Remarks by
The Honorable Leland A. Strom
Chairman and CEO, Farm Credit Administration
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Good morning, and thank you for that kind introduction. I would like to thank Chairman Mike Garnett and the Farm Credit Council Board for the invitation to be with you this morning at the 29th annual meeting of the Farm Credit Council.

Let me first recognize my two colleagues on the FCA board, Ken Spearman, who chairs the Insurance Corporation board, and Jill Long Thompson, for their tireless passion for Agriculture and the work of the Farm Credit Administration.

I would also like to recognize the FCA and Insurance Corporation senior management who are here today, and all the hard-working staff back at the office and in the field, who continually dedicate their efforts to the successful operation of the Agency. This past fall, it was an honor for me to receive, on behalf of the Agency, its first ever recognition as a "Best Places to Work in the Federal Government" awarded by the Partnership for Public Service. This is a significant achievement for the Agency.

I want to say a special thanks to my loving wife of 35 years, Twyla, for all of her love and support. I could not do the things I do without you. She and I became first-time grandparents this past fall with the arrival of a little granddaughter back in Illinois.

As is typical of my previous opportunities to be with you as FCA Chairman the past three years, I plan on sharing a brief update of our views of the condition of the System and of current issues on the Agency's regulatory schedule.

Because the end of my six-year term arrives later this year, and this may be my last address as FCA Chairman to this meeting, I plan on spending the last few minutes sharing some personal observations of the future for the System. Finally, I will leave you with three questions to consider for the future.

System Update
Now an update on the System: Overall, conditions in the agricultural economy continue to be quite good. The U.S. Department of Agriculture estimates net farm income to increase by 28 percent in 2011, due primarily to higher crop receipts as a result of elevated commodity prices and strong livestock sales.

The Farm Credit System remains fundamentally safe and sound as it continues to report strong results. For the first nine months of 2011, System net income totaled just under $3 billion. An increase in average earning assets, favorable net interest margins, and lower loan provisions were the main drivers. With its strong earnings, the System continues to enhance its capital base. As of September, System capital totaled nearly $36 billion, up more than 8 percent from year-end 2010.

Asset quality in the System's loan portfolio has shown some improvement. Nonaccruals and provisions for loan losses have declined as certain sectors like livestock and dairy benefitted from strong pricing.

The overall picture for agriculture remains strong especially in the Corn Belt states, as evidenced by the recent acceleration of land prices to record levels. Farmers, having made good returns and armed with strong balance sheets, have bid up the price of farmland along with a more active investment community who see good opportunity in owning land. Consequently, cash rents have gone up also. I've received more press inquiries on this topic than any other this past year, with the question being "Is this a land price bubble?" My response has been, and continues to be, that the underlying fundamentals support strong land prices, but everyone involved needs to "exercise extreme caution." The Agency held meetings this past year with the Federal Reserve, FDIC, and the Office of the Comptroller of the Currency to examine this issue, and we plan to hold more this year.

Agency Operations

Now let me move on to several of the Agency's operations, beginning with our rulemaking efforts. Please note that since several of the rules I will discuss are proposed rules, I am limited in what I can discuss regarding those proposals.

First, I'll mention the Proposed Rule on Planning (Diversity and Inclusion). At its April 2011 meeting, the FCA Board proposed an amendment to our rules that would require System institutions' business plans to incorporate marketing and human capital plans that address diversity and inclusion within the institution's marketplace, workforce, and governance structures. I want to thank those of you who provided us with many well-thought-out comments and constructive input.

Diversity and inclusion will continue to be of key interest to FCA. 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. To further illustrate our own commitment to diversity and inclusion principles, FCA recently hired a full-time Equal Employment Opportunity and Inclusion Director.

In May 2011 the FCA Board amended the Lending and Leasing Limits Rule and established a new Concentration Risk Mitigation Policy requirement. The long-term objective of this rulemaking is to strengthen the safety and soundness of System institutions.

In August, the FCA Board adopted an Advance Notice of Proposed Rulemaking on Capital Regulations, requesting comment on potential alternatives to the use of credit ratings to determine risk weights for regulatory capital purposes.

Staff also continues to review and analyze developments in the financial industry and what other federal financial regulators are proposing or adopting in their capital regulations from guidance being issued by the Basel Committee. We plan to develop a proposed rule later this year, once we have sufficient information and a better idea of how the financial and regulatory landscape is evolving regarding capital.

In November, the FCA Board approved a Proposed Rule on Liquidity and Funding. The proposed rule would

- improve the capacity of FCS banks to pay their obligations when they fall due,
- strengthen liquidity management, and
- strengthen contingency funding plans.

In December, the FCA Board approved a Proposed Rule on Senior Officer Compensation Disclosure and Related Topics. The proposed rule would

- require banks and associations to hold nonbinding advisory votes on senior officer compensation,
- require banks and associations to issue timely and transparent reports to shareholders regarding significant events that occur between annual reporting periods, and
- require disclosure of the overall risk and reward structure for senior officer compensation plans and the relationship between compensation and performance.

Earlier this month, the FCA Board adopted a System Audit Committee Proposed Rule that would remove the ability of the Funding Corporation board of directors to deny, by a two-thirds majority vote, a System Audit Committee request for resources to engage independent legal counsel, outside advisors, or consultants. The proposed rule would instead require appropriate funding to the Committee to perform these duties, quarterly reporting to the Funding Corporation board on resources used, and annual reporting to investors.

You may recall that in May 2008, the FCA Board issued a Rural Community Investments Proposed Rule that would allow System institutions to make specific types of investments in rural communities. The Agency received a record number of comments, the majority of which were in opposition to the proposed rule. Since then, the Agency has contemplated the issuance of a new rulemaking with a narrower focus than the previously adopted proposed rule. Staff plans to present this new proposal for Board consideration in early 2012.

Let me also mention other actions the FCA Board took this past year. We approved two corporate applications:

- **CoBank/U.S. AgBank Merger:** This merger represented the largest corporate restructuring in the history of the Farm Credit System and included the most comprehensive review ever conducted by the Agency.
- **Merger of FCS of the Mountain Plains, ACA, and American AgCredit, ACA**

Both of these mergers took effect January 1, 2012.

Consistent with years past, the Office of Examination recently provided information to each Farm Credit System institution on its National Oversight Plan covering areas where we have a specific examination emphasis for the upcoming year. These focus areas are in addition to the Agency's ongoing examination and oversight activities. Senior staff from the Agency, including the Chief Examiner, will be presenting at the breakout sessions later today and discussing these topics. I encourage you to sit in on those sessions.

We continue to work with the System to improve the quality and consistency of the FCS Loan Database as well as address issues with shared asset data. In our Fall 2011 Unified Agenda, we included a rulemaking project to consider minimum regulatory FCA data needs for evaluating risk in System loan portfolios. This is a very important ongoing project for both the Agency and the System.

In December, we distributed the 2011 Young, Beginning, and Small Farmer Annual Report Call Questionnaire to System banks and associations. Revisions this year will help us better review how associations implement and measure the outcomes of their YBS policies with a particular emphasis to lending results of the YBS programs.

On December 23, USDA's Rural Business Investment Companies Rule for the licensing of non-leveraged RBICs was published in the Federal Register. FCA Staff is working with USDA on steps to assist in the implementation of the licensing program.

The Agency continues to monitor implementation of the Dodd-Frank Act as well as the new rules being brought forth by the newly created Consumer Financial Protection Bureau and other financial regulators.

In November, the FCA Board adopted Policy Statement 81, "Ethics, Independence, Arm's-Length Role, Ex Parte Communications and Open Government." This policy reaffirms the Board's commitment to the ethics laws and regulations, its avoidance of ex parte communications in its judicial and rulemaking roles, its commitment to open Government, and its role as an independent, arm's-length safety and soundness regulator.

We take our independent, arm's-length role very seriously at the Agency because it is important that the System, as a GSE, have a strong independent regulator. We saw Fannie and Freddie hire high-powered lobbyists to restrict regulators' ability to regulate and to cut their budgets. More recently, MF Global visited the CFTC and argued against further regulations shortly before the company collapsed. You as individuals, and collectively as institutions and as a system, have a right to speak your minds under the Constitution. But I suggest that some prudence is called for in self-regulating your own approach here in Washington. For the System, this is important if you are to continue to make the argument that you are not just like the other GSEs.

As a forward-looking, risk-aware agency, we are always looking to the future and preparing for change. For example:

- We are hiring new talent to replace our retirement-eligible workforce.
- We are adopting new technologies that will help us be more effective in risk identification and build further efficiencies.
- As part of a Government-wide initiative, we are planning for the potential impacts climate change may have on our mission, programs, and operations.

Local Foods Sector

I would like to follow up on my comments from last year in regard to developments around the local foods sector. My comments are tempered because we remain in a rulemaking stage on the diversity and inclusion proposed rule. In that rule, the Agency added a marketing plan component to the business planning process to further the System's responsiveness to <u>all</u> farmers and ranchers in each association's territory who have a basis for credit. I would like to address two components of this proposal.

First, what is meant by all (and I emphasize **<u>all</u>**) farmers and ranchers? Many associations have developed very efficient marketing programs for farmers and ranchers involved in commodity-type agriculture (from corn and soybean production to livestock, for example). Education and outreach to these farmers and their children have been ongoing and impressive. However, the concept of service to **<u>all</u>** farmers and ranchers includes those farmers who are not involved in commodity agriculture, but rather farm and market their products directly to consumers, local restaurants, schools, hospitals, etc., in what many call the Local Foods System. My recent travels to meet with some of these farmers, and the groups that work within this sector, demonstrated to me that these groups of farmers are for the most part operating viable farming operations that are part of the **<u>all</u>** of agriculture. But in my discussion with these farmers, I discovered that many do not know the Farm Credit System, or know that its mission is to serve all agricultural producers with a basis for credit. I encourage you, in your research of the agricultural operations within your lending territory, to seek out these farmers and understand their operations and credit needs.

The second issue is the concept of creditworthiness as it relates to these farmers. As you know, a model to determine the creditworthiness of these farmers would likely be different from that used for a commodity-based farmer. These farmers typically do not present strong capital positions or real estate to pledge as collateral, but that, in and of itself, does not mean that they are not creditworthy. I am not advocating that you make loans that would pose safety and soundness concerns for your association, but in fact these farmers may be creditworthy, taking into account their various strengths.

My hope is that all of our collective efforts will, in the long term, help producers and operators in this and other emerging sectors of the agriculture and food industry. We've enhanced the Agency's commitment to the further study of these issues with the appointment of a Special Advisor of YBS and Local Food Systems.

Personal Observations

Now, on to some of my personal observations: Having spent virtually all of my working life connected to the System in some form, beginning as a borrower 35 years ago, to being the Chairman of FCA these past four years, time and roles have afforded me an interesting perspective.

I have seen and been part of the best of times and the worst of times in the agriculture industry. Starting farming in the 1970s was certainly an interesting time. Land prices were going up as were many of the costs, including interest paid on debt. But times were perceived to be good and the future looked bright.

But then the 1980s struck a serious blow to the entire industry, and as a result, many producers left the industry. Particularly hard-hit was the upper Midwest grain belt, where land prices were most affected.

Having been elected to a PCA board in 1981, I was a participant in the important but many times difficult decisions that boards of directors had to make. By the late '80s, Congress had stepped in to assist the System with a line of credit from the Treasury. As directors, we set about the long and arduous task of rebuilding and restructuring.

It is an amazing story, these past 25 years—a story filled with grit and determination by so many in the System and the agriculture industry. As I stand here today, I can recall the faces of leaders, both board and management, who played such significant roles in shaping the System's road to success.

Today, the agriculture industry and the Farm Credit System have arrived at their most healthy and profitable juncture in decades. For 2011, the ag sector will post a record net income, and the System will likely report record net earnings of nearly $4 billion. This will have occurred at a time when the System's debt obligations decreased nearly 2 percent while its noninterest expenses rose more than 10 percent.

A couple of factors have contributed significantly to these earnings. First is the System's tax exemption, provided many decades ago, on the earnings from its long-term real estate lending activities. My estimate, based on a back-of-the-envelope calculation, is that approximately $600 million of the $4 billion in earnings is a result of the tax exemption. In addition, even though it is impossible to put an exact value on the System's GSE status in terms of savings from lower funding costs, certainly there is a monetary benefit extracted because of that status.

Since the low point for the System and the agricultural economy in the mid-1980s, the focus of System leadership was on building stronger institutions. Earnings were used to build capital, in addition to building the insurance fund and repaying the financial assistance including interest. Both the GSE status and tax benefits enhanced the System's ability to do so.

Today, the System is well capitalized and has a fully funded Insurance Fund. With the System being in a much better financial condition, I applaud some of the recent actions by institutions to become better corporate citizens. But there is still much that can be done to help build a secure future, not only for those already involved in agriculture, but those yet to enter.

So I leave you today with some important questions that I believe every board and management team needs to consider from this point going forward.

First, given the events and changes of the last several years with regard to financial institutions, regulators, and GSEs, how is the System going to proceed as a GSE, with its own independent arm's-length regulator, to differentiate itself from others and their recent practices?

Second, with the System today being financially stronger in all aspects than at any time in its history, going forward, how will it be a steward of the benefits provided by the public, such as the GSE status and tax exemption?

And finally, with the agriculture industry being much different today than at any time in its history, how will the System continue to meet its mission of serving all of agriculture in the years to come?

I look forward to continuing to work with my colleagues on the important matters of the Agency this year. I wish the System well now and in the future, and am confident all of our efforts will secure a bright future for agriculture and rural America.

Thank you.