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 here with you today, and I especially want to thank Buddy Cortese and Larry Doyle for the invitation. It's a pleasure to be here in the "Land of Enchantment," which is a beautiful setting for your annual stockholders' meeting.

I'm also pleased to see a number of familiar faces again as I've worked with many of you over the years in my roles as an association director and Bank director. Now, I am very honored to serve in my new role as the Chairman of the System's regulator. I am also honored to serve on the FCA Board with two very distinguished colleagues – Nancy Pellett and Dallas Tonsager. Both Nancy and Dallas are so dedicated to agriculture and have been of tremendous service to the Board and FCA. As you have heard, Dallas has been announced by President Obama to serve as USDA Undersecretary for Rural Development. So, it's likely the FCA Board will have two new members in the near future.

Since I became FCA Chairman just 10 months ago, so many things have happened so quickly. Some of the world's largest financial institutions have failed. Fannie Mae and Freddie Mac have been taken over by the Government. And the Government has provided, and is poised to provide, unprecedented financial assistance to help end the crisis. As we have just seen in the past few weeks, the Government has provided even more assistance to CitiBank and AIG. Who could have imagined the extent and pace of all of these changes?

As your 2008 Annual Report noted, "During the turbulence that rocked the global financial sector in 2008, virtually every lender felt the tremors. A number of institutions were shaken, and a few collapsed." Your report also noted that the Farm Credit Bank of Texas "stood strong and stable," and that Farm Credit was established for times like these.

Indeed, the Farm Credit System was designed to be there for agriculture and rural America in good times and bad. And fortunately, the Farm Credit System remains safe and sound. The System is financially strong and well positioned. It has good credit quality, adequate capital, strong earnings, and sufficient liquidity.

But, risk is beginning to surface through some of the ratings of System institutions by the FCA examiners, as part of our Financial Institution Rating System (FIRS). I will comment further on this in a moment.

At the Farm Credit Council Annual Meeting in January, I noted the agricultural industry has been largely spared the effects of the current financial crisis. The financial condition of agriculture continues to look quite positive. Farm income is strong and debt ratios are low. For this we can be grateful.

But as I said in January, the overall numbers don't reflect the pressure of increasing input costs, which have plagued livestock (especially dairy and poultry) and ethanol producers. And increasing input costs may soon trouble other producers as well if commodity prices continue to soften. Grain prices, which reached historic highs in the summer of 2008, have dropped substantially. If prices stay at these levels, this may hurt the profitability of grain farmers this year.

And, as I'm sure you know, we are seeing some stresses in some of your institutions in this District.

The System may also face new challenges and opportunities. For example, how do the policies of the new administration, such as the emphasis on a greener economy, affect agriculture and your institutions? There are likely new opportunities as well as risks involved in pursuing these policies, just as we've seen more recently with the ethanol industry. The System has been a major lender to the ethanol industry, a major initiative of past Administrations, and we all know the stress this industry is now facing. How will this affect the System's interest to support new initiatives toward a greener energy industry?

With so many threats to agriculture and the general economy, the System does face risk. As the leaders in the 10th Farm Credit District, you have the daunting task of navigating your institutions through this tumultuous period.

Just before I left to come here this week, I received a summary report of the recent FIRS ratings of all FCS institutions. These ratings peaked in 2005 with over 80 percent of all institutions rated 1, the best possible rating, and the remaining 20 percent were rated 2. The most recent reports indicate that 1 ratings have dropped to 60 percent; 33 percent are now rated 2; 6 percent are rated 3; and one institution is now rated 4.

So, we do see that risk is beginning to surface in the System, and I urge you to be prepared and to be proactive. As FIRS ratings decline, the Agency's oversight and enforcement of safety and soundness will increase accordingly.

As the regulator of the System, FCA is committed to helping ensure the safety, soundness, and strength of your institutions. We have demonstrated this commitment by our recent actions.

For example, we are working with other financial regulators to raise their awareness of the impact of their actions on FCS institutions. Late last year, Jamie Stewart of the Funding Corporation and I met with Donald Kohn, Vice Chairman of the Federal Reserve Board. Separately, I also met with Sheila Bair, Chairman of the Federal Deposit Insurance Corporation. Since then, FCA staff has had follow-up contacts with staff at the Fed and FDIC, as well as regular contacts with Treasury, to further enhance our communication and to improve their understanding of the System and FCA.

Throughout 2008, we also provided guidance to System institutions. We issued Informational Memorandums addressing such issues as collateral evaluation requirements and asset growth, market volatility, and best practices for fast-growing institutions.

Earlier this month, we issued an Informational Memorandum regarding changes we have made to the Agency's Financial Institution Rating System. In our desire to maintain a strong examination and supervisory program, we have revised the factors and related examination guidance used in the FIRS to better reflect the conditions and environment in which System institutions currently operate.

For example, the FIRS guidelines have been revised to place a greater emphasis on risk management, the quality of management and governance, and other factors that affect the safety and soundness of System institutions.

Last November, FCA's Chief Examiner Tom McKenzie sent the System information outlining our "National Oversight and Examination Program for FY 2009." One of the areas dealt with stress testing, which I think is a key issue in dealing with this riskier environment. For example, have you stressed your portfolios to determine who is going to be hit first and the hardest from this drop in farm income? Earlier this week at FCA, Dr. John Penson, Jr., an agricultural economics professor at Texas A&M University, spoke to our staff. He noted the drought affecting Texas is the worst since 1918, and he specifically mentioned the importance of stress testing.

Another question to ask yourselves is: Do you have a good understanding of your counterparty risk exposure? Who do your customers have business relationships with? As we have seen recently with large poultry integrators, it is an essential risk management process for you to be able to readily identify significant common relationships in your portfolios. As events affect integrators, they can have a marked impact on the downstream relationships that may be financed by your institutions. Therefore, it's important that you have information systems and control processes to manage counterparty risks.

As agriculture faces more difficult times, I would also encourage you to make sure you are knowledgeable and up to date on administering various borrower rights afforded by the Farm Credit Act to borrowers that become distressed. Times have been good in agriculture for many years, and you may need to "dust off" your procedures and ensure they are adequate for dealing with a possible downturn in the agricultural economy. FCA will insist on strict compliance with the Borrower Rights provisions of the Farm Credit Act, so this is one you should get ahead of.

These are a few of the specific actions we've already taken. I'd now like to discuss the three main objectives I see as key to meeting the challenges of this crisis. As we move forward, these three objectives will be the focus of FCA.

First, the Agency's overriding objective must be to maintain the safety and soundness of the Farm Credit System. We are required by Congress to ensure that the System can adequately serve its public purpose and mission-related responsibilities. To do this, we must maintain strong examination and supervisory programs.

To ensure that we can provide the proper supervision and oversight of the System and Farmer Mac, we are increasing our examination staffing levels and staff resources. As a result of our increased focus on examination activities, you can expect to see our examiners more often — they will be spending considerably more time onsite in your institutions. They will be performing more loan reviews to test your credit risk controls and your internal credit review.

The Agency's second objective is to focus on establishing the right level of regulatory capital for Farm Credit System institutions. Along with liquidity and earnings, capital is a fundamental underpinning upon which the System's safety and soundness is built.

In 2008 we conducted a series of detailed informational meetings as part of the Advance Notice of Proposed Rulemaking on possible regulatory changes to the System's capital rules. Our goal is to enhance the System's capital framework and more closely align minimum capital requirements to risks taken by System institutions.

With the recent failures in the financial markets, we have seen an increasing interest and focus on capital levels of all lenders, and I urge you to reassess your positions and consider the current environment and market uncertainties.

And, finally, our <u>third</u> objective is to ensure that the System continues to meet its public policy purpose and mission-related responsibilities. For example, we will continue to encourage the System to serve young, beginning, and small farmers. We will carefully consider the Rural Community Investments rulemaking effort. And we will encourage System institutions to develop partnerships with other financial services institutions.

By focusing on these three objectives, I am confident that FCA can provide the System the guidance and support it needs to meet the challenges of this financial crisis and the needs of rural America.

But the System faces one challenge I haven't mentioned yet — regulatory and financial marketplace reform. The financial landscape has changed, perhaps forever. The Farm Credit System may be in a period of extraordinary strategic risk that could threaten its long-term GSE value, its mission, its structure, and its oversight as a separate GSE.

As a result of the financial crisis and the loss of confidence in financial institutions, there will be greater scrutiny of GSEs and their financial regulators.

This greater scrutiny and reform could even affect entities that have been doing things right — such as the Farm Credit System. Therefore, it is important that you be prepared to strategically respond to this challenge.

Before I close today, I'd like to briefly touch on one other issue. As you may have seen a few weeks ago, I sent a memorandum to all FCS institution boards communicating some of my thoughts on executive compensation and benefits programs.

There has been a very vocal Government and public outcry over excessive executive compensation packages. Just last week Federal Reserve Board Chairman Ben Bernanke, speaking at the Independent Community Bankers of America's National Convention, said, "Poorly designed compensation policies can create perverse incentives that can ultimately jeopardize the health of the banking organization." Specifically, Chairman Bernanke said, "Management compensation policies should be aligned with the long-term prudential interests of the institution, be tied to the risks being borne by the organization, provide appropriate incentives for safe and sound behavior, and avoid short-term payments for transactions with long-term horizons."

Now I fully support executive compensation programs that reward success and retain outstanding talent. However, it is important to also be mindful of the current business environment as well as the potential perception by the public and Congress.

I urge boards to carefully consider all of the issues, such as performance and retention, appropriate long-term and current incentive compensation, benefits packages, and concerns of your cooperative membership. I further suggest fully quantifying and understanding both the near-term and long-term expenses and financial consequences associated with the entirety of the executive compensation program and benefits, and, as always, the importance of paying particular attention to any potential reputation risks as a GSE.

The Farm Credit Act of 1971, as amended, requires FCA's examinations of banks to include an analysis of CEO compensation and employee salary scales.

I have asked FCA staff to review examination procedures, governing regulations, and activities in these areas. Soon, we will issue a Bookletter that provides additional information and guidance on executive compensation. We have also included a proposed rule on executive compensation disclosures as part of our regulatory agenda.

We will continue to look for ways to assist boards and compensation committees as they make some tough decisions on executive compensation and pension programs in an environment of increasing public scrutiny.

These are all collectively issues that relate to the importance of transparency and accountability, and I place a high priority on these issues.

I'll conclude today with this: It is in times such as these that the System, as a GSE devoted to agriculture and rural America, must continue to stand tall in the marketplace and be there for America's farmers, ranchers, agricultural cooperatives, and rural communities.

In all likelihood, the financial markets will continue to be in turmoil for some time. I am confident, however, that the Farm Credit System will successfully navigate through these difficult and uncertain times.

Again, my one piece of advice is to prepare for the challenges ahead. Don't be reactive, be proactive.

Remember what we learned from the 1980s. Agriculture can change rapidly — from feast to famine and back again. Let the knowledge and wisdom you gained from the hardship of the '80s crisis help you chart a course through these very uncertain times.

And know that, as your regulator, FCA stands ready to work with you to help you meet these challenges.

I have seen and witnessed much over the years as a farmer, as a System borrower, and as a System director. Today, as the Chairman of the System's regulator, I will strive to work with you in maintaining the safety and soundness of the System while it continues to meet its mission as a GSE to better serve agriculture and rural America in the decades to come.

Again, I appreciate the opportunity to be here with you.