Opening Remarks,
FDIC Chairman Sheila C. Bair,
FDIC Farmland Price Symposium
March 10, 2011

Good morning, and welcome to this morning's FDIC farmland price symposium.

I am pleased to have the opportunity to make a few opening remarks before turning the proceedings over to our moderators and panelists, who will have much to say on this very important topic.

At the outset, I would like to thank the organizers of the National Agricultural Credit Committee for coordinating their meeting with us.

Doing so has helped to ensure that some of the nation's foremost experts in agricultural finance can participate in this morning's event.

As we begin the symposium, I would like to say a few words about the FDIC's risk-analysis activities and how they relate to the agricultural sector.

I would also like to place these activities, and today's symposium, in the context of the work of the new, interagency Financial Stability Oversight Council, or FSOC, that was authorized by last year's Dodd-Frank financial reform legislation.

Why is the FDIC Convening this Symposium?

The first thing I should discuss with you is why the FDIC has chosen to convene a risk-management symposium at this time on the topic of U.S. farmland prices.

The short answer is that while we don't see a credit problem in agriculture at this time, the steep rise in farmland prices we have seen in recent years creates the potential for an agricultural credit problem sometime down the road.

And that's precisely the sort of long-term risk that farm operators, lenders, and regulators need to stay attuned to as they carry out their day-to-day business.

Other Risks Predominated in the Crisis

Stepping back for a moment, we know that the banking industry has faced some historic credit challenges in the past few years, but agricultural lending has not been prominent among them.

Since the onset of the recession in December 2007, FDIC-insured institutions have charged off just under half a trillion dollars in loans and leases, including:

$125 billion in credit card loans, $90 billion in 1- to 4-family mortgage loans, $69 billion in commercial and industrial loans, and $69 billion in loans for the construction and development of real estate

Over this same period, net chargeoffs in loans secured by farmland have amounted to just $573 million – with an "m" – dollars, while chargeoffs on agricultural production loans have totaled just $812 million.

To be sure, this disparity in loss experience reflects not only lower loss rates in ag-related portfolios, but also the fact that ag-related loans made up just under 2 percent of total industry loans and leases at year end.

Ag Lending Has a Prominent Role in U.S. Banking

But the overall size of the industry's agricultural portfolio tends to understate the importance of the farm sector to the banking industry and to local economies that depend so heavily on farming in their economy and their way of life.

At year-end, more than 1,500 banks and thrifts were designated as agricultural lenders under our informal definition, which includes any institution with ag-related loans of at least 25 percent of total loans.

Together, these institutions make one out of every five FDIC-insured institutions.

As you might guess, farm banks are clustered in the mid-section of the country, in the FDIC's Kansas City, Dallas and Chicago Regions.

But in rural areas that depend heavily on agriculture, even institutions that do not meet the 25 percent test for ag-related loans still find that the fortunes of most of their non-farm borrowers tend to rise and fall with the agricultural economy.

Community institutions are critically important to meeting the credit needs of business and household borrowers in rural areas.

Because they are locally operated, community banks are in the best position to understand and respond to the unique credit needs of local farmers and small businesses.

That is why I cannot emphasize enough the importance of preserving the long tradition of community banking in America, and ensuring that the future prospects for this sector are not undermined by deficiencies in risk management or a burdensome regulatory process.

The Farm Sector Is Strong at Present

Recently, times have been very good in farm country.

U.S. net farm income rose 27 percent in 2010 on the strength of high commodity prices and good harvests.

Globalization is helping to improve living standards in emerging nations.

As their people begin to eat more like Americans, with more protein-based diets, the demand for meat, grains and other farm commodities is rising rapidly.

U.S. farm exports last year set a new record of $116 billion, and China became the number one importer of U.S. farm products for the first time.

This strong performance comes on the heels of a string of recent years in which inflation-adjusted earnings in the farm sector have been the highest since the 1970s.

Farmland Prices Have Risen Sharply

All of this good news for U.S. farmers brings us to the topic of this morning's symposium, which is the historic increases that have been observed in average U.S. farmland prices over the past decade.

Based on data from the U.S. Department of Agriculture, average U.S. farmland prices have roughly doubled in the past decade in nominal terms, and have increased some 58 percent after inflation.

Farmland has clearly been a preferred asset class in an era when many other asset classes have stumbled as a result of the financial crisis.

But for farm operators, farm lenders, financial regulators and investors, the key question is: What lies ahead after this historic boom?

The Farm Sector Is Inherently Volatile

In considering this question, we must recognize that the farm sector has historically been associated with a significant amount of volatility.

Like only a few other sectors, U.S. farmers are subject to abrupt changes in both their level of output and the price of their product based on a variety of factors beyond their control, including:

the weather; the value of the dollar; the level of interest rates; the cost of energy, fertilizer and other inputs; foreign production;foreign demand; changes in trade policy; and changes in domestic farm programs.

When these factors are generally favorable, as they are now, we see strong farm incomes and rising land prices.

However, such a boom period can also give way to a reversal in conditions that can result in falling commodity prices, falling incomes and falling land prices.

Under such a scenario, farm operators can suddenly find it very difficult to make ends meet and service their outstanding debt.

The 1980s Downturn

After the boom years of the 1970s, the U.S. farm sector experienced just such a downturn that had a devastating impact on farm operators, farm lenders and farm communities in the early to mid-1980s.

In all, almost 300 farm banks failed between 1977 and 1993.

I am very pleased that one of my distinguished predecessors, former FDIC Chairman Bill Isaac, is on hand this morning to give you his account of the challenges that faced the sector during that tumultuous period.

Agriculture can be a volatile sector.

And the upside we have seen recently for commodity prices, farm incomes, and land prices represents only one side of this inherent volatility.

I think farmers and their bankers understand this as well as anyone.

Those that experienced the hard times in the 1980s know that collateral is only one of the "four c's" of safe and sound lending.

The other three are character, capital, and the capacity to repay.

Good community lenders know more than what the price of farmland happens to be today.

They also know their customers -- their businesses, their track records, and how they go about planning for an uncertain future.

By staying focused on these long-term fundamentals, community institutions can ensure that they will remain in a position to help their customers in good times and in bad.

The Role of Risk Monitoring in Prudential Supervision

It is also our responsibility as prudential regulators to constantly monitor developments in key industry sectors such as agriculture.

This risk-monitoring function has always been part of the FDIC's responsibility as regulator of state-chartered banks and as steward of the Deposit Insurance Fund.

In these roles, we rely heavily on bank examinations that are conducted on-site by the FDIC itself and other state and federal regulatory agencies.

These examinations not only evaluate the financial condition of the institution, but also its policies for loan underwriting and administration, as well as its other risk-management practices.

But, as we have once again learned in the recent crisis, it is equally important to monitor market conditions at the macro level and develop a clear picture of emerging risks that individual institutions may face in the months and years ahead.

This is no easy task.

There are many potential emerging risks in the financial system that are shaped by macroeconomic events, financial market practices, credit decisions both within and outside the banking industry, and the interactions between these trends can be complex.

For example, the credit problems that arose from subprime and nontraditional lending in the recent financial crisis were generally not well-anticipated in advance due to an inability to connect the seemingly disparate market trends that, in the end, made them so dangerous to our system.

Not every emerging risk that comes onto our radar screen will ultimately develop into the type of systemic threat to financial stability that we experienced in the Fall of 2008.

The fact is that risks of that magnitude will be the exception rather than the rule.

That said, we all now recognize the devastating economic consequences of failing to identify and act on emerging risks in housing and mortgage markets until it was too late, and our system was already hurtling towards crisis.

So it is clearly one of our primary tasks as prudential regulators to monitor a wide range of risks -- large and small, near and far -- to become as informed as possible as to their nature, and to be as prepared as possible for the contingencies associated with them.

It is in that spirit that we convene today's farmland price symposium.

We believe that frequent, frank communication on these topics among regulators and with industry participants can promote understanding of risk-management topics by all parties.

This type of communication can help to reduce the risk of unanticipated developments that could become a threat to important segments of the financial industry or to the stability of our system as a whole.

I was pleased to see Tom Hoenig, President of the Kansas City Fed, recently describe some of his concerns about how rising interest rates could affect farmland prices in the years ahead.

I am also pleased that a member of his staff could participate in our first panel this morning.

Identifying Emerging Risks Through the FSOC

None of us can predict the future.

But that should not dissuade us, as regulators, from asking hard questions and articulating our concerns before a crisis is upon us, while times are still good.

The importance of risk monitoring and communication was recognized by Congress in the Dodd-Frank financial reform legislation.

The new law authorizes the Financial Stability Oversight Council -- the FSOC -- to coordinate these risk-monitoring activities across regulatory jurisdictions on a wide range of topics.

One of the primary lessons of the crisis was that not enough was done to communicate and share information across regulatory jurisdictions about the risks in mortgage lending -- and in the complex derivative instruments based on mortgage loans -- that led to the crisis.

In the first two FSOC principals meetings, we have had some very productive discussions on a wide range of risk-management topics.

More work along these lines is taking place at the staff level.

Again, not every topic that is identified will ultimately be deemed a threat to the stability of the financial system.

But I believe we can improve the communication on these issues among regulators and between regulators and the public.

These discussions are in addition to the workstreams we are pursuing to identify systemically important financial institutions and financial market utilities, and to subject them to greater regulatory oversight and market discipline.

Conclusion

The task of making our system more resilient to shocks will not be accomplished overnight.

But if we take this task seriously, and take the initiative to investigate and respond to emerging issues before they cause large-scale damage to our financial system, I believe we can greatly enhance the stability of our financial system in the years ahead.

Thank you.

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