FARM CREDIT ADMINISTRATION

Newsline

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Martin Assures Congress FCS is Prepared for an Economic Downturn

On February 12, FCA Chairman and CEO Marsha Pyle Martin testified on agricultural credit conditions at a House Agriculture Subcommittee hearing held by Rep. Bill Barrett (R-NE). She told the Subcommittee that a financially strong Farm Credit System is prepared for a downturn in the agricultural economy.

"Strong earnings, improved capital, and low levels of problem loans in recent years have allowed the System to rebuild its financial strength since the agricultural crisis of the 1980s," Martin testified. She said the FCS is well positioned to handle an agricultural downturn, a condition very different from the last serious agricultural recession.

Over the past 4 years, Martin said, the System's capital grew from 13.5 percent of total assets to more than 15 percent. She noted credit quality also improved, although nonperforming assets increased slightly from 1.4 percent of total loans at yearend 1997 to 1.6 percent as of September 30, 1998.

Martin reported that while the System is strong financially, she expects the worsening condition for many borrowers to begin to show up in the financial statements of System institutions for the first quarter of 1999. She cited a financial forecasting model developed by the Agency that identifies existing and potential risk in System institutions over the next 12 to 24 months under both "most likely" and "worst case" scenarios.

"Our analysis indicates that current conditions pose no serious threat to the System's financial condition in the next 12 months," Martin said. "Our worst case scenario over a 2-year horizon indicates 16 percent of the System's direct lenders and 12 percent of their total assets would be hurt significantly," she added. "Nevertheless, given the current economic conditions, we will monitor the situation closely," said Martin.

Martin noted the FCA recently issued a policy statement encouraging System institutions to work with pork producers having financial difficulties. "We also suggested institutions contact all borrowers they believed would be hurt by the unfavorable economic environment," she said. Martin pointed out that communication before a borrower's loan becomes delinquent can help resolve problems, benefiting both borrower and lender.

Martin said that although FCA's financial forecasting model projects the System can "weather the storm" over the next 2 years, a prolonged downturn could adversely affect the System's financial condition. She said the next few years may present more opportunities for the System to meet the mandate envisioned by Congress to serve agriculture in its time of need. "We would hope that within the next 2 years, agriculture can return to a profitable business again," said Martin.

The FCA Chairman told the Subcommittee that FCA has taken other steps to benefit agriculture by issuing policies encouraging the FCS institutions to reaffirm their commitment to financing young, beginning, and small farmers; and use government loan guarantees and farm assistance programs.

Jorgensen Outlines Skills Needed to Run Successful Farming Operation

On February 4, FCA Board Member Ann Jorgensen was the opening speaker at the 12th Annual Ag Outlook Conference sponsored by Farm Credit Services of Southeast Kansas in Emporia. She addressed issues facing young, beginning and small (YBS) farmers and their importance to the future of agriculture.

Jorgensen discussed what it takes to build a successful operation, what skills are needed, and what programs are available for help. She noted FCA recently adopted a new policy that encourages each FCS institution to refocus its commitment to being a reliable, consistent and constructive lender to YBS farmers.

"We encourage System institutions to coordinate and manage the risks associated with the YBS program in order to increase your access to credit," Jorgensen said. "A young and beginning farmer, as with any farmer seeking credit, needs to have a viable business plan that is well thought out and reasonable," she added. Jorgensen emphasized that an FCS institution, while encouraged to serve YBS farmers, must continue to operate as a safe and sound lender.

"Business planning and communications are clearly needed to build a successful operation," Jorgensen told the conference participants. She also emphasized the importance of managing risks. "Learn about marketing contracts and hedging to control price risks, and use crop insurance to manage yield risk," she said.

Jorgensen addressed the need to develop good communication skills to express your views, to be a good listener, and to be a good negotiator. "You need to communicate with your parents, if you are in a family farm operation," she said. "You also need to be able to communicate with your lender, your local cooperative or supply business, the government, and you will need to listen to your neighbors," Jorgensen added.

Jorgensen said another factor important to success is access to good information for making decisions. "You probably get a lot of information from the local coffee shop, but you should also seek a wider band of information, such as from the Internet," she said. "Your farming operation is affected by global circumstances, and you need to understand how those events impact you and your management decisions," Jorgensen added.

More Use of Loan Guarantees Urged

Over the past several months, the prices farmers receive for several commodities, such as hogs, wheat, and soybeans, have declined significantly. As a result, many lenders are seeking to guarantee more of their loans by the Farm Service Agency (FSA) and other agencies and instrumentalities of the U.S. Government. Government programs are also available that target young and beginning farmers or socially disadvantaged farmers.

Therefore, we thought it would be appropriate to review our most recent guidance and clarification regarding FCA's treatment of such loans in the examination process. We provided details of our examination approach in a July 10, 1998 Informational Memorandum.

As noted in the memorandum, we examine the terms and conditions of Government-guaranteed loans and appropriately test and examine the loans to determine whether the institution is adhering to the terms and conditions of the guarantee. We also assess whether the institution has internal control systems that effectively identify and control risk and properly classify loans.

Previously, only the Government-guaranteed portion of a loan was classified Acceptable, while the remaining balance was classified according to the standard classification criteria. Now, the entire balance of a loan guaranteed by the FSA or other U.S. Government agency that is performing as agreed normally will be classified as Acceptable/Performing. This change in examination approach eliminates "split classifications" and should result in a higher credit quality rating for the loan. The memorandum details how the loan performance category is determined when repayment problems or other credit weaknesses exist.

In some instances, the collectibility or enforceability of the Government guarantee may be in doubt because the lender's compliance with the terms of the guarantee is questionable. In those instances, the loan should be classified, accounted for, and reported in a manner consistent with its own unique risks without relying upon the guarantee for ultimate collection.

In summary, guarantees are an effective risk management tool for lenders when used in accordance with the guidelines of the individual guarantor programs. In addition, such guarantees provide lenders the opportunity to reach a larger portion of the agricultural community. Therefore, we encourage System institutions to obtain valid guarantees to reduce risk and meet the needs of the agricultural community as circumstances warrant.

FCA to Host 8th Annual Series of Association Meetings

"Building a Foundation for the 21st Century" is the theme the 1999 Association Information Exchange Meetings with leaders of the 197 Farm Credit associations nationwide.

The conferences are designed primarily to improve communication between the FCA Board and management and Farm Credit System leaders. They also help identify emerging issues. "These face-to-face meetings are vital to an effective regulatory process. They also provide an opportunity to explain some of our concerns and plans while obtaining valuable immediate feedback on many issues," said FCA Chairman Marsha Pyle Martin.

The agenda includes presentations that deal with three focus areas: a vision for Farm Credit's future, risk management tools, and a snapshot of current and pending projects at FCA. In addition, an open question-and-answer session will address current topics, including the FCA Board Philosophy Statement on Competition.

The meetings will be held in: Las Vegas, Nev., March 10-12; Dallas, March 22-23; and Miami, April 26-27.

It Takes Time to Develop a Good Regulation

Many of you may wonder how FCA's regulation development process works and why it sometimes takes so much time for a rule to become final. To answer some of the most common questions, we spoke with Patricia W. DiMuzio, director of the Regulation and Policy Division.

"The time required to develop and approve a regulation varies greatly depending on the subject matter and complexity of the issues," DiMuzio said. "It can range from several days to months to even a couple of years in some cases. However, much of our process is required by law."

DiMuzio said the law requires that our process allow sufficient time for public participation. Typically, rules are first proposed and the public is allowed to comment for a 30- to 90-day period. These comments help the FCA evaluate the impact its regulations have on the public and the System institutions it regulates. According to DiMuzio, the typical steps involved are:

- When FCA receives suggestions for regulatory changes, staff reviews its regulations to determine those that may be burdensome or no longer necessary.
- The FCA Board determines how the Agency should respond, i.e., revise an existing regulation, issue a new regulation, issue a policy or provide some other form of guidance.
- A workgroup is formed to research issues and recommend options.
- Staff presents a proposal to the FCA Board for review.
- If the FCA Board approves the proposed regulation, it is submitted to Congress for review and comment.
- After a 30-day congressional review and comment period, we publish the proposed regulation in the *Federal Register* for a 30- to 90-day public comment period.
- After considering the public comments, we draft the final regulation.
- If the FCA Board approves the final regulation, it is published in the *Federal Register.*
- The regulation becomes effective 30 days after either or both Houses of Congress are in session.

"The FCA Board's over-riding objective is to issue regulations that ensure System institutions operate in a safe and sound manner with the minimum amount of regulatory burden," DiMuzio said. "We try to complete regulation projects in the minimum amount of time necessary to properly address the issues and comply with all statutory requirements." She noted, however, these requirements can make the process lengthy, even when the regulation itself is quite simple.

FCA, FCS Make Steady Progress Toward Y2K Readiness

During the past year, FCA has devoted much attention to the Year 2000 (Y2K) problem, both internally and externally. As a Federal government agency, we are required to review, test, and develop a contingency plan for our Y2K operating readiness. Also, as a financial regulator, we have responsibility for ensuring the Farm Credit System is Y2K compliant. In fact, we must provide Congress a monthly status report on our efforts.

"Internally, we developed a detailed action plan to address Y2K issues and identified 29 mission critical systems," said FCA Chief Information Officer Steve Smith. "Of these, 24 relate to the Agency's safety and soundness mission, and the other five are administrative systems, such as the payroll system," Smith said. He noted that two systems have been retired, reducing the number of mission critical systems to 27.

"Our Y2K plan also calls for testing systems that are significant to our operations," Smith said. "We are 88 percent complete on the testing of these systems and plan to have all testing completed by March 31," he added.

Externally, FCA implemented procedures to closely monitor FCS institutions' efforts to become Year 2000 ready. We established a special Year 2000 Task Force in the Office of Examination to oversee and coordinate Year 2000 examination activities. We adopted the Y2K rating system of the Federal Financial Institutions Examination Council and survey FCS institutions quarterly to measure their progress. High-risk institutions were identified early enough to allow us to monitor their corrective actions. Additionally, we provide information and guidance to System institutions through Informational Memorandums on a variety of Year 2000 topics.

The December 31, 1998 survey results reflect continued improvement in Y2K efforts by System institutions. Specifically, 188 FCS institutions, or slightly more than 90 percent, were rated "Satisfactory;" 22 institutions, or about 10 percent, were rated "Needs Improvement;" and no institutions were rated "Unsatisfactory." While steady progress continues, the 90 percent "Satisfactory" level for the FCS is below the 97 percent level reported by the FDIC and OCC for the same quarter. Results from the National Credit Union Administration are not yet available.

The *FCA Newsline* is a publication of the Farm Credit Administration. Suggestions, comments or questions should be sent to: Editor; Office of Congressional and Public Affairs; Farm Credit Administration; 1501 Farm Credit Drive; McLean, VA 22102-5090; Phone: 703-883-4056; Fax: 703-790-3260; E-mail: info-line@fca.gov; Web site http://www.fca.gov.

Chairman and CEO, Marsha Pyle Martin; Board Members, Ann Jorgensen and Michael M. Reyna.

The Farm Credit Administration is the Federal agency responsible for the regulation and examination of the Farm Credit System, a nationwide network of cooperatively owned agricultural lending institutions and their service organizations.

Office of Examination Reminds FCS of Loan Pricing Policy

In response to several inquiries from Farm Credit System institutions and commercial banks regarding FCS loan pricing policies, Roland Smith, chief examiner, issued an Informational Memorandum answering the most common questions related to loan pricing and regulatory requirements.

The memorandum noted that the Farm Credit Act provides that it shall be the objective of FCS institutions to set interest rates and other charges at the lowest reasonable cost on a sound business basis.

According to Smith, each institution should also have a written policy that directs and controls loan pricing decisions. Consistent with the law, regulations, and sound business practices, System institutions should price loans at a level sufficient to cover all costs, fund provisions to the allowance accounts, and accumulate capital. The memorandum lists some of the specific factors that the institution should consider in pricing loans.

FCA examiners review each institution's loan pricing philosophy, policy, and practices. The memorandum and FCA's Examination Manual provide further details on OE's review of this issue. In general, examiners evaluate whether interest rates charged are consistent with established policies and cover costs and adequately capitalize the institution, while maintaining safety and soundness and remaining competitive in the marketplace.

If you have any questions, please contact Chief Examiner Smith or Tom Holland, director of OE's Special Examination and Supervision Division.

In Brief . . .

- The FCA Board presented its Proposed Budget and Annual Performance Plan for Fiscal Year 2000 to Congress on February 1. The proposed budget is $35.8 million, the same amount as proposed for FY 1999. The budget request supports a staffing level of 310, also the same as approved for FY 1999.

- The Annual Performance Plan for Fiscal Years 1999 and 2000 is posted on FCA's Web site under Publications and Audio Tapes. It provides detailed information about how the Agency will implement initiatives contained in the FCA Strategic Plan for Fiscal Years 1998-2003 and then measure the results obtained from Agency operations. The presentation of material in the Performance Plan is designed to establish clear linkages among the Strategic Plan, performance measures and goals, and the Agency's budgetary needs.

People

Floyd J. Fithian, secretary to the FCA Board, retired January 31 following a distinguished career in Federal service. Before joining FCA in July 1994, he served as a Member of the House of Representatives from northwest Indiana from 1975 to 1982, when his congressional district was wiped out by redistricting.

During his time in Congress, he served eight years on the Committee on Agriculture and six years on the Governmental Relations Committee. He went on to serve two years with former Senator Lloyd Bentsen as the finance director of the Senate Campaign Committee, 10 years as chief of staff for Senator Paul Simon, and then as campaign manager for Senator Simon's bid for the Democratic nomination for President.

Fithian was particularly proud of his agricultural roots. He grew up on a small farm in Nebraska and farmed with horses long after that was out of fashion because the family could not afford a tractor. He was the first of his family to go to college, which he paid for by raising hogs.

After serving four years in the Navy, Fithian returned to graduate school and completed a Ph.D. in American history. He first taught at Nebraska Wesleyan University. Later, while an associate professor at Purdue University, he also operated a small farm. He's already at work on his post-retirement job — writing an autobiography.

On February 1, FCA welcomed Vivian L. Portis as the new secretary to the FCA Board. She comes to FCA from USDA's Risk Management Agency, which administers the Federal Crop Insurance program. There, she was the confidential assistant to the Administrator and, later, director of Congressional and Government Relations, where she was instrumental in the development of policy and legislation, including the 1994 Crop Insurance Reform Act.

Portis was a team leader in USDA's 1996 reorganization and renaming of the Federal Crop Insurance Corporation to the Risk Management Agency. She led the direction of the Congressional and Government Affairs Office's strategic planning. Before joining USDA, she worked as a licensed securities representatives and insurance agent with the New York Life Insurance Company and The Vanguard Group of Investments. Portis is a graduate of Mount Mary College, in Milwaukee, Wisconsin, with a B.A. in public relations and journalism.