

Farm Credit Administration

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November 12, 2009

To: Chairman, Board of Directors
Each Farm Credit System Bank and Association

From: Leland A. Strom
Chairman and Chief Executive Officer

A handwritten signature in black ink, appearing to read "Leland A. Strom", is written over the printed name and title.

Subject: My Thoughts on Association Mergers in Economically Challenging Times

In previous communications, I have shared my thoughts with you about the challenges facing the Farm Credit System (System) and those matters that are important to its continued success. Corporate restructuring discussions are becoming more prominent and often begin when an association experiences financial stress, management changes, or marketplace issues. In stressful and challenging times, boards of directors may need to pursue and make merger decisions quickly. I believe it is important that each association strategically and proactively consider different merger scenarios before facing tight timeframes for such a critical decision. As you prepare for potential corporate restructurings in these economically difficult times, I want to share my views on what I believe to be the important issues surrounding association mergers and encourage you to begin a discussion within the System on these issues as I do the same within FCA.

Directors of System associations have a fiduciary duty to evaluate merger opportunities in a manner that is in the best interest of the association and its shareholders. They also have a responsibility to consider the long-term implications of a merger for the System as a whole. Therefore, it is important to fully analyze the long-term business strategy and broader implications of proposed mergers to ensure they result in safe and sound associations that contribute to the collective strength of the System.

To foster good merger opportunities, it may be necessary to set aside pre-conditions for key management and board positions. Setting aside such conditions may lead to mergers that make better business sense that, from my perspective, result in stronger structures, solid financial performance, and improved member service. Such mergers also enhance shareholder value and promote greater member involvement in the management, control, and ownership of the resulting association.

I see five key areas that I encourage associations and their funding banks to fully consider:

- **Shareholder representation** – For the success of any merger, it is critical that merging associations resolve complex board representation and size. The cooperative principle of "one person, one vote" is a crucial factor when determining such representation. I urge the merging associations to carefully weigh this factor in the method they use to determine board representation, whether it is based on the number of shareholders, marketplace needs, geographic realities, or other considerations.
- **Geographic structure** – While geographic diversity can provide benefits from a risk management perspective, geography of a territory can also provide significant challenges in operational and management structure, corporate culture, shareholder representation and engagement, and marketplace service. Therefore, it may be necessary to balance proposed portfolio risk diversification with the potential loss of synergies and the ability to practice cooperative principles within the merging associations' local markets. It is important to determine how the resulting association will resolve any differences between the merging associations, including those related to agricultural industries, territorial cultures, geographic locations, and association product offerings.
- **Resulting association size** – A close review of an association's size (loan volume, number of borrowers, and geographic territory) helps ensure that it can be effectively and efficiently managed in a cooperative manner, that it improves shareholder involvement and marketplace service, and that it provides economic efficiencies and operating benefits. The size of the association also has the potential to increase concentration or other risks to that association's funding bank and the System. Therefore, it is essential that larger associations and their funding banks address these attendant issues as they consider merger opportunities. I also encourage System banks to continue conducting financial analyses and stress testing to fully evaluate the potential impact that a merger has on district risk and System dynamics.
- **Overchartering** – It is important for associations to fully consider the long-term implications of overchartering. The reduction in overchartering from a merger of territories could produce long-term benefits for marketplace and member service. Conversely, a merger that continues or creates overchartering could harm the association's long-term value to its shareholders, marketplace and mission service.
- **Safety and soundness** – It is essential that directors and the System act proactively, collaboratively, and aggressively to effect a merger of a financially weakened or poorly managed association. It is imperative that such mergers fully consider the future financial health and the safety and soundness of the System, including strengthening its long-term viability, reputation, repayment of debt obligations, market access, and competitive credit and related services for future generations of farmers and ranchers.

In addition to the foregoing areas, I am confident that boards will continue to ask the tough questions about the value of any proposed merger as they discuss these matters. As you prepare and consider potential restructuring scenarios, I am also confident you will continue to carry out your responsibilities with the full knowledge and understanding of your accountability to the members who own and control the associations, while considering implications of a merger on the System. Finally, I challenge System leadership to proactively prepare for potential corporate restructurings in these challenging times by having an open, thoughtful, and meaningful internal dialogue about structure and the types of mergers that may best position the

System for its safe and sound long-term future success in the marketplace and in achieving its Government Sponsored Enterprise mission.

Copy to: Chief Executive Officer
Each Farm Credit System Bank and Association