



Statement by
Mr. Bob Frazee, President and CEO
MidAtlantic Farm Credit
Westminster, Maryland
Before the
Subcommittee on Department Operations, Oversight and Credit
House Committee on Agriculture
May 10, 2012

Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify today on behalf of the Farm Credit System. My name is Bob Frazee, and I am President and CEO of MidAtlantic Farm Credit. MidAtlantic is a part of the nationwide Farm Credit System. My remarks today will provide some background on the Farm Credit System, comments on current credit conditions and discuss how we are working to meet the credit needs of agriculture in the geographic area served by my institution.

Background on the Farm Credit System

Established in 1916, the Farm Credit System is a unique set of 87 private institutions, including four funding banks (three Farm Credit Banks and one Agricultural Credit Bank) and direct-lending associations, all of which are cooperatively owned by farmers, ranchers, agricultural cooperatives, rural utilities and others in rural America. We are chartered by the Federal government to provide credit and other related financial services to our owners and others consistent with the eligibility criteria set out in the Farm Credit Act.

MidAtlantic is one of these 87 Farm Credit cooperatives. We are owned by more than 10,500 farmers that borrow from us in the states of Maryland, Delaware, and parts of West Virginia, Virginia, and Pennsylvania. As President and CEO, I report to an 18 member Board of Directors. Sixteen of these directors are farmers elected by the members of the cooperative. MidAtlantic is required to have at least one appointed outside director that has financial experience, and we have chosen to have two. In no case are employees allowed to serve as directors.

There are 83 independently operated Farm Credit associations like MidAtlantic serving agriculture throughout the United States and Puerto Rico. Every Farm Credit association is organized as a cooperative that is owned and governed by its farmer-members. Our Board of Directors is responsible for establishing our institution's capitalization plan consistent with Federal regulations and for ensuring that management makes available loan products and financially related services appropriate to the unique needs of agriculture in the geographic territory that we serve.

Each Farm Credit association obtains funds for our lending programs from one of four Farm Credit banks. At MidAtlantic, we get our funding from AgFirst Farm Credit Bank

(located in Columbia, SC), which is cooperatively owned by twenty-two local associations. The four System banks own the Federal Farm Credit Banks Funding Corporation (located in Jersey City, NJ), which, as agent for the banks, markets to the investing public the Systemwide debt securities that are used to fund the operations of all Farm Credit System institutions. Unlike commercial banks, Farm Credit institutions do not have access to insured deposits guaranteed by the FDIC and backed by the U.S. Treasury as a source of funding for our operations.

Regulatory Oversight by the Farm Credit Administration

All Farm Credit institutions are regulated by the Farm Credit Administration (FCA), which was created by Congress and is subject to oversight by both House and Senate Agriculture Committees. The FCA is an arm's-length, independent safety and soundness regulator. FCA's three board members are nominated by the President and confirmed by the Senate. The FCA has the oversight and enforcement powers that other Federal financial regulatory institutions have to ensure that Farm Credit institutions operate in a safe and sound manner.

The Farm Credit System's mission, ownership structure and authorizing legislation are unique among financial institutions. For farmers, ranchers and the cooperatives that they rely on, it is critically important that Farm Credit's safety and soundness regulator understands our unique mission and what it takes to be successful in accomplishing that mission.

Fulfilling Farm Credit's Mission of Serving Agriculture and Rural America

All Farm Credit System institutions are focused on accomplishing the mission established for us by Congress: to serve agriculture and rural America. Our cooperative structure and governance is designed specifically to ensure that our lending and financially related service activities are driven by the needs of our farmer-members and to ensure that there is a reliable and competitive credit source available to agriculture that farmers own and control. Our practice is to engage our customers in a consultative lending relationship, using our accumulated expertise and knowledge of agriculture and finance to craft long term lending relationships that are often delivered across the farmer's kitchen table.

Farming has changed since the Farm Credit System was created. We embrace that change, and are constantly evaluating programs to ensure that we are serving all of agriculture. Five years ago, MidAtlantic Farm Credit began our StartRight program, a suite of loan products specifically designed to address the hardships faced by young, beginning, and small farmers. Today, we are looking to expand that program to include the challenges faced by small, urban farmers. Our staff is working with the state of Maryland to create a fund which would allow city farming the same access to credit and operating capital that's available to other agricultural producers in our area. We are finalizing our agreement with state programs, and expect to have a robust microloan program available in Baltimore in the next few months.

Farming—no matter where it takes place-- isn't a short-term investment for our member-borrowers. Our cooperative structure allows us to work with our farmer-owners with an

approach not focused on achieving quarterly returns to impress investing stockholders. When our customer-owners achieve success in their business, our business will succeed as well. Farm Credit's lending relationship with our member-borrowers is based on constructive credit over the long haul—we make loans, retain loans, and service loans. We do not enter and exit agricultural lending as farm profitability waxes and wanes.

Distributing Profits to Farmers through Patronage

Our commitment to our farmer-members' business success is demonstrated further by the fact that we share our profits directly through patronage dividends with the farmers that borrow from us. Each year, the MidAtlantic Farm Credit's board of directors makes a determination based on our profitability and financial strength as to what portion of our net earnings will be returned directly to the farmer-members that own our institution.

In 2011, MidAtlantic Farm Credit distributed over \$25 million in earnings as patronage dividends to the member-borrowers of our cooperative. In total the Farm Credit System in 2011 distributed just over \$900 million in patronage. This patronage distribution is rural stimulus that allows our customer-owners to re-invest in their own operations and to support rural communities through local spending.

Farm Credit's Financial Strength

The Farm Credit System remains very strong financially. The System's combined net income was \$3.94 billion for 2011, and we are pleased to report that the System's net income in the first quarter of 2012 was nearly \$1.1 billion. Nationwide, Farm Credit ended 2011 with a loan portfolio of about \$175 billion and we added another \$3.9 billion in loans during the first quarter of this year closing the period at about \$178.6 billion. Farm Credit's financial performance has allowed growth in combined capital to almost \$36 billion as of year-end 2011. At the end of the first quarter of this year capital as a percentage of total assets stood at 15.8%.

Current Conditions in Agriculture

The Farm Credit System continues to be a steady source of credit for agriculture. There continues to be much interest in price increases in agricultural real estate, most notably in the Midwest. Farmland values have increased for many reasons - a continuing low level of turnover in agricultural land, higher commodity prices resulting in the availability of cash in the pockets of farmers as well as continued low interest rates and the relatively low returns of alternative investments for farmers. Farm Credit System institutions approach their markets prudently. System institutions continue to finance land transactions by remaining focused on sound underwriting principles and making credit decisions based on the repayment capacity of the individual borrower. Because we hold virtually all of our loans on our own balance sheet, we have a strong interest in seeing that our customers are successful and prudent in their own risk-taking, including the purchase and financing of farm real estate.

Given the volatility and risk in the present agricultural real estate values, most Farm Credit System institutions have implemented adjustments to their underwriting processes to reduce the risk on new real estate loans. These actions have included setting lower

loan to value limits or establishing maximum loan per acre limits, strengthening loan analysis by stress testing a borrower's repayment capacity, shortening loan terms, or cross-collateralizing loans with property that has limited debt encumbrance. Appraisals are completed by certified and licensed appraisers who are totally independent of the credit decision process. The net result is terms that are more conservative than the maximum allowed by law and regulation, but which are designed to maintain safety and soundness.

A Commitment to Serving Young, Beginning and Small Farmers

Every Farm Credit association has programs in place targeted specifically at meeting the needs of three special categories of borrowers, those that are young, those that are just beginning in farming, and those that are small farmers. Our mission to serve the needs of young, beginning, and small farmers leads us to identify, understand, and finance the farm operations that these new agriculturalists engage in, such as organic, sustainable, local food-related, direct-to-retail, or other emerging business models. We recognize that we must reach out to those who are innovators in farm enterprises in order to follow today's niche operation as it becomes tomorrow's mainstream business.

Nationwide, the Farm Credit System's dedication to serving the credit needs of Young, Beginning, and Small farmers is evident by the level of credit we have extended to these groups. New loans in 2011 to young farmers totaled \$7.4 billion, in the same period those to beginning farmers added up to \$9.6 billion, and to small farmers totalled about \$11.2 billion. (It is important to note that farmers may be included in multiple categories since they are included in each category for which they meet the defined characteristic; young—35 or younger; beginning—10 years or less of farming experience; small—less than \$250,000 in annual gross farm sales)

Importance of Maintaining USDA Programs

Farm Credit institutions make good use of USDA's Farm Service Agency (FSA) loan guarantees to support our lending, particularly to young and beginning farmers and ranchers. The guarantees available through FSA allow us to serve higher risk credits that might not otherwise meet our underwriting standards. We would encourage the Committee to review the eligibility requirements for these programs to ensure that they are flexible enough to permit modern legal structures that farmers are turning to as they structure their businesses. We applaud the efforts of two members of this committee, Congressman Owens and Congressman Courtney, who introduced HR 874 last year, important legislation that would address one of these issues. We would encourage the Committee to adopt this as you consider the credit title of the Farm Bill.

The version of the Farm Bill recently approved by the Senate Agriculture Committee includes a substantial re-write of the statutory provisions that govern the operation of the FSA direct and guaranteed loan programs as well as the Rural Development programs. We are still reviewing these changes in an effort to fully understand their implications for those programs. Should we find areas of particular concern we will bring those to the Committee's attention. Rural Development's Community Facility Guarantee Program has been an important way for our Farm Credit institutions to provide funding for

critically needed facilities in many of the rural communities they serve. We have been disappointed that USDA in recent years has sought to zero out funding for this program, instead intending to rely solely on its direct lending program. We appreciate the continued support Congress has provided for the guarantee program.

Crop insurance remains an extremely important risk management tool for farmers throughout the country. It is extremely important as a lender to agriculture that we know our customers have insured their production. This protects the farmer and it protects lenders as we provide credit to farmer to cover their operating expenses. A strong, effective crop insurance program is vitally important to maintaining credit flows to agriculture. We strongly urge the committee to maintain a robust crop insurance program and that it not be burdened with conservation compliance requirements nor be limited through caps on the level of supported insurance that individuals may receive.

Serving Rural Communities and Global Markets

Through CoBank, the Farm Credit System continues to serve the needs of rural communities in the energy, communications, and water industries. Customers in these industries include rural electric generation and transmission cooperatives, electric distribution cooperatives, independent power producers, rural local exchange carriers, wireless providers, cable television systems, and water and waste water companies. Farm Credit loans to these customers totaled about \$15.6 billion at the end of 2011. This represents a \$1.7 billion increase since 2008.

CoBank also facilitates the export of U.S. farm products through its international financing activities. At the close of 2011, CoBank had just over \$3.8 billion of agricultural export loans outstanding. USDA's GSM-102 export credit guarantee program is very important to our nation's ability to export agricultural products. Since the last Farm Bill, the GSM-102 program has helped move more than \$17 billion in U.S. farm products to overseas markets. We support the continuation of the GSM-102 program and encourage the committee to reauthorize it in the coming Farm Bill.

Addressing Derivatives Reform

We appreciate the leadership of the Committee in moving forward HR3336, the Small Business Credit Availability Act. This legislation addressed needed clarifications regarding the treatment of certain financial institutions that use derivatives to manage their interest rate risk and that enter into swaps with customers seeking to manage risk in the connection with the extension of credit to those customers. These institutions were not the source of the problems in these markets, they should not be penalized as the result of the actions of others, and it is clear that it was never the intent of this Committee to have these institutions and their activities caught up in the technical definitions and adversely impacted. The approval of this legislation by the House helps accomplish this.

Liquidity at Times of Market Disruption

The Farm Credit System relies on our access to the financial markets to make credit available to our borrowers. A disruption in the efficient operation of those markets can adversely impact our ability to serve agriculture. In 2008 we witnessed how a world

financial crisis could disrupt capital flows. Farm Credit continued to access funding but we were forced to change our offerings due to the unwillingness of the market to accept longer term debt at that time. Farm Credit never had to deny a single farmer, cooperative or other eligible borrower access to credit because we could not access the Nation's money markets. Nevertheless, that financial market turmoil demonstrated to us that our ability to access the necessary funding to meet our mission to agriculture and rural America may be at risk if circumstances beyond our control disrupt our market access. We want to continue to keep this issue before the Committee as we study how it might best be addressed.

Conclusion

The Farm Credit System remains financially strong, stable, economically vital, and focused on serving its mission for agriculture and rural America. We continue to make credit available to all segments of agriculture including commercial producers as well as young, beginning and small farmers. We are proud of our commitment to rural America. There are no federal dollars invested in the Farm Credit System. We pay for the expense of being regulated by the federal government through assessments on all Farm Credit System institutions, and we pay insurance premiums to provide protection for those who invest in our debt securities. To continue serving our mission, we must have continued access to the national debt markets and an independent, arm's-length regulator that comprehends the unique requirements of agriculture and rural communities. In addition to being closely regulated, we have the built in oversight mechanism of our owners holding our feet to the fire to keep service quality high while protecting their equity in the cooperative.

Mr. Chairman, thank you again for the opportunity to testify today on behalf of the Farm Credit System. I will be pleased to respond to your questions.

Committee on Agriculture
U.S. House of Representatives
Information Required From Nongovernmental Witnesses

House rules require nongovernmental witnesses to provide their resume or biographical sketch prior to testifying. If you do not have a resume or biographical sketch available, please complete this form.

1. Name: Bob Frazee

2. Organization you represent: MidAtlantic Farm Credit on behalf of The Farm Credit Council

3. Please list any occupational, employment, or work-related experience you have which add to your qualification to provide testimony before the Committee: _____
President & CEO of \$2.4 billion lending institution with over 10,000 farm customers.

4. Please list any special training, education, or professional experience you have which add to your qualifications to provide testimony before the Committee: _____
Undergraduate degree in agricultural and extension education and graduate work in business and banking.
More than three decades of experience in banking.

5. If you are appearing on behalf of an organization, please list the capacity in which you are representing that organization, including any offices or elected positions you hold: serve as Chairman of the Regulatory, Legislative and Public Relations Committee of the Farm Credit System's Presidents Planning Committee.

PLEASE ATTACH THIS FORM OR YOUR BIOGRAPHY TO EACH COPY OF
TESTIMONY.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2009.

Name: Bob Frazee

Organization you represent (if any): MidAtlantic Farm Credit on
behalf of The Farm Credit Council

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2009, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Source: N/A Amount: _____

Source: _____ Amount: _____

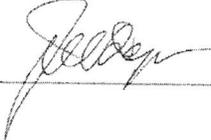
2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2009, as well as the source and the amount of each grant or contract:

Source: USDA - NIFA Amount: \$675,109

Source: USDA - RMA Amount: \$50,000

(Both of these grants were to The Farm Credit Council)

Please check here if this form is NOT applicable to you: _____

Signature: 

* Rule XI, clause 2(g)(5) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.