February 6, 2014

Mr. William Hoffman
Chief Operating Officer
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Dear Mr. Hoffman:

Thank you for the opportunity to participate in the Farm Credit Administration Symposium regarding consolidation on February 19, 2014, and for your time in discussing expectations for that session. I agree with your belief that further understanding of the perspectives of industry leaders, both managers and directors, will assist the FCA in the future as you conduct your analysis of proposed mergers of Farm Credit System institutions. As a farmer-member of Farm Credit Mid-America, and Chairman of the Board of Directors of AgriBank, I hope that I can share the views of not only a System institution, but also the views of a farmer-producer that the System was created to serve.

More particularly, I am writing to you today in response to your request to submit written comments in advance of the February 19th Symposium to address the five questions that will be further explored at that session. I have organized my comments as a response to each of the five questions, however, as you might imagine, there may be some overlap between those separate questions. My initial responses to each of the questions are as follows:

- **What factors are driving institutions to consolidate?**

  The Farm Credit System was established with the mission to provide sound and dependable credit and financial services to farmers, ranchers and other eligible borrowers within rural America. As American production agriculture has evolved over the years, the Farm Credit System has evolved in lock step, adapting its structure and product offerings to continue meeting the credit and financial services needs of its member-borrowers and remain at the forefront of rural agricultural finance. As we have witnessed in the broader financial services industry, consolidation of providers has been driven primarily by the need to adapt to the increasing complexity and financial sophistication of the customer base – striking the appropriate balance between generating operating efficiencies and economies of scale to enhance financial capacity to serve increased credit requirements, while continuing to maintain customer intimacy and a sharp focus on local and niche markets.

  American agriculture and the Farm Credit System have not been immune from experiencing this trend. Production agriculture has continued to evolve and progress, driving consolidation among member-borrowers. The result of this trend is an association customer base that is larger, more operationally and structurally complex, and financially sophisticated. This evolving profile of our member-borrowers requires a financial services provider that has the operating efficiency, economies of scale, financial wherewithal to meet increased capital requirements, and the business expertise to meet the diverse product and service requirements within local markets.

- **What institution characteristics are most significant when determining how to best serve the territory in an efficient and effective manner?**

  Larger, more operationally and structurally complex and financially sophisticated member-borrowers will require a financial services provider with financial scale, who possess a diverse portfolio and product expertise to satisfy more complex credit requirements, deliver value and concentrate expertise in one organization. Merger of System entities will afford System institutions the opportunity to generate operating efficiencies by eliminating redundant management and resource capabilities and leveraging economies of scale to deliver financial services on a cost-effective basis to member-borrowers

  Structural changes to System institutions, including mergers, affords those institutions the opportunity to bolster capital levels and efficiently leverage capital to increase the capacity of the institution to serve increased credit needs of member-borrowers. A stronger capital foundation promotes continued reliable access to the liquidity and third-party capital markets and facilitates larger credit hold levels.

  Merger of System institutions will generally result in a more diversified credit portfolio which serves to diversify credit risk across a wide array of commodities and geographic segments and mitigate concentration risk. This diversification of credit risk will increase the credit capacity of the System institutions and provide greater assurance of continued access to credit to all of its member-borrowers.

  System institutions with sufficient operational scale will have product and intellectual capital expertise necessary to serve a wide array of member-borrowers – from large, complex and sophisticated syndicated credit facilities to specialized, niche credit structures. These institutions will have the capability to maintain customer intimacy and local market knowledge, and be better able to serve all aspects of its market and better fulfill its public mission.

- **How do consolidations affect the System's ability to meet the needs of eligible, creditworthy borrowers for credit and financial services?**

  The primary financial services provided by Farm Credit System institutions today encompass a broad spectrum - from lending and leasing to multi-peril crop and crop hail insurance to risk management products. As agriculture production has continued to evolve and progress, so has the need for new, oftentimes complex, and competitively priced loan products that offer multiple repayment options, including revolving credit, and a wide variety of variable and fixed interest rate alternatives. To remain viable in the future, System institutions must continually develop new channels and new products to serve an ever changing agricultural and rural landscape.

There is a clear need for the appropriate level of scale of a financial services provider to ensure that there are sufficient capital resources to protect that entity and over which to spread the costs associated with developing new financial solutions that meet the needs of our ever-changing agricultural and rural marketplace. This larger scale is needed to develop and maintain specialized human resources skilled in serving the many and varied industry segments of agriculture.

A financial institution with the appropriate scale also has greater resources available to enhance the focus on lending to all eligible borrowers. Those member-borrowers may have very large operations and require access to credit in very large dollar amounts, or have very small operations and have very limited loan needs. For the larger operators, there will continue to be a need for syndicated loan structures involving specialized syndication resources, and many individual lenders both within and outside of the Farm Credit System. For the smaller operators, there will continue to be a need for a very quick credit scorecard - based approval decisions based upon limited financial information. Even though the vast majority of agriculture production is in rural areas, urban agriculture is developing into a market segment that will undoubtedly be served by the System. Those member- borrowers may be an ethnically diverse group living in urban areas, or rural home owners operating a hobby farm, and this wide range of producer types will continue to expand the need for more specialized credit resources.

Further consolidation of Farm Credit entities may also allow for more efficient channels to provide financial services to member- borrowers through third party alignments such as point-of-sale lending programs. These types of programs can provide significant opportunity for Farm Credit entities and provide far greater convenience to member-borrowers. In addition, providing well-researched and useable industry information, which demonstrates a financial services institution's understanding of agriculture and provides valuable insight to agriculture producers, has become a source of competitive advantage and differentiation in the marketplace. Generally speaking, a Farm Credit entity with greater scale is better able to provide these types of financial products and information sources for the benefit of its member-borrowers.

Given increasing capital requirements, access to third party capital, primarily in the form of preferred stock or subordinate debt, will gain greater importance in the future. Generally, Farm Credit entities with appropriate scale are more likely to have the human resources and expertise to access forms of capital that are not directly tied to member- owners or retained from earnings. This ability to raise third party capital will allow System institutions to serve the needs of the agricultural marketplace without being fully dependent on retained earnings and capital provided by member-borrowers.

Consolidations can also create a competitive environment between Farm Credit institutions by creating geographic areas served by more than one institution or by creating institutions that have a broader range of lending authorities than other institutions. In those situations, it is important for FCA to recognize the need to limit the competitive advantage of one institution over another or to otherwise ensure that any advantage of one institution is not used in such a manner that it is detrimental to other institutions, more importantly, the member-owners of those institutions.

- **What challenges or enhancements might these consolidations create for serving young, beginning and small farmers and ranchers?**

  I do not believe that consolidation of institutions will create any challenges for serving young, beginning or small farmers and ranchers. As you are aware, all System lending institutions have developed and maintain lending programs focused upon serving YBS customers. Those institutions view their YBS programs as an important part of serving that segment of the market and view that market segment as a part of the Farm Credit mission to serve rural America.

  More importantly, the overwhelming majority of institutions recognize that meeting the needs of the YBS market is critical to developing the next generation of agriculture producers. It is hard to imagine that any System institution, regardless of size, would choose to wilfully ignore such a strategic segment of their marketplace. More likely, consolidation of institutions would result in a further enhancement of YBS programs by expanding the framework for a broader and more robust YBS program as these entities gain operating efficiencies and the ability to spread the operational and human resource costs of such programs over a larger loan base. In addition, a larger scale Farm Credit institution should have greater staffing expertise to develop more creative ideas for providing enhanced programs to provide lending and other financial services to member- borrowers in these segments.

- **What factors should FCA consider when evaluating merger applications?**

  First and foremost, FCA must consider the safety and soundness of the merged institution. A transaction that results in an institution that is not safe and sound should not gain the approval of FCA. That does not mean however that the resulting institution must be more safe and sound than either of, or both of, the constituent institutions. If the resulting institution meets the safety and soundness criteria of FCA, the focus of the evaluation should then shift to other advantages and disadvantages of the merger.

  I believe we all recognize that the merger of financial institutions can result in operating efficiencies that greatly benefit the stockholders of those institutions. Those benefits become even more important in the merger of Farm Credit System institutions in that those benefits inure directly to the members-owners of those institutions rather than to remote stockholder investors as in traditional corporate structures. Given the cooperative ownership model of the System, I believe that member-owners are best positioned to determine whether those efficiencies are in fact beneficial to those member-owners. Likewise, those member-owners are also best positioned to determine whether any negative effects of a proposed merger offset the potential benefits of those gained efficiencies. Thus, once FCA has determined that the resulting institution has met its safety and soundness threshold, it should defer to the judgment of the member-owners of those institutions to determine the appropriate corporate structure that will best serve both the short and long-term needs of those member-owners.

I do recognize that the formation of larger institutions results in a greater concentration of risk in that institution. That greater concentration of risk results in the decisions of its board of directors and management team having far greater consequences to a larger group of stakeholders. A much larger group of member- owners will be effected by any financial stress to that institution, both through the terms of their lending relationship and in the value of their investment in that institution. However, as mentioned above, this risk may be fully offset by the mitigation of credit risk in a merged institution serving a broader geographic area.

When considering the merger of a System bank, we all recognize that a larger farm credit bank results in a greater concentration of risk in regard to the remaining System banks who share joint and several liability for System-wide debt obligations. Obviously, the ability of the remaining banks to absorb the liabilities of a failed sister bank diminishes with the increased size of any particular institution.

Note, however, that I do not believe that these concentrations of risk should result in the automatic denial of a bank merger request. Rather, the FCA should ensure that the financial condition of the merged institution meets the safety and soundness criteria of the FCA, and ensure that the merged institution does not have an economic or lending authority advantage over the other System banks such that it would be detrimental to the safety and soundness of those banks. As mentioned above, once that safety and soundness threshold has been met, FCA should then defer to the judgment of the member-owners of those institutions.

Again, I appreciate the opportunity to provide these comments and look forward to a thorough discussion of these issues at the upcoming Symposium.

Sincerely,

Richard N Davidson

Richard Davidson
Chairman, AgriBank, FCB