# Farm Credit System Insurance Corporation

## Annual Report

## 1993

Farm Credit System Insurance Corporation

May 31, 1994

Gentlemen:

In accordance with the provisions of section 5.64(a) of the Farm Credit Act of 1971 as amended, the Farm Credit System Insurance Corporation is pleased to submit its Annual Report for calendar year 1993, the first year the Corporation was fully operational.

The aggregate amount in the Insurance Fund at December 31, 1993, was $642 million. The Corporation expects to incur $1.78 million in operating costs during calendar year 1994. On January 31, 1994, the Corporation collected $74 million in premiums from the insured Farm Credit System banks.

Sincerely,

Gary C. Byrne

Gary C. Byrne
Chairman

The President of the United States Senate
The Speaker of the United States House of Representatives

McLean, Virginia 22102-0826
703/883-4380

# Mission Statement

*As an independent entity, the Farm Credit System Insurance Corporation (Corporation) shall:*

- *Protect investors in insured Farm Credit System obligations and taxpayers through sound administration of the Farm Credit Insurance Fund (Insurance Fund);*
- *Exercise its authorities to minimize exposure to the Insurance Fund; and*
- *Help ensure the future of a permanent system for delivery of credit to agricultural borrowers.*

# Contents

# Board of Directors

The Corporation is managed by a three-member board of directors comprised of the Members of the Farm Credit Administration (FCA) Board. The Chairman of the Corporation's Board, however, must be a Board Member other than the Chairman of the FCA Board. There is currently one vacancy on the Board of Directors.

**Gary C. Byrne**, Chairman of the Corporation, is a former Administrator of the Rural Electrification Administration (REA) and Governor of the Rural Telephone Bank. As Administrator of the REA, he managed an agency that approved more than $62 billion in loans to 2,116 rural electric and telephone utilities in 47 States and several U.S. territories and possessions. A native of California, Mr. Byrne served as Chairman of the Bank of Alex Brown in Sacramento and also as President and Chief Executive Officer of the Alex Brown Financial Group, a multibank holding company. He holds a B.A. from the University of Redlands and a Ph.D. from the University of North Carolina.

**Billy Ross Brown**, a Member of the Corporation's Board and former Chairman of the Corporation, is also Chairman and Chief Executive Officer of the Farm Credit Administration. He served as a director of Production Credit Associations in the Fifth Farm Credit District for 20 years, 9 of them as Chairman of the Board of Directors of the Oxford (Mississippi) Production Credit Association. He is a prominent farmer, cattleman, and conservationist, has been active in a number of State and national agricultural and conservation organizations, and has been honored by the Mississippi Association of Conservation Districts and the U.S. Forest Service. In 1985, he was inducted into the Hall of Fame by the Mississippi Agriculture and Forestry Museum. Mr. Brown received a bachelor's degree in business administration from the University of Mississippi.

# Overview

The Farm Credit System Insurance Corporation (Corporation) was established by the Agricultural Credit Act of 1987 (1987 Act) as an independent U.S. Government-controlled corporation. The Corporation's purpose is to ensure the timely payment of principal and interest on insured notes, bonds, and other obligations issued on behalf of Farm Credit System (System) banks. The Farm Credit System is a nationwide system of banks and affiliated associations which serve borrowers and related entities in the agricultural sector. By ensuring the repayment of System securities to investors, the Corporation helps to maintain a dependable source of funds to the farmers, ranchers, and other borrowers of the Farm Credit System. The 1987 Act provided for all System banks to be insured effective January 6, 1989; at yearend 1993, there were 13 insured System banks.

Highlights of the first year of full operations include:

- Growth of $154 million in the Insurance Fund to $642 million;
- First payout for insurance claims;
- Early retirement of financial assistance by one System bank and the successful merger of another System bank without the need for financial assistance;
- Continued decline in eligible borrower stock obligations to $241 million; and
- Commencement of a study to develop a methodology for evaluating risks to the Insurance Fund.

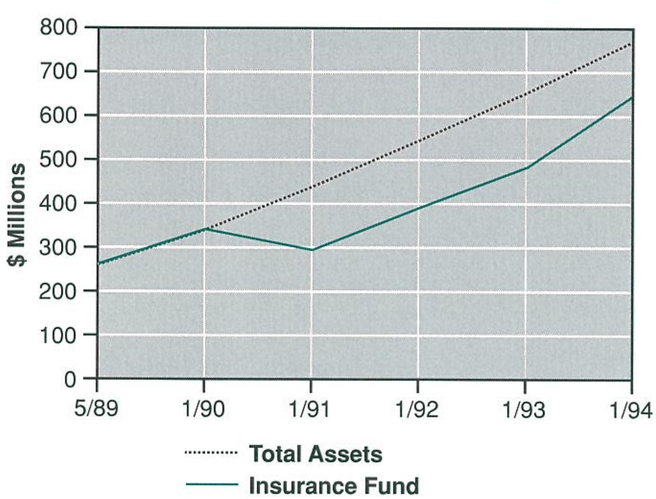
# Corporate Activities

## Insurance Fund Management

### *Growth in the Insurance Fund*

The Insurance Fund grew to $642 million at December 31, 1993, an increase of 31 percent from December 31, 1992. The Insurance Fund represents the Corporation's equity, or difference between total assets ($769 million) and liabilities, and insurance obligations ($127 million). The following graph depicts the growth in the Corporation's total assets and the Insurance Fund.

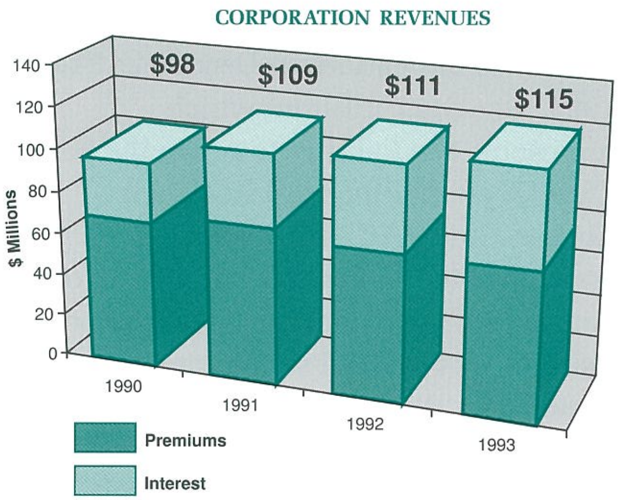
**Growth in the Insurance Fund**
(Total Assets vs. Insurance Fund Equity)




The Corporation's principal liability for insurance obligations at December 31, 1993, was $127 million, which represents the liability to repay the Farm Credit System Financial Assistance Corporation (FAC) for financial assistance to the Federal Land Bank of Jackson in Receivership. This expected liability was revised significantly downward at yearend 1993 to reflect management's expectation that the FAC Trust Fund will be available to assist in the repayment of FAC assistance (see Note 5).

### *Corporation Revenues*

The Corporation's revenues are derived from two sources, premiums collected from insured System banks and interest income earned on the Corporation's investment portfolio. Total Corporation revenues have increased from $98 million in 1990 to $115 million in 1993. While premium revenue has been relatively stable during this period, total revenue has increased as a result of the growing contribution of investment earnings, as depicted in the following graph.




## *Premium Collection and Secure Base Amount*

Premium revenue has been stable since 1990. Premiums are collected annually from System banks based on each bank's, and its related associations', retail loan volume (see Note 4). The Corporation had accrued $74 million on December 31, 1993, representing the estimated premiums that were earned but not yet collected for calendar year 1993; these premiums were collected on January 31, 1994. Each insured System bank will continue to make annual premium payments until the aggregate amount in the Insurance Fund reaches the secure base amount, at which time premiums will be reduced to a level adequate to maintain the Fund at the secure base amount. The secure base amount is a percentage of the insured obligations issued and outstanding by all System banks (see Note 4).

## *Investment of Insurance Fund Assets*

The Corporation had cash and investments of $671 million at December 31, 1993. Funds are invested in U.S. Treasury securities in accordance with 12 U.S.C. 2277a-11 and the Corporation's investment policy. The policy provides that the Corporation will seek the maximum return consistent with its liquidity needs and a minimum exposure to loss of principal. The average portfolio yield for 1993 was 6.28 percent compared with 6.63 percent for 1992. The lower average yield for 1993 resulted from lower interest rates prevailing in 1993.

The Corporation's investment policy permits flexibility to make investments with maturities from 0 to 5 years. There must be a minimum of 15 percent and a maximum of 25 percent invested in any maturity range. At December 31, 1993, the actual portfolio maturity groupings were:

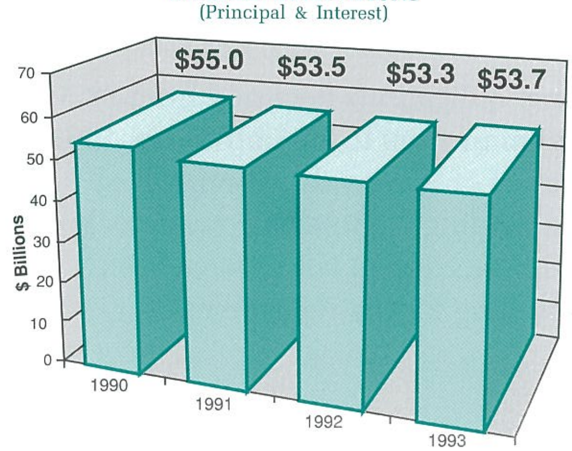
| Maturity Schedule | $ Millions | % of Portfolio |
|---|---|---|
| 1 Day to 1 Year | $106 | 15.8 |
| 1 Year to 2 Years | 135 | 20.0 |
| 2 Years to 3 Years | 118 | 17.6 |
| 3 Years to 4 Years | 158 | 23.6 |
| 4 Years to 5 Years | 154 | 23.0 |
| **Total** | **$671** | **100.0** |

At December 31, 1993, the portfolio's market value exceeded book value by $20 million. This appreciation resulted from some of the Corporation's longer term investments which were purchased when market interest rates were significantly higher than they were in 1993. The weighted average portfolio maturity at yearend was 2.7 years.

## *Insured and Other Obligations*

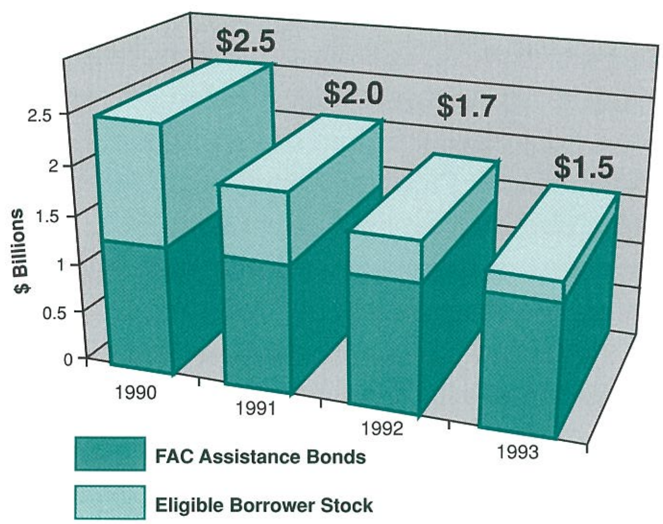
Obligations insured by the Corporation are statutorily defined as any note, bond, debenture, or other obligation issued on behalf of System banks under subsection (c) or (d) of section 4.2 of the Act, 12 U.S.C. 2153. Section 4.2(c) authorizes a System bank to join with any or all banks organized and operating under the same title of the Act to issue consolidated notes, bonds, debentures, or other obligations. Section 4.2(d) authorizes a System bank to join with the other banks of the System to issue Systemwide notes, bonds, debentures, or other obligations. Insured obligations are issued through the Federal Farm Credit Banks Funding Corporation on behalf of the System banks. The outstanding principal and interest balances of insured obligations at December 31 for the past 4 years are shown in the following graph.

INSURED OBLIGATIONS
(Principal & Interest)



The Corporation is also required by statute to use the Insurance Fund to: (a) satisfy System institution defaults on obligations related to FAC-issued bonds under section 6.26(d)(3) of the Act, and (b) ensure the retirement of eligible borrower stock. The outstanding balances of these obligations at December 31 for the past 4 years are illustrated in the following graph.

OTHER OBLIGATIONS




Other obligations declined from $2.5 billion in 1990 to $1.5 billion in 1993 as a result of the steady retirement of outstanding eligible borrower stock. In addition, System banks have been providing for the repayment of outstanding FAC assistance bonds. At December 31, 1993, the System had provided for the repayment of approximately $0.5 billion of the FAC assistance bonds.

## Insurance Claims

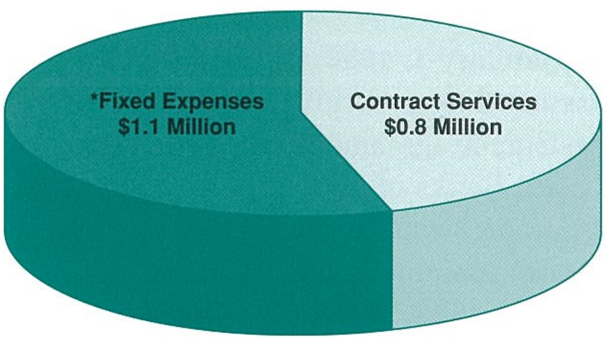
In early 1993, the Corporation paid its first insurance claims expense to facilitate the retirement of eligible borrower stock outstanding at the Richmond, Texas, Production Credit Association (PCA), which was placed in receivership in 1989. The Corporation paid 211 claims for $1.17 million; the average claim was approximately $5,500.

## Operations

The Corporation operates with a core staff of 9 employees. In order to leverage this small staff and to comply with a congressional mandate to avoid unnecessary operating costs and duplication of effort, the Corporation relies on FCA for examination and legal support. Other specialized services are available through contractual arrangements on an as-needed basis.

For 1993, the Corporation's budget was $1.9 million. The following graph illustrates how the budget is structured to leverage resources through contracting.

**CONTRACT SERVICES REPRESENT 42% OF CORPORATE OPERATING BUDGET**




* Includes staff compensation, travel, rent and misc.

Actual expenses of $1.3 million were significantly below budget. This positive variance resulted principally from the Corporation's decision to contract for accounting services rather than to purchase its own system, and lower FCA examination and legal expenses due to the improving financial condition of the Farm Credit System.

During 1993, the Clinton administration issued guidelines for reinventing government. The Corporation voluntarily complied with this effort and submitted its streamlining plan to the Office of Management and Budget in November. To implement this plan, the Board amended the Corporation's Bylaws to abolish the Chief Executive Officer position. This not only eliminated a layer of management but created a more streamlined structure in which the Chief Operating Officer reports directly to the Board. In addition, in keeping with the administration's goal of reducing the number of Federal employees, the Corporation's budget was revised to eliminate a full-time staff position.

## Risk Management

The Corporation's ongoing program to identify and manage risk to the Insurance Fund minimizes the Fund's exposure to potential losses through early detection. Corporation staff have developed special examination procedures to evaluate the condition of weaker System institutions. FCA examination staff performs these special examinations on a reimbursable basis. In addition, the Corporation assesses risk exposure to the Insurance Fund through its ongoing review and analysis of the financial condition of System institutions, corporate actions approved by FCA for System institutions, Reports of Examination of System institutions, and by serving as a nonvoting participant on FCA's enforcement committee. Corporation staff also monitors the development of legislative, judicial and regulatory issues that could alter the various risks to the Insurance Fund.

In the fourth quarter of 1993, the Corporation initiated a study to develop a methodology for evaluating the adequacy of the Insurance Fund's secure base amount, and to identify and quantify the various risk factors that impact the Fund. This study is expected to produce a dynamic model that will enable staff to project the appropriate level of the Insurance Fund on an ongoing basis.

### *Assistance Agreement Management*

On January 1, 1993, the Corporation assumed responsibility for managing assistance agreements with the Farm Credit Banks of Louisville and Spokane from the Farm Credit System Assistance Board, which ceased operations on December 31, 1992. The Corporation approves assisted banks' business plans and budgets and closely monitors their financial performance. It has also established a Credit Review Committee to review assisted banks' proposed involvement in participation loans. In 1993, the committee reviewed participation in loans with an aggregate principal balance of $79.6 million. In addition, the Corporation is required to review and approve certain bank actions which are not covered by the annual business plans that may have an impact on the bank's ability to repay the assistance.

Effective January 1, 1994, the Farm Credit Bank of Louisville merged with AgriBank, FCB. Concurrent with the merger, the Corporation approved the Farm Credit Bank of Louisville's early redemption of the assistance preferred stock held by FAC and the termination of the assistance agreement.

Also during 1993, the Farm Credit Bank of Spokane announced its intention to merge with the Farm Credit Bank of Omaha. The Corporation has approved the Farm Credit Bank of Spokane's request for early retirement of its assistance, which will effectively terminate the assistance oversight responsibilities of the Corporation as successor to the Farm Credit System Assistance Board.

The Corporation is currently developing revised financial assistance procedures in line with its authority to employ assistance as a future means of helping troubled institutions.

## *Receivership Capability*

The Corporation has developed a program for managing receiverships and conservatorships. To contain costs while providing the mandated capacity to deal effectively with any potential receiverships and conservatorships, the Corporation has qualified a pool of private sector vendors who can be called upon to provide specialized support if the need arises. These contractual arrangements effectively leverage permanent staff resources while maintaining low overhead during periods of limited activity.

# Report of Independent Public Accountants

Coopers
&Lybrand

certified public accountants

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of the
Farm Credit System Insurance Corporation

We have audited the accompanying statements of financial condition of the Farm Credit System Insurance Corporation (Corporation) as of December 31, 1993 and 1992, and the related statements of income and expenses and changes in insurance fund, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Farm Credit System Insurance Corporation as of December 31, 1993 and 1992, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand

Washington, D.C.
February 10, 1994

# Financial Statements

## Farm Credit System Insurance Corporation
## Statements of Financial Condition as of December 31, 1993 and 1992
($ in thousands)

| | 1993 | 1992 |
|---|---|---|
| **Assets** | | |
| Cash and Cash Equivalents | $ 528 | $ 832 |
| Investments in U.S. Treasury Obligations (Note 3) | 670,569 | 561,100 |
| Accrued Interest Receivable | 24,012 | 20,203 |
| Premiums Receivable (Note 4) | 74,081 | 74,082 |
| Other Assets | 0 | 7 |
| **Total Assets** | **$769,190** | **$656,224** |
| **Liabilities and Insurance Fund** | | |
| Accounts Payable and Accrued Expenses (Note 7) | $ 185 | $ 147 |
| Liability for Eligible Borrower Stock, Richmond PCA (Note 5) | 2 | 1,173 |
| Liability for Estimated Insurance Obligations (Note 5) | 127,000 | 166,444 |
| Farm Credit Insurance Fund | 642,003 | 488,460 |
| **Total Liabilities and Insurance Fund** | **$769,190** | **$656,224** |

*The accompanying notes are an integral part of these financial statements.*

## Farm Credit System Insurance Corporation
## Statements of Income and Expenses and Changes in Insurance Fund for the Years Ended December 31, 1993 and 1992

($ in thousands)

| | 1993 | 1992 |
|---|---|---|
| **Income** | | |
| Premiums (Note 4) | $ 74,100 | $ 73,902 |
| Interest Income | 41,277 | 36,982 |
| Realized Gain on Sale of Investment | 0 | 216 |
| **Total Income** | **$115,377** | **$111,100** |
| **Expenses** | | |
| Administrative Operating Expenses (Note 7) | $ 1,278 | $ 1,200 |
| Provision for Eligible Borrower Stock (Note 5) | 0 | 1,173 |
| Provision for Estimated Insurance Obligations (Note 5) | (39,444) | 10,889 |
| **Net Income** | **153,543** | **97,838** |
| **Farm Credit Insurance Fund, Beginning of Year** | **488,460** | **390,622** |
| **Farm Credit Insurance Fund, End of Year** | **$642,003** | **$488,460** |

*The accompanying notes are an integral part of these financial statements.*

## Farm Credit System Insurance Corporation - Statements of Cash Flows for the Years Ended December 31, 1993 and 1992 ($ in thousands)

| | 1993 | 1992 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Net Income | $153,543 | $ 97,838 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| (Increase) Decrease in Accrued Interest Receivable | (3,809) | (2,918) |
| (Increase) Decrease in Premiums Receivable | 1 | 175 |
| (Increase) Decrease in Other Assets | 7 | 9 |
| Net Amortization and Accretion of Investments | 9,662 | 6,844 |
| Realized Gains on Sale of Investments | — | (216) |
| Increase (Decrease) in Accounts Payable and Accrued Expenses | 38 | 52 |
| Increase (Decrease) in Refund Payable to System Banks | — | (1,403) |
| Increase (Decrease) in Liability for Eligible Borrower Stock, Richmond PCA | (1,171) | 1,173 |
| Increase (Decrease) in Liability for Estimated Insurance Obligations | (39,444) | 10,889 |
| **Net Cash Provided by Operating Activities** | **118,827** | **112,443** |
| **Cash Flows from Investing Activities** | | |
| Payments for Purchase of U.S. Treasury Obligations | (251,182) | (243,953) |
| Proceeds from Sale and Redemption of U.S. Treasury Obligations | 132,051 | 130,773 |
| **Net Cash Used in Investing Activities** | **(119,131)** | **(113,180)** |
| **Net Decrease in Cash and Cash Equivalents** | (304) | (737) |
| **Cash and Cash Equivalents, Beginning of Year** | 832 | 1,569 |
| **Cash and Cash Equivalents, End of Year** | **$ 528** | **$ 832** |

*The accompanying notes are an integral part of these financial statements.*

## Farm Credit System Insurance Corporation—Notes to the Financial Statements as of December 31, 1993 and December 31, 1992

### Note 1—Insurance Fund: Statutory Framework

The Agricultural Credit Act of 1987 (1987 Act) established the Farm Credit System Insurance Corporation (Corporation) for the purpose of insuring the timely payment of principal and interest on notes, bonds, debentures, and other obligations issued under subsection (c) or (d) of section 4.2 of the Farm Credit Act of 1971 (Act) (insured obligations). Effective January 6, 1989, each bank in the Farm Credit System (System) participating in insured obligations became an insured System bank. The Corporation is managed by a board of directors consisting of the same individuals as the Farm Credit Administration (FCA) Board except that the Chairman of the FCA Board may not serve as the Chairman of the Corporation's Board of Directors.

The Corporation has the responsibility to expend amounts to the extent necessary to:

1. Ensure the timely payment of interest and principal on insured obligations in the event of default by an insured System bank;

2. Satisfy, pursuant to section 6.26(d)(3) of the Act, defaults by System banks on obligations related to the issuance of U.S. Treasury-guaranteed bonds by the Farm Credit System Financial Assistance Corporation (FAC) (FAC bonds) (see Note 5); and

3. Ensure the retirement of eligible borrower stock at par value.

The balances outstanding at December 31, 1993, for each of the components of the Corporation's insurance responsibilities were $53.7 billion of insured obligations, $1.3 billion of FAC bonds (of which $0.5 billion in repayments have been provided for), and $241 million of eligible borrower stock.

If the Corporation does not have sufficient funds to ensure payment on insured obligations, System banks will be required to make payments under joint and several liability.

The Corporation, in its sole discretion, is authorized to expend amounts to provide financial assistance to certain insured institutions.

Under section 5.63 of the Act the Corporation is exempt from all federal, state, and local taxes with the exception of real property taxes.

## Note 2—Summary of Significant Accounting Policies

*Accounting Principles and Reporting Practices*—The accounting and reporting policies of the Corporation conform to generally accepted accounting principles and, as such, the financial statements have been prepared using the accrual basis of accounting.

*Cash and Cash Equivalents*—Cash and cash equivalents include investments in U.S. Treasury obligations with original maturities of 90 days or less.

*Investments in U.S. Treasury Obligations*—An investment portfolio is maintained as required by section 5.62 of the Act. The Act requires that funds of the Corporation, not otherwise employed, shall be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. Investments are held to maturity and stated at cost, adjusted for amortization of premiums and accretion of discounts. Premiums and discounts are amortized or accreted using the straight-line method, which approximates the interest method, over the terms of the respective issues.

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standard Number 115, Accounting for Certain Investments in Debt and Equity Securities, which the Corporation plans to adopt in 1994. Upon adoption, management anticipates that the Corporation will continue to classify the investments as held to maturity and carry them at amortized cost. This is consistent with the Corporation's investment policy and its positive intent and ability to hold its investments to maturity.

*Liability for Estimated Insurance Obligations*—The liability for estimated insurance obligations is the present value of estimated probable insurance payments to be made in the future based on the Corporation's analysis of economic conditions of insured System banks. (Also see Note 5.)

The insured System banks' primary lending markets are borrowers engaged in farming, ranching, and producing or harvesting of aquatic products, and their cooperatives. Financial weaknesses in these market segments and the effect of general market conditions on the insured System banks' borrowers could adversely affect the banks' financial condition and profitability. Insured System banks also face risks from changing interest rate environments and the need to maintain ongoing access to financial markets. Adverse changes in the financial condition and profitability of insured System banks resulting from increased levels of credit, financial, or other risks could occur in the future which would have a material effect on the liability for estimated insurance obligations.

*Premiums*—Annual premiums are recorded as revenue during the period on which the premiums are based. All premiums are due on or before January 31 of the year subsequent to the year in which they are earned.

*Retirement Plan*—All permanent Corporation employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS).

The Corporation's contribution to the CSRS plan equals the 7 percent of base pay contributed by employees covered by that system. For those employees covered by FERS, the Corporation's contribution is 12.9 percent of base pay. In addition, for FERS-covered employees, the Corporation automatically contributes 1 percent of base pay to the employee's Thrift Savings Plan account, matches the first 3 percent contributed by the employee, and matches one-half of the next 2 percent contributed by the employee.

Retirement plan expenses amounted to $59,015 in 1993 and $55,000 in 1992.

## Note 3—Investments

At December 31, 1993, investments in U.S. Treasury obligations consisted of the following:
($ in thousands)

| | Par Value | Book Value | Market Value | Face Rate | Maturity Date |
|---|---|---|---|---|---|
| **U.S. Treasury Notes** | $ 90,000 | $ 90,343 | $ 92,137 | 8.000% | 7/15/94 |
| | 3,600 | 3,611 | 3,685 | 8.000% | 7/15/94 |
| | 11,304 | 11,547 | 11,572 | 8.000% | 7/15/94 |
| | 90,000 | 91,493 | 96,441 | 8.875% | 7/15/95 |
| | 41,021 | 43,247 | 43,957 | 8.875% | 7/15/95 |
| | 85,000 | 85,117 | 91,933 | 7.875% | 7/15/96 |
| | 425 | 425 | 460 | 7.875% | 7/15/96 |
| | 6,000 | 5,994 | 6,489 | 7.875% | 7/15/96 |
| | 24,693 | 26,321 | 26,707 | 7.875% | 7/15/96 |
| | 1,644 | 1,775 | 1,840 | 8.500% | 7/15/97 |
| | 90,395 | 97,531 | 101,186 | 8.500% | 7/15/97 |
| | 4,047 | 4,374 | 4,530 | 8.500% | 7/15/97 |
| | 30,963 | 33,911 | 34,659 | 8.500% | 7/15/97 |
| | 200 | 219 | 224 | 8.500% | 7/15/97 |
| | 487 | 535 | 545 | 8.500% | 7/15/97 |
| | 20,194 | 20,079 | 20,674 | 5.500% | 7/31/97 |
| | 136,468 | 154,047 | 153,484 | 8.250% | 7/15/98 |
| | $636,441 | $670,569 | $690,523 | | |

At December 31, 1993, the Corporation's investment portfolio had gross unrealized gains of $20.5 million and gross unrealized losses of $0.6 million. At December 31, 1992, the Corporation's investment portfolio consisted of U.S. Treasury notes with a book value of $561.1 million and a market value of $579.6 million, which included gross unrealized gains of $18.6 million and gross unrealized losses of $0.1 million.

## Note 4—Premiums

Each System bank which issues insured obligations under subsection (c) or (d) of section 4.2 of the Act is an insured System bank and is required to pay premiums to the Corporation.

In accordance with the Act, the annual premium due from each insured System bank for the calendar year is equal to the sum of: (1) the annual average principal outstanding for the year on loans made by the bank that are in accrual status, other than the guaranteed portions of Government-guaranteed loans, multiplied by 0.0015; (2) the annual average principal outstanding for the year on loans made by the bank that are in nonaccrual status multiplied by 0.0025; (3) the annual average principal outstanding for the year on the guaranteed portions of Federal Government-guaranteed loans of the bank that are in accrual status, multiplied by 0.00015; and (4) the annual average principal outstanding for the year on the guaranteed portions of State government-guaranteed loans of the bank that are in accrual status, multiplied by 0.0003.

Each insured System bank will continue to make these annual premium payments until the aggregate amount in the Insurance Fund exceeds the secure base amount. The secure base amount is equivalent to 2 percent of the aggregate outstanding insured obligations of all insured System banks (adjusted downward by a percentage of the guaranteed portions of principal outstanding on Government-guaranteed loans in accrual status) or other such percentage or amount determined by the Corporation, in its sole discretion, to be actuarially sound. When the amount of the Insurance Fund exceeds the secure base amount, the Corporation is required to reduce the premium to a percentage necessary to maintain the level of the Insurance Fund at the secure base amount. At December 31, 1993, the Insurance Fund was 1.3 percent of insured obligations outstanding.

## Note 5—Financial Assistance to System Banks and Estimated Insurance Obligations

*Financial Assistance to Certain System Banks*

The 1987 Act required that the FCA charter the Farm Credit System Assistance Board (Assistance Board) and the FAC (see Note 1) for the purpose of carrying out a program to provide assistance to System institutions experiencing financial difficulty. In order to raise funds to provide this assistance, the FAC had the authority to issue debt obligations with a maturity of 15 years. Subject to Assistance Board approval, these funds were used by the FAC to purchase preferred stock issued by an institution experiencing financial difficulty.

During the period from 1988 to 1992, assistance was provided to four open banks through the purchase by the FAC of $419 million in preferred stock issued by these institutions. Similar assistance was provided to the Federal Land Bank of Jackson in Receivership.

Prior to the maturity of the related 15-year debt obligations, each institution can redeem its preferred stock, pursuant to Section 6.26 of the Act, so as to allow the FAC to pay the principal of the maturing obligation. While an institution that issues preferred stock to the FAC is primarily responsible for providing funds for payment of the FAC bonds (through redemption of the preferred stock purchased with the proceeds of the FAC bonds), the institution may be prohibited from redeeming, or may elect not to redeem, the preferred stock pursuant to section 6.26 of the Act. If this occurs, then the FAC must use funds from its Trust Fund, to the extent available, to retire the debt. The FAC Trust Fund (Trust Fund) represents the funds received from System institutions' purchase of stock in the FAC. The Trust Fund totaled approximately $75 million and $72.7 million at December 31, 1993 and 1992, respectively. If the Trust Fund is not sufficient to retire the debt, then the Corporation must purchase preferred stock from the FAC to provide funds to retire such debt. If the Corporation does not have sufficient funds, the U.S. Treasury must retire the debt. If this should occur, the Corporation is required to repay the U.S. Treasury as funds become available from the payment of premiums.

On May 20, 1988, the FCA placed the Federal Land Bank of Jackson and the Federal Land Bank Association of Jackson in receivership (collectively the FLBJR) and appointed a receiver to liquidate their assets. As of April 27, 1990, the FCA, the receiver of the FLBJR, the FAC, the System banks, the Assistance Board, and the Corporation entered into an agreement which called for the FAC to issue 15-year U.S. Treasury-guaranteed bonds to purchase preferred stock in the FLBJR. Upon the maturity in 2005 of the FAC bonds used to purchase preferred stock in the FLBJR, the Corporation will provide funds to repay the principal of these debt obligations, to the extent that the Trust Fund is not sufficient for such purpose. Assistance given by the FAC to the FLBJR totaled $388 million.

*Estimated Insurance Obligation*

The Corporation estimated the present value of its liability to provide funds for payment of the $388 million of 15-year maturing debt to be approximately $127 million and $166 million at December 31, 1993 and 1992, respectively. This liability is reflected in the accompanying statements of financial condition. The present value of this obligation is based on a discount rate of 7 percent to maturity, which was established at the time this liability was originally recorded. In accordance with Statement of Financial Accounting Standards No. 107, the fair value of this liability has been estimated by management using discount rates based upon U.S. Treasury securities of similar durations (6 percent for 1993 and 7 percent for 1992). The fair value was approximately $141 million and $166 million as of December 31, 1993 and 1992, respectively.

Provisions for changes in the Corporation's liability are reflected in the statements of income and expenses in the amount of ($39.4) million and $10.9 million for the years ended December 31, 1993 and 1992, respectively. The ($39.4) million provision for 1993 reflects a change in management's estimate of the liability.

From 1990 when the Corporation's liability was established, until December 31, 1992, the Corporation estimated its ultimate liability for the FAC obligations at the present value of the entire amount of the underlying FLBJR preferred stock assuming no funds would be available in the Trust Fund. During these years, the availability of the Trust Fund was considered uncertain by management, primarily because of the existence of the preferred stock obligations of the other four open System banks discussed earlier, the options provided under the Act regarding redemption of their preferred stock, and related questions regarding how amounts accumulated in the Trust Fund might be used.

During 1993, management reevaluated its estimated insurance obligation and revised its estimate to reflect availability of the full amount of the Trust Fund to repay a portion of the FLBJR-related FAC bonds. Significant developments underlying management's current evaluation were the establishment of an irrevocable trust by the Louisville FCB for the early redemption of financial assistance-related preferred stock and the merger agreement entered into by the Spokane FCB, which provides for the establishment of a similar trust in early 1994. Upon establishment of the Spokane FCB trust, which management has no reason to believe will not take place, all four of the open FCBs to which the FAC provided assistance through the purchase of preferred stock will have provided the funds necessary to redeem their $419 million in preferred stock.

Other significant developments during 1993 supporting management's consideration of the Trust Fund's availability included: (1) the continuing annual annuity payments by System banks required by the Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 Act) to provide for the repayment of Capital Preservation Agreement-related FAC bonds and Treasury-paid interest, and (2) the improved financial condition of System banks. The Corporation cannot predict the effects of future events upon System operations and upon the amount of the Trust Fund that will ultimately reduce the Corporation's liability for FLBJR-related FAC bonds. The Corporation will annually reassess the likelihood of earlier use of the Trust Fund, changes in Trust Fund earnings, and other assumptions underlying the Corporation's estimate of its liability for FLBJR-related FAC bonds.

*Other Financial Assistance Provided to System Institutions by the FAC*

The 1992 Act expanded the Corporation's responsibility to insure defaults by System institutions on payments related to other assistance funded by FAC bonds. These FAC bonds, aggregating $454 million, were issued to pay System Capital Preservation Agreement accruals, to retire eligible borrower stock of certain liquidating System institutions, and to pay operating expenses of the Assistance Board.

Previously, the Corporation had only been required: (1) to satisfy defaults on the repayment of Treasury-paid interest, and (2) to purchase the preferred stock of an assisted institution when the institution does not retire the stock at the maturity of the FAC bonds issued to purchase it. The 1992 Act made the Corporation responsible for defaults by System institutions on obligations related to the remaining $454 million of FAC bonds and related interest if such amounts cannot be recovered from defaulting institutions by the FAC or the Treasury, as the case may be, within 12 months.

The 1992 Act also expanded the potential uses of the Trust Fund to satisfy System institution defaults on the principal and interest of other FAC obligations and required System banks to make annual annuity payments to the FAC to provide funds for the retirement of the Capital Preservation Agreement-related FAC bonds aggregating $417 million and Treasury-paid interest at maturity. The Corporation is also required to satisfy defaults on the annual payments to the FAC to permit the repayment of Treasury-paid interest.

During 1992 and 1993, all System banks made their annual annuity payments as scheduled. The Corporation closely monitors the performance of System banks and is not aware of any events or circumstances which will prevent System banks from meeting their FAC obligations.

*Liability for Eligible Borrower Stock - Richmond PCA*

At December 31, 1992, the Corporation recorded a liability to ensure the retirement of eligible borrower stock of the Richmond, Texas, PCA in Receivership. The amount of eligible borrower stock to be retired at December 31, 1992, was $1.17 million. At December 31, 1993, substantially all of this liability had been paid.

The Corporation actively monitors the creditworthiness and financial position of the insured System banks. Other than obligations that have occurred as a result of resolving the FLBJR and having to provide funds to retire the eligible borrower stock at the Richmond PCA in Receivership, as described above, management is not aware of any events or circumstances at this time which would require a liability for estimated insurance obligations to be recorded.

## Note 6—Operating Lease

On September 2, 1993, the Corporation's lease agreement with the Farm Credit System Building Association for office space and furniture rental was modified to extend the term to September 30, 1996. The agreement requires payment of an annual base rent for office space, with fixed annual increases of 2 percent. The Corporation recorded $78,890 and $75,132 in operating expenses related to the lease in 1993 and 1992, respectively. Remaining minimum future payments under the terms of the lease are $70,556, $66,786, and $50,826 for 1994, 1995, and 1996, respectively.

## Note 7—Related Parties

The Corporation purchases services from the FCA under an Inter-Agency Agreement. Such services include examination, administrative, and legal support services. The Corporation had payables due to the FCA of $63,357 at December 31, 1993, and $50,880 at December 31, 1992. The Corporation purchased services for 1993 which totaled $326,347 compared with $361,705 for 1992.

# References

For additional information about the System, its financial condition and performance, and activities of the FCA, the following publications are recommended.

Farm Credit System Annual Reports to Investors and Quarterly and Annual Information Statements for the current fiscal year and the two preceding fiscal years. These are available without charge from:

**Federal Farm Credit Banks**
**Funding Corporation**
**10 Exchange Place**
**Suite 1401**
**Jersey City, NJ 07302**
**(201) 200-8000**

Annual Reports of the Farm Credit Administration for the past five fiscal years. These are available without charge from:

**Office of Congressional and**
**Public Affairs**
**Farm Credit Administration**
**1501 Farm Credit Drive**
**McLean, VA 22102-5090**
**(703) 883-4056**

Reports for previous years are subject to availability, but copies are available for inspection.