

**Remarks by  
The Honorable Dallas P. Tonsager  
Board Chairman and CEO  
Farm Credit Administration  
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**Introduction**

Good morning. Thank you for the opportunity to speak with you today. I'd like to recognize Bill Thone and Matthew Walther for their leadership here at AgriBank. I would also like to recognize the FCA staff members who are with us today.

My FCA colleagues and I share with you a deep commitment to agriculture and the mission of the Farm Credit System. American agriculture is crucial to meeting the food and fiber needs of our country and much of the world. And your role in meeting the credit needs of American agriculture has contributed greatly to its success.

In my speech a few weeks ago to the Farm Credit Council, I discussed the five key areas that I plan to focus on during my chairmanship. I'd like to touch on each of them again right now and then expand on a couple of them.

The first area is confidence. I want to encourage System institutions to focus on ways to maintain and strengthen the confidence that their stakeholders have in them. This confidence is critical to the System's success.

The second area is the concept of the "best possible outcome." In this time of financial stress in the agricultural industry, I want to encourage System institutions to seek the best possible outcome for every single borrower.

The third area is partnerships. System institutions have formed many successful partnerships with other entities, including banks, government agencies, universities, and others, to fund projects in rural America. I would like to encourage the System to continue to seek partnerships that strengthen the communities in which farmers and ranchers live. These partnerships have helped you diversify and strengthen your loan portfolios, manage your risk, bring equity capital and liquidity to rural America, and lower the cost of financing for farmers and ranchers. And I would like to recognize AgriBank in particular for the many valuable partnerships you have developed over the years.

The fourth area is the concept of "all services to all borrowers." I believe it's important for all System borrowers to have access to the same products and services, no matter where they are located.

And the fifth and final area is System structure. Rather than allowing the System to evolve in a haphazard fashion, I believe it's important to think strategically about the structure of

the System and how structural changes can affect the ability of the System to meet its mission.

### **Current challenges in the farm economy**

But the topic that's on everyone's mind right now is the farm economy. In the recent congressional hearing at which I testified, members of Congress expressed concern about the producers in their districts. And they have good reason for concern. Net farm income has dropped every year for the past three years. If USDA estimates for 2017 are correct, net farm income this year will be only \$62.3 billion, about half of what it was in 2013. And because of the string of bad years, many farmers have used up their working capital.

Fortunately, thanks to strong yields, an increase in government payments, and better-than-expected soybean prices, 2016 is turning out to have been better for many grain producers than projected. Though land values have been declining, they've held up reasonably well, and fertilizer and fuel expenses came down.

Nevertheless, the near-term outlook for the crop sector is sobering. South America is expected to have a large crop of corn and soybeans this year and unless U.S. yields are down considerably, cash grain prices will likely continue to be low. Compounding the effect of low prices, government payments will be down this year according to USDA estimates. Also, higher interest rates will likely put additional pressure on producer profits and land values.

For the AgriBank district, with about 33 percent of its portfolio in cash grains, this could produce a notable decline in credit quality. We also expect weaknesses in some segments of the protein sector.

While farm lenders, including the Farm Service Agency, continue to report that overall loan quality remains good, many loan performance indicators are now weaker. And nonaccrual rates for the System's farm production loans were at 0.98 percent as of December 31, 2016, up more than a quarter of a percentage point from a year earlier. According to Federal Reserve Bank surveys, repayment rates on agricultural production loans have declined, and the number of renewals and extensions has increased.

Lenders don't expect a large increase in problem loans because many farmers are expected to adjust their farm balance sheets or change their operating structures to lower their production costs. But there will certainly be many producers who struggle to meet their loan payments.

One of the questions I received at the congressional hearing was, how will the System help those producers? And that's what I would like to talk about now.

## **Best possible outcome**

As I mentioned in the speech to the Farm Credit Council, the 1980s were a difficult period for farmers and farm lenders alike. Many farmers lost their farms during this period, and they saw banks, including the farmer-owned institutions of the System, as the enemy.

What can the System do to ensure this doesn't happen again? How can System institutions protect their good reputation among farmers and preserve the confidence that farmers have in their lending institutions? I believe the answer is to look for the best possible outcome for every borrower.

I encourage every association to look carefully at each and every borrower who faces financial difficulty. If there is a good chance this borrower will become successful again when the economy rebounds, I encourage you to take what measures you can — within the bounds of safety and soundness — to work with the borrower. In general, the System is well-capitalized and has risk-bearing capacity. You can use this capacity to meet your mission by helping borrowers overcome the challenges of the current farm economy. We particularly encourage you to help young, beginning, and small farmers. In general, they are more vulnerable to financial stress than larger, more experienced operators.

Having said that, I'll add that credit cannot be used as a long-term substitute for income. This is not in the long-term interest of the lending institution or the borrower. You won't be there to assist future borrowers if you don't preserve your safety and soundness now.

As your regulator, we have developed capital benchmarks to help you maintain your safety and soundness, and we expect you to monitor these financial measures. At the same time, it is important, in meeting your mission, that you work with your borrowers.

We also believe that it's important to maintain capital requirements at both the association and the bank levels. The direct-lending associations must have risk-bearing capacity. At the same time, each bank must have adequate capital because it has joint and several liability for the debt of all other banks.

And achieving the best possible outcome for every borrower does not always require financial assistance. One of the most valuable ways you can serve borrowers is to provide proactive guidance. The agricultural, financial, and business expertise of your employees is a tremendous asset. Your staff can work with struggling borrowers to help them identify strategies to weather the storm and achieve their best possible outcome.

But I encourage you to identify these borrowers before their problems become dire, and I commend those of you who are already taking steps to work with borrowers in your territories. Monitor your portfolios closely to look for those early signs that a borrower is beginning to struggle. Then reach out to the borrower. Don't wait for them to reach out to you. By the time the borrower reaches out to you, many of their options may be exhausted.

I believe the key to achieving the best possible outcome for every borrower is to closely monitor your loan portfolios for early signs of distress, to provide guidance or other assistance to those in need, and to follow all the borrower rights provisions of the Farm

Credit Act. In doing so, you will successfully fulfill your congressional mission of meeting the credit needs of our farmers and ranchers even in challenging times like these.

### **All services to all borrowers**

But I believe there is another key element to fulfilling your congressional mission, and that is to offer all System services to all eligible and creditworthy System borrowers. In other words, the System needs to have a level playing field. If borrowers in some territories can obtain rural home loans or ag operating loans, then borrowers in all System territories should have that same access.

How can you ensure this equality of opportunity? You have different options. You can use territorial concurrence to invite other institutions to lend in your territory. You can choose to build up this expertise in your own territory by hiring people with the right skills or by training existing staff. Or you can form strategic alliances with institutions that offer what you don't.

In any given area of lending, the System has institutional experts. Look for ways to partner with them so that the people in your territories can get the services they need.

### **Structure**

Meeting the System's congressional mission also involves having the kind of structure that lends itself to this mission. That's why, in my speech at the Farm Credit Council meeting, I called for a year of dialog about the structure of the System.

As part of this dialog, I would encourage you to identify all of your stakeholders and their interests. For example, ag producers are the largest group of stakeholders; they rely on the System for dependable, affordable credit. How does structure affect the ability of System institutions to serve these individuals? When a territory becomes very large, how can the institution ensure that its staff is knowledgeable about all of the types of agriculture that are practiced in the territory? Is there a way to somehow preserve the connection with local communities after merging?

Another group of stakeholders are System bondholders. I believe that generally these individuals prefer having many diverse decision makers. In thinking about System structure, it's important to understand the concerns of the bondholders and to reflect these concerns in decisions you make about structure.

Another important example of System stakeholders is Congress. After all, Congress established the System. It has a keen interest in the System's mission and its safety and soundness. And I believe that members of Congress would also welcome the System's agricultural expertise to help them better understand the needs of ag producers in their districts.

In addition to considering the System's many stakeholders and how their interests might be affected, I encourage you to identify a list of questions to answer. For example,

- What are the criteria that help determine the ideal number of banks and associations?
- Is there a minimum or maximum size for an association or bank to be able to adequately serve its customers?
- How do you expect the relationship between the banks and the largest associations to evolve?

And once you have identified the questions you should address, spend some time researching the possibilities. You can even stress-test different structural scenarios. And to better understand the kinds of service the System will need to deliver over the next century, you can conduct research on future agricultural markets and ag demographics.

Finally, I would urge you to keep your discussions and initiatives transparent. To be consistent with the democratic ideals of a cooperative, it's important to keep the System's owner-borrowers informed every step of the way.

These questions of structure are especially relevant in the AgriBank district. Already, your district includes the two largest associations in the System. If the Compeer merger goes through, you will have the three largest associations in the System. What's more, the portion of your district's assets that are concentrated in your three largest associations will jump from 59 percent to 70 percent.

Although mergers undoubtedly present economies of scale and other benefits, they also present some challenges. For example, in a district like AgriBank with a mix of very large associations and much smaller ones, how can you ensure that all associations are represented? And how can you address concerns about having fewer decision makers when associations become very large? These are just a couple of the many issues that I encourage you to explore.

In discussing corporate structure as well as other matters, I also encourage you to keep the communication channels open between the bank and the associations in the district. It is vitally important for the bank to consider the needs of the associations in its strategic planning. Likewise, associations must realize that the bank needs to make decisions that are in its best interests; at times, those decisions may not align fully with the interests or desires of individual associations.

And I would like to specifically address those of you who serve on System boards. Good governance is essential to the success and strength of the System. As board directors, you need to be knowledgeable, dedicated, and independent from management. You set the direction and policies of your institutions. As your regulator, we rely on you to demonstrate integrity, provide strong leadership, and oversee your institutions properly.

### **Recognition of the district's YBS achievements**

And finally I would like to recognize your district's continued support of young, beginning, and small farmer programs. We noted increases during 2016 in the reported number of loans and total loan volume outstanding to both young and beginning farmers and ranchers.

The future of American agriculture depends on the success of these producers, and the success of these producers depends in large part on their access to credit. We appreciate

your efforts to supply them with credit, as well as valuable educational and training programs. I hope you continue your efforts to serve YBS producers. I also urge you to encourage these producers to become more involved in their institutions — whether that means serving in an advisory capacity or as members of their boards. Like all democratic institutions, cooperatives benefit from the participation of a wide range of perspectives.

## **Conclusion**

In conclusion, the farm economy presents some challenges right now, and it's times like these that American farmers and ranchers need the System the most. By seeking the best possible outcome for every borrower, by providing all services to all borrowers, and by making structural changes strategically, you can help farmers and ranchers through this difficult period.

Again, thank you for the chance to talk with you today. If you would like, I would be happy to meet with you at a later date for more informal discussions.