

**Remarks by
The Honorable Dallas P. Tonsager
Board Chairman and CEO of the Farm Credit Administration
CoBank CEO/CFO/CCO Annual Meeting – Joint Session
Colorado Springs Colorado
August 17, 2017**

Good morning! Thank you for your kind welcome.

I want to take a minute to publicly congratulate Tom on his selection as president and CEO of CoBank earlier this year. His previous experience at this bank and 16 years of experience in the financial sector will serve CoBank well. Thank you for your excellent service to this institution and to rural America.

Before I begin my remarks, I want to take a moment to recognize Ken Spearman – a friend and colleague – who passed away earlier this year. As a leader, Ken was a consensus builder. He sought out the best ideas from across the agency and strove to make them happen, and his approach to leadership served the agency well.

Last week, FCA celebrated Ken's life by dedicating our special occasion dining room as the "Ken Spearman Room." His service to the System and the Farm Credit Administration was outstanding, and we will continue to benefit over the years from the leadership he provided.

Rural Economy

Today, I come to you not only as your regulator, but also as a farmer and a rural American. As many of you may know, I started my career as a farmer in South Dakota. My brother and I operated a dairy and grew wheat, corn, soybeans, and hay. My background and experience have always driven my interest and concern for agriculture and rural America.

For more than 100 years, the System has successfully fulfilled its mission. It adds value to agriculture and rural America *at all times*, but it really proves its worth in difficult times.

With the downturn in the farm economy, more farmers and ranchers have begun to experience financial stress. To help these borrowers through their difficulties, I would like to encourage farm lenders to seek the "best possible outcome" for every borrower.

As institutions of a government-sponsored enterprise, you have a responsibility to serve the credit and related service needs of farmers and ranchers. And times like these are when they need you the most.

In the 1980s America's farm lenders were challenged beyond their capacity. Credit became a substitute for income. As a result, there were thousands of bankruptcies; and tens of thousands of people left rural America to find livelihoods elsewhere. Certainly this was the worst possible outcome.

So I would strongly urge you to look twice at every borrower in difficulty. Do they have a good business plan? Do they have a good operation? Do they have a good chance of making it when the economy improves? If the answer to these questions is yes, I encourage you to

think about what you can do — within the bounds of safety and soundness — to help them through their difficulties.

Rural Investment

As a former undersecretary for Rural Development at USDA, I understand how important it is to expand opportunities in rural areas. Rural America provides us with the food we eat, the majority of the water we drink, and much of the energy we use.

Investing in rural America creates vibrant communities. It also encourages the children of farmers to stay on the farm rather than migrate to cities for career opportunities. The future of agriculture may rest in part on the strength of our rural communities.

In partnership with other System institutions, CoBank has been on the forefront of financing rural infrastructure and community facilities critical to the vitality of rural areas. In fact, at the end of 2016, CoBank had \$20.6 billion in outstanding loans in its rural infrastructure portfolio.

You have also partnered with veterans' groups, land-grant universities, and urban communities. You have partnered with private investors to bring equity capital to rural America. And each and every day you partner with banks large and small.

Through partnerships you have built the confidence of your stakeholders by making valuable investments in rural communities, where most of your borrowers live.

Your portfolio and partnerships have done an enormous amount of good for rural communities. However, as you all know, one bad investment can overshadow all of the good work you have done. So to protect your reputation and that of the whole System, be sure to exercise due diligence when making investments.

Regulatory Agenda

Congress has given the FCA board statutory authority to establish policy, prescribe regulations, and issue guidance to ensure that FCS institutions comply with the law and operate in a safe and sound manner. We are committed to developing balanced, flexible, and legally sound regulations.

Twice each fiscal year, we provide FCS institutions and the public a Unified Agenda and Regulatory Projects Plan. As outlined in the spring agenda, we have projects focused on

- internal controls,
- standards of conduct,
- investment eligibility,
- collateral evaluations, and
- stress testing.

System institutions must have strong internal controls. These controls safeguard the integrity of institution, district, and System financial reports.

Controls ensure that authorities are delegated logically, that duties are properly segregated, that only certain individuals have access to loan and accounting systems, and that

measures are taken to correct weaknesses. Effective controls are necessary regardless of an institution's asset size.

We're considering re-proposing our standards of conduct rule to require each System institution to establish its own benchmarks and have policies and procedures for its standards of conduct program. We believe this would place principles of loyalty, fairness, and ethics at the core of each institution's business practices.

This is important because it helps protect the System against wrongdoing or the appearance of wrongdoing. And it strengthens confidence in the System so that more cooperatives and farmers will turn to you for their credit needs and more investors will turn to you for sound investments.

Another rule on the agenda is investment eligibility. One of the objectives of this rule is to allow associations to make government-guaranteed investments for specific risk management purposes within certain portfolio limits.

We're also reviewing our collateral evaluation regulations to determine where updates may be needed. And we're looking at stress testing, too. We're reviewing the ways System institutions use stress testing for business planning and risk management.

Regulatory Burden

We are also undertaking a review of existing regulations. Through our regulatory burden process, we look to eliminate all regulations that are unnecessary, unduly burdensome or costly, or not based on the law. We, of course, do this in the context of safety and soundness.

Over the years, this process has led to several reforms to reduce regulatory burden on the System. For example, from 1988 through 1992, FCA reduced the number of regulations that required prior approval of the FCA board by more than 70 percent. In 2003, the regulatory burden process led to a final rule to repeal or revise five regulations. These reforms

- provided greater flexibility on the ownership of stock in service corporations,
- provided more flexibility for new employees to initially report matters under standards of conduct rules,
- deleted a dividend restriction for eligibility of cooperatives under title III,
- deleted the requirement for a USPAP [Uniform Standards of Professional Appraisal Practice]-compliant real property appraisal for certain business loans, and
- deleted an unneeded regulation related to bankers' acceptance financing.

Earlier this year, FCA continued its commitment to reviewing its existing regulations. We sought your input on regulations you believe to be unnecessary, unduly burdensome or costly, or not based on the law. Public comments on this initiative closed yesterday. I look forward to reviewing these comments with our team. I want you to know that we are committed to "smart regulation."

Structure

We are aware that there are a number of discussions and studies regarding the structure and capitalization of the System. Rather than allowing the System to evolve in a haphazard way, I believe System institutions should give careful thought to the implications of all changes in structure. And by System institutions, I truly mean *all* System institutions — not just those contemplating mergers or other structural changes. Again, because the System is a network of institutions, the actions of a few impact all others.

As the System's regulator, we must determine whether to approve structural changes to the System, so we have an obligation to consider all proposed changes carefully to ensure they don't compromise safety and soundness or the System's ability to meet its congressional mission. Those are always our foremost concerns: safety and soundness, and mission achievement.

As you may be aware, we're currently undertaking a merger study. This study involves looking at new ways to scrutinize and possibly limit mergers to ensure that the mergers don't create institutions that are too big to fail. We also must make sure that the mergers or other structural changes don't jeopardize the joint and several liability of the banks.

When discussing structural changes, I would encourage all of you to consider and explore questions like the following:

- How does the size of an institution (whether small, medium, or large) affect its relationship with its borrowers, its funding bank, and its investors?
- How would the change affect the joint and several liability of banks?
- How would it affect the ability to best serve customers?

And a critical question to ask is what are the reasons for, and goals of, a structural change? Is the retirement of a CEO sufficient reason for a merger? What will be gained from the merger, and what lost?

If you are considering merger, are there potential alternatives to mergers, such as joint management or strategic alliances? And what will be the impact of mergers or other structural changes on the confidence of investors and Congress?

Capital

It's hard not to discuss structure without a conversation on capital.

For my part, I'm pleased with the regulations so far. The stronger capital requirements will help ensure that institutions remain safe and sound through this downturn in the farm economy. They also give investors comfort that their investments in the System will remain safe despite the downturn.

And I'm pleased to report that System institutions themselves have adjusted to the new requirements well. In many cases, the requirements did cause a decline in the capital FIRS ratings from a 1 to a 2, but a 2 is still a good rating, so we see no cause for concern.

We are, however, aware about the concerns you and other associations have about dual capitalization — that is, maintaining certain levels of capital at both the association and the funding bank.

We're concerned about reducing the levels for banks because they are jointly and severally liable for each other, so reducing these levels could impair the safety and soundness of the System.

At the same time, we understand concerns about opportunity costs, and we're certainly willing to hear your suggestions and consider alternatives.

We would also want to fully understand how institutions plan to use the capital that would be freed up if capital levels were adjusted.

Closing

I will close by saying, since the moment President Wilson signed the Federal Farm Loan Act of 1916, everything the Farm Credit System has done to build confidence in the System has caused it to flourish. When confidence has been lost, the System's role in American agriculture has diminished. For the System to serve its members through the coming difficult times and for the next 100 years, there is much to be done, and it all revolves around building confidence.

And the Farm Credit Administration needs *your* confidence. To do our jobs well, we need you to believe in our expertise and our commitment to the mission of the Farm Credit System.

We also need you to be confident that we won't regulate arbitrarily. Our regulatory efforts will be for the sole purposes of ensuring safety and soundness, compliance with law, and mission fulfillment. And, as I said before, if you believe a regulation no longer fulfills any of those goals or it creates an undue burden, please let us know. I want you to be confident that we will hear your concerns and consider them carefully.

You can, and should, be proud of the service that each of you provides the cooperatives, farmers, ranchers, and other rural Americans in your territory.

Thank you for the opportunity to be here today.