Remarks by
The Honorable Kenneth A. Spearman
Farm Credit Bank of Texas
Stockholders' Advisory Committee
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I appreciate the opportunity to come to Austin and visit you here today. We at FCA recently hosted the Texas Bank's board chairman and vice chairman in addition to your management team, so I'm pleased to be able to repay the favor and visit with you on your turf.

I found the Texas presentation to be extremely useful and very much appreciated the candor and straightforward way the presenters addressed the problems and challenges faced by the bank. I also appreciate the opportunity to interact not only with the bank board of directors but also with some of the directors of the Texas district associations.

The backbone of the Farm Credit System is its cooperative structure and the necessary control that borrower-members exercise as directors and owners of their lending institutions. Therefore, I think it's very important for me, as an independent FCA Board Member, to visit with, and listen to, System directors. Of course, I also think it's important to listen to other voices as well. I believe that getting as much information and insights as possible—while maintaining an attitude of healthy skepticism—improves my ability to make informed decisions that affect the Farm Credit System and its borrowers.

As you can imagine, this is certainly a busy time for FCA, with many issues pushing their way onto our agenda. Today, I just want to make a few remarks about four very important areas: first, the role of FCA; second, the importance of quality corporate governance in the System; third, the future of System structure and mergers; and fourth, the breadth of the mission of the Farm Credit System.

Please note that the views I will be expressing today are my own based on my charge as an independent FCA Board Member.

Role of FCA

First and foremost, I believe FCA's primary job is to ensure that the Farm Credit System operates in a safe and sound manner so that the System can continue to serve its vital public mission of providing affordable credit to America's farmers and ranchers. In order to do this, FCA needs to be a strong, competent, and independent regulator.

This means that the Agency must proactively monitor System operations and act swiftly when we find problems or troublesome risks in the System. As a Board Member, I think it is important for me to support the efforts of FCA examiners so they have the confidence to act when they identify troublesome risks in System institutions.

A big part of FCA fulfilling its key task is hiring, training, and retaining high-quality staff. During my brief time with the Agency, I've been impressed with the dedication and professionalism of the staff, and I think it is important going forward to ensure that FCA staff has the necessary resources to effectively supervise and regulate the System.

As many of you know, FCA's Chief Examiner, Tom McKenzie, has just retired after more than 30 years of service to FCA. The FCA Board has hired Robert Coleman, who has more than 20 years of service with FCA, to replace him. Mr. Coleman has worked in FCA's Office of Examination, Office of Regulatory Policy, and, most recently, as FCA's Director of the Office of Secondary Market Oversight, which oversees the operations of Farmer Mac. I'm sure you'll be hearing from Mr. Coleman and that he will bring a steady and knowledgeable hand to the role of Chief Examiner.

That steady hand will, I'm sure, be tested early on as the general economy has a ways to go before a full recovery, with certain agricultural sectors in particular continuing to cause problems. While the Farm Credit System remains fundamentally sound and adequately capitalized, five associations remain under enforcement actions and a number of institutions are under special supervision, including several in the Texas district.

Notably, in December 2007, fully 82 percent of all System institutions had the highest FIRS rating of 1; in March 2010, only 28 percent of all institutions received this top rating. However, unlike commercial banks, no Farm Credit System institution has failed or been placed under receivership during the financial crisis.

I fully support the efforts of Mr. Coleman and FCA's Office of Examination as well as the FCA Chairman's leadership to ensure that the Agency keep its focus on the continued safety and soundness of the System and remain vigilant about monitoring looming risks.

While FCA will be following an active policy and examination agenda, FCA can't be everywhere at all times. Instead, we expect the board and management of each institution to actively monitor and scrutinize every aspect of its own operations when it comes to dealing with risk and safety and soundness issues.

Many System institutions have done an excellent and innovative job of monitoring risk; in fact, some of our recent safety and soundness policy actions, including our proposed rule lowering lending and leasing limits, and bookletter guidance on loan pricing, are informed by, and partially based on, best practices followed in the System already.

As you know, FCA's minimum capital and other safety and soundness limits are just that—minimums; we continue to encourage and expect each System institution to set internal institution-specific safety and soundness limits and safeguards appropriate to protect the institution against undue risk.

Additionally, to remain safe and sound during this turbulent period, I think the System should primarily stick to the basics: keep the focus on the core business of lending to creditworthy farmers and ranchers and ensure that good underwriting and lending practices are followed and that effective internal controls are in place.

Corporate Governance

Good management and effective internal controls don't happen by accident; they are a product of quality corporate governance. As you may know, my experience is primarily in the financial and accounting field, including 28 years working for large cooperatives in the Florida citrus industry. As you may also know, prior to being appointed to the FCA Board by President Obama, I served as an outside appointed director for AgFirst Farm Credit Bank for four years, serving on board compensation and governance committees. I came away from my experience on the AgFirst board with a deep appreciation for the knowledge and dedication of my fellow board members. I also came away with an understanding of the crucial need for an effective board of directors for each System institution.

The governance of all corporations is vested in its board of directors. This role is even more vital in a cooperative—such as a System association—where, for most board members, it truly is *your* institution: you own it and you borrow from it. Boards should certainly hire and trust good management, but it must be remembered that management works for the board, which in turn is ultimately responsible for the operation of the institution.

Unfortunately, good economic times sometimes hide management and corporate governance problems in institutions. We've seen an illustration of that over the last couple of years; many of the System associations that have gotten into significant financial trouble are also institutions where FCA examiners have identified significant corporate governance and management problems. It should be noted that a number of these associations are located in the Texas district.

I think that FCA examiners have done a good job in identifying risks, including risks associated with corporate governance problems. However, I think it's ultimately up to the borrower-owners of the System to be proactive about the quality of management and governance of their institutions. I also think we all need to realize that while System associations are owned and controlled by their borrower-members, they are also, in today's world, sophisticated financial institutions and need to be managed as such. I understand that the Texas Bank board and many of the Texas district associations have taken steps to correct these issues, and I encourage continued vigilance in this area.

As a general matter, good corporate governance starts with recruiting good candidates for the board. Getting good people on the board may mean looking beyond the usual suspects and making greater efforts to get new people involved. There is significant value in having diverse backgrounds and experiences on boards and in having new voices and perspectives represented. Notably, the appointed director position provides an important opportunity to add expertise and a truly independent viewpoint that might otherwise be overlooked.

Good governance also requires that board members stay informed about important matters affecting their institution and to receive the training and support necessary to effectively do their job. I've seen that establishing strong committee structures, ones that allow a smaller group of board members to fully delve into particular issues, is very useful and productive in the management of an institution.

Additionally, I think good governance includes having a manageable board size that allows the institution to be effectively governed. Also, board members need to be cognizant of their duty to always act in the best long-term interest of the institution they serve and in the best long-term interests of all of their institution's stockholders—even in situations where that may affect their own future status as board members.

System Structure—Texas

Over the past 30 years, we've seen significant consolidation in the Farm Credit System—from a time when there were 37 banks and more than a thousand associations—to today, where there are five banks and fewer than 100 associations. As you know, there may be an additional bank merger on the horizon, with U.S. AgBank announcing that it is pursuing a potential merger with CoBank. We at FCA are required to look at any potential merger to ensure that it does not create undue safety and soundness risks and that stockholders of the merging institutions are adequately informed. Ultimately, however, Congress left it up to the stockholders of the involved institutions to make the business decisions for the institutions.

I do recognize that, with so few banks left, any merger does have an impact on the other bank districts. This merger, as well as any future bank merger, does present a potential opportunity for restructuring that goes beyond the two banks involved. For example, this merger may present an opportunity for associations in the affected districts to explore reaffiliation with a funding bank they feel more compatible with. Bank district lines are just lines on a map and can be changed; long-term business model compatibility is an important issue, and I would encourage the Texas Bank to work with the other banks and affected associations to see whether any strategic rearranging of System associations makes sense and promotes the long-term efficient and effective operation of the System.

With regard to associations, I also encourage System directors to pursue mergers that make the best long-term sense for System customers. We've seen mergers that happen simply because of a CEO retirement and many other mergers—that make geographic and financial sense—*not* happen because of personality conflicts between board members. Again, and I know that this is easier said than done, I urge System directors to think about the best long-term interests of their institutions and put aside personal issues when evaluating mergers and making other long-term decisions.

I think issues related to future association mergers may be particularly relevant in the Texas district—especially given the numerous over-chartered areas. I know this didn't necessarily happen by design. I also have been informed that at one time FCA was advocating the idea of intra-System competition through "customer choice" or "national charters." However, I don't think that intra-System competition is ultimately very good for the System as a whole—and as a single Government-sponsored enterprise I think it's increasingly important in the current economic and political climate to think about the System as a whole.

I don't think it is FCA's role to dictate what the System's structure should be or who should merge with whom. However, I would certainly encourage System directors and stockholders to think about the best long-term interests of their institution, their bank district and even their System in making decisions about the future. And even more importantly, I encourage all System directors and stockholders to think about the best long-term interests of customers in making decisions about the future. Ultimately, the System is here to make sure that America's farmers and ranchers have a dependable, adequate, and affordable source of credit; everything else, including how the pieces of the System are arranged, is secondary to that vital mission.

Mission

Speaking of mission, Congress established the System as a Government-sponsored enterprise with a specific mission to "meet the credit needs of *all* types of agricultural producers having a basis for credit." Congress also included a specific mandate to serve young, beginning, and small farmers in order to help make sure there will be a next generation of American farmers. Therefore, I think it's important for the System, and for FCA, to take a broader view and look at how the System is serving "*all types of agricultural producers"* in all segments of the agricultural marketplace.

This marketplace includes minorities, it includes women, it includes truly new farmers without family ties to farming, and it includes nontraditional farmers seeking to capitalize on consumer demand for organic and local foods. So the real question is, Is the System meeting its mission of serving the needs of *all* potential creditworthy agricultural borrowers?

Part of the answer may also be that it isn't enough to only "serve" farmers who walk in the door and ask for credit; arguably the System has an affirmative obligation to seek out underserved potential borrowers, which also makes good business sense in the long-term by cultivating a new generation of customers loyal to Farm Credit.

We at FCA certainly recognize the significant efforts made by a number of System institutions in this area. For example, I know that some Texas district associations have hired Spanish-speaking loan officers and made significant efforts to reach out to Hispanic borrowers. I applaud those institutions for their genuine efforts and look forward to other institutions emulating their example so that the System as a whole may truly fulfill its mission to meet the needs of all types of agricultural producers.

Conclusion

In closing, I’d like to thank you for the opportunity to address you today and share some of my thoughts on FCA and the Farm Credit System. While there are many challenges facing FCA and the Farm Credit System, I want you to know that I appreciate the dedication, knowledge, and expertise of the people of the Farm Credit System and FCA.

I believe that the Farm Credit System is an important part of the American financial system and plays a key role in supporting rural communities by providing a dependable source of credit to farmers and ranchers. As an FCA Board Member, I will work to ensure that the System remains safe and sound so that it can continue to meet its important mission.

Thank you again for inviting me, and I look forward to working with you over the coming years during my term on the FCA Board. THANK YOU and have a good afternoon!