Remarks By
The Honorable Jill Long Thompson
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Farm Credit Council Services
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Good morning! Thank you for the kind introduction. I appreciate the opportunity to be here with you today.

Setting aside time to focus on leadership is such a valuable thing. It's so easy to get caught up in the day-to-day operations of an organization. Getting together with peers to discuss strategic challenges can help us see solutions we might not otherwise have considered.

I particularly like the title of your workshop—"The Power of Knowledge and Influence," and I will talk here today about this idea in the context of two seemingly unrelated ideas—volatility and ethics.

Volatility

In the field of agriculture, the issue of volatility comes up a great deal. The same is true in the field of finance. And if you work at the intersection of the two fields as we all do, you can hardly get through the day without hearing the word.

Volatility is a two-edged sword, especially in agriculture. An event that causes prices to skyrocket for one sector can cause prices to plummet for another. This makes the effects of volatility very difficult to predict.

So what are the sources of the volatility that plagues farmers and their lenders? Weather comes to mind first. Weather has always been a wild card, but it's gotten wilder in recent years. Extreme events have become the new normal. We have barely begun the 2014 crop cycle, and already we are facing a huge water deficit in California. And this is the third consecutive year of drought in California.

Another source of volatility is geopolitical instability. In a world in which economies are as interdependent as they are today, unrest in a remote corner of the world can have a dramatic effect on our own economy.

Ukraine, for example, is a major exporter of wheat and corn, and it supplies more than half of the world's sunflower oil. The effect on these commodity markets could be dramatic if a confrontation disrupts exports. That could drive up American grain prices, which could in turn drive down incomes for livestock producers.

Unrest is not the only source of volatility. Geopolitical prosperity can cause it, too. China, with almost 20 percent of the world's population and only 12 percent of the world's arable land, has an increasingly powerful effect on agricultural markets here at home. Although the economy appears to be slowing, its growth is expected to remain in the 7 percent range for the next few years—far above the 2 to 3 percent economic growth rate projected for 2014 in the United States.

In recent years, the per capita income of China's people has been rising steadily and is expected to continue to do so. With greater purchasing power, its people are now buying more meat and dairy products. This has been a particular benefit to American dairy farmers and soybean producers.

Other sources of volatility are crop and livestock disease. PEDV is a recent example. Because of concerns about the virus, China, the world's largest consumer of pork, has imposed temporary restrictions on the imports of live U.S. pigs.

Another source of volatility is interest rates. They have a direct effect on both farmers and farm lenders. They've been low for so long that the double-digit interest rates of the 1980s seem like a bad dream. And although USDA projects that interest rates will remain relatively low over the next few years, we are beginning to see them rise with the gradual phasing out of the Federal Reserve's quantitative easing.

These are just a few of the many ways volatility affects farmers and farm lenders. The danger of volatility is great whether it happens to bring hardship or prosperity. In fact, prosperity may be even more risky because it's seductive. As they say, bad loans are often made in good times.

So what's a farmer or a farm lender to do to survive and thrive in volatile times like these? Perhaps the most valuable tool for managing volatility is knowledge. By harnessing the power of knowledge, lenders can ensure that the loans they make are safe and sound.

And there are many ways of doing this. Keeping a close watch on emerging risks is one important way. You should also conduct regular stress tests on loan portfolios and closely monitor loan-to-value ratios. These steps will help you anticipate volatility and mitigate the effects of it.

Is knowledge enough to manage volatility? Unfortunately, no. It's impossible to predict all of the circumstances that can affect credit quality. Until someone invents a reliable crystal ball, lenders will have to use capital. By maintaining strong capital reserves, you can protect yourselves against the painful effects of volatility.

In fact, you proved that just recently. In the wake of the financial crisis that began in 2008, System institutions shored up their capital positions. As a result, the System's financial condition remains strong. I encourage you to continue to maintain strong capital ratios. This is particularly important in light of declining grain prices.

To help ensure that the System remains well-capitalized, we will issue a proposed rule at our next regular Board meeting to update our capital requirements. Like regulators around the world, we are revising our capital standards in response to recent changes in the international regulatory capital framework. This framework, first adopted in the late 1980s, is designed primarily for large, internationally active banks. Over the years, bank regulators in the United States and other countries have adopted simplified versions of the framework for smaller banks in their jurisdictions.

We intend to propose a simplified version of the international framework that reflects the unique characteristics of the Farm Credit System: its cooperative structure and its status as a Government-sponsored enterprise. If adopted in final form, the new regulations would replace our existing capital regulations.

The new international framework, known as Basel III, is intended to increase both the quality and quantity of capital held by financial institutions. The largest internationally active commercial banks in the United States have already begun implementing the full version of the framework. All commercial banks are expected to reach full compliance over the next few years. We expect that our rules will become effective over the same period. Our objective is to ensure that the System continues to operate safely in the new capital regime.

Ethics

And now I will move into the area of ethics. We’ve been hearing a great deal about it lately in the context of the U.S. military. A month ago, a widespread cheating scandal emerged at an Air Force base in Montana. Numerous individuals entrusted with the launching of our nation’s intercontinental ballistic missiles were caught cheating on monthly proficiency tests.

In the wake of these revelations, nine Air Force officers were fired and the base commander resigned. According to a *Washington Post* article, the dismissed officers were *not* found to have facilitated or condoned the cheating, but they *were* held “accountable for creating a culture that enabled it.”

I’m a strong believer in the sentiment expressed by Alexander the Great: “Upon the conduct of each depends the fate of all.” I believe that no organization can be successful for the long term without a strong culture of integrity.

In fact, integrity may be the single most important characteristic of an effective leader, and this is particularly true for leaders of Government agencies and Government-sponsored enterprises. As leaders, we must use our power of influence to emphasize ethics in our organizations. Our conduct must set the standard for our employees.

And to conduct business in an ethical manner is not just the right thing to do, it’s the smart thing to do. It can provide a significant business advantage. If your organization conducts itself with fairness, you attract customers and you earn public trust. If your organization fails to operate in an aboveboard manner, you lose customers and you lose public trust. And maintaining public trust is critical to survival for both Government agencies and Government-sponsored enterprises.

The catchphrase to remember is reputation risk. It's critical to avoid actions that could be considered unethical. Sometimes it's not even a matter of whether something is *actually* right or wrong—the *appearance* of wrongdoing can be enough to risk your reputation.

Because of our belief in the importance of ethics to the success of organizations, my fellow Board members and I adopted a proposed rule in January on standards of conduct for Farm Credit System institutions and their employees. The objectives of the proposed rule are

- to clarify prohibitions on lending transactions and the purchase of System-acquired property, and
- to require each System institution to adopt a code of ethics and to have an in-house standards-of-conduct official.

The value of this rule is that it elevates ethical considerations within the organization. It will help System employees more easily identify both real and apparent conflicts. And having a code of ethics and a dedicated standards-of-conduct official is important because it sends the message both to employees and to the outside world that your institution takes ethics seriously.

At FCA, we have strengthened the emphasis on ethics among our own employees. We are an independent, arm's-length regulator. In late 2011, the FCA Board issued a policy statement to clarify what this means for employees. As an independent agency, we must come to our decisions independently. Although we work cooperatively with Congress and the White House, we must not allow our decisions to be affected by partisan demands.

And as an arm's-length regulator, we must keep a certain distance from the institutions we regulate. We must make fair, impartial decisions to ensure that the System remains safe and sound, that it complies with all laws and regulations, and that it fulfills its congressional mission.

This becomes difficult when the relationship between the regulator and a regulated entity becomes too close. For this reason, our employees are ethically bound to keep an arm's-length distance from the entities they must oversee and examine. We provide annual ethics training to remind employees of ethical considerations and to help them identify potential conflicts of interest.

It's a paradox in a way. We, the Agency, and you, the System, share the same goal of ensuring a safe, sound, and constructive source of credit for America's farmers and ranchers, but we cannot operate as partners, per se.

Not only are we *required* to be an independent, arm's-length regulator, but I would also argue that the System *needs* us to be an independent, arm's-length regulator. If your borrowers, if Congress, and if the general public perceive us to be a "pocket regulator," their confidence in the checks and balances on the Farm Credit System weakens.

Public perception is a powerful thing. Seeing that the System has an independent, arm's-length regulator gives investors in System debt more confidence in the safety and soundness of their investments; it gives borrowers more confidence that they will receive fair treatment; and it gives Congress more confidence that the System will fulfill the mission for which it was created.

So as you explore leadership principles over the next two days, I hope you will keep these things in mind. The power of knowledge (along with strong capital levels) can help you survive and thrive in two volatile industries—agriculture and finance. And the power of influence will help you reinforce a culture of fairness and integrity in your organizations.

The System has so much to be proud of. For almost 100 years, it has delivered much-needed credit to America's farmers and ranchers. And in doing so, it has strengthened the security and financial strength of our nation, making agricultural products our most valuable exports.

By harnessing the power of knowledge and influence, you can help ensure that the System will continue to serve this nation for the *next* 100 years.

Thank you.