FCA Symposium on Consolidation – February 19, 2014

Remarks by Doug Stark, President and CEO, Farm Credit Services of America

The Farm Credit System is built on a unique and compelling business model. Nearly 100 years ago, Congress had the foresight to organize us as a farmer-owned cooperative. This structure has served us well.

Even so, if we were starting over today, I doubt that Congress or any of us for that matter would draw up the Farm Credit System as it is currently structured. Today we have some states that are home to four (or more) Associations, while other Associations serve four states. In spite of this, customers don't care what size we are – *they care how good we are*. Large institutions can be just as inept at serving some markets as small ones might be incapable of serving others. What matters is our ability to serve the diversities of the marketplace and to bring forth products, service offerings, and efficiencies that meet and exceed customer expectations. To that end, scope and scale play a significant role, whether institutions achieve it independently or collaboratively.

One of the key factors that are driving institutions to consolidate is the "capacity" to serve the market as it has evolved. This includes both "financial capacity" and "intellectual capacity." Obviously we need financial capacity to meet the needs of an agricultural industry that is consolidating. Agribusinesses and some family farm operations have grown to the point that it requires multiple lenders to meet their financial needs. Even if an individual institution has the expertise to serve a growing family farm operation or consolidated business, if they can't hold a significant portion of the operation's lending needs, their role as a lead lender is significantly diminished to the point that the local institution has little say in managing the credit relationship.

These sophisticated operations also expect and require "intellectual capacity," in other words, "specialized expertise" to serve diverse market segments that range from dairy or cattle feeding to cotton, fruit, nut production and more. Institutions have to have enough critical mass in these industry segments to be able to afford this specialized talent. At Farm Credit Services of America, we just hired an industry specialist whose market value is in excess of the salary of some Association CEO's. It is challenging to hire or develop this talent without the portfolio size and scale in these individual industries.

Furthermore, financial capacity is critical to developing innovative "programs" to meet the needs of young and beginning producers and to serve other diverse customer segments. Institutions have to be able to develop enough critical mass in these unique market segments to be able to manage the risk in individual loans by looking at the segment from a "portfolio" perspective, not only from an individual loan point of view.

The investment in technological capabilities is likely one of the areas where organizational scale and capacity is imperative. Employing technology is key to serving customers in today's demanding and data driven world, and it will be even more critical as we look to serving customers of the future; especially the next generation of producers, the young and beginning operators of today. Technology is an essential enabler to manage risk, deliver great customer service, and drive efficiencies, but it takes a substantial and ongoing investment of time, money, and people to build and maintain great technology. And it can't be aimed at automating existing, outdated processes. It takes advanced business methodologies – essentially aligning leading edge technology with specialists and expertise.

At FCSAmerica, for example, technology allows us to work effectively in the world of big data, to capture and store information that can be used to manage portfolio level risk as well as individual credit risk. Some examples include:

- When delinquency rates spiked a quarter percent for 60 days, tools and data were used to drill down and identify which products and customer segments were driving the increase. Adjustments were then made to decisioning models – within a couple of days – to minimally decrease approval rates while significantly improving the delinquency rate.

- In another example, early warning models have been developed that monitor customer repayment trends, line of credit usage, and credit bureau scores. These models help predict future repayment and credit quality challenges, at times even before financial officers and customers review financial information.

- Analytics have also been applied that identify low-risk customer segments, regardless of loan size, where technology is used to automate and streamline decisions, improving the customer experience and efficiencies at the same time.

- An integrated customer relationship management system was implemented including "voice-over-IP." Now when a customer calls in, their account information automatically pops up on the employee's computer screen for quick and easy access, resulting in efficient and effective customer service.

- On-hold times are constantly monitored, and in one business segment last December, 749 calls were answered during a single day. The maximum hold time on all of these calls was 58 seconds, and average wait time was 7 seconds. The data is used to plan for future staffing levels and ensure service quality standards.

My point is not to boast about FCSAmerica, but rather to illustrate some of the important ways that technology is helping us serve customers and improve business performance. Technology and technological investments are key issues facing the Farm Credit System today. Not every institution can afford to invest in and/or create these systems…at the same time they cannot afford not to. We even wonder if Farm Credit Services of America will have adequate capacity to address the rapidly changing demographics, social changes, and demands of the marketplace in the future.

In that light, and as we look to the future, technology also helps institutions serve customers when and where they choose to be served. We know that more than half of our customers ages 21 to 35 have a tablet, and 90 percent have a smartphone. Tools like online account access and mobile apps are critical to serving the next generation of producers. Thinking "mobile first" will be essential, as well as investing to allow customers to do business with us on new and different platforms in the future. The young producers on the farm today are the most technologically advanced of any generation. If institutions within the Farm Credit System do not develop the tools the desire, they will simply choose other financial service providers. Young producers define their relationship with their lender very differently than their parents or grandparents do. That is not to imply that these relationships will be totally virtual, but certainly access to their accounts and financial officers will be achieved increasingly through the use of electronic tools.

While many may say that one of the most important considerations of the regulatory agency with respect to the approval of consolidation applications is "safety and soundness," obviously we feel strongly that the willingness and ability of an institution to serve the entire marketplace within their LSA is likely the most imperative. This is amplified by the fact that the System employs exclusively chartered territories. In the System's storied 100 year history, it has done an incredible job in fulfilling its mission, however, the "exclusivity" of charters is increasingly becoming an obstacle to the System meeting the individual needs of all customers.

As an example, in rural home financing, some Associations have chosen not to serve that market because of the technology and expertise necessary to maintain regulatory compliance – yet Associations that *have* invested in systems and specialists to serve that market segment are restricted from rural communities that have these needs.

This same scenario exists today in the dairy and cattle feeding sectors. Customers are being denied access to the System's financing because a local Association that has neither the financial capacity nor the expertise to satisfy the credit needs of a large producer may refuse to partner with other Associations that have the resources to develop the relationships and bring sufficient financial resources to the table.

The collaborative AgDirect program offers point of purchase financing for equipment. The product is offered by Associations in more than 20 states, yet an individual Association with a limited market share can restrict AgDirect partners from serving customers there, effectively denying producers access to the product and sending them to seek other financing.

I raise these examples because they are important as we consider whether we are collectively doing the job we're intended to do in the 21st century. We cannot ignore exclusivity of charters in today's environment. With close to 80 institutions of extraordinary variations in size and capabilities, it is not practical, much less feasible, to believe that each one is going to be able to develop the tools and employ the resources to serve the dynamic marketplace in front of us. When the FCA is considering mergers, this should be a key consideration. The answer is not over-chartering, but more flexibility is needed in allowing customer choice in some form or fashion.

The issue of “consolidation” is not unique only to the Farm Credit System. A recent report in Banktech.com was headlined “Banks Must Evolve Business Model or Die”. The article quotes a study completed by KPMG that concludes, “The banks that embrace change and systematically transform themselves to become more customer centric will achieve a competitive advantage in the marketplace”. KPMG goes on to say, “Further, banks should re-examine merger and acquisition opportunities…to achieve critical mass needed to undertake the transformative change required of them.”

In closing, the world is changing around us, and so are the customers and the markets we serve. We need to evolve our business processes and structures to serve this rapidly evolving environment. There’s no turning back the consolidation of agricultural producers and of business and industry in general. Scope and scale are critical to efficiency, investment, and the changing demographics of serving customers. They also open up niche markets for others. There’s no one answer. Yet the System will need to evolve, too; and it must evolve if we expect to survive, thrive, and serve future generations of agriculturalists, much less be around to celebrate another 100 years.

As Mark Sievewright said in a recent presentation to leaders, “We should worry less about becoming insolvent and more about becoming irrelevant.” Resisting change will only hasten irrelevancy. And suppressing innovations in structure and market approaches will do the same. No one can predict the future, but we all know it won’t be the same.

Thank you for the opportunity to be a part of your panel today. I look forward to your questions.