Farm Foundation Forum

The Financial/Credit Crisis and its Impact on Agriculture and Food Industries

J. Robert Frazee, President and CEO
MidAtlantic Farm Credit
National Press Club, Washington, DC
November 18, 2008

"May you live in interesting times". That's an oft quoted proverb that's been attributed to the Chinese. But, they're quick to say…and I think especially so in these times… we didn't really say it.

I'm speaking today on behalf of the Farm Credit System which is a nationwide federation of member owned retail and wholesale financial institutions that provides credit and related services to farmers, ranchers, agricultural cooperatives, farm businesses and rural communities. We're rooted in the public policy decision that was made over 90 years ago by the Congress that there's a need for a steady supply of sound and constructive credit to agriculture and rural America that's owned and controlled by its users. Today, we have over $150 billion in loans outstanding to member owners in all 50 states and the Commonwealth of Puerto Rico. As such, we provide about 40% of the total credit needs of agriculture and related businesses. I'm the CEO of one of the retail associations and I can tell you that our Board of owner users embraces the public policy charge of the Congress and challenges me to deliver on that promise while doing it safely, soundly and efficiently.

With that as background, I'll offer a perspective on these issues:

1) The capacity of the Farm Credit System to extend credit
2) Challenges facing financial institutions in funding and extending credit
3) Challenges facing our customer owners
4) Lessons learned from the 1980's

Farm Credit System Capacity

The Farm Credit System is profitable and well capitalized. Through September 30, 2008 earnings of more than $2.3 billion exceed those of the same period in the prior year. Capital stands at 13.4% of assets. Much as agriculture has experienced years of strong financial performance, so has the Farm Credit System. Credit quality indicators are favorable with loans past due 30 days or more at 0.36% of total loans. Non-performing loans have seen a modest up-tick but remain at relatively good levels. The loan risk rating system used by our regulator, which is similar to the one used by other banking regulators, reflects good credit quality with only 2.1% of our loans classified as substandard. These measures of loan performance are stronger than what is historically typical. That being said, increased volatility in commodities markets and rising input costs has raised the risk profiles of some of our borrowers and we've seen that reflected in some modest slippage in the past year in credit quality.

Our equity capitalization is unique and I believe an important distinction. As a cooperatively owned government sponsored enterprise (GSE), the primary source of equity capital comes from our owner users. They make initial equity investments in our institutions. Profits from the business we do with those owner users are either returned to them as patronage refunds or retained in the business as capital.

Our financial reporting is transparent. We report results not only to our members but also to investors and other stakeholders on a quarterly and annual basis. Our financial statements are prepared in accordance with generally accepted accounting principles, audited by Pricewaterhousecoopers and have carried their unqualified opinion.

We are regulated by a strong, independent regulator. The Farm Credit Administration (FCA) is charged by Congress with overseeing the safety and soundness of the Farm Credit System. It has the full range of regulatory and enforcement authorities of other federal banking regulators including the ability to issue cease and desist orders and set capital standards. Having also worked as a commercial banker in a bank that was subject to regulatory oversight by the Office of the Comptroller of the Currency (OCC), the FDIC and the Federal Reserve Board, I've experienced the similarity in regulatory oversight.

Investors in Farm Credit securities are protected by our insurance fund. Self funded by our individual institutions, we are the only GSE that offers such protection to investors. The fund, administered by the independent, U. S. government controlled Farm Credit System Insurance Corporation holds some $2.8 billion to provide a means to pay investors in the event that a System bank is unable to retire a debt issuance on schedule.

The federated Farm Credit System profiles as financially strong, mission focused and strongly regulated.

Challenges Facing Financial Institutions

Turmoil in the financial markets has brought challenges to all of us who rely on them for funding. In our case, there are two that have special implications:

1) Investor appetite for short term, high quality investments
2) An unintended consequence of the "bailout" has been that financial instruments of some issuers have jumped to the front of the line because of explicit federal guarantees.

We, like other financial institutions, have seen investors globally seek alternatives to financial institutions. Consequently, that's been reflected in higher spreads relative to what we've historically paid. A second element of that is that general uncertainty in the world financial community causes investors to seek shorter term instruments. As a result, it becomes more challenging to us to offer pricing on longer term loans that is attractive to borrowers.

Challenges Facing our Owner Customers

In every meeting I've been in, every conversation I've had with customers, the main question is "will credit be available?". Between what they hear and see from news reports and are experiencing in isolated cases from some vendors and financial institutions, customers understandably are concerned that they may have difficulty accessing credit.

Beyond the accessibility of credit, managing the risks associated with volatile commodity prices, rising input costs and general economic conditions weigh heavily on them as they make strategic and operating decisions about their businesses. Others on this panel have spoken/will speak to that and I echo their observations.

Lessons learned from the 1980's

What have we learned from the 80's and what from those lessons is particularly relevant today?

1) **Don't lend a borrower more than they can repay**. That may seem simplistic and self evident, but, it's a lesson that is often forgotten or ignored. To invoke that lesson, we've challenged ourselves to make loan decisions on a borrower's realistic, sustainable repayment capacity rather than the value of collateral and assets. We need to be lenders, not pawn brokers.
2) **Everybody needs to do their job**. It takes all stakeholders effectively conducting their respective roles to ensure prospects for success. Public policy makers must set clear direction, regulators must prosecute their oversight roles in a timely and effective manner, owners through their elected boards must ensure institutions' policies advance mission needs safely and soundly, and managers need to effectively deliver performance that meets policy, safety and soundness objectives. Implicit in that is an alignment of stakeholder roles around common elements. Those elements are clarity of mission and standards for fiduciary responsibility and accountability. While we all have different and necessary roles, any one of us through our actions or inactions, can cause disruption or even failure. We all need to do our job.

Conclusion

It's an understatement to call these interesting times. Whatever we call them, there is no doubt that all of us who finance agriculture have and will have challenges for the foreseeable future. All of us on this panel today play a vital role in ensuring there's adequate and competitive financing for producing food and fiber that not only feeds, clothes and shelters us but also a growing and hungry world. I'm pleased to be able to say that the Farm Credit System's financial strength means that U.S. farmers, ranchers, agricultural cooperatives, farm businesses and rural communities continue to have access to a competitive source of credit to meet their needs. Despite the turmoil on Wall Street, Farm Credit continues to tap the nation's debt markets to efficiently bring capital to agriculture.