1994

Annual Report

Farm Credit System Insurance Corporation

Farm Credit System Insurance Corporation

May 8, 1995

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 1994.

The balance in the Farm Credit Insurance Fund at December 31, 1994 was $754 million. The Corporation expects to incur $1.8 million in operating costs during calendar year 1995. On January 31, 1995, the Corporation collected $76.5 million in premiums from the insured Farm Credit System banks.

Sincerely,

Doyle L. Cook

Doyle L. Cook
Chairman

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

McLean, Virginia 22102
703/883-4380

Mission Statement

As an independent entity, the Farm Credit System Insurance 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 loss 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 Farm Credit System Insurance Corporation (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 of Directors, however, must be a Board Member other than the Chairman of the FCA Board. One position on the Board of Directors is vacant following the March 31, 1995 resignation of Gary C. Byrne.

Doyle L. Cook joined the Corporation's Board in October 1994 and was elected Chairman in March 1995. He brings to this position 32 years of experience in agricultural lending, 19 of which were with various Farm Credit System institutions. Preceding his appointment to the Board, Mr. Cook served as President and Chief Executive Officer of the Farm Credit Bank of Spokane and as an active participant on various committees of the banks of the Farm Credit System, a director of the Federal Agricultural Mortgage Corporation, and a member of the Chicago Mercantile Exchange Lender Advisory Committee. Previously, he served as President and Chief Executive Officer of Farm Credit Services of Mid-America, Senior Vice President for Credit for the Federal Intermediate Credit Bank of Texas, and Senior Vice President of the Federal Intermediate Credit Bank of Louisville. He began his career with Ralston Purina where he worked in credit, marketing, finance, and general management for 13 years before joining the Farm Credit System. Mr. Cook, a native of Star City, Arkansas, holds a B.S. in agricultural business and an M.S. in agricultural economics from the University of Arkansas.

Marsha Pyle Martin, a Member of the Corporation's Board since October 1994, is also Chairman and Chief Executive Officer of the Farm Credit Administration.

She brings to her position 33 years of experience in agriculture and agricultural finance. The Texas native, who holds a B.A. from Texas Woman's University and an M.S. from Texas A&M University, joined the Federal Intermediate Credit Bank of Texas in 1970 and in 1979 earned the distinction of being the first woman appointed to a senior officer position. During her career with the Farm Credit Bank of Texas, she gained broad management experience, providing leadership and direction for the bank's corporate relations, legal, operations and supervision, management information, human resources, marketing, and public and legislative affairs departments. She has held leadership positions with various agricultural councils and advisory committees in the state of Texas, including the Texas Agricultural Loan Mediation Program Advisory Board, the Texas Department of Commerce's Credit Advisory Committee, the Board of Directors of Texas Agricultural Lifetime Leadership, and the Texas Agricultural Cooperative Council. In 1990, she received the Cooperative Communicators Association's H.E. Klinefelter Award, the association's highest honor, in recognition of her distinguished contributions to cooperative communications.

Gary C. Byrne served as Chairman of the Corporation from June 1992 until March 1995. He 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.

Overview

The Farm Credit System Insurance 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 privately owned banks and affiliated associations that serve borrowers and related entities in the agricultural sector. By ensuring the repayment of System debt securities to investors, the Corporation helps to maintain a dependable source of funds for 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 1994, there were 11 insured System banks.

During the past year, financial conditions in the System continued to improve, increasing the resources available to cushion any potential loss to the Insurance Fund. The System, on a combined basis, achieved $1 billion in net income and increased its capital-to-assets ratio from 12.5 percent to 13.2 percent at yearend. System asset quality also improved with nonperforming assets declining from 4.2 percent of total loans and other property owned in 1993 to 2.9 percent at yearend.

Other significant highlights for 1994 include:

- Growth in the Insurance Fund to $754 million, an increase of $112 million from 1993;
- Provision for repayment of the remaining open bank financial assistance;
- Implementation of the Market Access Agreement;
- Implementation of the Corporation's program performance measures; and
- Development of insurance risk monitoring models.

Performance Measures

The Corporation has developed an initial set of performance measures for its principal program areas. The Government Performance and Results Act of 1993 requires all Federal Government organizations to begin reporting on program performance in FY 1999. As performance measures are implemented, modifications may be made to respond to changes in the Corporation's operating environment and experience. These performance measures, which are listed below, are discussed in more detail in each of the program areas.

Insurance Fund Management

Investment results will be measured by comparing the Corporation's average yield with peer investment funds which have similar investment parameters for quality and maturity.

Risk Analysis/Management

Special examination procedures will be applied to all institutions identified by the Corporation's risk analysis criteria.

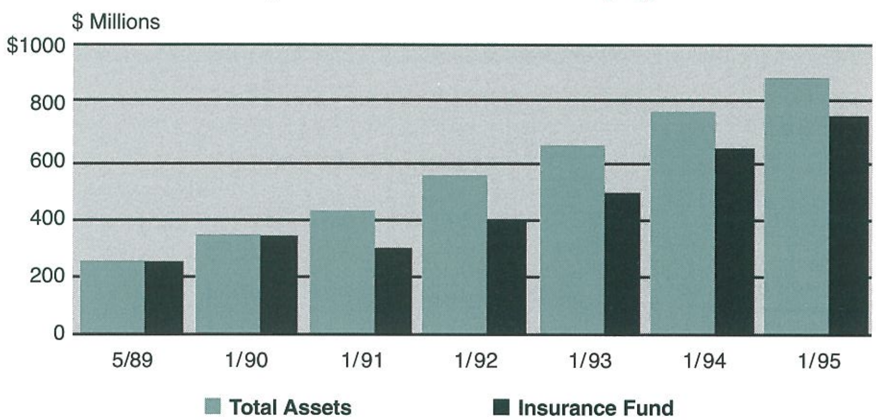
Additional performance measures will be developed in the event of any receiverships or conservatorships in the future.

Insurance Fund Management

Growth in the Insurance Fund

The Corporation had net income for 1994 of $112 million. The Insurance Fund balance at December 31, 1994, was $754 million, an increase of 17 percent from 1993. The Insurance Fund represents the Corporation's equity i.e., the difference between its total assets ($891 million) and its total liabilities, including its insurance obligations ($136 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)

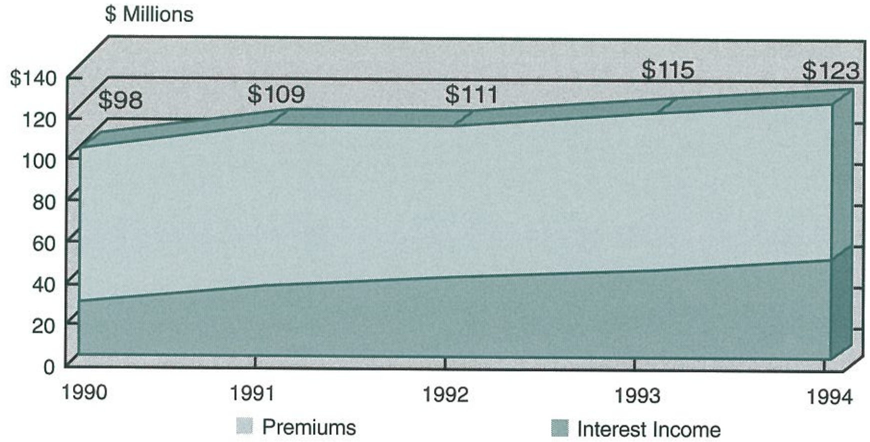


The Corporation's principal liability for insurance obligations at December 31, 1994, was $136 million, which represents the liability to repay the Farm Credit System Financial Assistance Corporation (FAC) for financial assistance to the Federal Land Bank of Jackson in Receivership. This liability was 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 revenues increased by 6.5 percent from $115 million in 1993 to $123 million in 1994. Revenues for the past five years are depicted in the following graph.

CORPORATION REVENUES



Premium Collection and Secure Base Amount

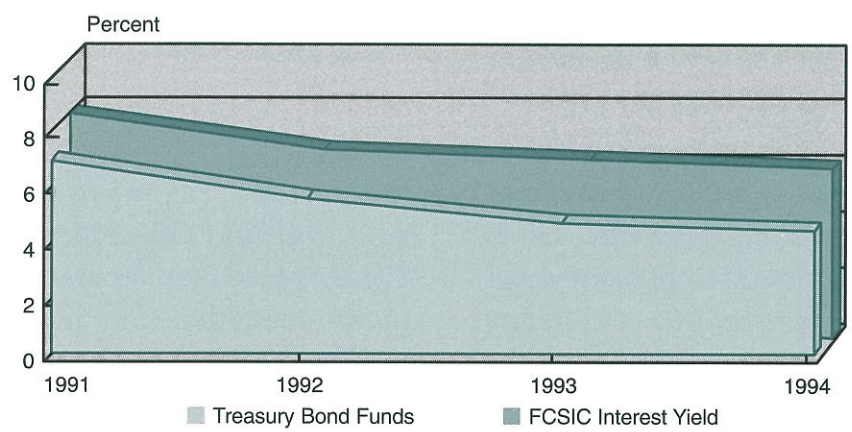
Premium revenue increased by 3 percent in 1994 to $76.5 million. Premiums are collected annually from System banks based on each bank's and its related associations' retail loan volume (see Note 4). Premium revenue is accrued at December 31, 1994, representing the estimated premiums that were earned but not yet collected for calendar year 1994; these premiums were collected on January 31, 1995. All insured System banks will continue to pay insurance premiums until the aggregate amount in the Insurance Fund reaches the secure base amount, at which time premiums will be reduced to a level 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 $787 million at December 31, 1994. Funds are invested in U.S. Treasury securities in accordance with section 5.62 of the Farm Credit Act of 1971 as amended (Act), 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 1994 was 6 percent compared with 6.28 percent for 1993.

As a measure of investment management performance, the Corporation's average yield was compared with the interest yield of five peer investment funds. These funds invest in short-term U.S. Treasury securities. This comparison for the past four years is shown in the following graph.

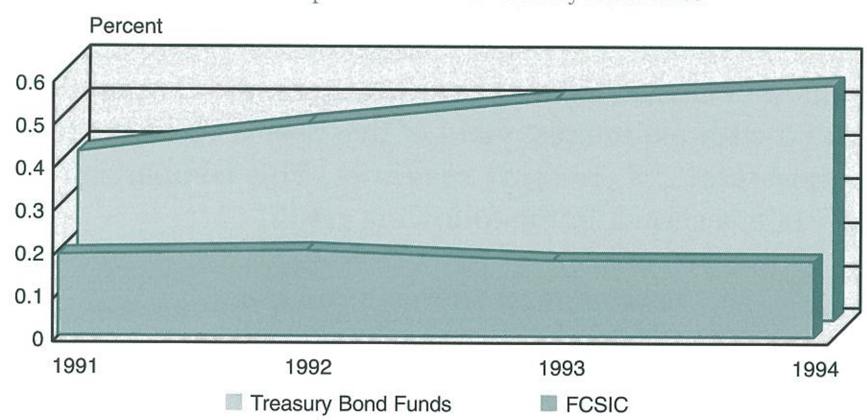
FCSIC INTEREST YIELD COMPARED WITH SIMILAR BOND FUNDS' INTEREST YIELD



The Corporation's average yield is higher than the peer group, primarily as a result of the slightly longer weighted average portfolio maturity maintained by the Corporation during the period. The Corporation pursues an investment strategy of purchasing a ladder of maturities and holding investments to maturity while several of the funds in the peer group trade their securities prior to maturity.

Corporation operating costs as a percentage of average assets are significantly lower than the peer group as shown in the following graph.

OPERATING EXPENSES AS A PERCENTAGE OF ASSETS
FCSIC Compared with Similar Treasury Bond Funds



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, 1994, the actual portfolio maturities were:

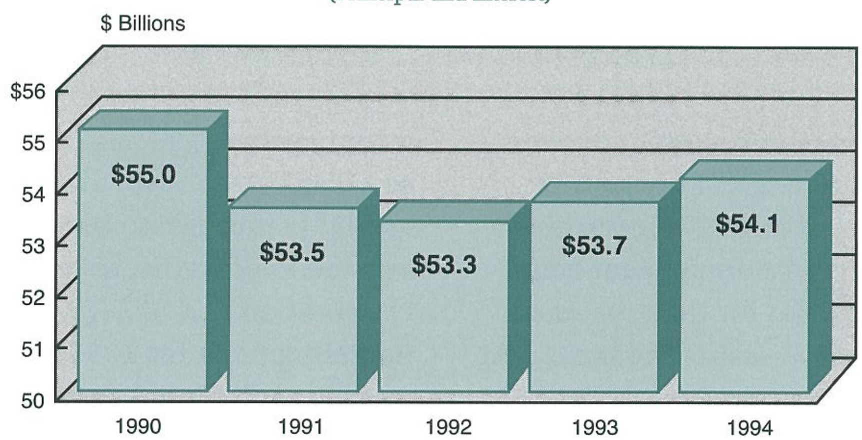
Maturity Schedule	$ Millions	% of Portfolio
1 Day to 1 Year	$133	17
1 Year to 2 Years	140	18
2 Years to 3 Years	184	23
3 Years to 4 Years	184	23
4 Years to 5 Years	146	19
Total	**$787**	**100**

At December 31, 1994, the portfolio's book value exceeded market value by $31.7 million. This depreciation resulted from some of the Corporation's longer term investments that were purchased when market interest rates were significantly lower than in 1994. The weighted average portfolio maturity at yearend was 2.6 years.

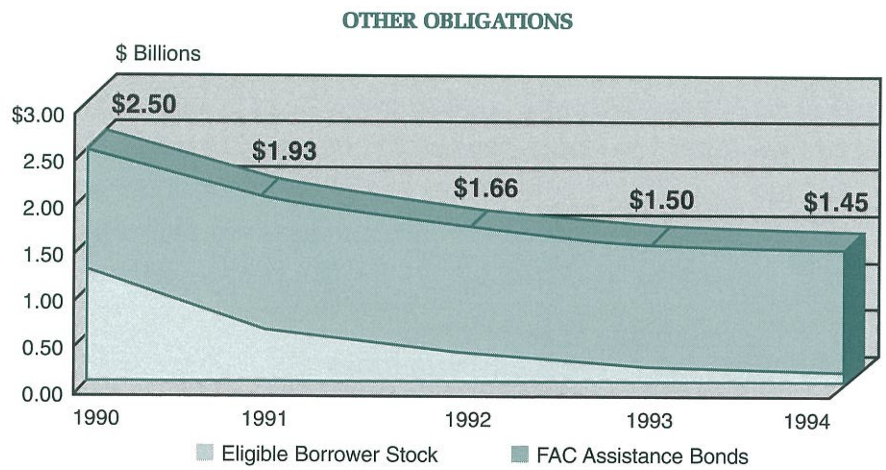
Insured and Other Obligations

Obligations insured by the Corporation are statutorily defined as any note, bond, debenture, or other obligation issued on behalf of insured 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 5 years are shown in the following graph.

INSURED OBLIGATIONS
(Principal and 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 5 years are illustrated in the following graph.



Other obligations continued to decline during 1994 as a result of the further retirement of outstanding eligible borrower stock. In addition, System banks have been providing for the repayment of outstanding FAC assistance bonds. At December 31, 1994, the System had provided for the repayment of approximately $0.6 billion of the $1.3 billion FAC assistance bonds outstanding.

Operations

The Corporation operated with a total staff of 9 employees in 1994. The small staff leverages its resources by utilizing the Farm Credit Administration for examination, legal, and certain other services. Other specialized services are available through contractual arrangements on an as-needed basis. The Corporation had $1.5 million in operating costs for 1994 representing 0.2 percent of average assets. Of this amount, the Corporation's fixed costs for its permanent staff, travel, rent, and miscellaneous expenses totaled $1.0 million. Contract services represented the balance of operating expenses of $0.5 million. These expenses include amounts reimbursed to the FCA for examination, legal, and other support and amounts paid to other contractors for purchased services.

Beginning January 1, 1996, current law requires the Corporation to be governed by a full-time, three-member Board of Directors independent of the FCA Board. The Corporation anticipates that implementation of the current law's requirements will significantly increase its operating costs. The Clinton Administration in its fiscal year 1996 budget proposes to seek an amendment to current law to provide for a Board structure that will be cost-effective, ensure appropriate coordination with the System's regulator, the FCA, and have adequate authority and resources to carry out the Corporation's mission.

Risk Management

The Corporation's program to identify and manage risk to the Insurance Fund minimizes the Fund's exposure to potential losses through early detection. Corporation staff has 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.

During 1994, work proceeded on the study to develop a methodology for evaluating the adequacy of the Insurance Fund's secure base amount, and to identify and quantify various risk factors that could generate insurance claims. The study, now nearing completion, will produce an analytical model to enable the Corporation to evaluate changes in insurance risk and to estimate the probability of insurance claims on an ongoing basis.

Other risk management initiatives in 1994 included implementation of streamlined special examination procedures, and the adoption of additional screening factors to support risk monitoring activities and determine Corporation loss allowances.

Assistance Agreement Management

The Insurance Corporation is authorized to provide assistance to a Farm Credit System institution to prevent default, restore it to normal operations, or to facilitate a merger or consolidation.

In January 1993, the Corporation also assumed responsibility for managing the assistance agreements that were previously administered by the Farm Credit System Assistance Board. This assistance program ended in April 1994 when the remaining assisted institution, the Farm Credit Bank of Spokane, provided for the repayment of its assistance in conjunction with the bank's merger with the Farm Credit Bank of Omaha.

Receivership Capability

The Corporation has developed a program for managing receiverships and conservatorships. To contain costs while providing the statutorily 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 needed. These contractual arrangements effectively leverage permanent staff resources while maintaining low overhead during periods of limited or no activity.

Market Access Agreement

In November 1994, the Farm Credit System banks implemented the Market Access Agreement (MAA). The MAA establishes certain financial thresholds at which conditions are placed on the activities of a bank or the bank's access to participation in Systemwide debt obligations is either restricted or curtailed. The Corporation supports the MAA and believes that it will make a positive contribution to the System's financial condition.

Report of Independent Public Accountants

Coopers & Lybrand

Coopers & Lybrand L.L.P.

a professional services firm

Report of Independent 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 as of December 31, 1994 and 1993, 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 *Government Auditing Standards* issued by the Comptroller General of the United States. 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 Farm Credit System Insurance Corporation as of December 31, 1994 and 1993, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Washington, D.C.
February 2, 1995

Coopers & Lybrand L.L.P., a registered limited liability partnership, is a member firm of Coopers & Lybrand (International).

FINANCIAL STATEMENTS

Farm Credit System Insurance Corporation
Statements of Financial Condition as of December 31, 1994 and 1993
($ in thousands)

	1994	1993
Assets		
Cash and Cash Equivalents	$ 530	$ 528
Investments in U.S. Treasury Obligations (Note 3)	786,132	670,569
Accrued Interest Receivable	27,463	24,012
Premiums Receivable (Note 4)	76,556	74,081
Other Assets	6	--
Total Assets	**$ 890,687**	**$ 769,190**
Liabilities and Insurance Fund		
Accounts Payable and Accrued Expenses (Note 7)	$ 249	$ 185
Liability for Eligible Borrower Stock, Richmond PCA	2	2
Liability for Estimated Insurance Obligations (Note 5)	135,890	127,000
Farm Credit Insurance Fund	754,546	642,003
Total Liabilities and Insurance Fund	**$ 890,687**	**$ 769,190**

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, 1994 and 1993

($ in thousands)

	1994	1993
Income		
Premiums (Note 4)	$ 76,526	$ 74,101
Interest Income	46,389	41,277
Total Income	**$ 122,915**	**$115,378**
Expenses		
Administrative Operating Expenses (Note 7)	$ 1,482	$ 1,279
Provision for Estimated Insurance Obligations (Note 5)	8,890	(39,444)
Net Income	**112,543**	**153,543**
Farm Credit Insurance Fund, Beginning of Year	**642,003**	**488,460**
Farm Credit Insurance Fund, End of Year	**$754,546**	**$642,003**

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, 1994 and 1993
($ in thousands)

	1994	1993
Cash Flows from Operating Activities		
Net Income	$112,543	$153,543
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
(Increase) Decrease in Accrued Interest Receivable	(3,451)	(3,809)
(Increase) Decrease in Premiums Receivable	(2,475)	1
(Increase) Decrease in Other Assets	(6)	7
Net Amortization and Accretion of Investments	12,902	9,662
Increase (Decrease) in Accounts Payable and Accrued Expenses	64	38
Increase (Decrease) in Liability for Eligible Borrower Stock, Richmond PCA	--	(1,171)
Increase (Decrease) in Liability for Estimated Insurance Obligations	8,890	(39,444)
Net Cash Provided by Operating Activities	**128,467**	**118,827**
Cash Flows from Investing Activities		
Payments for Purchase of U.S. Treasury Obligations	(245,388)	(251,182)
Proceeds from Redemption of U.S. Treasury Obligations	116,923	132,051
Net Cash Used in Investing Activities	**(128,465)**	**(119,131)**
Net Change in Cash and Cash Equivalents	2	(304)
Cash and Cash Equivalents, Beginning of Year	528	832
Cash and Cash Equivalents, End of Year	**$ 530**	**$ 528**

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

Notes to Financial Statements

Farm Credit System Insurance Corporation—Notes to the Financial Statements as of December 31, 1994 and December 31, 1993

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 ensuring 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, 1994, for each of the components of the Corporation's insurance responsibilities were $53.6 billion of insured obligations, $1.3 billion of FAC bonds (of which $0.6 billion in repayments have been provided for), and $195 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. In 1994 the Corporation adopted Statement of Financial Accounting Standard (SFAS) Number 115, Accounting for Certain Investments in Debt and Equity Securities. The Corporation classified its investments as held to maturity and carried them at cost, adjusted for amortization of premiums and accretion of discounts in 1994 and 1993. This is consistent with the Corporation's investment policy and its positive intent and ability to hold its investments to maturity. Premiums and discounts are amortized or accreted using the straight-line method, which approximates the interest method, over the terms of the respective issues. Management reviews the portfolio classifications at least quarterly in accordance with the Corporation's Investment Policy to ensure the classifications are consistent with Corporation liquidity requirements and SFAS 115.

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 11.4 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 $79,500 in 1994 and $72,537 in 1993.

Note 3 — Investments

At December 31, 1994, and at December 31, 1993, investments in U.S. Treasury obligations consisted of the following:
($ in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
December 31, 1994				
U.S. Treasury Notes	$786,132	$625	($31,760)	$754,997
December 31, 1993				
U.S. Treasury Notes	$670,569	$20,517	($563)	$690,523

The amortized cost and estimated market value of U.S. Treasury obligations at December 31, 1994, by contractual maturity, are shown below. Amounts are in thousands.

	Amortized Cost	Estimated Market Value
Due in one year or less	$132,320	$132,331
Due after one year through five years	653,812	622,666
	$786,132	**$754,997**

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 such other 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, 1994, the Insurance Fund was 1.5 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 $78 million and $75 million at December 31, 1994 and 1993, 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. At December 31, 1994, the only preferred stock held by the FAC was associated with the assistance provided to the Federal Land Bank of Jackson.

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 $136 million and $127 million at December 31, 1994 and 1993, 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 (7.9 percent for 1994 and 6 percent for 1993). The fair value was approximately $124 million and $141 million as of December 31, 1994 and 1993, respectively.

Provisions for changes in the Corporation's liability are reflected in the statements of income and expenses in the amount of $8.9 million and ($39.4) million for the years ended December 31, 1994 and 1993, respectively. The ($39.4) million provision for 1993 reflected 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 above, 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 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 provided for the establishment of a similar trust in early 1994. With the completion of the Spokane merger and early redemption of financial assistance-related preferred stock, all four of the open FCBs to which the FAC provided assistance through the purchase of preferred stock have provided the funds necessary to redeem their $419 million in preferred stock.

Other significant developments during 1993 and 1994, 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 did 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 through 1994, all System banks made their annual annuity payments as scheduled. The Corporation is not aware of any events or circumstances which will prevent System banks from meeting their FAC obligations.

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, 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 $64,280 and $78,890 in operating expenses related to the lease in 1994 and 1993, respectively. Remaining minimum future payments under the terms of the lease are $67,834, and $51,613 for 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 $70,951 at December 31, 1994, and $63,357 at December 31, 1993. The Corporation purchased services for 1994 which totaled $300,064 compared with $326,347 for 1993.

References

Annual Reports for the Farm Credit System Insurance Corporation for 1990-1993 are available without charge. Copies may be requested by contacting:

Farm Credit System Insurance Corporation
1501 Farm Credit Drive
McLean, VA 22102
(703) 883-4380 Fax (703) 790-9088

For additional information about the Farm Credit System, its financial condition and performance, and activities of the Farm Credit Administration, 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
(703) 883-4056

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