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 join you here in Orlando for your annual meeting and to get acquainted or re-acquainted with many of you.

Before beginning my remarks this morning, I want to mention that FCA has a relatively new Board. Mr. Kenneth Spearman joined the Board last October, and Dr. Jill Long Thompson just recently came on the Board in March. We are working in a manner to make sure the Agency appropriately carries out its role to oversee and maintain the safety and soundness of the System. For example, we are now undertaking a complete review of all FCA Board policies. Our goal is to make sure the agency operates not only effectively and efficiently, but also with as much transparency as possible.

Today I am pleased to report that, despite a very challenging period for the credit markets and the general economy, the System's overall condition and performance remained sound in 2009, and this positive performance has continued during the first half of 2010. The System is well positioned to withstand the continuing challenges posed by the general economy and by stress in some sectors of the agricultural economy.

However, the financial market turmoil, prolonged economic weaknesses, and deterioration in the agricultural economy pose significant management challenges for borrowers, System institutions, and FCA. During the past two years, sectors experiencing the most stress have been hogs, dairy, forestry, ethanol, and poultry. Together these sectors represent more than 20 percent of the System's portfolio. System borrowers continue to face increased risk from volatile commodity prices, soft farm product demand, higher input prices, and uncertain weather conditions.

Increased unemployment has also adversely impacted many rural communities. The potentially slow economic recovery and uncertain housing recovery suggest that 2010 may be another difficult year for many agricultural producers. As we have seen, the financial crisis that started in 2008 has particularly impacted certain regions of the country, especially Florida. These uncertainties will present challenges to lenders and regulators alike. The importance of being prepared for unknown challenges is exemplified by the recent oil spill in the Gulf of Mexico, a disaster of major proportions that will take some time to fully comprehend its impact.

Therefore, the System and FCA must remain vigilant and proactive. For many financial institutions, the past year was characterized by declining credit quality and increased loan losses. Some of the System's key performance measures have weakened because of the difficult economic environment and management issues in a few institutions. To address these instances, FCA has increased its supervisory activities. We now have 17 institutions under special supervision or enforcement actions. Also, the Financial Institution ratings for many institutions have slipped during the past year. System loan portfolios are still stressed, which in turn puts pressure on capital, management, earnings and liquidity.

We are continuing to focus the resources necessary to intensify oversight, take proactive measures to safeguard institutions, and identify emerging risks across institutions. Our Office of Examination developed a National Oversight Plan to ensure that all examinations have consistent priorities and focus squarely on material and emerging risks. Also, to ensure that we can provide the proper supervision and oversight of the System and Farmer Mac, we are continuing to increase our examination staffing levels. These additional resources are necessary, especially because of the higher risk environment and the impending retirement bubble we face.

Since I became FCA Chairman just over two years ago, we have increased our communications to the System on safety and soundness issues. For example, we issued an Informational Memorandum on “Confronting the Increased Risk Environment” and provided other guidance addressing such issues as executive compensation, responding to local financial institution failures, and financing land in transition. We issued an Informational Memorandum on “Consumer and Borrower Rights Compliance Requirements.”

We are continuing to provide you additional guidance during 2010 to address safety and soundness, as well as other important issues. For example, Chief Examiner McKenzie sent an Informational Memorandum further outlining our stress testing expectations for all System institutions. We believe an important goal of stress testing is to enhance the understanding by both management and the board of the institution’s portfolio risk under a range of operating environments. This is valuable in providing information for use in key decisions such as setting capital goals, formulating underwriting standards, pricing loans, and establishing concentration parameters. Stress testing also enables an institution to identify vulnerabilities by exposing it to plausible stress scenarios. We also recognize our own need to do work in this area, and we are nearing completion of a project to stress test capital and earnings capacity for all System associations and banks.

I also want to comment on what is happening on the legislative front. The U.S. House of Representatives recently approved the Wall Street Reform and Consumer Protection Act, and Senate approval of the bill is expected later this week and then on to the President for signing. During the past several months, we had productive meetings with Treasury and with key staff on the House and Senate Agriculture Committees to discuss how the proposed bill would affect the Farm Credit Administration, the System as a whole, and Farmer Mac. I’m glad that Congress addressed this difficult issue, and I believe the final bill resulted in an appropriate framework for the System. It keeps intact the current regulatory structure and ensures that FCA can continue to appropriately oversee the System and keep it safe and sound.

However, there are still challenges ahead, as Congress will address the 2012 Farm Bill and take up GSE Reform. As Congress looks to determine the future of Fannie Mae and Freddie Mac, the impact on all GSE's could be significant. The System should also be prepared for additional scrutiny as that process unfolds.

Going forward, the Agency's overriding objective must continue to be the safety and soundness of the Farm Credit System. As an example of our focus on safety and soundness, the FCA Board last week proposed a rule that would lower the lending and leasing limit for a single borrower or lessee from the current limit of 25 percent to no more than 15 percent of an institution's lending and leasing limit base. The proposed rule would also require System institutions to adopt written policies to measure, limit and monitor exposures to concentration risks.

By ensuring safety and soundness, we help the System serve the ultimate purpose for which it was created—to ensure market access and competitive credit for farmers, ranchers, and their cooperatives. However, we must continue to prepare for the increasingly complex nature of financing agriculture and rural America in response to the changing and riskier environment we face today.

But while we address the pressing problems, we must also keep an eye to the future. And, looking to the future requires us to think more strategically. A few months ago, I communicated to you my views on association mergers in economically challenging times. I noted that in stressful times, boards of directors may need to pursue and make merger decisions quickly. I believe that it is important for each association to strategically and proactively consider different merger scenarios long before a merger is imminent.

Last week the FCA Board approved a Bookletter on Farm Credit System bank mergers. In that Bookletter, we noted that mergers of System banks may provide benefits and create risks for the merging banks, bank shareholders, the System as a whole and all eligible borrowers. Benefits of a bank merger may include portfolio and geographic diversification, improved risk-bearing capacity, management capability, and operational efficiencies. However, a bank merger may increase risk by creating a larger, more complex and difficult-to-manage institution. Such a bank may present broad risks to other System institutions. Therefore, when evaluating a bank merger application, the FCA will carefully consider the long-term impact on the safety and soundness at the institution, district, and System levels, including size, concentration risk, business model compatibility, and intra-System operational risk. Of particular importance are the implications these risks may have on the System's long-term service to eligible borrowers and its continued ability to fulfill its mission as a government-sponsored enterprise.

This past January at the Farm Credit Council's Annual Meeting, I challenged System leadership to proactively prepare for potential corporate restructurings by having an open, thoughtful, and meaningful internal dialogue about structure and the types of mergers that best position the System for its safe and sound long-term success. I realize that merger decisions primarily rest with a System institution's stockholders. But if a time comes that Congress has questions or concerns about the structure of the Farm Credit System, it will first direct its attention at the regulator.

In addition, Farm Credit institutions should plan for the future of an agricultural industry that continues to change. Consumers are now interested in knowing how, where, and by whom their food is produced. This interest has generated a surge in the local foods sector, creating opportunities for producers. The next generation of farmers is watching this development closely. They recognize that meeting the demand for sustainably produced local foods allows them to diversify their farming operations, which in turn helps revitalize rural communities.

The growth in local food systems presents an opportunity for the Farm Credit System as well. Your institutions can play an essential role in supplying capital and expertise to create localized food supply chains. At the same time, this will also demonstrate Farm Credit's dedication to our young, beginning, and small farmer mission.

As agriculture and rural America continue to contend with a challenging economic environment, FCA remains committed to ensuring that the System can fulfill its mandate to current and future generations of farmers and ranchers and the rural areas in which they live. Again, I appreciate the opportunity to be here with you today at your Annual Meeting, and I look forward to working with you over the coming year.

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