

**Remarks by  
The Honorable Nancy C. Pellett  
Farm Credit Administration Chairman and Chief Executive Officer  
at the  
AgFirst Farm Credit Bank Annual Meeting  
Hot Springs, Virginia  
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Thank you for the generous introduction and good morning to all of you.

I would like to talk about several issues today—my thoughts on Rural America and where it is headed, some thoughts on the Horizons project, and finally I'd like to talk some about what we are doing at FCA and some things I would like to see accomplished throughout my tenure as Board Chairman. After that, I'd be pleased to take any questions that you might have.

**Rural America**

Let me first address the rural America issue. From a producer's perspective, I have lived and worked in agriculture my whole life and I have a good understanding of the needs of rural America. In the past, if agriculture did well, rural communities did well. Now, however, this interdependence between agriculture and rural America is becoming less of a reality because of volume buying, the internet and other factors. The health of agriculture and rural America are becoming separate issues so let me address both as such.

As I'm sure you have heard, there is a lot of talk about cuts in agriculture. As the Farm Bill comes up for renewal in 2007 and we continue to see budget deficits, this talk will only increase. However, I don't believe there will be a push to end subsidies completely and quickly. Rather, I think we may see a gradual phase-out through the years as officials have an opportunity to assess countries around the world and their ongoing treatment of agricultural subsidies.

There are also other challenges to agriculture that we must be mindful of. Energy prices, animal and plant diseases such as BSE and soybean rust, and trade issues are just a few more of the challenges to the American producer that will continue to affect the Farm Credit System.

But while the viability of ag subsidies may be on the decline, there are, however, some clear opportunities and new frontiers such as energy production from biomass. In the Midwest, ethanol plants are doing extremely well—so well that they are now being financed by outside investors. Originally, it was farmers who scraped capital together to start a value-added agriculture product. Now farmers can hardly get in on these ventures. Bio-diesel is in a similar situation and wind energy is starting to get a lot of attention as well. I think alternative energy will create a very significant demand for ag commodities and land that we have not seen in the past.

Additionally, in heavily populated areas, we are seeing niche markets for food products increase dramatically. These usually bring additional income from related services of packaging, transportation and marketing to farm families. In many cases, these niche markets are competitive for small or even part-time farmers.

Rural communities are becoming a priority to policymakers. There is a recognition that we must stimulate and provide capital to rural areas or suffer the social and economic consequences of an economic downturn in those areas. In many cases, there are two groups that desire to return to rural America—retirees who want to return to their roots and a younger generation who want a better quality of life. What a combination! The older group brings business experience and liquidity while the younger group brings enthusiasm and ambition. However, both groups demand amenities that haven't been typical in rural America such as high speed internet, recreation sites and cultural opportunities.

There are plenty of exciting developments on the horizon for rural America. The list is virtually endless, limited only by our creativity and dedication to develop significant new income sources for America's farmers and ranchers and local businesses, while providing jobs and a better quality of life for those who choose to live in our rural communities. Opportunities don't have to go overseas. They can be created right here in rural America, and I believe the Farm Credit System has an important role to play in that trend.

On a national level, President Bush is committed to building an economic environment that encourages innovation, lowers the cost of doing business, and promotes growth. In light of all these changes and opportunities for growth, I want to continue to emphasize the necessity for the System to modernize and stay relevant and this applies to FCA as well.

Part of the System's mission is to provide sound, constructive credit to rural areas and I believe the statute offers an opportunity to encourage this re-growth and revitalization of rural America. As you know, at FCA we have begun an initiative called "Investments in Rural America," in which we are considering, on a case-by-case basis, your requests to make mission-related investments or to conduct pilot investment programs.

We have begun to use the investment authority outlined in the Farm Credit Act to approve new investments that fund the needs of agriculture or rural America.

You have submitted several proposals to us that we've been able to respond positively to including the first pilot program which allows AgFirst Farm Credit Bank to work with other lenders in promoting increased liquidity for affordable home financing to rural America through investments in rural housing mortgage securities guaranteed by government-sponsored agencies (RHMS).

The FCA Board also unanimously approved a booklet that outlines the Farm Credit System's institutions' authorities to provide lump-sum payments to tobacco quota holders and producers under the Tobacco Reform Act. The Tobacco Buyout program has significant implications for Farm Credit System institutions in the Ag First territory that serve the financing needs of tobacco quota holders and producers. We clearly understand that the ability of FCS institutions that serve tobacco quota holders and producers to provide lump-sum payments through assignments, successor in interest contracts and lending transaction is essential so they can immediately put their payments to work and reinvest in their future.

I applaud you for your creativity on these and other proposals, and I'm encouraged that you and other System institutions are responding to the Investments in Rural America initiative.

FCA Board approval of these and other projects shows that we are serious about living within the statute yet also allowing the System to participate in some new and important projects that help agriculture and rural areas throughout America. As you send more proposals to us to consider under the investment authorities, we'll look forward to a continuing and open dialogue regardless of whether we agree.

### **Horizons**

Secondly, I would like to talk a bit about the Horizons project. I can't comment on all the details since it is still a work in progress but I want to make several observations. Because of the ever-changing needs of agriculture and rural America and the need for the System to remain vital and relevant, I believe the Horizons project is very important and I commend the System for undertaking it. I have followed its progress very closely. I attended the Horizons meeting in Las Vegas, and both FCA staff and my fellow Board Members have represented FCA at the other regional Horizons meetings in Atlanta, Chicago, Dallas, and Denver.

The System has done a great job of conducting this process in a sound and thorough manner. Every report I receive indicates that Horizons has been very helpful in achieving a better understanding of System customers and their needs in a changing financial marketplace. It has also built partnerships and developed new relationships among individual FCS institutions. The System is sending a signal that it is willing to work together—to be cooperative in a national sense while recognizing the independence of the individual associations. I believe it has been a very healthy thing for the System to go through this process. The theme of your meeting is "Steeped in Tradition, Embracing Tomorrow" and I believe you and your colleagues are embracing tomorrow by wisely looking ahead and anticipating what the future holds rather than just reacting when it arrives.

I want to make one other point on the Horizons project. FCA has the very difficult job of balancing the realities of the System's GSE status and public mission as a limited purpose GSE with the desires of the System to expand and grow into new markets. As you well know, the Congressionally- mandated purpose of the System is to provide a permanent source of sound, adequate, and constructive credit to farmers and ranchers, and their cooperatives through good times and bad, whereas commercial banks have the option of diversifying their lending operations away from agriculture when ag lending becomes more of a risk.

This is, in my opinion, one of the strongest arguments for the existence of the Farm Credit System as a Government Sponsored Enterprise. Yes, I want to ensure that FCA is flexible enough when we can be. However, a responsible arm's-length regulator must first ensure the System is fundamentally sound and second, and that it fulfills its GSE mandate to serve those in agriculture and rural areas.

All the recent problems and scandals at other GSEs underscore the fact that you in the System and FCA must be well-prepared for increased scrutiny by those who might question the need for your continued status as a GSE. It is imperative that you in the

System and we as the arm's length regulator are above reproach in our responsibilities and duties and that we maintain the integrity of the GSE status.

Agriculture needs continual access to a stable source of credit. As such, the System has to continually re-evaluate itself to make sure that it remains relevant while doing its best within its mission to serve farmers, ranchers and rural America.

I'm looking forward to seeing the final recommendations of the Horizons study—We want to continue to keep the lines of communication open as this process unfolds because I believe we all have the same ultimate goal—we want to see a healthy and productive rural America.

### **Goals for the Future**

Now, I would like to outline for you what I want to accomplish during my tenure as Chairman by identifying several of my top priorities and initiatives.

First and foremost, FCA is charged with making certain the System is safe and sound so that agriculture has access to a competitive and dependable source of credit and closely-related services. While this may seem obvious, I like to repeat it so that we always keep our primary mission in mind.

Safety and soundness influences everything we do at FCA, including policy and regulation development and certainly our examination programs. As we develop regulations, we will focus our efforts on issues that address identified risks in System institutions or that enhance the ability of System institutions to better meet the needs of agriculture and rural America. We will also continue to emphasize strong governance and the cooperative principles of a farmer-owner GSE and work to eliminate outdated or unnecessary regulations that impair the ability of the System to accomplish its mission.

On the examination side, as the System changes, so does its risk profile. As a result, our oversight and examination activities must be flexible enough to move with those changes. Our programs must be more pro-active and must ensure that FCS institutions have appropriate management systems and internal controls in place well before risks become a reality in your financials. It is also vitally important that we use technology to a greater extent in our examinations.

We have recently updated our examination policy statement, which directs the Office of Examination to maintain a "risk-based" approach to oversight, as it maximizes effectiveness and strategically addresses the System's safety and soundness and compliance with laws and regulations.

Therefore, examination resources will now be allocated to matters of highest risk or potential risk to the System at large and at specific institutions to proactively address emerging risks. This approach is critical to maintaining shareholder, investor, and public confidence in the financial strength of the System.

I would like to mention one specific examination issue that is beginning to be of some concern to me, and that is the high price of farmland in some areas and the risk of extending credit on rapidly rising real estate values. This is an area that Tom McKenzie and his staff are looking into and you will hear more about it in the future, but I would just caution you to ensure that your loans are based on the borrower's repayment ability and

to be ever mindful of the collateral's ability, including income-producing capacity, to sustain its value through downturns in the economy. I urge you to review your risk management systems, loan underwriting, and your capital plans in light of this risk.

Another key goal for me continues to be improved communication internally as well as externally with all interested parties, in particular with the System. From the first day that I became Chairman, I've said that I want to facilitate good communication between you in the System and the FCA. Part of the effort towards good communication includes our commitment to maintain an open dialogue with you. While we may not always agree on every issue, we will continue to make you fully aware of our intentions and we will continue to provide you ample opportunity to weigh in on the regulatory matters we bring forth and will continue to respond to your requests in a timely manner. I hope you have seen evidence of our commitment to improved communications from our staff already, and I will continue to urge improvement in this area.

Another recent and ongoing accomplishment that I'm proud of is that we have been working on achieving more efficiency in how we run the agency. We want to be good stewards of the funds provided to us, so earlier this year we commissioned several studies to help us more clearly identify the challenges before us and provide recommendations on how we can best address those challenges. We have completed those studies and have begun to make several changes in our organization to make sure we have the right people in the right places.

We have recently named a new Director of Congressional and Public Affairs, Martha Schober, who comes to us from USDA. In addition, Andrew Jacob has been named Director of the Office of Regulatory Policy, which was formerly the Office of Policy and Analysis. Finally, Steve Smith has been named Director of a newly created Office of Management Services, which combines our financial, technology, and human resources functions under one office head.

Tom McKenzie is also making some changes that will align the Office of Examination with the updated philosophy I just mentioned. You'll hear more specifics about the OE changes soon, but the bottom line is that these and other Agency changes are meant to improve FCA's effectiveness and to provide the strong leadership needed as FCA continues to meet the changing needs of the Farm Credit System and agriculture in the 21st century.

The other initiative I'll mention today that I continue to emphasize and that you play a leadership role in is service to Young, Beginning and Small Farmers. Your efforts to help young, beginning and small farmers are critical in ensuring that the next generation of farmers is able to have farming as a viable career option and that it can be a profitable option.

Across the System I believe we are seeing the positive outcome of this emphasis on YBS as the number of young, beginning, and small farmers served by the System has been on the increase. I know that you are committed to serving Young, Beginning, and Small farmers and I look forward to seeing the fruits of your labor as you enable this important group of people to live out their dreams in agriculture.

### **Closing Remarks**

Let me wrap up by saying that I truly believe agriculture is one of the most honorable endeavors an individual could undertake.

Given all the current risks, in my opinion it is imperative that we maintain a strong agricultural sector and vital rural communities. To me, that is the principal reason why the Farm Credit System exists.

Quite frankly, I stand in awe of the contributions the System makes every day, not only locally, but nationally as well.

We at FCA are proud of what you have accomplished, and we hope that you are as optimistic as we are about the future contributions that you can make as you face the ever-present challenges of financing agriculture and rural America of the 21<sup>st</sup> century.

We look forward to continuing to work with you.

Thank you very much for having me here today, and if there are any questions I will do my best to address them.