Remarks by
The Honorable Kenneth A. Spearman
President's Planning Commission
Dallas, Texas
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In his introductory remarks, Mr. Spearman discussed his personal background, his one-year anniversary on the FCA Board, and his experiences during his tenure. He also pointed out the diversity of the FCA Board: each member has a different background, from farming, to politics, to accounting. Mr. Spearman also emphasized the independence of each Board Member and his or her responsibility as an arm's-length regulator. He pointed out that he was expressing his own and not official Agency views. The body of his speech follows.

As you are aware, FCA is currently tackling many problems and issues. As such, I wanted to provide you with some of my general observations on six significant topics, including the role of FCA, the personnel transition taking place at FCA and in the System, FCA's examination function, the condition of the Farm Credit System, the mission of the System, and System structure issues.

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, independent regulator.

I also think to have FCA functioning as a strong, competent, independent regulator will be of vital importance to the System as Congress takes up the future of Government-sponsored enterprises in the coming years. If the System wants to remain an independent GSE—and not get caught up in broader GSE reform—then I think that the System should want a competent, independent voice as its Federal regulator, something that Fannie and Freddie arguably didn't have. Notably, I believe that FCA's status as an effective, independent regulator was an important factor in Congress exempting the System from the reach of many of the provisions of the recent financial regulatory reform legislation.

Most importantly, FCA needs to be credible in the eyes of Congress, investors in System debt, and the public; interested parties need to believe that FCA is truly independent and capable of handling the job of regulating the System. I think an important part of being credible is maintaining transparency of FCA's operations so that the public can clearly see and understand what we are doing.

I think it's important for FCA to keep good lines of communication open with the System. However, I think we need to do that while always maintaining the appropriate "arm's-length" relationship so that FCA is not viewed by Congress or the public as a “captive” of the people we regulate. FCA ultimately exists to protect the interests of the American public; I think we have to recognize that those interests may not always coincide with the interests of System institution management.

I do think FCA should be open to suggestions from the System and to consider creative ways of furthering policy goals. However, FCA must ultimately respect Congress’s role and enforce the law as written. Having worked on the Horizons project while with AgFirst, I certainly recognize the difficulty in achieving legislative change. However, while parts of the Farm Credit Act may be outdated or no longer meaningful, FCA is just not authorized to ignore or change congressional policy as expressed in the Farm Credit Act.

Time of Transition in System

As many of you know, FCA’s Chief Examiner, Tom McKenzie, has just retired—effective tomorrow—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, served as FCA’s Director of the Office of Secondary Market Oversight, which is the office within FCA that oversees the operations of Farmer Mac. You’ll be hearing from Mr. Coleman over the next number of years, and I am sure he will bring a steady and knowledgeable hand to the role of Chief Examiner.

Tom McKenzie’s retirement also marks a time of transition for the Agency. Another familiar FCA face, Roland Smith, current FCA Board Secretary and former Chief Examiner, will be retiring at the end of this year after 30 years of service. A number of other long-time FCA staffers have retired recently or will retire over the next couple of years. With these departures, FCA is losing a great deal of institutional memory and experience. We are fortunate at FCA to have a very dedicated, professional, and knowledgeable staff. We have recently hired a number of new employees at FCA, including mid-career professionals with impressive resumes, and we will continue to place an emphasis on recruiting and training to ensure that we maintain a high-quality staff.

There appears to be a similar transition going on among System leaders as well, with experienced folks such as Tom Welch at AgFirst; Tom Hill of the Farm Credit Bank of Texas; Jay Penick, CEO at Northwest ACA; Ken Graff, CEO at Farm Credit West; and many others retiring or planning on retiring. I want to acknowledge the significant contributions all of these individuals have made over the years to make the System into what it is today.

While FCA and the System are losing some invaluable resources, this transition time also provides an opportunity for new voices to be heard and new approaches to be tried as we meet the challenges of financing 21st-century agriculture.

Examination Function

One thing that is not going to change at FCA is our fundamental obligation to protect the safety and soundness of the System. While technology allows us to do certain things more efficiently, I think effective examination will always be very much a hands-on proposition if we are to effectively monitor risk in the System.

I think it's important for FCA examiners to be empowered to act decisively when they identify troublesome risks. Therefore, as a Board Member, I think it's important for me to support the efforts of FCA examiners in our Office of Examination so they have the confidence to act when they identify troublesome risks in System institutions. And I think our Office of Examination has done a good job over the past couple of years in identifying risks and mitigating even greater troubles in the System by taking proactive steps. I have heard folks in the System, on more than one occasion, thank me for the efforts of OE in identifying problems, even when they had initially resisted OE's efforts. Over time they realized that OE's efforts helped identify and head off even greater problems.

Condition of System

FCA's Office of Examination, under the new leadership of Mr. Coleman, will continue to be tested, as the economy has a ways to go before a full recovery. While the Farm Credit System remains fundamentally sound and adequately capitalized, four associations remain under enforcement actions, and a number of institutions remain under special supervision.

In December 2007, fully 82 percent of all System institutions had the highest FIRS rating of 1. In June 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 think that fact reflects positively on both FCA and System management.

Institutions that focused on their core mission of lending to farmers and ranchers, and maintained underwriting discipline and strong internal controls through good times and bad, are those that have fared the best. This self-policing is clearly vital in the System. While FCA has followed 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.

Clearly, significant weaknesses in certain agricultural sectors have created significant problems in the System. However, the economic crisis has also exposed more fundamental weaknesses in certain System institutions.

Generally, the System institutions that have received the most attention from FCA over the past couple of years are ones that had pre-existing issues with corporate governance, management, internal controls, or operating philosophy—weaknesses previously hidden by the boom period prior to 2008. I would also note that the preponderance of troubled loans are at the edges of the System's lending authority, such as what we euphemistically call "land in transition" loans.

While System institutions need to follow conservative underwriting standards, there remains plenty of untapped safe and sound lending opportunities squarely within the System's lending authorities. For example, FCS of America has effectively used technology to efficiently make equipment loans to farmers and ranchers at the point of sale, providing significant added value to System customers.

Mission

Speaking of untapped opportunities, 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, women, truly new farmers without family ties to farming, and 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 associations have hired Spanish-speaking loan officers and made significant efforts to reach out to Hispanic borrowers in their territories. 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 take advantage of untapped opportunities while fulfilling its mission to meet the needs of all types of agricultural producers.

System Structure

I also recognize that the agricultural industry is continuing to evolve and consolidate. We are rapidly moving towards a situation in which 10 percent of farmers produce 90 percent of American agricultural output. Certainly the System needs to keep up with these changes, making sure it can continue—including by working together with other lenders when necessary—to serve these larger entities. I also understand that this consolidation in agriculture is part of the impetus for continued System consolidation at the bank and association level.

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.

This past July FCA issued a bookletter requesting that any bank seeking to merge address certain risks in its application. These include size concentration risk, business model compatibility risk, and intra-System operational risk. We have also held meetings with System representatives to discuss the issues raised by the bookletter. FCA Chairman Lee Strom has also been vocal about his concerns over continued consolidation.

First, I think we need to be clear what FCA is not doing with this bookletter. FCA is not telling banks not to merge. FCA is not prejudging any merger application we may receive. FCA is not telling the System they must create a new central entity. Finally, while FCA recognizes the existence of statutory authority for System associations to reaffiliate when both affected banks agree, FCA is not advocating for associations to change their funding banks.

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. Particularly as part of my role as Chairman of the Farm Credit System Insurance Corporation, I also need to ensure that any merger does not place undue risk on the Insurance Fund. 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. Therefore, I think it's appropriate for FCA to encourage discussion across the System on long-term structure and risk issues. While FCA is not advocating a "freedom to fund" approach for associations, 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, as long-term business model compatibility is an important issue, this merger may present an opportunity for the affected banks and associations to explore reaffiliations to ensure the best fit. As noted, banks and associations have the statutory authority to reaffiliate upon agreement of affected parties—agreement that must be reached before any FCA involvement can occur.

However, I recognize that there is no central System governing body and that FCA does not have the authority to create one. FCA also doesn't have the authority to simply rearrange the pieces of the System as we see fit. Therefore, it's up to 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.

I also think we have to recognize that the current System structure is *not* the product of careful planning or intelligent design. Instead, the current System structure has evolved through a series of uncoordinated mergers, sometimes driven more by the personalities involved than by careful analysis of the benefits and disadvantages. I would also note that Congress established a limited number of Farm Credit Banks and then authorized those banks to merge. However, Congress did not tell us when the banks should stop merging. Short of a crisis, Congress is unlikely to step in to reorganize the System again.

Congress founded the Farm Credit System in 1916 to ensure that adequate and affordable credit was available to America's farmers and ranchers. That same mission remains necessary and relevant today. However, if you were to take a blank sheet of paper and create a farm credit system in 2010, you likely wouldn't draw it up the way it exists today. In 1916, America's farmers worked in remote areas cut off from reasonable sources of credit. That's generally not true anymore. The world of American agriculture is a very different place than it was in 1916. It's also a very different place than it was in 1971, when the current Farm Credit Act was put in place. The agricultural world is also a very different place today than it was in 1987, the last time Congress reorganized the System's structure.

So we have to recognize that the current structure is not ideal or sacrosanct. However, before we go changing it, we need to try and understand what new and different risks we may be creating.

I don't know if there is a "right" number of banks. Or, for that matter, a "right" number of associations. However, I do know that we need to (1) understand and control risks in the System and (2) ensure that all of America's creditworthy farmers and ranchers have access to adequate and affordable credit. If we are able to do those two things, I'm not sure it matters how many banks or associations there are.

With regard to associations, I think it's appropriate for FCA to encourage System management and directors to pursue mergers that make the best long-term sense for System customers. As part of any merger, I would also expect the parties to examine how the new institution can better meet the System's mission of delivering credit to *all* creditworthy farmers and ranchers.

We've seen mergers that happen simply because of a CEO retirement and many 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 management and 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 am advised 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. Therefore, I would favor mergers that eliminate or otherwise resolve over-chartered territories.

Ultimately, however, I don’t think it is FCA’s role to dictate what the System’s structure should be or who should merge with whom. Therefore, I would certainly encourage System management, directors, and stockholders—before they submit an application to FCA—to think about the best long-term interests of their customers, their institution, their bank district, and their System in making decisions about the future. 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.

Conclusion

In closing, I’d like to again 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!