, profitability and expectations for further growth in returns have been bid into the value of U.S. farmland. Overall, average U.S. farmland values rose some 67 percent from 2003 to 2008, only to flatten in 2008 and 2009 as commodity prices slumped and the U.S. economy entered a major recession. It is worth noting that transitional lands near metro areas experienced significant declines in value from the 2007 highs as unsustainable residential real estate property values fell, thus affecting values of nearby agricultural lands that, to a lesser degree, had followed the increase of transitional land values. Farm loan performance suffered in these areas. It is also true that marginally productive lands, pasture land, and recreational lands have not participated in the most recent surge in farmland values.

There is considerable media attention comparing today's farmland market with that of the 1970s and 1980s. That period was characterized by some as a "bubble." We studied the land markets of both periods, and while there are a few similarities, important differences were identified; foremost is the level of debt or leverage used to purchase farmland. While it is true that today's farming sector is significantly less leveraged than in the early 1980s, the numbers readily available and reported include farmers who have no debt on their farmland. And with much of the land purchased today made with cash, the overall numbers do look quite good. However, we need to think carefully about how conditions today could change the drivers that have propelled farmland prices upwards. We also need to maintain proper supervision and guidance to ensure the safety and soundness of System institutions that are lending into these rising farmland markets.

We have been taking a proactive approach to address the rising farmland issue. For example, a few weeks ago, we hosted a Regulator Roundtable that was attended by FDIC, the Comptroller of the Currency, the Federal Reserve Board, and Federal Reserve Banks. We discussed the factors that have driven the increase in farmland prices, what risks we see for the future, and what further actions we are taking or considering regarding our regulated entities.

We are improving the loan level data from System institutions that can help us better analyze emerging lending risks, especially regarding real estate collateral. We are now able to provide information to Agency managers and examiners that give both a System-wide perspective as well as institution specific loan information on loan-to-value exposures and asset quality components.

Lastly, our monitoring and analysis of that data as well as other external data on land value trends is a key priority. For example, the FCA Board recently received two presentations from staff. One focused on trends in farm real estate prices, real estate debt, and the drivers affecting these prices. The other provided institution specific information on loan-to-value ratios for mortgage loans. Overall, the preliminary data gave us some comfort in the vast majority of the System's mortgage loans. This data will assist us in planning our examination oversight and future guidance.

The farmland value issue continues to gain much attention and will likely be one of the topics at a hearing next week by the House Agriculture Subcommittee on Credit. I have been asked to testify at the hearing.

Increased Supervision

The Farm Credit System's condition and performance remain satisfactory. However, the risk profile for many System institutions has weakened over the past two years, reflecting the weaknesses in the Nation's economy and credit markets, a rapidly changing risk environment in certain agricultural segments, and management's effectiveness in responding to these risks. Therefore, the System and its regulator must remain vigilant and respond quickly to changes in the risk environment. We now have six 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.

Future Challenges

As I mentioned earlier, I want to briefly discuss some 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. This relates to both employment and lending. Diversity and inclusion in employment focuses on using the talents of people of different backgrounds, experiences, and perspectives to improve the workforce environment and productivity. Diversity and inclusion in lending focuses on looking beyond the traditional customer base to ensure that all eligible and creditworthy persons have access to credit and related financial services. Examples of non-traditional customers may include women and minorities who often operate within local food systems producing organic or specialty crops. Local food systems typically involve small farmers, heterogeneous products, and short supply chains in which farmers also perform marketing functions, including storage, packaging, transportation, distribution, and advertising.

Diverse employees and effective outreach and marketing programs could aid the System in reaching new customers. I believe this is critically important because the mission of the Farm Credit System as a Government-sponsored enterprise is to serve all eligible, creditworthy borrowers. Next week the FCA Board will consider a proposed regulation that would ensure System institutions' operating and strategic business plans address service and outreach to creditworthy borrowers in all marketplace segments while also giving appropriate consideration to diversity in both the workforce and the marketplace.

My final challenge relates to the continued evolution of the System. This year marks the 95th anniversary of the creation of the Farm Credit System. Since that beginning, 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. And, of course, the proposed merger between U.S. AgBank and CoBank would further reduce the number of banks to four. We officially received this merger application on March 30th, and we have begun our review and analysis of the proposal.

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 recently 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 received input from nearly 30 institutions throughout the System on this issue. In addition to helping us understand the possible ramifications of the proposed merger, the information we gained 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. Finally, we have contracted with an outside consultant to assist us in analyzing and considering the current merger proposal.

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. I have challenged the System 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. I am hopeful that the System's leadership will 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. You, the stockholders 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.