Testimony of
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Mr. Chairman, members of the Subcommittee, I am Nancy Pellett, Chairman and Chief Executive Officer of the Farm Credit Administration (FCA or Agency). On behalf of my colleagues on the FCA Board, Doug Flory and Michael Reyna, I am pleased to be here this afternoon to discuss the current and future state of the Farm Credit System (FCS or System).

The FCA is the independent Federal agency responsible for regulating and examining the FCS and the Federal Agricultural Mortgage Corporation (Farmer Mac), government-sponsored enterprises (GSEs) designed to serve agriculture and rural America.

The FCS is a nationwide network of borrower-owned cooperative financial institutions and affiliated service organizations that serve all 50 states and the Commonwealth of Puerto Rico. The FCS is the oldest of the financial GSEs. Congress created the FCS in 1916 as a means to achieve affordable and dependable credit for farmers and ranchers.

The mission of the System is to serve agriculture and rural America through good times and bad. In establishing the Farm Credit Act, Congress set out its objectives by stating,

> *It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative FCS be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.*

The FCS currently provides approximately $100 billion in loans to farmers, ranchers, producers and harvesters of aquatic products, rural homeowners, agricultural cooperatives, rural utility systems, and agribusinesses. This includes loans for production agriculture, operating needs and capital purchases; rural housing needs; farm-related businesses; rural utilities, including water and sewer systems; and money to ensure that rural Americans have access to the latest communications technology. Almost a half million borrowers and several million rural residents benefit from System funding.

Overall, the FCS has about a 30 percent market share of total agricultural credit. FCA derives its authority and responsibilities from the Farm Credit Act of 1971, as amended (Act). The Act authorizes the FCA to "exercise the powers conferred on it [under the enforcement provisions of the Act] for the purpose of ensuring the safety and soundness of System institutions."

The mission of the Agency is to ensure the FCS, including Farmer Mac, remain a safe, sound, and dependable source of credit and related services for agriculture and rural America. To achieve our mission, we examine, regulate and supervise the banks and associations of the System and Farmer Mac. In our regulatory oversight role, we also have enforcement powers that are similar to those of other federal financial regulators that can be exercised should the need arise. At the same time, we are dedicated to maintaining a flexible regulatory environment that meets current and future rural credit needs while ensuring safety and soundness.

I am pleased to report that the System is sound in all material respects. Earnings and capital levels have continued to strengthen and asset quality remains high. Without the FCS, we believe the soundness of agriculture and the quality of life in rural America would be greatly diminished. American consumers have benefited enormously from American agriculture's high productivity and efficiency as reflected in the declining share of income that Americans spend on food….from 21 percent in the 1970s to around 14 percent today.

While the System is presently sound, there are many challenges facing agriculture and rural America today that raise the question of whether there should be modifications to the System's chartering legislation in order to enhance agricultural and rural economies of the future.

In the early 1990s, the General Accounting Office (GAO), at the request of Congress, conducted a comprehensive study of the cost and availability of credit in rural America. Congress requested GAO to address, among other things, whether the FCS should be granted new authorities to serve other credit markets in rural America. The GAO Report, released in March 1994, concluded that the System did not need new statutory authorities in the *near term*, but that ongoing structural changes in agriculture and rural America could justify such changes in the longer term (emphasis added). GAO noted that over time, as agriculture and rural America continued to change, the System's charter might need to be updated to ensure that the System is not hampered by outdated restrictions in serving its existing customer base.

Mr. Chairman, the changes in agriculture and rural America alluded to in the GAO Report have arrived. Such changes are borne out by the national statistics, which are staggering. In 1970, 26 percent of the American population was considered rural. By 2000, Americans living in rural areas had dropped a fifth to only 21 percent of the population. Over the same period, the total American labor force exploded by 70 percent, while agricultural employment actually dropped by 5 percent. Additionally, the number of farms in operation declined from 3 million in 1970 to around 2 million in 2000, a decrease of one-third. Agriculture has been transitioning to a bi-modal industry during the last decade, resulting in fewer traditional family farms as we knew them in the 1960s, 70s and 80s.

Farm real estate has undergone some dramatic changes since 1970 as well, dramatically increasing the need for readily available credit, particularly for young, beginning and small farmers. U.S. farm real estate values (all land and buildings on farms) have increased from $196 per acre to $1,360 per acre in 2004, a 594 percent increase, or equivalent to an average increase of around 17.5 percent a year in nominal dollar terms. This year represents the 17th consecutive year U.S. farm real estate values have increased.

The challenges of financing agriculture in a safe and sound manner remain great. This is particularly true given uncertain weather and commodity prices, changing world competition and public policy, continued concentration and integration in agriculture, and concerns regarding safety and security of the food system, transition to the next generation of farmers and ranchers, and improving producer's income through value-added agriculture.

In responding to these changes and their effect on agriculture, the FCA Board adopted a 5-year Strategic Plan after holding a series of planning sessions that obtained input from farmers and ranchers; the Farm Credit Council and other System representatives; economists and finance specialists; the American Bankers Association; the Independent Community Bankers of America; former FCA Board Chairmen; and FCA Senior Management.

What we learned is that we must maintain a flexible and responsive regulatory environment. And where appropriate, we should eliminate or revise regulations that unnecessarily impair the System's activities.

However, the limits of that flexibility are currently being tested as the changes in agriculture and rural America have eclipsed the legislative parameters initially granted to the System. The mission-driven desire and sometime financially-driven need of the System to expand its operations, not only within agriculture but also to rural America presents some challenges within existing authorities.

The FCA Board considers the Agency's 5-year Strategic Plan to be a dynamic document, requiring modification as conditions and circumstances change. Three strategic goals were adopted this year reflecting the changes taking place in agriculture and rural America. The goals are as follows:

Goal 1: Ensure the Farm Credit System and Farmer Mac fulfill their public mission for agriculture and rural areas.

Under this goal, FCA will continue to emphasize the public purpose and mission-related responsibilities of FCS and Farmer Mac. As a part of fulfilling its mission, we will encourage System institutions to develop both public and private partnerships and alliances with other financial service providers to further advance their service to agriculture and America.

Goal 2: Evaluate risk and provide timely and proactive oversight to ensure the safety and soundness of the Farm Credit System and Farmer Mac.

FCA's examination and supervisory programs have been recognized for their high quality and effective results. Goal 2 focuses on preserving and enhancing the integrity of FCA's examination and supervisory programs by making improvements to address changing risks in the institutions we oversee. We will stay abreast of changing market needs and customer forces, we will have a cost effective examination process that makes full use of available technologies, and we will take the necessary supervisory action to proactively ensure safety and soundness of the System and Farmer Mac.

Goal 3: Implement the President's Management Agenda.

We will implement to the fullest extent the five government-wide initiatives that comprise the President's Management Agenda, which include: strategic management of human capital; improved financial performance; expanded electronic government; budget and performance integration; competitive sourcing.

In developing the 5-year Strategic Plan, the FCA Board identified a number of factors that could affect achievement of one or more of the Agency's goals. Among the external factors identified, some relate to the structural changes taking place in agriculture that could pose challenges for the System and FCA, and also demonstrate the need to reassess current authorities in the Farm Credit Act. For example,

- *Structural changes in agriculture and rural areas.* The farm sector is increasingly reliant on off-farm income and government payments. In addition, many rural counties in traditional farming communities are losing population and their rural infrastructure is declining. Many producers are part-time farmers and rely on additional business opportunities to improve their economic welfare.

- *Lack of investment equity in many rural areas.* Some rural areas are suffering from a loss of critical infrastructure, population, and business investment necessary to support opportunities. Furthermore, much of the capital in rural areas is held in the form of fixed assets and is not easily converted for investment purposes. Therefore, there is a need for more flexible, innovative forms of capital that will help rural areas reach their economic potential.

- *Importance of GSE status.* GSE status of the System and Farmer Mac helps maintain a safe, sound, and dependable source of credit and related services for agriculture and rural America. This is because GSE status facilitates a competitive source of credit for eligible and creditworthy borrowers in good times and bad. Furthermore, it results in a capital structure that is vital to the borrowers themselves and to the safety and soundness of the System and Farmer Mac.

As the System comes under increasing pressure, in the face of these emerging changes, to provide the same level of accessible and affordable credit to agriculture and rural America that it has in the past, Congress may want to consider whether the Act is responsive to such demands or whether changes are warranted. Among some of the areas FCA has pondered that Congress may wish to consider are:

1. Change rural home lending authorities that restrict such lending to towns of 2,500 in population so that such loans can be made in larger rural communities.

2. Provide more flexibility for System institutions to engage in syndication lending. In addition, authorize banks to engage in syndication lending.

These are just a few examples of changes that could be made to the Act that would make it more relevant and responsive to the needs of rural America.

I would hope that today's hearing sets the stage for Congress to enlist the aid of FCA, the System, and representatives from agriculture and rural America in seeking legislative solutions that will result in an updated Act responsive to meeting the economic, social and cultural needs of today's farmers, ranchers and rural Americans. Although we are not in the middle of a farm credit crisis, as we have been before, we recognize that the Act was Congress' way of acknowledging that protecting and sustaining American agriculture, providing for national security, and those living and working in our Nation's rural areas, was and is crucial to our country's economic and social well being.

At FCA we would welcome the opportunity to work with you to help bring the Farm Credit Act into the 21st century while maintaining its original mission, which is as valid today as it was when it was formulated.

Let me now turn to a matter that has spawned much attention and has raised questions about the applicability of the Act and the purpose of the Farm Credit System. In early August, a System institution, the Farm Credit Services of America, ACA (association), notified us of its intent to terminate its status as a System institution. Such an action is permissible under the Act and we have regulations implementing these provisions of the Act that allow for the orderly exit of an institution from the System.

Since my colleagues and I would sit as the deciding authority on any termination application submitted to us, it would be inappropriate for me or anyone at FCA to comment on the particulars of the association's announced intention to terminate its System status. Therefore, I hope you will appreciate that I will not be able to respond to questions relating to this specific association's intended termination at this time.

What I can share with you is a brief summary of the key elements involved in the termination process. Within the Act and our regulations we have two very important decisions to make. First, we must approve or disapprove any termination application from a broad perspective, including whether a proposed termination will have a material adverse effect on the remaining System institutions in fulfilling their statutory mission.

Second, if we provide preliminary approval to a termination application, we must ensure that the termination plan, including the disclosure material describing the intended action that is provided to stockholders for a vote is complete and accurate. This is critical so that the stockholders can make an informed decision.

Concurrent with any termination of System status by an institution, FCA would take steps to ensure that FCS service to the terminating institution's territory is maintained. We believe that making credit available to all eligible borrowers regardless of location is necessary to carry out the purposes of the Act. The Board of the Farm Credit Administration has complete confidence in the Agency's ability to carry out all of its regulatory responsibilities as it relates to the oversight of System activities, including our ability to reach an informed decision on any termination requested by a System institution.

In conclusion, Mr. Chairman, FCA is committed to ensuring that the Farm Credit System remains financially sound and operationally equipped to fulfill its statutory mission to serve agriculture and rural America well into the future.

Thank you for the opportunity to appear before you today and I stand ready to answer questions you or members of the Subcommittee might have.