Testimony of the Honorable Vincent G. Logan
Board Chairman and Chief Executive Officer
Farm Credit Administration
Before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies
U.S. House of Representatives Committee on Appropriations
March 9, 2023

Mr. Chairman and Members of the Subcommittee, I am Vincent G. Logan, board chairman and CEO of the Farm Credit Administration (FCA or agency). On behalf of my board colleagues, Jeffery S. Hall of Kentucky and Glen R. Smith of Iowa, and all the dedicated men and women of the agency, I am pleased to provide this testimony. Before I discuss the agency's role, responsibilities, and budget request, I would like to thank the subcommittee members and staff for their assistance during the budget process.

Congress established and structured the Farm Credit System (FCS or System) to provide farmers and rural communities access to financial institutions where they have a voice in the decision-making process to ensure that the financial needs of rural America are addressed. The System is made up of banks, associations, and several service corporations, including the Federal Farm Credit Banks Funding Corporation (Funding Corporation).

Congress also established the Federal Agricultural Mortgage Corporation (Farmer Mac) to increase access to affordable credit for American agriculture and rural communities. Farmer Mac provides a secondary market for agricultural real estate mortgage loans, rural housing loans, and rural utility cooperative loans.[1]

FCA was created to ensure the financial viability of the System and to ensure that its institutions follow their legal obligations. Because System institutions are uniquely structured, FCA has developed regulatory and oversight approaches that are designed to fit these structures. In the case of Farmer Mac, that includes a separate FCA office, the Office of Secondary Market Oversight.

As a result of the collective efforts of the Farm Credit System, including Farmer Mac, U.S. agriculture (including agricultural cooperatives that provide inputs and market products for farmers and ranchers) and rural utilities receive hundreds of billions of dollars in financing every year. In carrying out its important mission, FCA does not receive a federal appropriation. Our administrative expenses come from funds that are assessed and collected annually from the government-sponsored enterprises we regulate and examine.

For fiscal year (FY) 2024, we are submitting a proposed total budget request of $94,710,000. Our proposed budget for FY 2024 includes current and prior-year assessments of $94,300,000 from System institutions, including Farmer Mac, and $410,000 from anticipated reimbursable work for the Farm Credit System Insurance Corporation and the National Consumer

---

[1] Although Farmer Mac is an FCS institution under the Farm Credit Act (12 U.S.C. 2279aa-1(a)(2)), we often discuss Farmer Mac separately from the other entities of the FCS because of the secondary market authorities unique to Farmer Mac. Therefore, when we refer to FCS or System institutions without specifically including Farmer Mac, Farmer Mac should be considered excluded in that context.

Cooperative Bank. Of this budget amount, 86.8% is for salaries, benefits, and related personnel costs.

A key factor driving the FY 2024 budget is our need to hire and train qualified individuals to replace the employees—especially examiners and risk analysts—who are retiring. Approximately 30% of our workforce will be eligible to retire in the next five years. We must ensure that our staff has the skills required to address changes in the agricultural industry and the complexities of agricultural finance.

Another key factor in this budget is our acquisition and implementation of technology. We anticipate that our staff's use of technological, business intelligence, and data tools will continue to grow. As the pace of technological change increases, we also need to invest in cybersecurity, automating manual processes, and modernizing applications.

The funding we have requested for FY 2024 will enable us to hire, train, and retain the people we need to properly examine, oversee, and regulate the System and to ensure that our employees have the tools they need to do their jobs.

Mission of the Farm Credit Administration

As directed by Congress, FCA's mission is to ensure that System institutions, including Farmer Mac, are safe, sound, and dependable sources of credit and related services for all creditworthy and eligible persons in agriculture and rural America. We accomplish our mission in two important ways.

First, we protect the safety and soundness of the FCS by examining and supervising all FCS institutions, including Farmer Mac, and ensuring that the institutions comply with applicable laws and regulations. Our examinations and oversight strategies focus on an institution's financial condition and any material existing or potential risks, as well as on the ability of its board and management to direct its operations. We also evaluate each institution's compliance with laws and regulations and evaluate whether it serves all eligible borrowers, including young, beginning, and small (YBS) farmers and ranchers. If a regulated institution violates a law or regulation or operates in an unsafe or unsound manner, we use our supervisory and enforcement authorities to ensure that appropriate corrective action is taken.

Second, we develop policies and regulations that govern how System institutions, including Farmer Mac, conduct their business and interact with customers. Our policy and regulation development is focused on protecting safety and soundness; implementing the Farm Credit Act; providing minimum requirements for lending, related services, investments, capital, and mission; and ensuring adequate financial disclosure and governance. The policy development program includes approval of corporate charter changes, System debt issuance, Farmer Mac's secondary market operations, and other financial and operational matters.

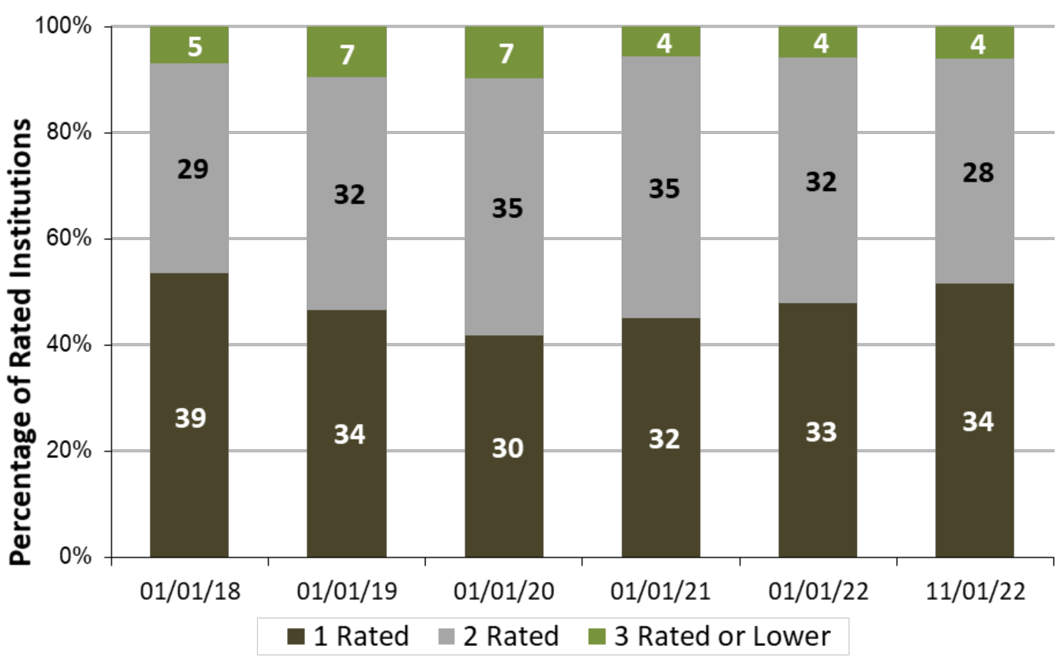
Examination programs for FCS banks, associations, and Farmer Mac

To help ensure the safety and soundness of FCS institutions, including Farmer Mac, FCA uses examination and supervision processes to address material and emerging risks at the institution level and across the System. We base our examination and supervision strategies on institution size, existing and prospective risk exposure, and the scope and nature of each institution's business model. We monitor agricultural, financial, and economic risks that may affect groups of institutions or the entire System, including Farmer Mac. Given the increasing complexity and risk in the agricultural and rural utility financial system and the human capital challenges at FCA, we continue to implement initiatives to improve operations, increase examination effectiveness, and enhance staff expertise in key examination areas.

The frequency and depth of examination activities vary based on risk, but each System institution is examined at least once every 18 months and receives a summary of examination activities and a report on its overall condition. In Farmer Mac's case, an examination is completed annually. FCS institutions, including Farmer Mac, are required to have effective loan underwriting and loan administration processes to properly manage assets and liabilities, to establish high standards for governance, and to provide transparent disclosures to shareholders. Our examination and supervision program promotes accountability in FCS institutions by working to ensure that institutions identify and manage risks. When necessary, we use our enforcement powers to require institutions to change their policies and practices to correct unsafe or unsound conditions, weak business practices, or violations of law or regulations.

To assess the safety and soundness of each regulated institution, we use our Financial Institution Rating System (FIRS). The FIRS provides a framework of ratings to help examiners evaluate significant financial, asset-quality, and management factors in a consistent way across the System. FIRS ratings range from 1 for a very sound institution to 5 for an institution that is likely to fail. As the following chart indicates, the System remains financially strong overall. As of November 1, 2022, four institutions were rated 3 or lower. These institutions hold less than 1.5% of System consolidated assets and do not materially affect the System's performance. Overall, System institutions, including Farmer Mac, are well capitalized, and they do not pose material risk to investors in their debt, to the Farm Credit System Insurance Corporation, or to their stockholders.

FCS Financial Institution Rating System (FIRS) composite ratings



Source: FCA's FIRS Ratings Database.

Note: This chart reflects ratings for only the System's actively reporting banks and direct-lending associations; it does not include ratings for the System's service corporations, Farmer Mac, or the Federal Farm Credit Banks Funding Corporation. Also, the numbers in the bars indicate the number of institutions by FIRS rating.

In examining and overseeing System institutions, we use a three-tiered supervision program: normal supervision, special supervision, and enforcement actions. As of November 1, 2022, a small number of institutions were under special supervision. These institutions require a higher level of supervisory oversight and significantly greater agency resources to oversee. No FCS institutions were under formal enforcement actions, in conservatorship, or in receivership.

Regulatory and corporate activities

Regulatory activities—Congress has given the FCA board statutory authority to prescribe regulations 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. Current regulatory projects outlined in the agency's fall 2022 Unified Regulatory Agenda include the following:

- Continuing to improve YBS data collection and System service to YBS farmers and ranchers.
- Revising the appraisal regulations for current credit and economic conditions.
- Implementing provisions of the 2018 farm bill by appointing the Farm Credit System Insurance Corporation the conservator or receiver of a distressed System bank, association, service corporation, or the Funding Corporation.
- Updating information technology regulations to address information security, multifactor authentication, and cybersecurity requirements.
- Revising the capital regulations to reflect updates to the permanent capital ratio based on the tier 1/tier 2 capital framework.
- Amending the financial reporting regulations to consider updated requirements for annual audits and internal controls over financial reporting for System institutions.
- Modifying loan participation requirements concerning System institutions' participation in loans outside their chartered territories.
- Aligning Farmer Mac's capital regulations with the Basel III framework and providing further transparency on Farmer Mac's capital structure.
- Clarifying what activities performed by eligible borrowers can be financed by System institutions under similar-entity authorities.
- Reviewing the cooperative principles and practices at System institutions.

Corporate activities—Because of mergers, the number of FCS institutions has declined over the years, but their complexity has increased, placing greater demands on both examination staff resources and expertise. Generally, these mergers have resulted in more cost-efficient and better-capitalized institutions with broader, more diversified asset bases, both by geography and commodity. As of January 1, 2023, the System had 61 associations, 4 banks, 6 service corporations, and 2 special-purpose entities.

Condition of the FCS

The FCS continued to be safe and financially sound and was well-positioned to accomplish its mission of providing reliable credit and related services in support of agriculture and rural America. Through the first nine months of 2022, the System reported favorable financial results, including continued strong loan growth and increased earnings. System institutions remained strongly capitalized, with significant risk-bearing capacity. FCS banks maintained reliable access to debt capital markets and held liquidity positions well above the regulatory minimum.

The U.S economy in 2022 faced significant economic challenges, including high inflation and sharply rising interest rates. Despite slowing economic growth, labor markets remained tight. Together these issues had wide-ranging implications for consumers, businesses, and agriculture.

The farm economy remained resilient despite volatile market conditions, rising costs, supply chain disruptions, and labor shortages. For agricultural producers, cost increases extended beyond higher labor and interest costs; they included major increases for energy, transportation, fertilizer, chemicals, and feed. Still, 2022 net farm income is forecast at $162.7 billion, up 15.5% from 2021 and significantly above its 20-year average. Profit margins continued to be favorable for most crop and livestock sectors. Strong demand and modest production increases helped support higher prices, but rising input costs limited profit gains. Livestock and dairy sectors, in particular, felt the impact of higher feed costs. Drought in the Western United States also created major challenges for producers in affected areas, especially in the cattle sector.

The System continued to report strong year-over-year growth at September 30, 2022. FCS assets were up $54.1 billion, or 13.2%, to $464.7 billion. Much of the increase was the result of growth in the System's loan portfolio, which grew by $35.9 billion or 11.0%. Balances for all major loan categories (real estate mortgage, production and intermediate-term, agribusiness, and rural infrastructure) were up year over year. Real estate mortgage and agribusiness lending, primarily in the processing and marketing segment, accounted for much of the growth, increasing 7.5% and 22.4%, respectively.

System capital levels remained steady in 2022, with total capital amounting to $69.4 billion compared with $69.5 billion a year earlier. Retained earnings as a percentage of total capital increased to 83.2% compared with 79.6% the year before. The System's overall capital-to-assets ratio declined to 14.9% from 16.9% the year before because of two factors: asset growth outpaced capital growth, and accumulated other comprehensive loss increased because of the impact of higher interest rates on the fair value of fixed-rate securities.

Through the first nine months of 2022, the System reported higher earnings, with net income totaling $5.4 billion, compared with $5.2 billion for the same period the previous year. Although net interest margin declined to 2.39% from 2.46% for the same period the year before, strong growth in average earning assets supported continued earnings growth.

System loans continued to perform well in 2022, and portfolio credit risk remained low. As of September 30, nonperforming assets totaled $1.830 billion or 0.51% of total loans and other property owned, compared with $1.784 billion or 0.55% a year earlier. Although portfolio loan quality is strong, input price risk and its impact on profit margins will be an important consideration for agricultural producers in 2023. High-cost producers and those with significant leverage will be the most vulnerable to financial stress.

With a balance of $6.5 billion as of September 30, 2022, the Farm Credit Insurance Fund further strengthens the System's financial condition. Administered by the Farm Credit System Insurance Corporation, this fund protects investors in Systemwide consolidated debt obligations. System banks also maintain liquidity reserves to ensure that they can withstand market disruptions. As of September 30, 2022, the System's liquidity position equaled 172 days, significantly above the 90-day regulatory minimum required for each FCS bank.

Condition of Farmer Mac

Congress established Farmer Mac in 1988 to create a secondary market for agricultural real estate and rural housing mortgage loans. Farmer Mac has authority to create and guarantee securities and other secondary market products that are backed by agricultural real estate mortgages and rural home loans, USDA-guaranteed farm and rural development loans, and rural utility cooperative loans. As mandated by statute, we have a separate office—the Office of Secondary Market Oversight—through which we regulate, examine, and supervise Farmer Mac's operations.

Farmer Mac is committed to enhancing the availability of reasonably priced credit to agriculture and rural America through its secondary market activities. Under specific circumstances defined by statute, Farmer Mac may issue obligations to the U.S. Treasury Department, not to exceed $1.5 billion, to fulfill the guarantee obligations on Farmer Mac guaranteed securities. Farmer Mac is not subject to any intra-System agreements and, unlike System banks, is not jointly and severally liable for Systemwide debt obligations. Moreover, the Farm Credit Insurance Fund does not back Farmer Mac's debt.

As measured using generally accepted accounting principles (GAAP), net income available to common stockholders as of September 30, 2022, was up 35.1% from FY 2021 to $144.7 million. The increase was primarily due to an increase in net interest income driven by program volume growth as well as an increase in the fair value of undesignated financial derivatives. These factors were partially offset by an increase in operating expenses and a decrease in guarantee fees.

Net effective spread for the third quarter of 2022 increased to 1.03%, up from 99 basis points for the same quarter 12 months earlier. This increase was primarily due to an increase in outstanding business volume and a decrease in funding costs.

In FY 2022, the total portfolio of loans, guarantees, and commitments grew 9.6% to $25.3 billion, and the quantity and quality of Farmer Mac's capital remained satisfactory relative to its risk profile. Farmer Mac's core capital totaled $1.296 billion, compared with $1.179 billion at the end of FY 2021. This was $540.1 million above the $755.5 million minimum statutory requirement for Farmer Mac's on- and off-balance-sheet exposures. Farmer Mac's tier 1 capital ratio was 14.7% as of September 30, a decrease from 15.1% one year earlier.

Credit quality in all program business lines remained satisfactory. Credit risk was manageable, and adversely classified volume decreased. As of September 30, 2022, substandard loans had decreased from the previous year and represented 2.1% of total direct credit exposure. Across all lines of business, 90-day delinquencies represented 0.17% of total outstanding business volume, which was an improvement compared with 0.24% a year earlier.

Conclusion

We at FCA remain vigilant in our efforts to ensure that the Farm Credit System, including Farmer Mac, remains financially sound and focused on serving agriculture and rural America. We will continue our commitment to excellence, effectiveness, and cost efficiency. Our budget proposal identifies our goals and the performance measures we have developed to help us use our resources efficiently and effectively. It is our intent to stay within the constraints of our FY 2024 budget as presented while ensuring that we attract and retain the staff needed to accomplish our mission. We will continue our efforts to be good stewards of the resources entrusted to us.