FARM CREDIT ADMINISTRATION

Newsline

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FCA Expects Farm Credit System Financial Condition To Remain Sound During Next 12 Months

Under the "most likely" scenario for the agricultural environment, the Farm Credit System (FCS or System) is expected to remain financially sound during the next 12 months, according to a recent Stress Analysis Report prepared by FCA's Office of Examination.

Chief Examiner Roland Smith said, "While the results of this stress test are relatively positive, FCA remains cautious on these projections, particularly over the 24-month 'worst case' scenario. The actual financial condition of the System will be influenced by external factors affecting agriculture that the System institutions can not control. These external factors include low commodity prices, export demand, weather conditions, and the competition."

Under "worst case" conditions projected at June 30, 2001, eight associations would have adverse assets in proportion to risk funds greater than 90 percent. These eight associations had total assets of $2,703 million at June 30, 1999, and were about 6.2 percent of total assets of all direct lending associations. An association's risk funds include at-risk capital, surplus, and allowance for losses. These eight associations would not materially impair the safety and soundness of the System or their funding banks.

FCS institutions are in a better position today to absorb risks than they were in the 1980s.

"Today's economic environment differs from the one that led to the agricultural crisis of the 1980s," Smith said. "Interest rates are low and stable, farm debt levels are moderate, and real farmland values, although increasing, have not escalated as they did in the 1980s. System institutions have higher capital and loan loss reserves levels than in the 1980s and are in a better position to absorb risks," he added.

"Although conditions today are different than those of the 1980s, several factors pose risks to System institutions," Smith said. These factors include the continuing low commodity prices, poor yields in drought stressed areas, and uncertainty regarding the future of Federal farm programs. While Congress is likely to act this year to provide aid to farmers, the safety net for farmers is shrinking. Government assistance to farmers will be essential to relieve the stress in 1999.

Copies of the report are available from FCA's Office of Congressional and Public Affairs, 1501 Farm Credit Drive, McLean, VA 22101-5090; phone, 703-883-4056; e-mail, info-line@fca.gov.

Chairman Martin Addresses National Agricultural Credit Committee

On September 13, FCA Board Chairman Marsha Pyle Martin addressed almost 50 representatives of regulatory agencies and banking organizations at the National Agricultural Credit Committee's semi-annual conference in Chicago. The conference was hosted by the Federal Reserve Bank of Chicago. The committee also holds a conference in Washington, D.C., during April each year.

Martin emphasized the need for change in the world of agricultural finance to accommodate the changes taking place in agriculture, the financial marketplace, related technological innovations, and the rise in partnerships and alliances. She specifically encouraged more alliances and partnerships between Farm Credit System institutions and commercial banks.

Martin concluded her remarks by highlighting the increasing globalization and concentration within agriculture and the significance of integrated markets. She also quoted Fed Chairman Alan Greenspan on the importance of agricultural trade to domestic agriculture and the U.S. economy.

Debate on Allowance for Loan Losses Expected to Have No Significant Effect on Farm Credit System Institutions

Farm Credit Administration Chief Examiner Roland Smith recently discussed his expectations regarding the effect on Farm Credit System institutions of the Financial Accounting Standards Board (FASB) guidance on accounting for allowance for loan losses (ALL).

"Despite the lengthy discussions the FASB statements have generated among banking and securities regulators, I do not expect a significant change in the FCS institutions' accounting for ALL," said Smith.

How to account for loan losses has been a topic of recent debate. The FASB issued Statements No. 5, "Accounting for Contingencies," and No. 114, "Accounting by Creditors for Impairment of a Loan," in 1975 and 1993, respectively. Those Statements provide the general principles a creditor should apply to account for impairment in a loan portfolio.

The FASB provided further guidance on accounting for ALL in its *Viewpoints* issue of April 1999. That *Viewpoints* issue led to discussions among the FASB, the Securities and Exchange Commission (SEC), and banking regulators. Earlier this year, Congress held hearings to clarify the loan loss reserve accounting issues and to strongly encourage the parties involved to work together to resolve their differences. Consequently, the Federal regulatory agencies and the SEC released a joint statement in July agreeing on the important principles of establishing and maintaining an allowance for loan losses.

The American Institute of Certified Public Accountants is scheduled to issue a final rule later this year in an attempt to further clarify the issues surrounding the allowance for loan losses. The FASB cleared the rulemaking project during a September 8, 1999, meeting.

The Office of Examination's (OE) position regarding the underlying principles on accounting for ALL is highlighted below:

- The ALL accounting employed by the FCS institutions should comply with Generally Accepted Accounting Principles (GAPP);

- The process of establishing an adequate ALL involves a significant degree of sound management judgment;

- In an increasing risk environment, a conservative approach should be used to establish an adequate but not an excessive ALL;

- The ALL evaluation process usually results in a range of estimated losses that can be considered acceptable, yet the amount selected must be based on management's best estimate within the range;

- The ALL evaluation and pertinent analysis must be well documented and applied consistently from year to year; and

- Given the current agricultural environment, any significant change in ALL or the ALL process by an FCS institution would prompt OE's concern.

As other Federal regulators, the FCA requires all FCS institutions to maintain their allowances in accordance with GAAP. The Office of Examination will soon release an Informational Memorandum for FCS institutions that outlines the Chief Examiner's expectations on FCS institutions' accounting for ALL.

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The Farm Credit Administration is the Federal agency responsible for the regulation and examination of the Farm Credit System, a nationwide network of cooperatively owned agricultural lending institutions and their service organizations.

Variety of Issues Discussed at FCA Examiner Conference

Office of Examination Conference participants return for another session after a break. Pictured, left to right, are Lynn Major, Sarah Kreger, Allen Moore, all from the McLean Field Office, and Doug Wheeler, Dallas Field Office.

FCA examiners from McLean headquarters and all field offices attended the Office of Examination's (OE) biennial conference in San Diego, California, August 9-13. FCA Board Chairman Marsha Pyle Martin addressed the group and discussed her vision of the Farm Credit System and FCA.

"In my discussions with directors and officers throughout the System, I have frequently heard comments that FCA examinations add value to the FCS," Martin told the examiners. "Anyone can follow a checklist, but your skills and experience allow you to go much beyond that and to get at the root of any safety and soundness problems." She concluded her remarks by noting the FCS has a great future in financing food and agriculture, and that FCA examiners will be key to that future success.

Board members Ann Jorgensen and Michael Reyna also attended the conference and provided their insights on various issues during a panel discussion. They shared their views on the future role of FCA and the System and discussed the major issues facing the Agency.

"The role of the regulator is changing," said Jorgensen. "We must continue to focus on safety and soundness, but we also need to develop new and creative ideas on how FCA can improve, and how we can enable the System to better serve agriculture and rural America."

Reyna said FCA's single biggest asset is its staff. "It is important that we have a talented staff that, in addition to doing a good job of examining and regulating, can spot emerging trends and take advantage of the early warning systems we have developed."

Besides breakout sessions on examination and credit issues, the conference featured several outside speakers. Bruce Roland of PricewaterhouseCoopers addressed Year 2000 technology issues. He said regulatory personnel must take the steps necessary to become an integral part of the risk management structure and process.

Dr. Ed Seifried, professor of economics and business at Lafayette College in Easton, Pennsylvania, discussed "Economic Forecasts in the New Millenium." He reviewed his selected economic indicators and how to use them to predict economic recessions. Seifried pointed out that two statistics are providing strong positive signals for the economy—the Index of Leading Indicators and the interest rate spread between 10-year Treasury securities and 90-day T-bills. He said these indicators lead him to believe that an economic recession is not likely to occur before the end of 2000. Seifried also discussed the "wealth effect" and the resulting spending patterns of individuals.

The conference also featured three farmer/ranchers who serve on the boards of Farm Credit System institutions—John G. Nelson, III, Chairman of AgAmerica, FCB; Wayne Allen, Chairman of Sacramento Valley Farm Credit, ACA; and John L. Guthrie, Chairman of Western Farm Credit Bank. Each provided his perspective on the "Role of a Bank Director" and shared his views and ideas on the FCS and FCA. They noted FCS directors learned a lot from the crisis of the 1980s and are now quicker to respond to problems. They also pointed out that FCS institutions today are technically stronger and more attuned to forecasting and long-range planning.

The conference concluded with FCA Chief Examiner Roland Smith presenting awards to examiners and support staff in recognition of their contributions and achievements.

FCA Board Approves Regulatory Performance Plan

The FCA Board recently approved FCA's Regulatory Performance Plan for fiscal year 2000. The plan contains the projected schedule for regulation development during the fiscal year beginning October 1, 1999. The Agency has placed special emphasis on developing regulations using innovative customer-focused techniques. These include Advanced Notices of Proposed Rulemaking (ANPRM), Direct Final Rulemaking, Negotiated Rulemaking, Streamlined Fast-track Rulemaking, and other methods of gathering additional information from clients and customers. To streamline the regulatory process, the FCA is also encouraging the public to submit comments on regulatory proposals electronically.

FY 2000 Regulatory Performance Plan

Regulation Project/Date	Type of Action	Purpose
October – December 1999		
Flood Insurance Amendment	Direct Final	To remove regulatory reference to the Federal Emergency Management Agency's standard flood hazard determination form and make other technical amendments needed.
Stock Issuance	Proposed	To consider permitting Farm Credit System institutions, including service corporations, to issue additional amounts of certain classes of stock and allow service corporations to issue non-voting stock to non-System institutions.
January – March 2000		
Mission-Related Investments	ANPRM	To assist us in developing safety and soundness standards and other criteria for mission-related investment activity. We hope to gain valuable information in response to the ANPRM that will enable us to better address this issue through future regulatory initiatives. Mission-related investment activities are those that directly relate to agriculture, increase the flow of funds to farmers, ranchers, cooperatives, and rural areas, or otherwise support the ongoing mission of the FCS.
OFIs – Risk Weighting of Loans at FCBs	ANPRM	To consider revising the current risk-weighting requirements for OFI direct loans and other related changes necessary for the safety and soundness of Farm Credit Banks.
Customer Choice	Final	To provide additional flexibility for borrowers to obtain financing from System institutions of their choice and to otherwise de-regulate lending restrictions on FCS entities.
Regulatory Burden – Phase II	Notice	To address comments received from the Regulatory Burden Notice published in August 1998. Would specifically inform the public of the Agency's rationale for retaining certain regulations due to statutory requirements or safety and soundness concerns.
April – June 2000		
Loan Participations & Purchases	Proposed	To remove regulatory restrictions affecting the System's ability to purchase interests in eligible loans and address any technical changes necessary.
Disclosure – Annual Report	Proposed	To consider eliminating the requirement that FCBs distribute their financial reports to the stockholders of their associations.
Standards of Conduct Plain Language Revision	Direct Final	To revise existing Standards of Conduct regulations so they are written in "Plain Language."
July – September 2000		
Borrower Rights	Proposed	To revise the borrower rights regulations to provide clarification and remove unnecessary burdens.
Termination Regulations	Final	To establish regulations under which a bank or large association within the Farm Credit System can terminate its charter as provided in the Farm Credit Act of 1971, as amended.
Mission-Related Investments	Proposed	To develop safety and soundness standards and other criteria for mission-related investment activity. Mission-related investment activities are those that directly relate to agriculture, increase the flow of funds to farmers, ranchers, cooperatives, and rural areas, or otherwise support the ongoing mission of the FCS.