Remarks by
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Farm Credit Administration
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Good morning and thank you for the opportunity to be here. I always appreciate opportunities to engage with the System and learn what's on your mind, as well as to talk about some of the issues important to me.

I would like to quickly recognize Todd Batta, my executive assistant, who's with us this morning. Prior to coming to FCA, Todd ran the U.S. Department of Agriculture's Office of Congressional Relations and served as one of Secretary Vilsack's senior policy advisors.

I spent the Memorial Day holiday on my farm in South Dakota. It was great to be home and on a tractor and out of Washington, D.C. While helping get the final rows planted, I couldn't stop thinking about the amazing diversity of agriculture we have in this country.

Big, small…organic, conventional…crop production, livestock production…just a tremendous diversity. And that's especially true here in the Central Valley, where I'm told you raise more than 240 kinds of crops. That's hard for a farmer from South Dakota to imagine, where wheat, corn, soybeans, and hay are about as diverse as you get!

Over the past year, I've been traveling to various System meetings to better understand the issues that are important to you and to talk about some of the areas I'm focused on during my chairmanship.

This morning I thought I would spend some time talking about my background. I think it will help shed light on why I've selected confidence, best possible outcomes, all services to all borrowers, partnerships, and structure as areas to focus on during my tenure as chairman and CEO.

Best outcomes

I'd like to see a show of hands. How many farmers or ranchers are there in the room?

It looks like a good number of folks.

I started my career as a dairyman back in Oldham, South Dakota, in the late '70s and early '80s. I know that agriculture is a tough business, and I remember all the times when I needed a little help — if not in the form of credit, then at least in the form of good, sound advice.

I was fortunate to have a good partnership with my lender. I could turn to them for my credit needs and for business advice. Many of my friends and neighbors weren't as fortunate. As a result, many came to see lenders as the enemy.

Too often, I saw credit become a substitute for income. This wasn't just the case in South Dakota; this scenario played out across the country.

It led to thousands of bankruptcies and the displacement of tens of thousands of farmers, ranchers, and rural residents who were forced to leave rural America to find livelihoods elsewhere.

Seeing firsthand the on-the-ground impact of the farm crisis was, in part, what led me to work at the South Dakota Farmers Union. There we worked with producers and their lenders to make sure we could bridge the downturn for those producers who had a good chance of making it when the economy improved. We also had to have tough conversations when it was clear that there were no options left.

Today, it's my hope that System lenders can position borrowers for the best possible outcome. And you can do that by identifying the borrowers who are facing difficulty and working with them proactively. The goal is to make sure credit does not become a substitute for income. System institutions should never enable troubled borrowers to go further into debt and to deplete their equity if they aren't likely to achieve their goals.

By encouraging you to work with borrowers in difficulty, I am not suggesting you throw caution to the wind. But identifying troubled borrowers early on will improve their outcomes while protecting the credit quality of your portfolios.

Finding the best possible outcome for every borrower also builds confidence in the System's mission with critical stakeholders in Congress. It shows them that you're dedicated to serve agriculture in the good times and bad.

Partnerships

Before coming back to FCA, I had the opportunity to serve as undersecretary for rural development at the U.S. Department of Agriculture. The agency has an incredible mission. Every day the men and women who work in USDA's rural development mission area work hard to improve rural vitality by facilitating investments in community facilities, housing, broadband, and infrastructure.

As undersecretary, I quickly learned that to be successful USDA needs partners. It needs the expertise of local communities, counties, economic development organizations, and lenders. Through partnerships, USDA can provide opportunities in rural America that encourage the children of farmers to stay on the farm rather than migrate to cities for career opportunities.

Now that I'm at FCA, I see the important role the System can play in strengthening rural America through partnerships. By using your authorities to finance rural development projects, you can help rural communities acquire additional equity capital and liquidity. These partnerships also help you diversify your asset portfolios.

I believe that rural business investment companies provide great partnership opportunities for the System. They require only a modest amount of capital, but they can do an enormous amount of good by injecting investment capital into the rural economy, helping small businesses grow, and strengthening local communities.

And speaking of partnerships that help local communities, I would like to commend you for your work with the local community food bank. Unfortunately, many people in this country struggle with hunger. In fact, USDA estimates that one in eight Americans were food insecure in 2016. So the financial contributions and donations your employees make have a significant impact on those struggling with food insecurity in your community.

Another great example of what I mean by partnership is the partnerships your association has with your sister associations to meet your IT and human resource needs. By working together, you can achieve efficiencies and improve service to your members.

All services to all borrowers

I believe the System's congressional mission involves providing all System services to all eligible, creditworthy borrowers. 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.

I believe more can be done in the System to facilitate the cooperative spirit and raise the level of service for all System members. That's why I have been strongly encouraging the System to partner and find ways to make a full suite of services available to all borrowers.

Structure and capital

On my first tour at FCA, capital and structure were issues I heard about time and again. That hasn't changed in my second tour. As I said at the Farm Credit Council meeting earlier this year, the System has been in a constant state of renewal since its inception in 1916. As it continues to evolve, we must evaluate how any proposed change could impact the integrity and cooperative structure of the System.

We must look at the operational, managerial, and reputational risks that might result from the change. And we must consider how the change might affect the relationship between the funding bank and its associations.

Here's the bottom line: Your members and stakeholders must have confidence that structural changes are in the best long-term interest of the System and those it serves.

Now let's talk about capital.

There continues to be a lot of discussion within the System about the new capital rules, capital efficiency, and placement of capital. We've also heard concern that the new criteria used to assign a capital rating under the Financial Institutions Rating System or FIRS may constrain growth in the future.

To implement the capital rules, our Office of Examination developed criteria to assess capital adequacy. These criteria include numeric benchmarks that our examiners can use when assigning capital ratings.

Now that the new capital regime has been in place for over a year, FCA staff is reviewing whether any changes are warranted in how we examine and evaluate capital adequacy at System institutions.

As you know, capital is only one of *six* components we use to evaluate the safety and soundness of System institutions under FIRS. Today, we want to make this clear: achieving a FIRS 1 capital rating is not — in itself — the only measure of strength for a System institution.

What *is* of vital importance is ensuring that FCS institutions are well managed and are meeting their mission to provide competitive credit to agriculture and rural America. High levels of capital alone cannot guarantee this.

Over the past year, some System institutions have expressed the need to maintain a FIRS 1 capital rating regardless of what else is going on. The FIRS 1 benchmark has become a sort of self-imposed minimum for some institutions.

Keep in mind that various FIRS benchmark ratios are intended to measure different aspects of capital. Some ratios measure total capitalization, while some measure quality and composition of capital. When evaluating capital adequacy and setting FIRS ratings, our examiners look at both qualitative and quantitative elements.

How much capital any institution really "needs" requires careful evaluation of current and emerging business risks by board members and management. This process is often more a matter of reasoned judgment than scientific precision. It also means not relying too much on only one model or one measure.

Also, how much capital an institution needs — or its board believes it needs — can vary based on local situations. Many System associations currently operate at capital levels well over the FIRS 1 benchmark.

We want you to know that, if you are following prudent risk management practices, you can safely operate with a FIRS 2 capital component rating. A FIRS 2 rating indicates that you have adequate capital. I can assure you today that our chief examiner is relaying this message to our examination staff at every opportunity.

We know that determining how much capital is needed is complex. I want you to know that we're open to a healthy discussion with and among System representatives on capital issues.

There are two additional topics I want to comment on briefly. During the May board meeting, FCA voted to finalize the investment rule and to re-propose the standards of conduct rule.

Investment rule

The investment rule revises and updates the existing investment eligibility regulations for System banks and associations. The final rule contains significant changes to the investment regulation for associations. It allows each association to invest in securities issued or unconditionally guaranteed or insured by the United States or its agencies in an amount not to exceed 10 percent of its total outstanding loans for the purpose of managing risks.

Whereas the previous regulation identified two specific investment purposes — reducing interest rate risk and managing surplus short-term funds — the new rule does not identify any specific risks that associations are supposed to manage with these investments. Instead, each association must identify, evaluate, and document how the investments will contribute to the management of its risks.

We believe this will provide associations an important tool and the flexibility to use these securities to manage the common or unique risks they each face. It is also important to mention that the new regulation does not change the existing regulation that allows System associations to hold other investments that FCA approves on a case-by-case basis.

Standards of conduct

Also during the May board meeting, the agency agreed to propose a new standards of conduct rule.

Public confidence in the integrity and ethical business practices of any financial institution is fundamental to its viability. The new proposed rule aims to establish broad but well-defined core principles for behavior that directors and employees of System institutions are expected to follow in carrying out their official duties. Because the System is a GSE, it's critical for you to strive for high ethical standards and business practices.

We believe that the proposed rule would be the catalyst for sustaining systemic ethical corporate culture at each System institution. A cooperative that fosters ethical conduct as a best business practice attracts highly skilled persons to serve as members of its board of directors and its workforce.

The rule will be out for public comment soon and we encourage your engagement in the process.

Conclusion — confidence

I will close today by talking about confidence — a final theme that many of you have heard me talk about.

I encourage you to work toward a future in which all stakeholders have complete confidence in the System. You can do this by finding the best possible outcome for every System borrower; by forming partnerships to meet the challenges of rural America; and by offering all System services to all System borrowers.

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 continue to make the System safe and sound — and a dependable partner for farmers and ranchers in good times and bad.