Remarks by
The Honorable Dallas P. Tonsager
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Farm Credit Administration
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Introduction

Good morning. Thank you for the opportunity to speak with you today. I'd like to recognize Todd Van Hoose and Curtis Hancock for their leadership of the Farm Credit Council. I know you have worked hard this past year to commemorate the System's 100th anniversary of service to American agriculture.

I would also like to recognize the FCA and FCSIC staff who are with us today, as well as my FCA board colleagues, Jeff Hall and Ken Spearman. Jeff is now chairman of the board of directors of the Farm Credit System Insurance Corporation. And Ken, of course, just completed a term as FCA board chairman and CEO. His contributions to the System and FCA will serve us well for years to come. Thank you, Ken.

It is a great honor for me to be able to address you today and to help usher in the next 100 years for the Farm Credit System. Back in our office in McLean, we have a photograph of President Wilson, pen in hand, surrounded by individuals who have come to watch him sign the Federal Farm Loan Act of 1916.

At that time, the System was just a concept. Congress wanted to ensure that farmers and ranchers could get the credit they needed in good times and bad. Today, that concept is a reality — the System has over $240 billion in loans to its eligible borrowers. Over the past century, the System has weathered many storms. I believe the lessons the System learned in its first 100 years will help you meet the challenges of the next 100 years.

I come to you today not only as your regulator, but also as a former farmer and rural American. I've seen firsthand the impact that you can have in rural areas, and I believe in your mission. As board chairman and CEO of FCA, I will do all I can to help you succeed in fulfilling your congressional mission to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. During my chairmanship, I plan to focus on five key areas:

- Confidence
- Best possible outcome
- Partnerships
- All services to all borrowers
- System structure

Confidence

Let’s begin with the biggest lesson from the first 100 years — the importance of confidence. Since the moment President Wilson signed that bill, everything the Farm Credit System has done to build confidence has caused it to flourish. When confidence has been lost, the System’s role in American agriculture has diminished.

For the System to serve its members through the next 100 years, there is much to be done and it all revolves around maintaining confidence. The System needs the confidence of many groups, including ag producers.

Ranchers caring for their livestock each day and farmers going off to their fields in the spring need to know they will have the financial resources to achieve their goals. Many of them are member-owners of System institutions, and they have put their faith in the services provided by their associations.

But the System also needs the confidence of producers to whom it does not lend. These producers, regardless of their race or gender, the size of their operation, or the products they raise, need to be confident that the System will do its best to meet their credit needs as well. Serving all eligible, creditworthy producers is fundamental to the System’s mission.

But during the 1980s, many producers viewed lenders as soulless bankers who wouldn’t hesitate to grind them into the ground if they fell into difficulties. Since then, the System has overcome this image and recovered the confidence of producers.

But as we navigate this downturn in the farm economy, the way the System responds to producers in distress will again determine whether they maintain or lose confidence in their lenders.

And what about the bond markets? Because of your success in maintaining the safety and soundness of your institutions, investors have confidence in System debt. I believe that the capital rule that FCA adopted last year will strengthen that confidence. But keep in mind that investors view the System as one entity. So the actions of one System institution affect the reputation of the System as a whole. This means that each of you has a crucial role in maintaining the confidence that the markets have in the System.

The System must also be mindful of the confidence that Congress has in it. It only takes one example to raise doubts and questions among members of Congress. So to strengthen congressional confidence in the System, I would suggest three things:

- First, focus on your mission. Keep farmers and ranchers as your top priority.
- Second, tell your story. Don’t hide in the shadows. Meet with members of Congress. Tell them about your good work in their districts. Your critics spend a lot of time on the Hill putting you on the defensive by talking about your supposed failings. Get out in front of these people and tell your story to more effectively disarm your critics.
- And third, become a valued source of information to members of Congress. Your databases contain a goldmine of information that you use to identify trends in

agriculture and rural America. Meet with your congressional representatives to share your findings. They will appreciate the information, and you will demonstrate the unique value that the System brings to the credit industry. No one out there has the knowledge and experience you have, and this underscores the continued need for a government-sponsored enterprise to serve the credit needs of agriculture.

The confidence that all of these stakeholders have in the System is critical to its success. As we at FCA consider possible regulatory actions in the coming years, our focus will always be to strengthen and increase confidence in the System.

Best possible outcome

Another key area on which I plan to focus is the concept of the "best possible outcome." With the downturn in the farm economy, some farmers and ranchers have begun to experience financial stress. To help these borrowers through their difficulties, I would like to encourage you to seek the "best possible outcome" for every borrower.

As institutions of a government-sponsored enterprise, you have a mandated responsibility to serve the credit and related service needs of farmers, ranchers, and farm-related businesses. And times like these are when they need you the most.

In the 1980s America's farm lenders were challenged beyond their capacity. Credit became a substitute for income. As a result, there were thousands of bankruptcies; and tens of thousands of farmers, ranchers, and rural residents left rural America to find livelihoods elsewhere. Certainly this was the worst possible outcome for many.

So I would strongly urge you to look twice at every borrower in difficulty. Do they have a good business plan? Do they have a good operation? Do they have a good chance of making it when the economy improves?

If the answer to these questions is yes, I encourage you to think about what you can do — within the bounds of safe and sound lending — to help them through their difficulties.

But if the answer to any of these questions is no, then it may be time for a tougher conversation. In the long run, credit cannot be a substitute for income. You don't want to enable a borrower to go further into debt and to deplete their equity if they aren't likely to achieve their goals. You want to help them preserve their capital. What you have to look for is the "best possible outcome" for every borrower.

Partnerships

And now I'd like to address the third key area on which I plan to focus: partnerships. Over the past 10 years, you've been very successful in forming a variety of partnerships across rural America.

You have partnered with one another, with private investors, with banks large and small. These partnerships have helped you diversify and strengthen your loan portfolios, manage your risk, bring equity capital and liquidity to rural America, and lower the cost of financing for farmers and ranchers.

You have also partnered with veterans' groups, land grant universities, and urban communities.

Some of your partnerships have enabled you to improve the rural communities in which our farmers and ranchers live. They have resulted in new hospitals, schools, nursing homes, and other community facilities.

These initiatives have required only a modest amount of your capital, but they have done an enormous amount of good — not only for rural America but for agriculture, too. After all, viable rural communities are critical to a viable ag economy. As your regulator, we will continue to work to bring clarity to the approval process for these projects so that you can continue to participate in them.

All services to all borrowers

And the fourth key area involves providing all services to all borrowers. I believe that meeting the System's congressional mission involves providing all System services to all eligible, creditworthy borrowers. In other words, the System needs to have a level playing field. If borrowers in some territories can obtain rural home loans or ag operating loans, then borrowers in all System territories should have that same access.

How can you ensure this equality of opportunity? You have different options. You can use territorial concurrence to invite other institutions to lend in your territory. You can choose to build up this expertise in your own territory by hiring people with the right skills or training existing staff. Or you can form strategic alliances with institutions that offer what you don't.

In any given area of lending, the System has institutional experts. Look for ways to partner with them so that the people in your territories can get the services they need.

System structure

And the fifth and final key area on which I plan to focus is System structure. I would like to propose a year of dialogue between the System and FCA on this issue.

Over the past few years there's been a lot of talk about the right number of banks and associations. I don't know if there is a right number for associations. However, since the banks are jointly and severally liable for System debt, I believe there is a point where the System could be left with too few banks.

So in looking ahead, both the System and FCA will need to reflect more closely on the reasons and ramifications for mergers and other changes in System structure. Most merger proposals maintain the merger will result in economies of scale. But we must also consider how a merger would affect customer access and the institution's ability to understand the type of agriculture, commodities, and credit needs of the producers in the merged territories.

And there are many other questions to consider. How might a merger affect the relationship between the funding bank and its associations? Could the merger weaken the integrity and cooperative structure of the System as a whole? What operational, managerial, and reputational risks might result from the merger? And are we creating institutions that are "too big to fail" or leaving behind institutions that are "too small to prevail"?

To go back to my first key area, member-borrowers must have confidence that these mergers are in their best interest.

Like all of you in the System, those of us at FCA have a passion for agriculture and rural America. We all have a role to play in ensuring that the System remains designed to meet its mission of delivering sound and constructive credit to all creditworthy borrowers. Just like us, all of you in the System have a role to play in shaping your future structure. Don't sit on the sidelines and let the System evolve in a haphazard way. Think strategically. Be part of the decisions on how best to evolve as you move into your next 100 years.

State of the farm economy and the System

Of course, the challenge that is on all of our minds right now is the decline in farm income. After years of historic highs, farm income reached a peak in 2013, and it has been dropping every year since then.

Some farmers have depleted the working capital they built up during the string of good years, and they are feeling the strain of the tighter profit margins. At the moment, there are no signs of meaningful price improvements on the horizon.

Fortunately, the System is well-positioned to manage this stress. For the first nine months of 2016, it reported modest loan growth, favorable earnings, and higher capital levels. And despite some declines in credit quality, the System's portfolio loan quality is good.

Also, the Farm Credit Insurance Fund is now very close to its secure base amount, and this gives the System additional security. In fact, FCSIC Chairman Jeff Hall has asked me to announce the good news that FCSIC will reduce your assessments to 15 basis points as a result of the growth in the fund.

Farm economy today versus 1980s

Still, despite these causes for optimism, the state of the farm economy today is serious enough to bring back some bad memories. The specter of the 1980s haunts us still, so I'd like to take a moment to compare the challenges of those days with what we're facing now.

Let's start with farm income. This was certainly a problem in the 1980s. And just like the current decline, the '80s decline came on the heels of several years of record high farm income. Overproduction drove the decline then just as it does now.

But we also have some advantages over the 1980s. For one, corn producers have a huge new market that they didn't have in the 1980s. Today, ethanol soaks up 35 percent of our nation's corn crop.

And crop insurance is another advantage. More farmers today use crop insurance than they did in the 1980s.

With regard to interest rates, we are in a much better position today than we were in the early ’80s. At that time, the 10-year Treasury rate reached over 15 percent. Although interest rates are now rising, they are still very low, with the 10-year Treasury rate around 2.5 percent.

And what about farmland values? After several years of rapid growth, farmland values stalled in 2014, and they are now declining in the Midwest. But we’re much better off than we were 30 years ago. With a more diverse group of investors showing interest in farmland these days, it appears to be holding its value much better than it did in the ’80s.

And then there’s farm debt. Over the past year or two, the farm sector’s ratio of debt to net cash income has been rising, but it’s nothing like it was in the early 1980s. As lenders, you deserve a lot of credit for this healthier ratio. Your underwriting standards have been far more prudent in recent years than they were 30 years ago.

As the System’s regulator, we supported your efforts to stay safe and sound during the run-up in farmland values in the mid to late 2000s. We monitored trends in values and promoted prudent lending practices.

And since 2011, we have met annually with other financial regulators to share information on collateral values and financial conditions in agriculture. Each regulator sees a different segment of the market, so it’s critical that we share information to form a clearer picture of the whole economy.

Other advantages that we have today that were lacking in the ’80s were provided by legislation that Congress enacted in the wake of the crisis.

Take the Farm Credit System Insurance Corporation, for example. It was created by Congress in 1987 to protect System investors and U.S. taxpayers. Today, FCSIC has a balance of $4.3 billion in its Insurance Fund. Its very existence benefits the System by making its debt more attractive to investors.

And there’s Farmer Mac, which was created in 1988. By infusing more capital and liquidity into rural America, this secondary market entity also helps meet the credit needs of farmers and ranchers.

Another advantage that Congress provided was borrower rights. These rights are unique to System borrowers. They’ve helped prevent the abuses that took place in the ’80s. They’ve helped restore the confidence of farmers and ranchers in the Farm Credit System. And they’ve brought more due process and transparency to the lending process.

Congress also changed the role of FCA following the credit crisis, making the agency an arm’s length regulator and granting it enforcement authorities. This change strengthened the System’s safety and soundness and gave investors more confidence in System debt.

So the takeaway from this comparison is that we're in a much better position than we were in the 1980s in almost every respect.

At the same time, we have to be vigilant and prudent. Interest rates are low, but they are trending up. Collateral values have been strong, but they are softening. Debt levels are low, but they are rising. Credit risk is modest, but it's growing.

And I'd like to touch on one more area for which a comparison may be instructive, and that area is trade. Back in the late '70s and early '80s, we relied heavily on exports, just as we do today. So when our country enacted a trade embargo in 1980 against one of our biggest grain customers, U.S. farmers took a major hit.

Today, the future of our trading policies and partners is uncertain. And we don't know how the future farm bill may affect the farm economy. These unknowns just underline the need for caution.

Conclusion

Until now, I've spoken only of the confidence you need from others. But the Farm Credit Administration needs your confidence. To do our jobs well, we need you to believe in our expertise and our commitment to the mission of the Farm Credit System.

And we need you to be confident that we don't regulate arbitrarily. We issue regulations for the sole purposes of ensuring safety and soundness, compliance with law, and mission fulfillment. And if you believe a regulation no longer fulfills any of those goals or it creates an undue burden, please let us know.

I want you to be confident that we will hear your concerns and consider them carefully. Although we are an arm's length regulator, we certainly want to keep the lines of communication open with you.

And now, as we embark on the next 100 years, I'd like to encourage you to work toward a future in which all stakeholders have complete confidence in the System. I'd like to encourage you to find the best possible outcome for every System borrower. To form new partnerships to meet the challenges of rural America. To offer all System services to all System borrowers. And to work toward a structure that ensures the System can meet the needs of U.S. agriculture for the next 100 years.

You, the System, and we, the regulator, each have our own roles in ensuring that farmers and ranchers have a dependable source of constructive credit and related services. Each of us must play our role to make the process work. And I'm confident that by working together we can make the System's next 100 years even more successful than its first.

Thank you.