Remarks by Dallas P. Tonsager
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Good morning. It's great to be with you. Rollin, thank you for the kind introduction. And I would like to thank all of you for the opportunity to be a part of your annual meeting. I'd like to recognize Todd Van Hoose and the Farm Credit Council staff. They work hard every day to ensure the System has a strong voice for its interests in Washington.

I'd like to recognize my FCA board colleagues — Jeff Hall and Glen Smith. Too often politics gets in the way of finding common ground and getting the job done effectively and efficiently in Washington. That's why I have great appreciation for Jeff and Glen. Their willingness to put politics aside and roll up their sleeves to find common ground is a great example of what can be achieved when we focus on the big picture and not the minutiae.

Jeff has been on the FCA board since March of 2015. He currently serves as the chairman of the Farm Credit System Insurance Corporation. His candor and steady hand are valuable assets for the FCA and FCSIC boards, and it's been a privilege to serve with him. Jeff, thank you for your partnership and for being a champion for FCSIC, FCA, the System, and all rural America. If you would, please stand to be recognized.

Glen has been a board member for a little over a year. He came to us directly from production agriculture and agribusiness. He and his wife started out as true beginning farmers in the early 1980s. Currently, three of their four children are involved in production agriculture in Iowa. This may explain Glen's passion for the System's young, beginning and small farmer mission. Glen, thank you for your partnership. If you would stand to be recognized.

I'd also like to recognize the FCA and FCSIC staff and those who are with us today. They are committed to the mission of the Farm Credit System and some of the hardest-working people in all of government. Please stand to be recognized.

We are all part of a truly remarkable story. American agriculture has been a cornerstone of our economy since our nation's beginning and continues to be so today. The agriculture, food, and related services sector of the U.S. economy accounts for nearly one trillion dollars in annual economic activity. It accounts for roughly 1 out of every 10 jobs in the United States. And it supports 35,000 food and beverage manufacturing plants across the country where workers transform raw agricultural materials into the products we see in our stores.

American agriculture is a story of hard work and perseverance. It's also a story of innovation. The gains in agricultural productivity since the 1950s are nothing short of a miracle.

Think about it. The average amount of milk produced by a dairy cow has increased by more than 330 percent. Average corn yields have increased by more than 360 percent. And per hour, farmers are more than 12 times as productive as they were in the 1950s. I think you would be hard pressed to find a sector of the economy that has increased its productivity as much over the same timeframe.

These amazing gains in productivity are the result of intensive capital investments. And these investments are only possible with reliable and competitive credit at affordable rates. Farmers and ranchers need credit to plant and harvest the products that are used to produce the food we eat, the clothes we wear, and the energy that powers our lives.

For more than 100 years, the Farm Credit System has been a driving force in unleashing the full potential of American agriculture by providing access to affordable credit. With more than 40 percent of farm sector debt, the Farm Credit System is truly an integral part of the story of American agriculture. Together, we can ensure that the System continues to play a critical role in providing safe and affordable credit to agriculture and rural America for another 100 years.

Everyone in this room knows how tough the agriculture business is. It's a business that tends to be cyclical in nature — leading farmers to prepare for the worst and hope for the best. To prepare for the worst, farmers need a strong partner in their lender — someone with a deep understanding of their operations, particularly when the storm clouds are on the horizon.

That is the beauty of the Farm Credit System and its cooperative structure. As a cooperative, your institution exists to serve your membership. You, as the owners, managers, and leaders of System institutions, have firsthand knowledge of the conditions facing agriculture in your respective territories. As its leaders, you chart a course for your institution, so it can serve the credit needs of your members — not only when times are good but also when ag conditions are not as good as we would like.

State of the farm economy

We find ourselves amid a downturn in major sectors of the farm economy. After several years of robust times and the cyclical decline that's followed, we find ourselves looking at deteriorating conditions for a number of farmers and ranchers.

The economic environment facing System borrowers remains challenging. Large commodity supplies and weak prices for crops and livestock products continue to pressure the farm sector. Higher operating costs for labor, inputs, and other expenses are putting stress on farm cash flows and liquidity levels. Abundant commodity supplies, resulting in part from favorable weather and continued gains in agricultural productivity, are colliding head-on with changes in trade policy.

For decades, lower tariffs and improved access to foreign markets have benefited U.S. agriculture. The sector is now in the crosshairs of retaliatory tariffs as the administration pursues larger policy objectives. As a result, price risk has increased for agriculture and affected key commodities, including soybeans, pork, dairy, almonds, and citrus. Since last summer, trade flows have shifted away from U.S. agriculture. We await a speedy resolution to trade issues with China and other countries so that longer-term damage to U.S. agricultural export demand can be avoided.

Thankfully, the System is in a strong position to weather the storm and to support its membership. Overall, the System is safe and financially sound. For the first nine months of 2018, the System reported strong earnings that continued to support capital growth. While portfolio credit quality has declined compared to a year ago, System institutions have strong risk-bearing ability and are well-positioned for the challenges facing agriculture.

And that's a good thing because, as a government-sponsored enterprise, how you respond in these challenging times will place you under the microscope and the scrutiny will only increase as the farm economy continues to deteriorate.

Congress provided your membership with certain borrower protections. These commonsense protections, or rights, aim to strengthen the cooperative partnership between the lender and borrower. By working to identify risk as early as possible and applying these rights, you can position your members to achieve the best possible outcome for their operations.

I know you are committed to doing just that. Many associations have established units dedicated to early risk detection to work with borrowers and put them on track for the best possible outcome for their operations.

Given the current conditions facing the farm economy, one might expect to see an uptick in the number of borrower complaints. But we're not seeing this. This likely shows that the work you've done to identify risk early on is working.

As the System's regulator, we expect you to use all available and appropriate tools to help farmers through this downturn. This might mean strategically using the capital you've built to support your mission.

Having a clear mission to serve agriculture and rural America creates an expectation for your institutions to be reliable financial partners for your members. Farmers and ranchers have many financing options during good times — it's during the downturns that they need reliable financial partners. This is a responsibility that I know you have not shied away from, and I encourage you to continue this mission focus during these trying times.

2019 plans

While we have planned some regulatory activities for 2019, I want you to know that we continue to look for ways we can reduce red tape through a review of existing regulations. We are reviewing the comments received on our regulatory burden notice and soon will update you on actions we plan to take.

Over the years, this process has led to a 70 percent reduction in actions that require prior approval from the agency. I think that shows a commitment to "smart regulation."

Most recently, we worked with you to streamline annual and quarterly Farm Credit bank shareholder reporting requirements. This will create operational efficiencies for the banks. I'm proud of the progress we've made in making our regulations more effective and efficient, and I'm committed to looking for further opportunities for improvement.

In reviewing regulations, we must also update regulations that are outdated and need to be modernized. You've all heard the statistics. The average age of a farmer is over 58 years old. There are more farmers over the age of 65 than under 35.

I'm strongly committed to the System's mission to serve young, beginning, and small farmers. The existing YBS regulations are a perfect example of regulations that need to be modernized. They are 20 years old, and a lot has changed in 20 years. It's time to revisit these regulations — particularly around reporting and disclosure.

Modernizing the YBS regulations will help provide Congress and other stakeholders the most transparent view of the System's work to encourage the next generation of producers to get into the business. At the same time, we also believe we can make the reporting and disclosure process more efficient than it currently is.

The current regulation focuses primarily on reporting quantitative metrics to measure the success of the System's support for young, beginning, and small farmers. That's only half of the story of your work.

We'd like to explore ways to more fully incorporate the qualitative work you undertake in support of your YBS mission. For example, associations continue to develop targeted advertising campaigns, implement specific YBS outreach programs, and provide detailed financial education programs for YBS producers.

These efforts are critical to meeting your YBS mission effectively, but your institutions are not currently getting enough credit for these efforts. As we look toward a rulemaking, our hope is that we can more fully capture all your work to get the next generation of farmers and ranchers into the business. We have established a workgroup at the agency, and I hope you will engage with them as we begin the process of modernizing the YBS regulations.

During 2019, we plan to issue additional regulatory projects regarding issues such as appraisal rules, accounting for nonaccrual loans, borrower rights, and eligible investments. Our staff will continue to seek your input as we develop these proposals.

We are carefully sorting through the comments you submitted on the standards of conduct and outside director eligibility proposed rules. Our staff is working through the comments we received on both rules, and we expect to finalize both rules in 2019.

I would like to thank the many individual System executives and staff members who are working collaboratively with FCA staff to implement both the CECL allowance methodology and the new framework for internal controls over financial reporting. Both projects demonstrate the benefits that the System and FCA can achieve when we work together.

Over the past year, we have engaged in healthy discussions with System representatives on capital-related issues. The current capital rule represents years of work with the System and other stakeholders to develop a Basel III rule that is comparable with the capital rules adopted by the other federal regulatory agencies. In doing so, we made important modifications to recognize the cooperative structure and organization of the System.

While only in place for a short time, the capital rules aim to ensure sufficient capital to meet your mission while providing continued comfort to bond investors and other interested parties in understanding System capital. The rules also allow for easy capital comparison with other banking organizations.

That said, I remain committed to an open dialogue with the System on capital issues. We've created an internal working group to review capital issues raised by System institutions and to evaluate the effectiveness of the current rule and our associated FIRS rating benchmarks. I look forward to your continued engagement on these issues.

FIRS ratings

Speaking of FIRS ratings, I've continued to hear from System leaders about the need to operate at a FIRS 1 level. I want you to know that 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 System institutions are well-managed and are meeting their mission to provide competitive credit to agriculture and rural America in good times and bad to all eligible and creditworthy borrowers. So a FIRS 2 rating can indicate that you have adequate capital if you are following prudent risk management practices and strong system controls.

Farmer Mac

While I'm talking about capital, I want to address some concerns I have heard about the capitalization of Farmer Mac. On a risk-weighted basis, Farmer Mac reported a 13.3 percent tier one capital ratio as of Sept. 30 of last year. This is an acceptable operating range for Farmer Mac.

Farmer Mac and the FCS banks and associations have very different business models. The Farm Credit Act recognizes the differences in the business models of primary lenders and a secondary market provider when considering capital levels. The act specifically requires FCA to recognize the reduced risk in appropriately structured secondary market transactions.

Farmer Mac's book of business consists of large proportions of low-risk assets, including USDA-guaranteed securities and AgVantage bonds. In fact, they make up more than 50 percent of Farmer Mac's portfolio, so it makes sense to recognize this difference when evaluating capital adequacy.

Farm Bill authorities

Now I want to take a moment to mention a couple new authorities that Congress included in the recently passed Farm Bill.

The new Farm Bill expands the System's ability to participate in rural business investment companies. Previously, an RBIC that had more than 25 percent investment from the System was limited to activities that were expressly authorized in the Farm Credit Act. Now, an RBIC can have up to 50 percent investment from the System before its investments are limited to the activities that are expressly authorized in the Farm Credit Act. This aims to encourage more System participation and increased investment in rural America.

If you've heard me speak before, you know that I am strongly supportive of RBICs. These RBIC initiatives require only a modest amount of your capital, but they can do 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. This change to the RBIC authority is a great opportunity to expand the System’s commitment to rural vitality.

Another area of the Farm Bill we are reviewing are the hemp provisions. However, before talking about this, I first want to address marijuana and medicinal marijuana. Nothing in the Farm Bill removes marijuana from the Controlled Substances Act. Marijuana is still an illegal Schedule 1 narcotic under federal law.

As an instrument of the federal government, we will continue to treat marijuana as a controlled substance until there is a change in federal law. Therefore, it is our view that marijuana is ineligible for financing by the System, a government-sponsored enterprise.

The Farm Bill *did* make changes to create a legal pathway for the commercial production of hemp and hemp products. These provisions require USDA to take certain actions before the program is up and running. We will be seeking to work closely with USDA and other federal partners on implementation of this new program. I know there is significant interest in hemp cultivation. And we will provide guidance on System financing at the appropriate time. But we must allow this process to evolve appropriately.

There are also three new provisions included in the Farm Bill that provide FCA enforcement powers that are comparable to other federal financial regulators.

Moving on to the examination front, we will continue to focus on institutional portfolio risk and internal controls as outlined in our 2019 National Oversight Plan. With portfolio risk, we are focusing on how institutions are currently navigating the current economic conditions at the farm level. And our internal controls examination work will focus on the three lines of defense — operational management, risk management, and internal audit.

Conclusion

In closing, we’re all aware of the cyclical nature of agriculture. The storm clouds we’ve been talking about over the past couple years are at our door step.

I’ve worn many hats in my career, but at my core I am a farmer. And as a farmer I am an eternal optimist.

We’ve seen these challenging times before. We’ve learned from the past. And as leaders of the Farm Credit System, you have positioned your institutions to help your membership face and weather the storm.

Now is your time to shine. Now is your time to use the strength of your institutions. Continue to partner with your members to find the best possible outcomes and strengthen confidence in the System’s mission.

As your regulator, I assure you that we will do everything within our power to ensure that the System will remain a reliable source of capital for rural America. And we will stand with you so that America’s farmers and ranchers continue to produce the safest and most abundant food supply in the world.

There is no better time to show why this GSE is as relevant today as it was when Congress created it over 100 years ago.

Thank you.