Remarks by
The Honorable Jeffery S. Hall
Board Member, Farm Credit Administration
Chairman, Farm Credit System Insurance Corporation
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I appreciate the invitation to speak this morning, and I thought I would start with some of the current issues at FCA.

Current board structure

As you are well aware, our friend and my colleague Ken Spearman passed away in March. I miss him. His leadership and legacy will be evident in our agency and the Farm Credit System for many years to come. The FCA board has been operating with just two board members for more than six months. The White House Office of Personnel has nominated Glen Smith from Atlantic, Iowa. We don't know when his confirmation hearing will occur but are hopeful that it will happen in the next couple of months.

As you know, the federal government is operating under a continuing resolution until Dec. 8. FCA is under the spending level of $68.6 million until FY 2018 appropriations are approved or another CR determines FCA's spending cap for another year. This is critical for FCA as we try to bring on new examiners to fill several vacancies. We are hoping to hire 15 to 18 new examiners for the commissioning program.

Current ag economy and conditions in the Farm Credit System

The current financial conditions of the agricultural economy are obviously one of the key issues that we are all following very closely. Fortunately, the System is very well capitalized. While there has been some increase in nonaccrual levels, FCA believes the System is well positioned to work through the current commodity price declines. The big question is how long this current down cycle for major commodities will last. For several reasons, FCA does not see a repeat of the 1980s. The System has better underwriting standards today, as well as more and better capital, and FCA has more regulatory enforcement authorities than it did in the 1980s.

Since the beginning of 2017, FCA has approved two large mergers. In part because of the size and concentration risk of the institutions that resulted from those mergers, the agency decided to require attestation of their stress testing by an independent third party. Stress testing, even outside the context of mergers, is something I hope the System will embrace so that the agency does not have to move beyond its current guidance.

Internal controls over financial reporting

While progress has been made, the System continues to work on strengthening internal controls over financial reporting (ICFR), and this needs to remain a top priority for all institutions. Transparency and consistency in financial disclosures are critical to investor confidence, market access, and System credibility and reputation.

We need to work together to enhance due diligence and internal controls. I am glad that the ICFR Workgroup continues to provide ongoing communication, education, and training. I am hopeful that these continued efforts will make for a smooth transition when the general financing agreements are updated effective Jan. 1, 2018.

Ken Spearman, an accountant by profession, made internal controls a priority of the agency. He believed, as I do, that a strong and effective system of internal controls is important to the regulator but may be even more beneficial to banks and associations because it helps maintain the confidence of the investors who purchase Farm Credit System debt.

I recognize there is concern over cost of compliance, and I encourage you to look at internal controls as a benefit, not a barrier. The system of internal controls is the first line of defense — an early warning system that you need to trust.

Principles-based approach to standards of conduct rule

FCA has been reviewing the current standards of conduct rule with the goal of establishing broad but well-defined core principles for behavior that directors and employees of System institutions are expected to follow in carrying out their official duties.

The effort is to set clear expectations for the board of directors to establish a standards of conduct program with internal controls to test compliance and hold individuals accountable and to clearly outline prohibited conduct. FCA will then examine for compliance.

FCSIC topics

Currently the Farm Credit System Insurance Corporation has more than 2 percent of the secure base amount in the Farm Credit Insurance Fund. At our FCSIC board meeting last week, staff recommended a premium rate of 9 to 11 percent for 2018 planning purposes, and that was approved by the board. The board will revisit the premium assessment in January when the rate is actually determined.

The Insurance Fund is holding about $230 million above the required secure base amount primarily because, for the first eight months of this year, the Farm Credit System's insured debt obligations were lower than they were at this time last year. However, outstanding debt obligations historically increase during the last quarter of the calendar year.

FCSIC has contracted with Oliver Wyman to study whether the statutorily mandated 2 percent secure base amount is the appropriate benchmark or whether there is a more actuarially sound target for the Insurance Fund. We hope to get the results of the study before the FCSIC board sets premium rates at our January 2018 meeting. Beyond the study, consideration should be given to a more sophisticated way to predict insurable debt. I am interested in reducing the volatility in the year-over-year insurance assessment.

Data and information

FCA continues to work with the Funding Corporation, the Information and Data Workgroup, and the Management Workgroup to ensure data quality and consistency in the System's data warehouse.

At FCA, we are looking at ways to better utilize the data that we already have. The System has data on agricultural lending that is second to none. The Loans 2 Database is probably the most comprehensive and up-to-date data set on the financial conditions in agriculture. In my opinion, this database is currently underutilized, and we are working to identify or create tools that do a better job measuring the financial conditions of the System and the System's borrowers. I believe there are analytic tools that will help us detect early signs of stress among specific groups of borrowers, such as young, beginning, and small farmers.

But I will offer a word of caution: data and information are valuable tools, but data can't tell the whole story and should not cloud common sense. Data gives us insight into transactions, success, and financial stress. Interpreting data, however, still relies on knowing the practices and procedures of the institution, the lender, and even the borrower.

System capitalization

Let's talk about System capitalization. That is a topic getting considerable attention currently, specifically on what might be the appropriate level of capitalization. The System is a bit unique because banks and associations are each required to hold a prescribed level of capital through the leverage ratio, plus the CAMELS scores provide the level of capital required to attain certain FIRS [Financial Institution Rating System] benchmarks.

Some very interesting work has been done at the loan level for six (now nine) of the larger associations. It has provided deeper insight into how different levels of capital requirements are stacked within the reviewed associations and their funding banks. It also provides some comparisons with other federally regulated financial institutions.

So the appropriate level of capital required is in the eyes of the beholder. Requiring too much capital to be held by institutions does limit the System's ability to meet increasing credit needs. However, requiring too little capital to be held does pose a risk to the safety and soundness of the System since capital is the cushion in case the value of the bank's assets declines or its liabilities rise. It is the most important tool in covering any losses.

As we weigh the various options, I think we should ask ourselves several questions:

1. Since the System is considered a mono-line lender, are there greater inherent risks to consider? Conversely, do mono-line lenders have greater expertise and better underwriting standards?
2. Because there is major variation in the size of institutions within the System, are there reasons to treat capital requirements differently for each institution?
3. Given the current strong financial condition of the System, is this a solution in search of a problem? Or can some changes in capital requirements put the System in a stronger financial position?
4. Is this the right time for significant changes given the increasing credit risks caused by the softer ag economy?

I will tell you that I remain open minded and have encouraged FCA staff to remain the same. We need to keep the conversation moving forward and be willing to listen to all opinions in this important discussion. The loan information that has been aggregated and analyzed has provided valuable insight into the efficiency and effectiveness of the System's largest institutions.

System structure

Chairman Tonsager's comments about a dialog on System structure have been successful in stimulating discussion.

The Farm Credit System's century-long success is due in large part to the cooperative structure. Members of the cooperative feel a sense of ownership, and directors have a responsibility for the success of the association.

The reputation of the System relies on fundamentally sound decisions by management and directors in every board room. The System isn't a combination of 76 separate, sovereign institutions but rather a group of very interdependent, interconnected cooperatives bound by a statutory mission.

The System is dependent on a few advantages that Congress gave it. Do not take for granted the System's GSE status or its tax status. Critics of the System will be spending political capital to, in their mind, "level the playing field." There are sound policy reasons behind the System's GSE status. I have heard GSE status described as the "crown jewel" of the System. Mergers and consolidations are clearly a way to gain efficiency of operations, but to what end? There is a tipping point, and I don't know where that is, but it will be argued that a larger, consolidated, and concentrated Farm Credit System no longer needs or deserves GSE status.

So I think I have brought up enough subjects to stimulate some questions. I appreciate the opportunity to be with you, I feel fortunate to be a member of the FCA board, and I truly respect and appreciate what the Farm Credit System does to serve our nation's farmers, ranchers, agribusinesses, and rural communities.