Farm Credit System Insurance Corporation

2011 *Annual* Report

Protecting Investors in Agriculture and Rural America

Mission Statement

The Farm Credit System Insurance Corporation (FCSIC or Corporation), a Government-controlled, independent entity, shall

- protect investors in insured Farm Credit System obligations and taxpayers through sound administration of the Farm Credit Insurance Fund,
- exercise its authorities to minimize Insurance Fund loss, and
- help ensure the future of a permanent system for delivery of credit to agricultural borrowers.

June 15, 2012

Dear Mr. President and Mr. Speaker:

In accordance with section 5.64 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 2011.

This report highlights the Corporation's role as the independent Federal corporation established to ensure the timely payment of principal and interest to investors in insured Farm Credit System debt securities.

The balance in the Farm Credit Insurance Fund at December 31, 2011, was $3.39 billion. The Corporation collected $97.3 million in insurance premiums from Farm Credit System banks for 2011, earned $72.6 million in investment income during the same period, and expects to incur $4 million in operating costs in 2012.

Sincerely,

Kenneth A. Spearman
Chairman

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

Contents

Cover photo by Linda M. Toki. Unless otherwise noted, all other photos are stock photos. Board member photos courtesy of Bachrach.

Message from the Chairman

I am pleased to present the FCSIC's 2011 Annual Report. It is gratifying to note that, for the twenty-second consecutive year since the Corporation began issuing financial statements, our independent public auditor has issued unqualified opinions on those statements. Their opinion letters, which are enclosed, indicate that the financial statements concerning the Insurance Fund, of which we are stewards, are fairly and accurately presented.

This year's report also highlights the Corporation's success in building and maintaining a strong and healthy Insurance Fund, while promptly returning excess funds to the Allocated Insurance Reserves Accounts.

The Corporation's net income for 2011 was $166.6 million compared with $143.0 million for the previous year. The Insurance Fund balance at December 31, 2011, was $3.39 billion compared with $3.23 billion at year-end 2010.

Premium revenue was $97.3 million for 2011 compared with $79.6 million for 2010. Interest income for 2011 totaled $72.6 million, an increase of $6.2 million from 2010.

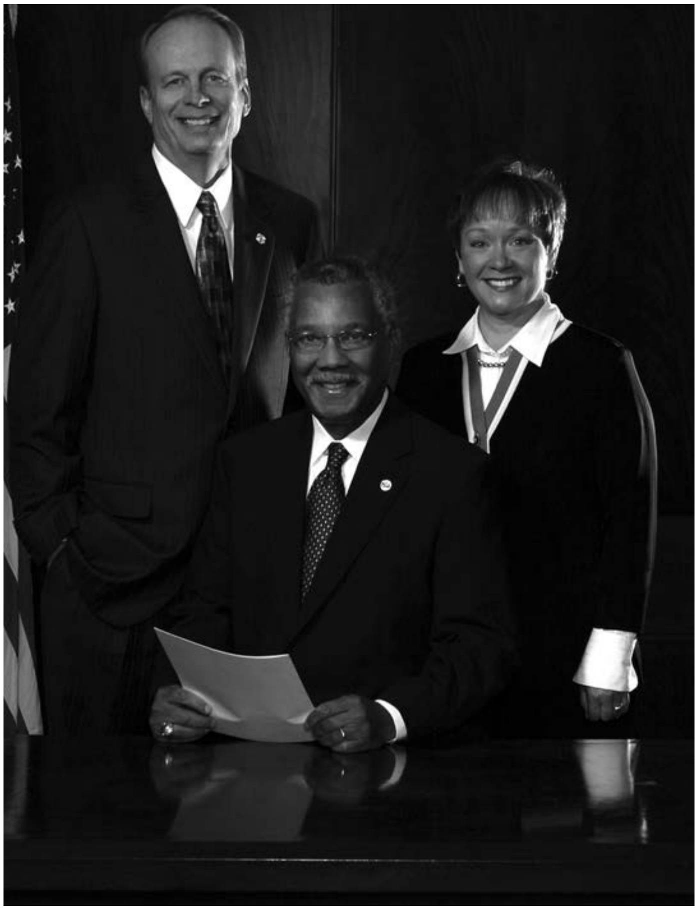
In accordance with the requirements of the Federal Managers' Financial Integrity Act of 1982, the FCSIC's management conducted its annual assessment of the system of internal controls. Its findings show that, in the reviewed areas, internal controls comply with the standards prescribed by the U.S. Government Accountability Office and provide reasonable assurance that program objectives are being met.

In 2012 we will continue to carry out our mission and work towards achieving our strategic goals and objectives. In the process of identifying and addressing risks to the Insurance Fund, we are mindful of our public trust, and will ensure that investors, Congress, the Farm Credit System, and other regulatory agencies receive timely and accurate information on issues concerning the Fund.

Sincerely,

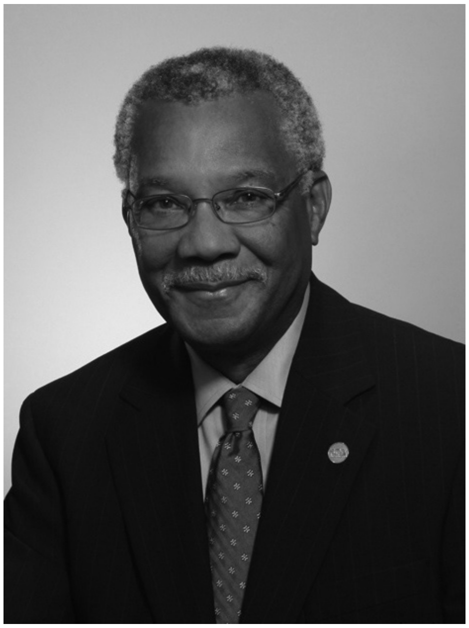
Kenneth A. Spearman

Board of Directors



The FCSIC is managed by a three-member board of directors comprising the same three individuals who compose the Farm Credit Administration (FCA) Board. However, the same member may not serve as chairman of both entities. FCA is the independent Federal agency responsible for the regulation and examination of the Farm Credit System (FCS or System), a nationwide network of financial cooperatives that lends to agriculture and rural America.

Kenneth A. Spearman



Kenneth A. Spearman is Chairman of the Board of Directors of the Farm Credit System Insurance Corporation. He also serves as a member of the Board of the Farm Credit Administration.

Mr. Spearman brings to his position as Chairman of the FCSIC many years of experience in finance, agriculture, and agricultural cooperatives. He spent 28 years in the citrus industry.

From 1980 to 1991, he was controller of Citrus Central, a $100 million cooperative in Orlando, Florida, where he was responsible for financial management and reporting and the supervision of staff accountants.

He later served as director of internal audit for Florida's Natural Growers, where he designed and implemented the annual plan for reviewing and appraising the soundness, adequacy, and application of accounting, financial, and other operating internal controls.

From January 2006 until his appointment to the FCSIC Board of Directors, Mr. Spearman served as an independently appointed outside director on the AgFirst Farm Credit Bank board in Columbia, South Carolina. During his tenure, he served on the board compensation committee and the board governance committee.

Before entering agriculture, Mr. Spearman served in the U.S. Army in Vietnam. Later, he was involved with development of a public accounting firm in Chicago, Illinois, and worked as an accountant for a major public accounting firm. He served as chairman of the board of trustees for the Lake Wales Medical Center. He is a member of the Institute of Internal Auditors, as well as the National Society of Accountants for Cooperatives, where he served at one time as president.

He obtained his master's degree in business administration from Governors State University in University Park, Illinois, and his B.S. in accounting from Indiana University.

Mr. Spearman and his wife Maria of Winter Haven, Florida, have three children—twin daughters, Michelle Springs and Rochelle Puccia, and a son, Dr. Kenneth Spearman.

Leland A. Strom

Leland A. Strom was appointed to the Farm Credit System Insurance Corporation Board of Directors and to the Farm Credit Administration Board by President George W. Bush on December 12, 2006, for a term that expires on October 13, 2012. He served as Chairman of the FCSIC Board until he was appointed Chairman and CEO of the Farm Credit Administration on May 22, 2008.

For more than 30 years he has been active in the agriculture industry. He served for more than 25 years on the board of 1st Farm Credit Services, an FCS institution in Illinois, holding various positions, including chairman. During the agriculture crisis of the 1980s, he was selected to sit on the Restructuring Task Force of the Sixth Farm Credit District.

From 2000 to 2006, he was on the Federal Reserve Bank of Chicago Advisory Council on Agriculture, Labor, and Small Business. Part of this time he also served on the Country Mutual Fund Trust Board, an investment fund of the Illinois Farm Bureau and its Country Financial organization.

Other boards on which Mr. Strom has served include Northern F.S., Inc., a farm service and supply cooperative serving farmers in Northern Illinois; AgriBank, FCB; and the Farm Credit Council, the national trade organization representing the Farm Credit System in Government affairs.

Mr. Strom has served in several capacities with the Illinois Farm Bureau. He also served on his county Farm Bureau board. He was a member of the State Young Farmer Committee from 1981 to 1985. For his overall involvement in agriculture, he received an Outstanding Young Farmer Award.

In his community of Kane County, Illinois, which lies at the edge of suburban Chicago, Mr. Strom helped develop a farmland preservation program. The original Strom Family Farm was the first to be dedicated to permanent agricultural use under the program.

In 2011, Mr. Strom received the Honorary Doctorate of Humane Letters from Northern Illinois University for his commitment to sustaining agricultural systems and food security. He studied agriculture business at Kishwaukee College and business administration at Northern Illinois University.

His community involvement includes having served as vice president of his local K–12 school district, chairman of his church council, 4-H parent leader, and coach of boys' and girls' sports teams. Mr. Strom owns a third-generation family farm in Illinois that produces corn and soybeans. He and his wife, Twyla, have three children and one grandchild.

Jill Long Thompson

Jill Long Thompson was appointed to the FCSIC Board of Directors and the FCA Board by President Barack Obama in March 2010. Her term continues to May 2014.

Ms. Long Thompson has many years of leadership experience. From 1989 to 1995, she represented northeast Indiana as a Member of the U.S. House of Representatives, serving on the Committee on Agriculture, the Committee on Veterans' Affairs and the Select Committee on Hunger. She also served as Chair of the Rural Caucus. While in Congress, she introduced one of the nation's first pieces of legislation banning members of Congress from accepting gifts; this legislation also expanded disclosure requirements for lobbying activities.

From 1995 to 2001, she served as Under Secretary for Rural Development in the U.S. Department of Agriculture, where she oversaw an annual budget of $10 billion and a staff of 7,000 employees. In this position, she managed programs that provide services to the underserved areas of rural America.

In addition, Ms. Long Thompson served as chief executive officer and senior fellow at the National Center for Food and Agricultural Policy, a non-profit research and policy organization in Washington, D.C.

The first and only woman nominated by a major party to run for Governor of Indiana, Ms. Long Thompson is also the first and only Hoosier woman to be nominated by a major party to run for the U.S. Senate.

Ms. Long Thompson also has many years of experience as an educator, having taught at Indiana University, Valparaiso University, and Manchester College. She is also a former fellow at the Institute of Politics at Harvard University's John F. Kennedy School of Government. She holds an M.B.A. and Ph.D. in Business from the Kelley School of Business at Indiana University and a B.S. in Business Administration from Valparaiso University.

Ms. Long Thompson grew up on a family farm outside of Larwill, Indiana; today she lives with her husband, Don Thompson, on a farm near Argos, Indiana.

2011 – Year in Review

Insurance Fund Finishes 2011 at 2.14 Percent – Above the Statutory 2 Percent Secure Base Amount

At December 31, 2011, the Farm Credit Insurance Fund (Insurance Fund or Fund) was $3.39 billion (2.14 percent of adjusted insured debt outstanding), which was $225.9 million above the secure base amount (SBA). After applying the required statutory adjustments, $221.9 million was transferred to the six Allocated Insurance Reserves Accounts (AIRAs) as mandated by the Farm Credit Act. (See the Insurance Fund Management section for additional details.)

Corporation's Legislative Initiative

As part of the FCSIC 2010–2015 Strategic Plan, the Corporation is pursuing a legislative initiative to enhance its resolution authorities, including its receivership and conservatorship powers. A principal goal of this initiative is to ensure that FCSIC will have authorities commensurate with those of other Federal receivers and conservators if it is appointed to act as a Federal receiver or conservator for a System institution. Because the overall condition of the System, as determined by FCA, its safety and soundness regulator, is sound, it appears unlikely that FCSIC will act as receiver or conservator at the present time.

Clarifying and enhancing these powers, which have not been substantially updated since FCSIC's creation in 1988, will make any receivership or conservatorship that might occur less costly and more efficient. The Corporation has developed a detailed legislative proposal clarifying the receivership claims process, the authority to repudiate contracts, and the treatment of certain "qualified financial contracts." The proposal would also limit judicial power to attach receivership property, to review claims, or to restrain a conservator's or receiver's powers; and would authorize organization of "bridge" institutions—temporary institutions useful in resolution of troubled financial institutions.

Corporate Governance

During the past year FCSIC's Board of Directors reviewed the structure and operation of its audit oversight program, including policy guidance and audit committee function.

In December 2011, the Board approved the revised Policy on Internal Controls and Audit Coverage (Audit Policy) and the Audit Committee Charter, which replaced the Audit Policy and Audit Committee Charter that had been in place since December 14, 2006. The revision incorporates best practices and a number of clarifications that recognize additional audit activities conducted over FCSIC financial operations and additional duties of the Audit Committee. As part of this process, staff reviewed audit policies and charters of several public and private sector firms as well as a model policy provided by the Corporation's auditor, Clifton Larson Allen.

Operating Efficiency and Cost Containment

The Corporation operates with no appropriated funds. It collects insurance premiums from each System bank that issues insured obligations. These premiums and the income from the Corporation's investment portfolio provide the funds necessary to fulfill its mission.

To avoid duplication of effort and to minimize costs, since 1993, the Corporation's business model has been to operate with a small core staff and use the assistance of private and public sector contractors to leverage its efforts. The Corporation's Board of Directors and management have adopted this model as a cost-effective and efficient way to use available expertise, services, and resources to accomplish its mission.

The Corporation's operating costs as a percentage of its total assets represented 10 basis points for 2011. In September 2011, the Board of Directors approved budgets for 2012 and 2013. The 2012 budget is slightly below the 2011 budget, primarily due to decreases in equipment and investment software rental expenses. The 2013 budget projects an increase of 0.8 percent over the 2012 budget, due to expected equipment replacement costs.

On December 22, 2010, President Obama signed legislation to prohibit statutory pay adjustments for most Federal civilian employees and freezing base pay for senior executives for two years. President Obama also issued a memorandum on December 22, 2010, which stated that agencies should forgo similar increases to pay schedules and rates that are set by administrative discretion. Corporation pay adjustments not covered by the freeze include promotion increases and individually based merit increases for non-executive employees.

Selected Financial Statistics

Farm Credit System Insurance Corporation
(Dollars in Millions)

	2011	2010	2009
BALANCE SHEET:			
Total Assets	$ 3,392.3	$ 3,225.7	$ 3,288.6
Total Liabilities	0.4	0.3	0.9
Insurance Fund Balance			
Allocated Insurance Reserves Accounts	221.9	-0-	205.3
Unallocated Insurance Fund Balance	3,170.1	3,225.3	3,082.4
OPERATIONS:			
Revenues	169.9	146.1	376.1
Operating Expenses	3.3	3.1	3.0
Insurance Expense	-0-	-0-	-0-
Net Income	166.6	143.0	373.1

The Farm Credit System

Structure and Funding

The System is owned by the rural customers it serves, including farmers, ranchers, producers or harvesters of aquatic products, agricultural cooperatives, and farm-related businesses. As of December 31, 2011, the Farm Credit System (System or FCS) had five banks and 84 associations. (Due to two recent mergers, the System has four banks and 83 associations as of January 1, 2012.) Each of the associations has its own chartered territory and is affiliated with one of the banks. Each association receives wholesale funding from its affiliated bank and lends directly to its owner-borrowers, providing a consistent source of agricultural and rural credit throughout the United States and the Commonwealth of Puerto Rico. CoBank also has nationwide authority to make retail loans to cooperatives and other eligible entities. The banks primarily receive their funding through the issuance of Federal Farm Credit Banks Consolidated Systemwide debt securities (Systemwide debt securities). These securities are issued by the Federal Farm Credit Banks Funding Corporation (Funding Corporation). The Funding Corporation distributes these securities in the capital markets via a selling group of selected investment and dealer banks to raise the funds needed by the System.

Investor Protection

Investors provide the funds the System lends to agriculture and rural America. The Corporation's primary purpose, as defined by the Farm Credit Act, is to ensure the timely payment of principal and interest on insured debt securities to these investors.

Combined Farm Credit System Statistics

(Dollars in Billions)

	2011	2010	2009
Insured Debt Outstanding[1]	$ 184.2	$ 188.3	$ 177.1
Production Agriculture:			
Real Estate Mortgage Loans	80.7	78.0	75.4
Production and Intermediate-term Loans	41.3	40.6	39.6
Agribusiness Loans[2]	24.7	29.6	23.6
Communication Loans	3.8	3.6	3.9
Energy, Water and Waste Disposal Loans	11.8	11.5	10.7
Rural Residential Real Estate Loans	5.8	5.5	5.0
International Loans	3.8	4.0	4.0
Lease Receivables	2.1	2.0	2.2
Loans to Other Financial Institutions	0.6	0.5	0.6
Cash and Investments	47.3	46.3	42.2
Net Income	3.9	3.5	2.9
Nonperforming Loans as a Percentage of Total Loans	1.7%	1.9%	2.1%

1. Insured debt-outstanding is based on System institution Call Report information and reflects the book value of insured debt outstanding, excluding fair value adjustments plus accrued interest as of December 31, 2011, including prior year adjustments.
2. At December 31, 2011, agribusiness loans consisted of loans to cooperatives of $11.9 billion, processing and marketing loans of $10.3 billion, and farm-related business loans of $2.5 billion.

Regulatory Oversight

FCA is the safety and soundness regulator responsible for the examination, supervision, and regulation of each FCS institution. It is an independent agency in the executive branch of the U.S. Government and derives its broad authorities from the Farm Credit Act. These authorities include examination and enforcement authorities similar to those of commercial bank regulators. The U.S. Senate Committee on Agriculture, Nutrition, and Forestry and the U.S. House of Representatives Committee on Agriculture oversee FCSIC, FCA, and the FCS.

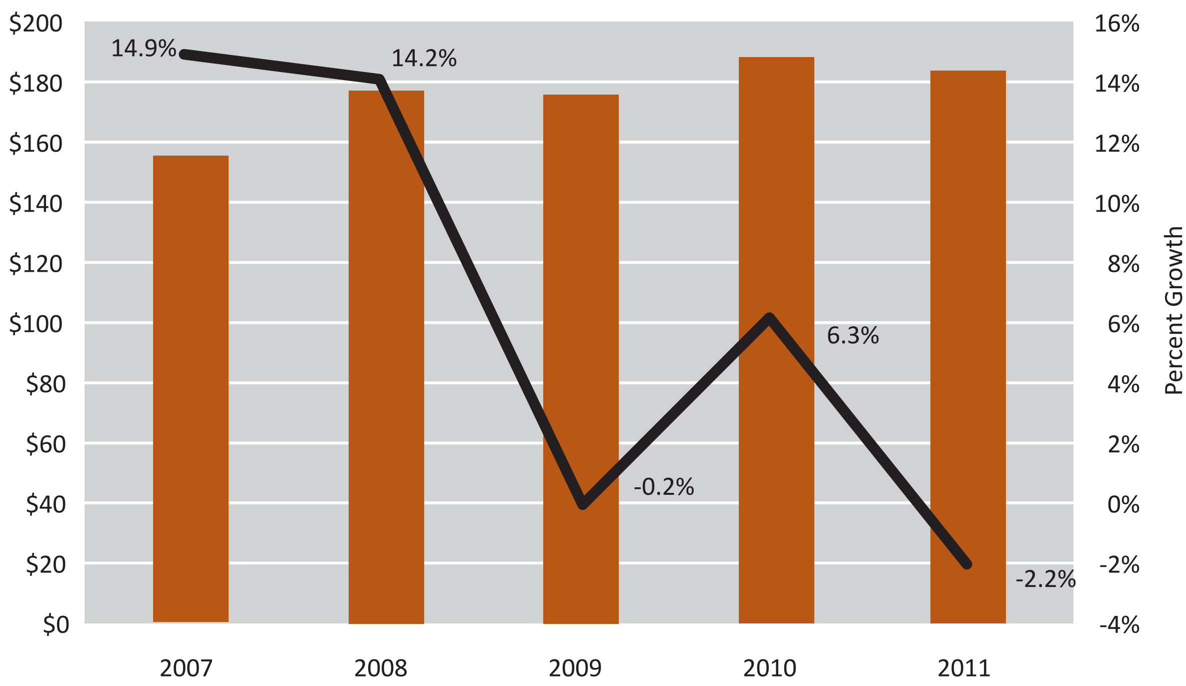
Insured and Other Obligations

The Corporation insures Systemwide and consolidated bonds, notes, and other obligations issued by the System banks through the Funding Corporation under section 4.2 (c) or (d) of the Farm Credit Act. As figure 1 shows, insured debt outstanding declined by 2.2 percent in 2011 to $184.2 billion. This is in contrast to an increase in insured debt outstanding of 6.3 percent in 2010. The Corporation must also ensure the retirement of eligible borrower stock at par value, as required by section 4.9A of the Farm Credit Act. This stock, also known as protected borrower stock, was outstanding prior to October 6, 1988. At year-end 2011, protected borrower stock outstanding at System institutions totaled $5 million, down from $7 million at year-end 2010.

Figure 1

Insured Debt Outstanding 2007 to 2011

(Dollars in Billions)



Note: Insured debt outstanding is based on System institution Call Report information and reflects the book value of insured debt outstanding, excluding fair value adjustments plus accrued interest as of December 31, 2011, including prior year adjustments.

Farm Credit System Capital

The primary source of funds to repay insured Systemwide debt securities is the System's borrowers. Each borrower is required to have a minimum net worth and, in most cases, collateral posted in connection with his or her loan. The borrower makes payments on the loan to the lending bank or association. A lending association in turn makes payments to its affiliated bank. Both the banks, which ultimately repay insured Systemwide debt securities, and the associations, exceed minimum regulatory capital requirements as protection and support for the repayment of the outstanding debt. If a bank were unable to repay its portion of an insured Systemwide debt obligation, the Insurance Fund would make that payment. In the event the assets of the Insurance Fund were exhausted, the provisions of joint and several liability of all banks would be triggered, which means the financial resources of the other banks would be used to repay the defaulting bank's portion of the debt issuance.

As figure 2 shows, the amount of FCS bank capital and the balance in the Insurance Fund together increased 43 percent from $11.7 billion at year-end 2007 to $16.7 billion at year-end 2011. Bank capital plus the amount in the Insurance Fund as a percentage of insured debt outstanding increased from 8.3 percent in 2010 to 9.1 percent in 2011 (see figure 3). The rate of growth in insured debt outstanding outpaced growth in bank capital and the Insurance Fund in 2007 and 2008 but declined between 2009 and 2011 as System institutions reduced overall levels of loan growth. The System's increased profitability in 2007 and 2008 resulted primarily from loan growth, while profitability between 2009 and 2011 resulted from the net interest spread produced by favorable loan and debt pricing. The financial performance and condition of the System on a consolidated basis remains strong, though some individual institutions have experienced significant stress from credit deterioration in certain agricultural sectors as well as from continued stress in the general economy. (See trends in Financial Institution Rating System ratings in the Risk Management section.)

System associations have been building capital through the net income they have earned and retained. Association capital helps reduce the credit exposure of the association's affiliated bank. As figure 4 shows, from 2007 to 2011, combined association capital increased $6.7 billion or 37.9 percent, with an annual average increase of approximately 8.3 percent. In 2008, growth in association assets outpaced growth in capital, causing a slight decline in association capital as a percentage of total assets, from 15.6 percent in 2007 to 15.5 percent in 2008 (see figure 5). However, since 2008, associations have collectively preserved capital, causing association capital as a percentage of total assets to steadily increase to 17.8 percent in 2011.

Figure 2

Bank Capital Plus Insurance Fund

(Dollars in Billions)

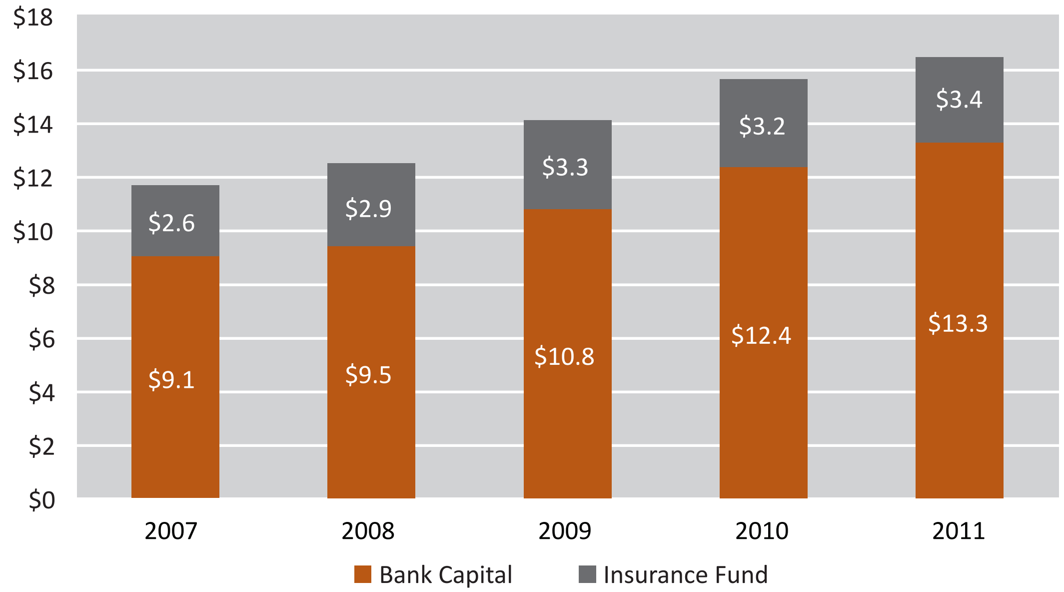


Figure 3

Bank Capital Plus Insurance Fund as Percentage of Insured Debt

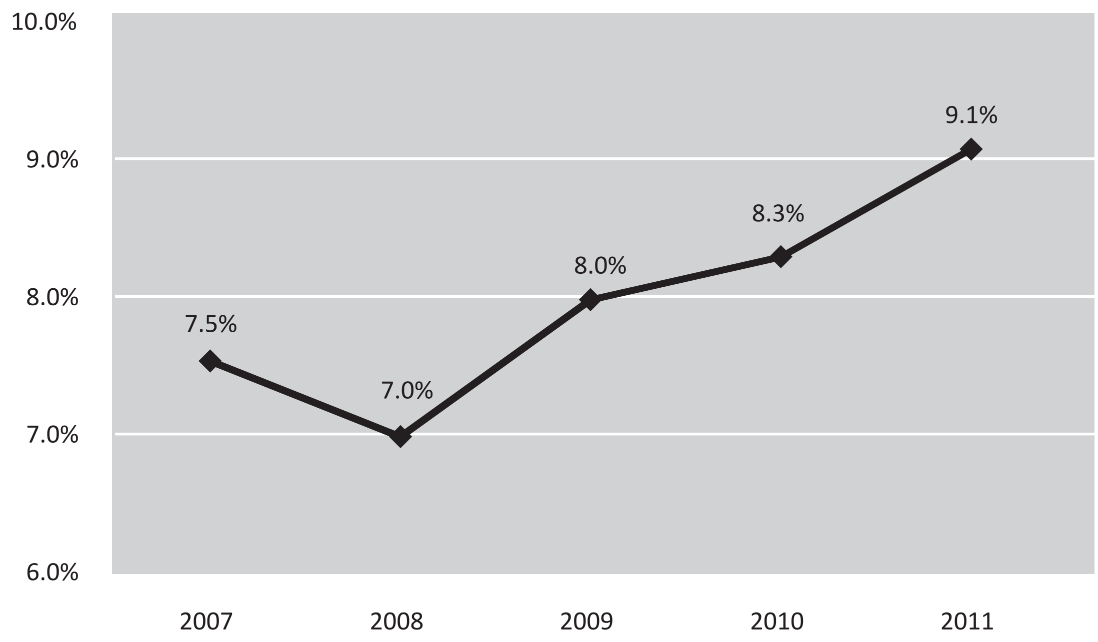


Figure 4

Combined Association Capital

(Dollars in Billions)

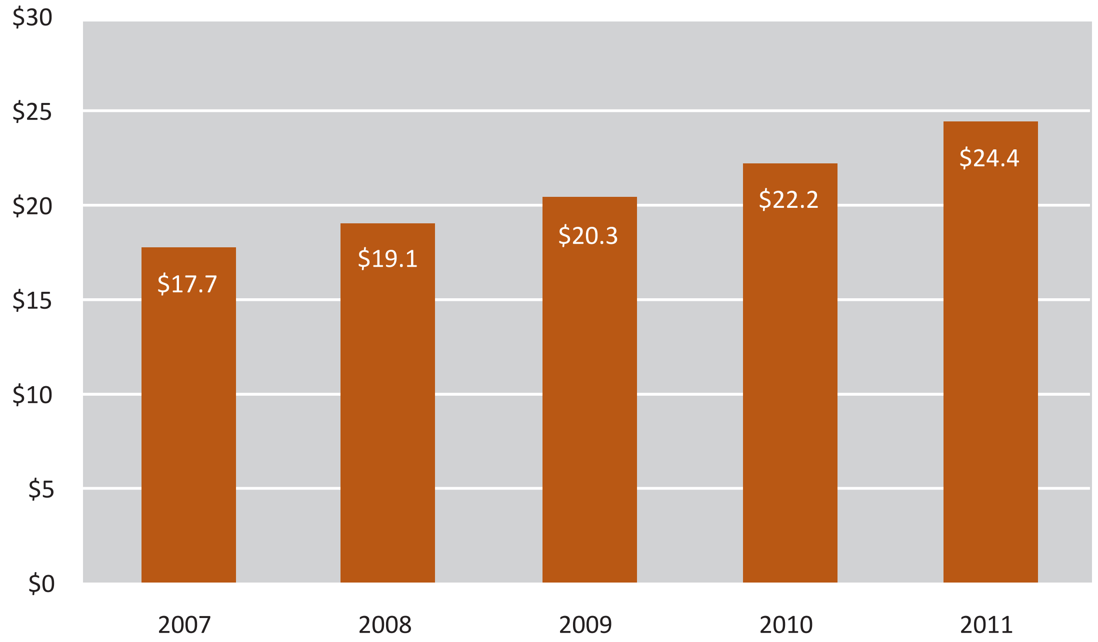
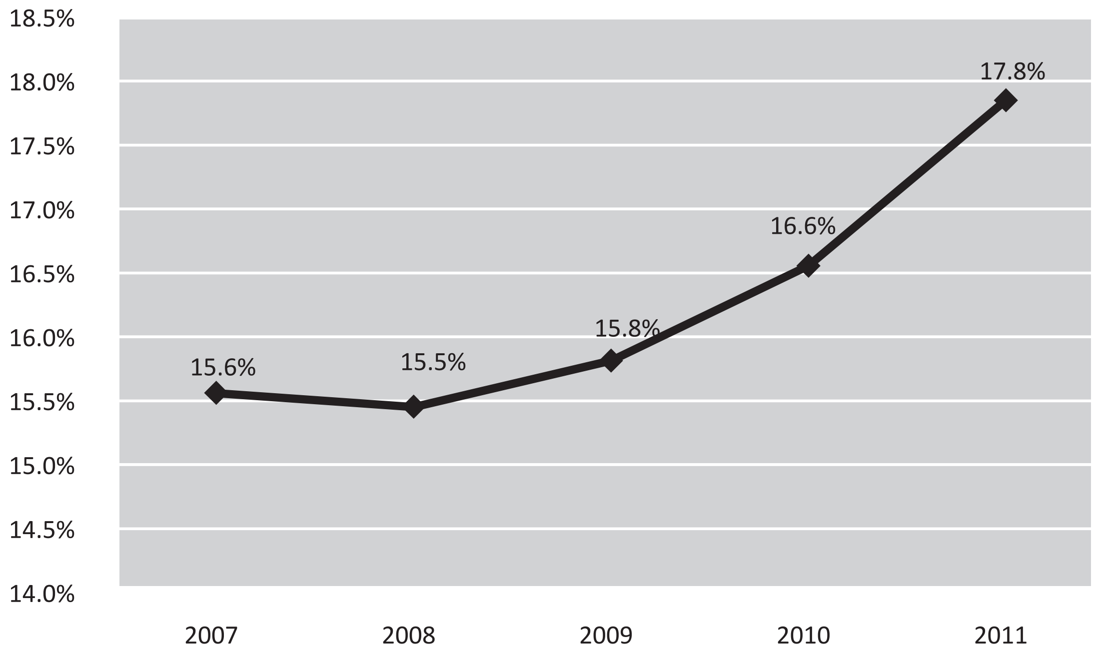


Figure 5

Combined Association Capital as a Percentage of Total Assets



Additional Protections

The System has additional risk management tools to protect investors. One such tool is the Contractual Interbank Performance Agreement (CIPA). All System banks have entered into this agreement, which measures the financial condition and performance of each bank by using ratios that consider capital, asset quality, earnings, interest rate risk, and liquidity. The CIPA financially penalizes banks that do not meet performance standards.

The System banks and the Funding Corporation have also entered into the Market Access Agreement (MAA), which establishes conditions for each bank's continued participation in the debt market. If a bank fails to meet agreed-upon performance measures, including capital and collateral ratios, the bank may be restricted from issuing debt. The criteria used under the MAA are the CIPA scores and two capital ratios.

The System also has a common minimum liquidity standard. At December 31, 2011, the System standard required each bank to have enough liquidity to operate for at least 90 continuous days without access to the capital markets. For additional information, please see the discussion in the Risk Management section.

Insurance Fund Management

The Insurance Fund and the Secure Base Amount

In 2011, both the total Insurance Fund and total assets grew by 5.2 percent to $3.39 billion. Insured debt outstanding contracted in 2011 by $4.13 billion (-2.2 percent). This reduced the five-year average annual growth in insured debt outstanding to 6.6 percent.

The Insurance Fund finished 2011 at 2.14 percent, which is $225.9 million above the SBA (see figure 6). The Farm Credit Act requires the deduction of the Corporation's operating expenses ($4.0 million) and expected insurance obligations ($0) for the coming year from the amount above the SBA, with the net difference, $221.9 million in 2011, available for allocation to the AIRAs.

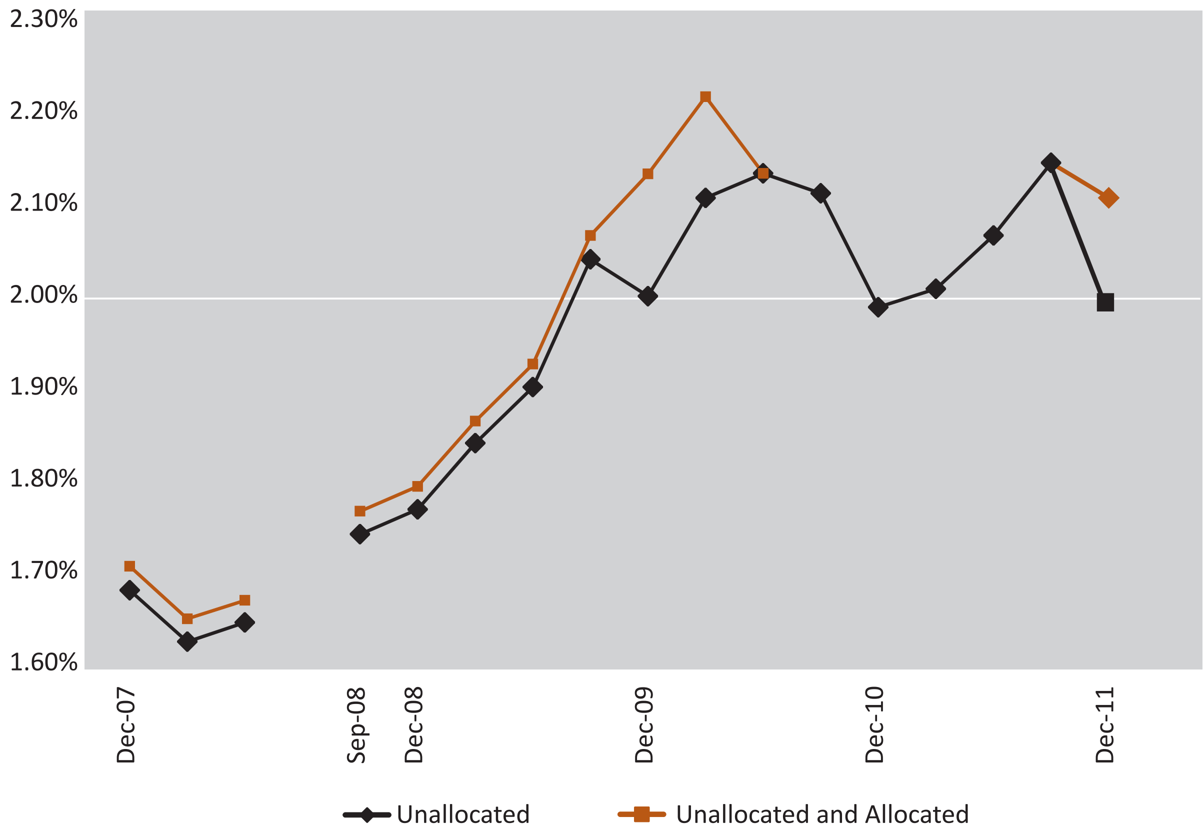
Over the past five years, the total Insurance Fund and total assets each grew at an annual rate of 8.1 percent. The Corporation did not accrue a provision for insurance obligations in 2011.

The Insurance Fund represents the Corporation's equity, the difference between total assets and total liabilities, including insurance obligations. The Insurance Fund is composed of an unallocated Insurance Fund (the assets in the Insurance Fund for which no specific use has been identified or designated) and an allocated Insurance Fund. Premiums are due until the unallocated portion of the Insurance Fund reaches the SBA.

The SBA established by the Farm Credit Act is 2 percent of the aggregate outstanding insured obligations (adjusted to exclude a part of certain Government-guaranteed loans in accrual status and non-impaired Government-guaranteed investments), or another percentage that the Corporation determines to be actuarially sound to maintain in the Insurance Fund, taking into account the risk of insuring outstanding insured obligations.

Figure 6

Insurance Fund Relative to 2 Percent Secure Base Amount



Note: A change in the SBA calculation methodology was included in the Food, Conservation, and Energy Act of 2008 (FCE Act). The new methodology, which was implemented on July 1, 2008, allows the deduction of a portion of Federal and State-guaranteed investments from the SBA in a manner similar to that used for Federal and State-guaranteed loans. In January 2010, the Board of Directors authorized payment of $39.9 million from the AIRAs to the accountholders. This amount had been transferred into the AIRAs at year-end 2003. In March 2010, the Board authorized the payment of the $165.4 million transferred into the AIRAs at year-end 2009 to the accountholders.

Premiums

The Corporation's Board of Directors reviews premium assessment rates as often as necessary but at least semiannually. Their review focuses on five factors:

- The level of the Insurance Fund relative to the secure base amount
- Projected losses to the Insurance Fund
- The condition of the System
- The health of the agricultural economy
- Risks in the financial environment

The most important factor in determining premium rates for 2011 was the level of the Insurance Fund relative to the SBA. Based on System growth projections ranging from 3 to 7 percent, the Corporation's Board set the assessment rate on adjusted insured debt at 6 basis points in January 2011. Through May 2011, insured debt grew by 0.6 percent and System institutions indicated that growth for the year would likely be lower than estimated in January, but still within the 3 to 5 percent range. As a result, the Board, at their scheduled mid-year premium review in June, maintained the premium assessment on adjusted insured debt at 6 basis points for 2011. (Note: 1 basis point (bp) = 1/100 of 1 percent.)

Enactment of the Food, Conservation and Energy Act of 2008 (FCE Act) amended the premium provisions of the Farm Credit Act to, among other things, base premiums on the adjusted outstanding insured debt obligations instead of on loans, and to permit the Corporation to collect an increased range of premiums on insured debt.

The FCE Act allows FCSIC to collect from 0 to 20 basis points on adjusted insured debt outstanding and clarifies that premiums may be collected more frequently than annually, if necessary. A risk surcharge of up to 10 basis points on nonaccrual loans and on other-than-temporarily impaired investments was also authorized. In addition, the FCE Act reduces the total insured debt on which premiums are assessed by 90 percent of Federal Government-guaranteed loans and investments and 80 percent of state government-guaranteed loans and investments, and deducts similar percentages of such guaranteed loans and investments when calculating the secure base amount.

The premium rates assessed from January 1, 2011, to December 31, 2011, were 6 basis points on adjusted insured debt and 10 basis points on the average nonaccrual loans and the average amount outstanding of other-than-temporarily impaired investments.

Premium Rates January to December 2011	**Premiums (in basis points)**
Adjusted insured debt	6
Nonaccrual loans	10
Other-than-temporarily impaired investments	10

Revenues and Expenses

Corporation revenues in 2011 increased 16.3 percent to $170 million from $146 million in 2010 (see figure 7). The increase in revenues resulted from higher premiums. Because of an increased amount of U.S. Treasury securities held in the Corporation's investment portfolio and a slightly higher yield, interest income increased 9.3 percent in 2011 to $72.6 million from $66.4 million in 2010.

The Corporation's operating costs as a percentage of its total assets represented 10 basis points for 2011. Fixed costs for staff, travel, rent, and miscellaneous expenses were $2.5 million of the $3.3 million total for the year (see figure 8). The remaining expenses of $0.8 million were for contract services.

Figure 7

Corporation Revenues

(Dollars in Millions)

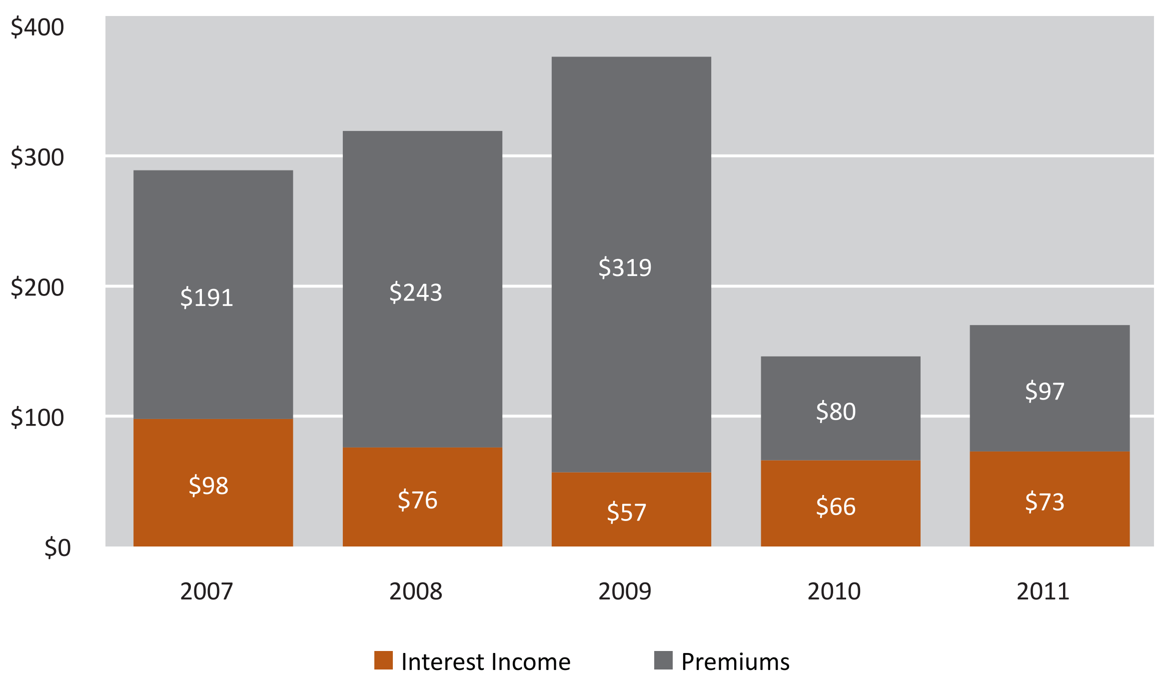
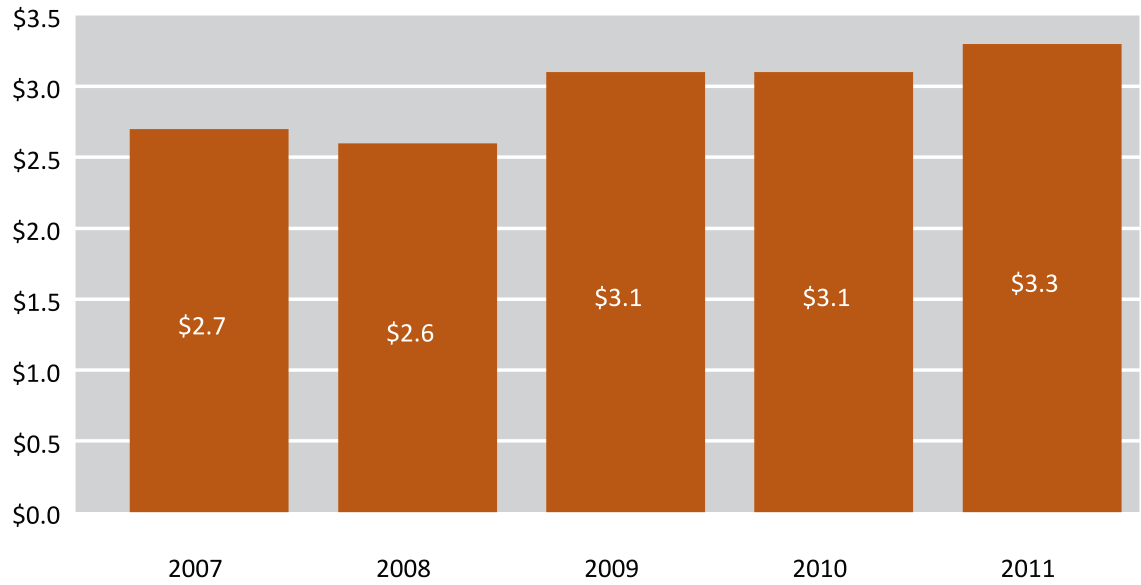


Figure 8
Corporation Expenses
(Dollars in Millions)



Investments

Investments increased during the year from $3.1 billion at December 31, 2010, to $3.3 billion at year-end 2011 (see figure 9).

The Corporation's investment objective is to maximize returns consistent with liquidity needs and to minimize exposure to loss of principal. Funds are invested in U.S. Treasury securities in accordance with the Farm Credit Act and the Corporation's investment policy.

The average portfolio yield was 2.25 percent, up from 2.14 percent the prior year. The return on the Insurance Fund continued to outperform the benchmark index the Corporation uses to measure performance. This index is composed of Treasuries and a private sector mutual fund with holdings of similar type and maturities to the Corporation's portfolio. The average return of the benchmark group was 0.9 percent for 2011.

In accordance with the Corporation's investment policy, the portfolio is composed of a liquidity pool and an investment pool. The liquidity pool consists of short-term Treasury securities maturing in less than two years. The investment pool is composed of Treasury securities with maturities that vary from 2 to 10 years. The FCSIC's investment policy requires at least 20 percent of the portfolio to be maintained in the liquidity pool, and allows a maximum of 25 percent of the investment pool to be invested in securities with maturities between 5 and 10 years. The weighted average portfolio maturity at year-end was 1.6 years. The composition of the investment portfolio at December 31, 2011 is illustrated in figure 10.

In June 2008, the Corporation began purchasing Treasury Inflation-Protected Securities (TIPS). Evaluation Associates, which had completed a study of FCSIC's investment program, recommended that FCSIC consider purchasing TIPS to help improve the diversity of investments and to hedge against future inflation. At year-end 2011, FCSIC's TIPS investments totaled $506 million or just over 15.5 percent of the investment portfolio.

Figure 9
Corporation Investments
(Dollars in Billions)

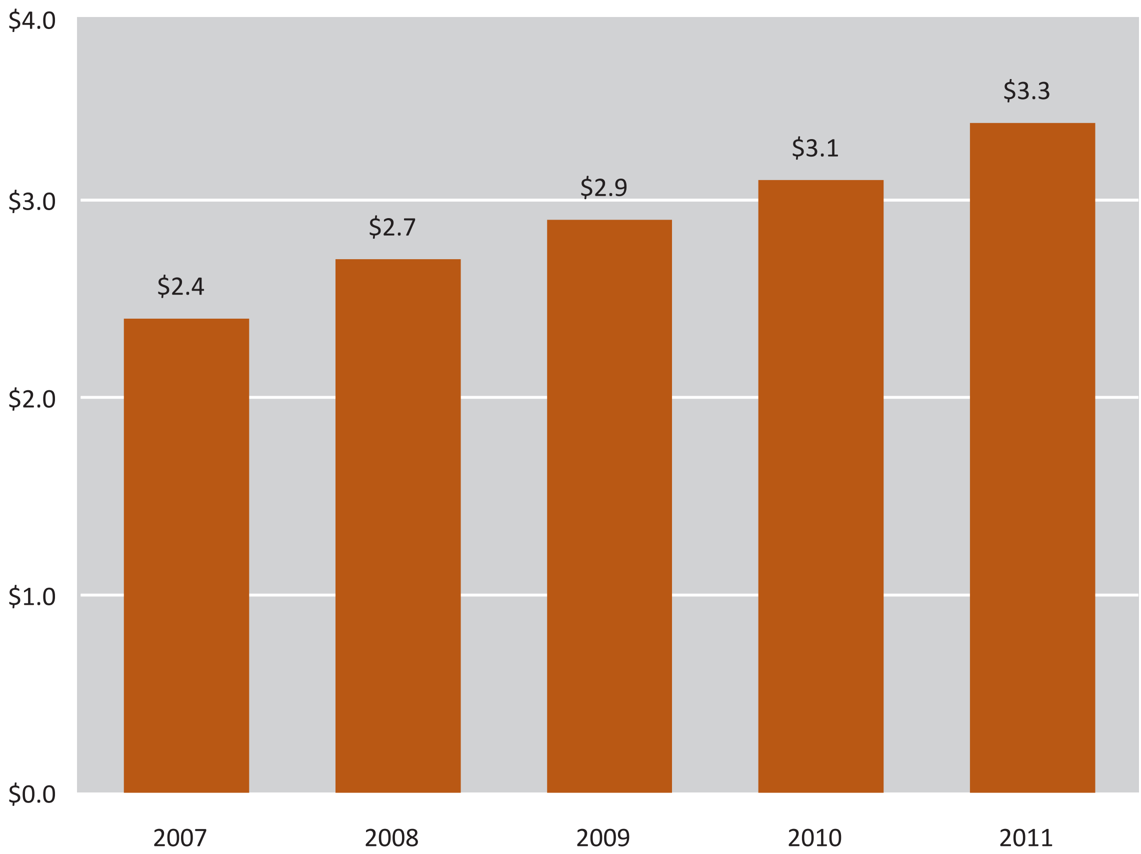
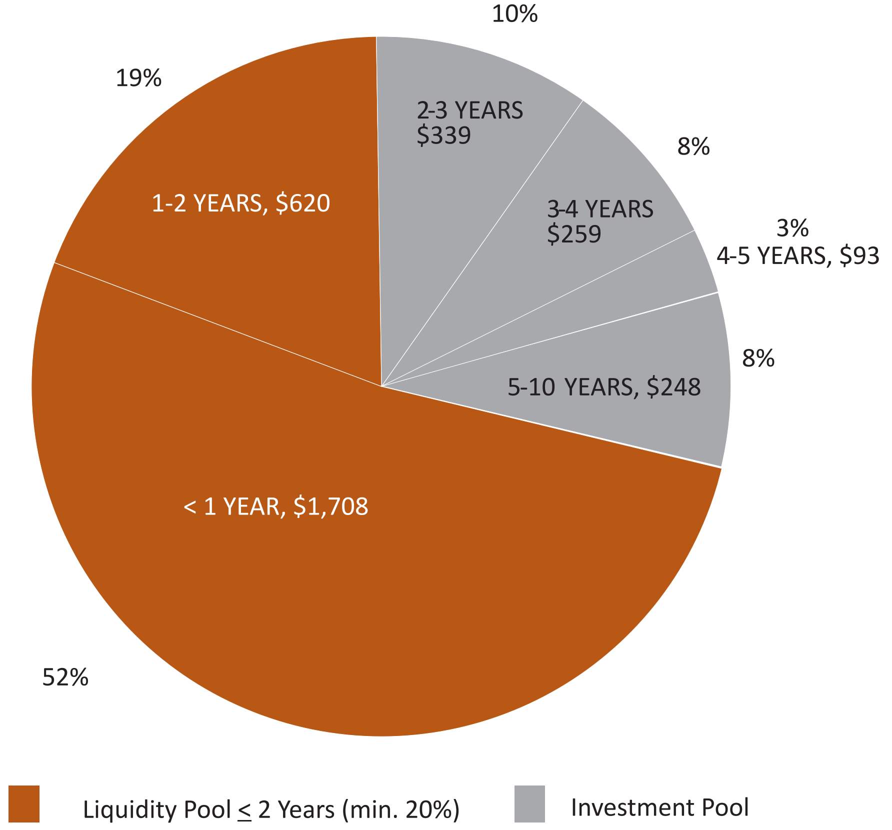


Figure 10

Investment Portfolio by Maturity at December 31, 2011

(Dollars in Millions)



Risk Management

The Corporation actively monitors and manages insurance risk to minimize the Fund's exposure to potential losses. Staff analyzes and evaluates the financial performance and condition of System institutions, maintains continual dialogue with FCA examiners, and reviews reports of examination. When necessary, the Corporation requests special examinations at System institutions of concern. On a quarterly basis, the Corporation screens all System institutions against key performance criteria to identify those that may pose increasing insurance risk.

The Corporation also assesses risk to the Insurance Fund by

- reviewing corporate actions (merger, restructuring, and other regulatory requirements) approved by FCA for System institutions;
- monitoring legislative, judicial, regulatory, and economic trends that could adversely affect the agricultural or financial services industries;
- using analytical models; and
- participating as a nonvoting member on FCA's Regulatory Enforcement Committee.

During 2011, risk management staff monitored and evaluated trends affecting agriculture and System institutions, including

- conditions in the nation's general economy, capital markets, and the agricultural and financial sectors;
- potential budget cuts to Government programs that support U.S. agriculture;
- the effects of commodity price volatility on agricultural operations and the sharp increases in farmland values in the midwestern U.S.;
- the effects of the housing crisis on agricultural real estate values in certain regions of the country;
- stress in several farm sectors affecting the quality of System institutions' loan portfolios, including the dairy, swine, poultry, forestry, nursery, and biofuels industries;
- negative trends at specific System institutions with declining Financial Institution Rating System (FIRS) ratings; and
- the consolidation of System institutions, including the merger of CoBank and U.S. AgBank, which reduced the number of System banks to four.

The Risk Environment in 2011

The effects of the 2007–2009 recession were still evident in 2011. Since mid-2009, the U.S. economy has been on a path of recovery, though the pace of growth has been slow and uneven. Economic output as measured by real gross domestic product increased by 3.0 percent in 2010, but growth decelerated to 1.7 percent in 2011. Employment conditions remained weak. While the unemployment rate has fallen from its peak of 10.1 percent in October of 2009, it remained high at 8.5 percent at year-end 2011. Weak consumer spending, falling housing prices, and reduced credit flow also continued to dampen economic recovery in 2011.

The U.S. banking sector improved despite the continued sluggish housing market and related high levels of delinquencies and foreclosures. FDIC-insured institutions reported the highest level of industry profits since 2007, primarily from lower expenses for loan-loss provisions. More than 96 percent of all FDIC-insured institutions, representing more than 99 percent of total industry assets were classified as well-capitalized institutions at year-end 2011. Nonetheless, 92 FDIC-insured institutions failed, and the list of problem banks (that is, those with CAMELS ratings of 4 and 5) remained high at 813 at year-end.

Interest rates have been maintained at very low levels since 2008 when the economy weakened. During 2011, the Federal Reserve announced that it expected to maintain this low interest rate environment during 2012 and 2013. The timing and magnitude of a change in the direction of interest rates may significantly affect the profitability of agricultural producers who use debt financing in their operations.

The agricultural sector remained strong in 2011 despite slow growth in the domestic economy. In February 2012, USDA forecast a record national net farm and cash income of $98.1 billion and $108.7 billion, respectively, for 2011, up 24 percent and 18 percent, respectively, from 2010. Record revenues from strong crop markets (especially corn, wheat, cotton, and soybeans), combined with sharp gains in livestock revenues, offset a smaller increase in input costs. Higher commodity prices were driven primarily by tighter stocks and a robust export market. The poultry, dairy, timber, nursery and biofuel sectors continued to experience some stress in 2011.

In August 2011, as a consequence of the Federal budget deficit trends, Standard and Poor's (S&P) downgraded the U.S. Government from a "AAA" rating to a "AA" rating. At the same time, the S&P also similarly downgraded the debt of select Government-related entities including the Farm Credit System banks.

Despite Standard and Poor's downgrade of System debt, investor demand for System insured obligations remained favorable across the maturity spectrum. In the very low interest rate environment that prevailed, System banks continued to call and refinance a significant amount of their debt obligations. This contributed to another strong year of Systemwide earnings as interest spreads and margins widened throughout the year.

Credit quality improved in 2011. System loans classified under FCA's Uniform Loan Classification System as Acceptable or Other Assets Especially Mentioned as a percentage of total loans increased to 96.2 percent in 2011 from 95.4 percent in 2010. The improvement in institution FIRS ratings (see figure 11) reflects the better asset quality and its effect on institutions' earnings and capital levels. The primary source of credit quality weakness remained in the livestock, biofuel, and housing-related sectors. Institutions with performance-related issues continued to receive higher examination scrutiny and supervisory attention from FCA.

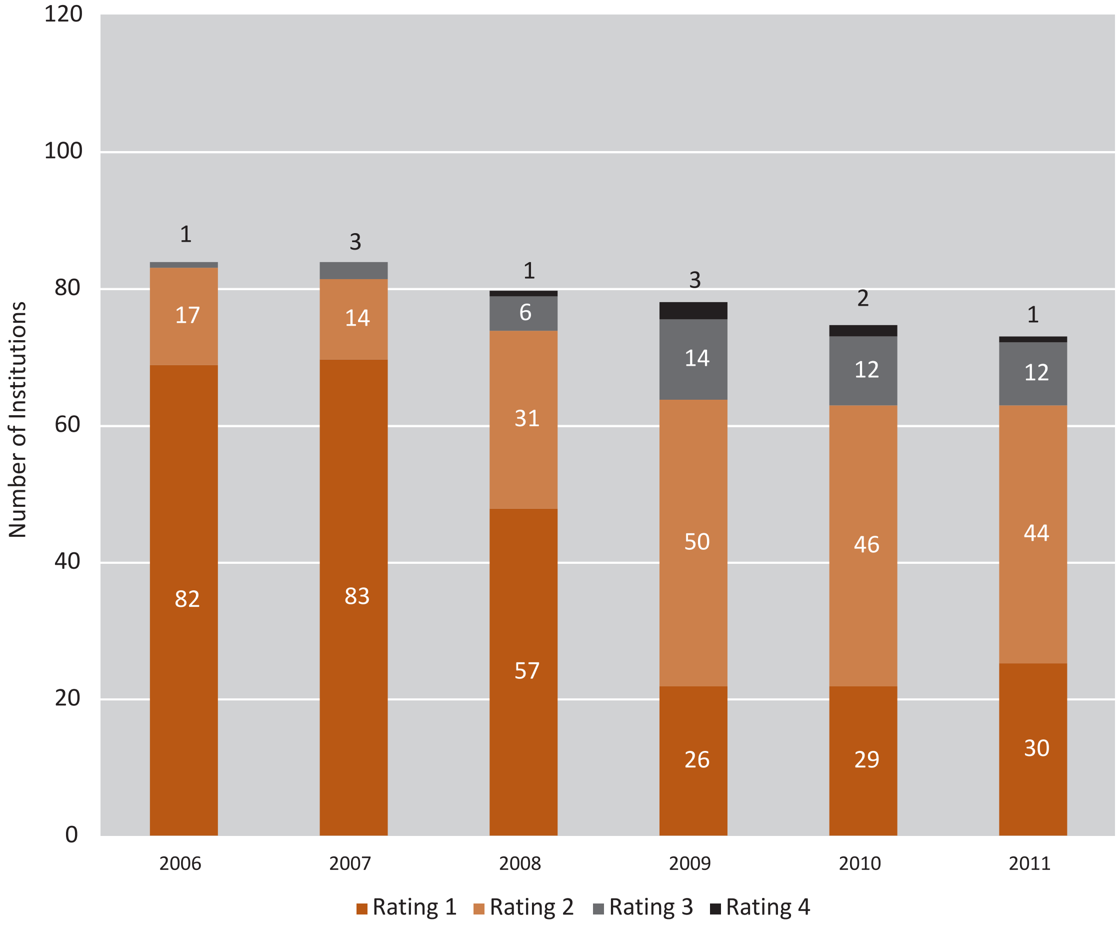
During 2011, System banks continued to strengthen the quality of their respective liquidity portfolios by purchasing and holding enough high-quality liquid assets, including cash, cash equivalents, and Treasury securities with maturities of less than 3 years, to cover 15 days of maturing debt. The banks also agreed that the next 30 days of liquidity would come from investments in excess of those that qualify for the 15-day bucket. These investments consist of U.S. Government-guaranteed instruments and top-rated commercial paper and Fed funds that mature in 45 days or less.

The Federal Government's fiscal situation became a significant uncertainty during the year. Federal farm programs which have provided large benefits to certain agricultural producers in recent years are at risk of curtailment or modification that may change the level and direction of Government support to the agricultural sector. Another aspect of the Federal budget deficit is taxation. Federal Government revenues have been sharply lower over the past several years and are seen as a major issue in the 2012 elections. Federal tax policy for the bioenergy sector was tightened at the end of 2011 when the ethanol tax credit program was allowed to expire. How the budget may be reformed through spending or tax changes remains to be seen, and may not be resolved until after the 2012 election cycle.

Figure 11

FCS Institution FIRS Ratings

As of December 31, 2011



Source: FCA

Note: Figure 11 reflects ratings for only the System's banks and direct-lending associations; it does not include ratings for the System's service corporations, the Federal Agricultural Mortgage Corporation, the two institutions that merged effective January 1, 2012, or the Federal Farm Credit Banks Funding Corporation.

Financial Assistance and Receivership

The Corporation is authorized to provide assistance to System institutions to prevent default, restore normal operations, or facilitate a merger or consolidation. At present, no assistance agreements are outstanding. If a System institution were to need financial assistance, FCSIC must first ensure that the proposed assistance is the least costly method for resolving the institution's problems. By law, FCSIC may not provide financial assistance if the cost of liquidation is lower.

When appointed by FCA, the Corporation has the statutory responsibility to serve as receiver or conservator for System institutions. Upon appointment as receiver, FCSIC will take possession of a Farm Credit institution to settle the business operations of the institution, collect the debts owed to the institution, liquidate its property and assets, pay its creditors, and distribute any remaining proceeds to stockholders. There are no active receiverships or conservatorships currently in the System.

To maintain the capability to act as receiver or conservator while continuing to operate with a small core staff, the Corporation uses contractors on an as-needed basis. These contractors provide knowledgeable and readily available staff resources while allowing the Corporation to contain costs during periods of limited or no activity.

Corporation staff also maintains contact with the resolution staff of the Federal Deposit Insurance Corporation and the National Credit Union Administration to stay informed about best practices and to exchange information concerning receivership management.

As discussed earlier, FCSIC is pursuing a legislative initiative to modernize its resolution authorities. Since 1987, there have been no substantive amendments of the Farm Credit Act relating to FCSIC's resolution authorities. During 2011, the Corporation developed proposed language to enhance its receivership and conservatorship authorities contained in the Farm Credit Act. The proposal is modeled after FDIC's current resolution powers, but tailored for the Farm Credit System.

During the year, FCSIC engaged several consulting firms to assist in planning for the potential resolution of any FCS institutions that may become troubled and to help enhance resolution processes and authorities. Contractor services used to enhance resolution readiness included the following:

- Assistance in developing a communication strategy and plan to support a FCSIC resolution, receivership, or conservatorship. This includes the identification of significant stakeholders, including investors in Farm Credit System insured debt obligations and System borrowers. This communication plan was completed and presented to FCSIC's Board of Directors at its January 2012 meeting.

- Testing of preresolution examination procedures.

FCSIC has a number of Board-approved policy statements that provide guidance related to resolution activities, including appraisals of real estate securing nonperforming assets, insurance of assets that come under the Corporation's control, and environmental hazards assessments of real estate securing nonperforming assets. In addition, the Corporation is in the process of updating its policy statement concerning financial assistance.

Independent Auditor's Report
CliftonLarsonAllen LLP

CliftonLarsonAllen

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Independent Auditor's Report

To the Board of Directors
Farm Credit System Insurance Corporation
McLean, Virginia

We have audited the accompanying statements of financial condition of the Farm Credit System Insurance Corporation (the Corporation) as of December 31, 2011 and 2010, and related statements of income and expenses and changes in insurance fund, and statements of 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 auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *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 the Corporation as of December 31, 2011 and 2010, and the results of its operations and cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 24, 2012, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of income and expenses by year is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

CliftonLarsonAllen LLP

Calverton, Maryland
April 24, 2012

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Directors
Farm Credit System Insurance Corporation
McLean, Virginia

We have audited the financial statements of the Farm Credit System Insurance Corporation (the Corporation) as of and for the year ended December 31, 2011, and have issued our report thereon dated April 24, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The management of the Corporation is responsible for maintaining effective internal control over financial reporting and for compliance with laws and regulations.

Internal Control Over Financial Reporting

Management of the Corporation is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Corporation's Board of Directors and management, and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

Calverton, Maryland
April 24, 2012

Farm Credit System Insurance Corporation
Statements of Financial Condition
As of December 31, 2011 and 2010
(Dollars in thousands)

	2011	2010
Assets		
Cash and cash equivalents	$ 1,101	$ 149,831
Investments in U.S. Treasury Obligations (Note 3)	3,266,285	2,974,341
Accrued interest receivable	26,264	21,544
Premiums receivable (Note 4)	98,699	79,969
Total assets	**$ 3,392,349**	**$ 3,225,685**
Liabilities and Insurance Fund		
Accounts payable and accrued expenses (Note 6)	$ 385	$ 339
Total liabilities	385	339
Farm Credit Insurance Fund		
Allocated Insurance Reserves Accounts Allocated in 2011	221,851	0
Unallocated Insurance Fund Balance	3,170,113	3,225,346
Total Insurance Fund	3,391,964	3,225,346
Total liabilities and Insurance Fund	**$ 3,392,349**	**$ 3,225,685**

(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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Income		
Premiums (Note 4)	$ 97,257	$ 79,648
Interest income	72,616	66,438
Gain or (Loss) on the disposition of investments	0	14
Total income	**$ 169,873**	**$ 146,100**
Expenses		
Administrative operating expenses (Note 6)	$ 3,255	$ 3,130
Total Expenses	**$ 3,255**	**$ 3,130**
Net Income	**$ 166,618**	**$ 142,970**
Farm Credit Insurance Fund – beginning of year	**$ 3,225,346**	**$ 3,287,696**
Payments to AIRAs Accountholders	**$ 0**	**$ (205,320)**
Farm Credit Insurance Fund – end of year	**$ 3,391,964**	**$ 3,225,346**

(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, 2011 and 2010
(Dollars in thousands)

		2011		2010
Cash flows from operating activities				
Net income	$	166,618	$	142,970
Adjustments to reconcile net income to net cash provided by operating activities:				
Increase (decrease) in Capital – Payment to AIRAs Accountholders		0		(205,320)
(Increase) decrease in premium receivable		(18,730)		239,317
(Increase) decrease in accrued interest receivable		(4,720)		1,969
Net amortization and accretion of investments		26,681		26,635
Increase (decrease) in accounts payable and accrued expenses		46		(567)
Net cash provided by operating activities		**169,895**		**205,004**
Cash flows from investing activities				
Payments for purchase of U. S. Treasury Obligations	$	(1,291,379)	$	(403,991)
Proceeds from maturity of U.S. Treasury Obligations		972,754		314,512
Proceeds from sale of U.S. Treasury Obligations		0		21,773
Net cash used in investing activities		**(318,625)**		**(67,706)**
Net change in cash and cash equivalents		(148,730)		137,298
Cash and cash equivalents, beginning of year		149,831		12,533
Cash and cash equivalents, end of year	**$**	**1,101**	**$**	**149,831**

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

Notes to the Financial Statements

Note 1 — Insurance Fund: Statutory Framework

The Agricultural Credit Act of 1987 (1987 Act) established the Farm Credit System Insurance Corporation (the Corporation or FCSIC) 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, as amended (Farm Credit Act), (insured obligations). Each bank in the Farm Credit System (System) participating in insured obligations is an insured System bank. At December 31, 2011, there were five insured System banks and 84 direct lender associations.

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 must spend the amounts necessary to:

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

2. Ensure the retirement of eligible borrower stock at par value under section 4.9A of the Farm Credit Act.

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

The balances outstanding at December 31, 2011, for each of the components of the Corporation's insurance responsibilities were $184.2 billion of insured obligations, and $5 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, as required by section 4.4 (a)(2) of the Farm Credit Act.

Under section 5.63 of the Farm Credit 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 accounting principles generally accepted in the United States of America (GAAP) and, as such, the financial statements have been prepared using the accrual basis of accounting. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents—Cash and cash equivalents include investments in U.S. Treasury obligations with original maturities of 90 days or less. At December 31, 2011, the Corporation held $1 million in overnight Treasury Certificates maturing on January 3, 2012, with an investment rate of zero percent, and $100,763 in cash.

Investments in U.S. Treasury Obligations—Section 5.62 of the Farm Credit 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. The Corporation has classified its investments as held to maturity in accordance with FASB ASC 320 (formerly Statement of Financial Accounting Standard No. 115) and carries them at amortized cost. Amortization of premium and accretion of discount on investments has been computed under the interest method since 2002. Fair value of investments is estimated based on quoted market prices for those or similar instruments.

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.

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 System's 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.

The Corporation actively monitors the creditworthiness and financial position of the insured System banks. Management is not aware of any events or circumstances at this time which would require a liability for estimated insurance obligations to be recorded.

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 during 2011 to the CSRS plan was 8.5 percent of base pay. For those employees covered by FERS, the Corporation's contribution was 10.7 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 $249,895 in 2011 and $240,229 in 2010.

Note 3 — Investments

In addition to the amounts referenced in Note 2, Cash and Cash Equivalents, at December 31, 2011 and 2010, investments in U.S. Treasury obligations which are carried at amortized cost consisted of the following:

($ in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
December 31, 2011				
U.S. Treasury Notes	$ 3,266,285	$ 56,045	$ (581)	$ 3,321,749
December 31, 2010				
U.S. Treasury Notes	$ 2,974,341	$ 63,402	$ (7,138)	$ 3,030,605

The amortized cost and estimated market value of U.S. Treasury obligations at December 31, 2011, by contractual maturity, are shown below.

($ in thousands)	Amortized Cost	Estimated Market Value
Due in one year or less	$ 1,706,980	$ 1,720,998
Due after one year through five years	1,360,494	1,401,134
Due after five years through ten years	198,811	199,617
	$ 3,266,285	$ 3,321,749

Note 4—Premiums, the Secure Base Amount and Excess Insurance Fund Balances

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

The Food, Conservation, and Energy Act of 2008 amended the Farm Credit Act of 1971 (12 U.S.C. § 2001 et seq.) to generally assess premiums based on each bank's pro rata share of insured debt (rather than on loans), aligning premiums with what FCSIC insures. The changes were implemented beginning July 1, 2008. Now FCSIC may collect from 0 to 20 basis points annually on adjusted insured debt outstanding. The amendments also authorize a risk surcharge of up to 10 basis points on non-accrual loans and on other-than-temporarily impaired investments. The amendments reduce the total insured debt on which premiums are assessed by 90 percent of Federal government-guaranteed loans and investments and 80 percent of state government-guaranteed loans and investments, and deduct similar percentages of such guaranteed loans and investments when calculating the secure base amount (SBA). The amendments clarify that FCSIC may collect premiums more frequently than annually.

In addition, the Farm Credit Act no longer specifies how the Farm Credit System banks pass premiums to associations and other financing institutions, although it will require that the banks do so in an equitable manner. This change allows the banks flexibility in allocating premium costs to associations. The amendments clarify that, in addition to FCSIC's regulatory authority under Title V of the Farm Credit Act, FCSIC has the authority to adopt rules and regulations concerning provisions in Title I of the Farm Credit Act related to banks passing along the cost of insurance premiums. Finally, the amendments change Farm Credit Act provisions regarding certified statements and simplify the formula for payments from the Farm Credit Insurance Fund Allocated Insurance Reserves Accounts (AIRAs) to allow more immediate distribution of excess Insurance Fund balances to insured banks and the Farm Credit System Financial Assistance Corporation (FAC) stockholders.

The Farm Credit Act sets a base amount for the Insurance Fund to achieve. The statutory SBA is equivalent to 2.0 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 certain government-guaranteed loans and investments) or such other percentage as determined by the Corporation, in its sole discretion, to be actuarially sound. When the assets in the Insurance Fund for which no specific use has been designated exceed the SBA, the Corporation is required to reduce the premiums, but it still must ensure that reduced premiums are sufficient to maintain at the SBA the assets in the Insurance Fund for which no specific use has been designated (the unallocated Insurance Fund).

Insurance premium rates are reviewed semiannually. For 2011, the Board of Directors set premium rates at its January 20, 2011, meeting at 6 basis points on average adjusted insured debt and continued the assessment of the 10 basis point premium on the average principal balance outstanding for nonaccrual loans and other-than-temporarily impaired investments. The Board of Directors again reviewed premiums at its June 21, 2011 meeting. The Board of Directors voted to maintain the premium accrual rate on average adjusted insured debt at 6 basis points and continued the assessment of the 10 basis point premium on the average principal balance outstanding for nonaccrual loans and other-than-temporarily impaired investments for the remainder of 2011. In 2011, outstanding insured obligations decreased by $4.13 billion (-2.2 percent). At December 31, 2011, both the unallocated Insurance Fund and the total Insurance Fund were 2.14 percent of adjusted insured obligations.

On January 19, 2012, the Board of Directors set premium rates for 2012, decreasing the premium rate on adjusted insured debt outstanding from 6 basis points to 5 basis points. The Board continued the 10 basis point premium on the average principal outstanding for nonaccrual loans and other-than-temporarily impaired investments.

A 1996 amendment to the Farm Credit Act requires the Corporation to establish Allocated Insurance Reserves Accounts (AIRAs) for each System bank and an account for the stockholders of the FAC. If at the end of any calendar year the unallocated Insurance Fund is at the SBA, the Corporation is to segregate any excess balances into these AIRAs. In 2011, the Corporation's Board revised the Policy Statement on the Secure Base Amount and Allocated Insurance Reserves Accounts which provides guidelines for implementing this statutory authority. If at the end of any calendar year, the aggregate of the amounts in the Insurance Fund exceeds the SBA, the Corporation shall allocate to the Allocated Insurance Reserves Accounts the excess amount less the amount that the Corporation, in its sole discretion, determines to be the sum of the estimated operating expenses and estimated insurance obligations of the Corporation for the immediately succeeding calendar year. At year-end 2011, this resulted in the transfer of $221.85 million to the AIRAs. The amount was allocated as follows:

FAC Stockholders	(10%)	$ 22.18 million
Farm Credit System Banks	(90%)	$ 199.67 million

The AIRAs balances are recorded as part of the Insurance Fund until approved for payment by the Corporation's Board. AIRAs balances may be used to absorb any insurance losses and claims. Furthermore, the Board of Directors has discretion to limit or restrict the AIRAs payments. In accordance with the Corporation's policy statement, any AIRAs balances do not count in measuring the Insurance Fund's compliance with the SBA.

Note 5 — Operating Lease

On November 30, 2009, the Corporation executed a six-year lease with the Farm Credit System Building Association for office space. The terms of the lease provide for an annual minimum base rent for office space for the remaining term of $142,249 for 2012 and $146,531 for 2013. The Corporation recorded lease expense (including operating cost assessments) of $138,443 and $134,410 for 2011 and 2010, respectively.

Note 6 — Related Parties

The Corporation purchases services from the FCA under an Interagency Agreement. These include examination and administrative support services. The intention of the parties as stated in the agreement is that specified rates and fees will reimburse the party providing services for all reasonable costs associated with provision of the services. The Corporation had payables due to the FCA of $92,330 at December 31, 2011 and $122,417 at December 31, 2010. The Corporation purchased services for 2011 which totaled $336,387 compared with $326,282 for 2010.

The Corporation provides assistance to the FCA under the same Interagency Agreement, recognizing revenue of zero for 2011 and 2010. At December 31, 2011, and 2010, the Corporation did not have any receivables from the FCA.

Note 7 — Subsequent Events

Management evaluated subsequent events through April 24, 2012, the date the financial statements were available to be issued. Events or transactions occurring after December 31, 2011, but prior to April 24, 2012, that provided additional evidence about conditions that existed at December 31, 2011, have been recognized in the financial statements for the year ended December 31, 2011. Events or transactions that provided evidence about conditions that did not exist at December 31, 2011, but arose before the financial statements were available to be issued have not been recognized in the financial statements for the year ended December 31, 2011.

SUPPLEMENTAL INFORMATION

Income and Expenses

Farm Credit System Insurance Corporation By Year
(Dollars in thousands)

	Income		Expenses		Net Income
Year	Premiums	Investment	Provision for Insurance Obligations	Administrative and Operating Expenses	Changes in Insurance Fund
1989	$ 65,000	$ 16,041	$ 0	$ 118	$ 80,923
1990	$ 72,000	$ 25,705	$ 140,000	$ 243	$ (42,538)
1991	$ 77,463	$ 31,483	$ 15,555	$ 953	$ 92,438
1992	$ 73,902	$ 37,198	$ 12,062	$ 1,200	$ 97,838
1993	$ 74,100	$ 41,277	$ (39,444)[1]	$ 1,278	$ 153,543
1994	$ 76,526	$ 46,389	$ 8,890	$ 1,482	$ 112,543
1995	$ 79,394	$ 54,688	$ (14,329)[2]	$ 1,379	$ 147,032
1996	$ 85,736	$ 61,471	$ 8,509	$ 1,469	$ 137,229
1997	$ 71,242	$ 71,088	$ 9,105	$ 1,511	$ 131,714
1998	$ 19,972	$ 79,545	$ 9,743	$ 1,525	$ 88,249
1999	$ 45,496	$ 81,719	$ 10,424	$ 1,631	$ 115,203
2000	$ 1,040	$ 92,776	$ 11,154	$ 1,797	$ 80,878
2001	$ 0	$ 94,112	$ 11,935	$ 2,127	$ 80,051
2002	$ 26,355	$ 93,499	$ 13,643	$ 1,906	$ 107,545[3]
2003	$ 105,079	$ 91,405	$ 13,725	$ 2,218	$ 180,561
2004	$ 46,520	$ 86,567	$ 14,686	$ 2,263	$ 116,138
2005	$ 49,393	$ 81,253	$ 6,228	$ 2,202	$ 122,236
2006	$ 164,417	$ 87,927	$ 0	$ 2,131	$ 250,213
2007	$ 191,336	$ 98,352	$ 0	$ 2,740	$ 286,948
2008	$ 242,970	$ 75,736	$ 0	$ 2,634	$ 316,080
2009	$ 318,802	$ 57,326	$ 0	$ 3,055	$ 373,073
2010	$ 79,648	$ 66,452	$ 0	$ 3,130	$ 142,970
2011	$ 97,257	$ 72,616	$ 0	$ 3,255	$ 166,618

[1] In 1993, the FAC Trust Fund was initially considered available to pay a portion of the Insurance Corporation's FAC obligation for assistance to the FLB of Jackson.
[2] In 1995, this provision was adjusted to reflect a change in the FAC Trust Fund's investment strategy and the termination of the FLB Jackson receivership making available additional funds to reduce the Insurance Corporation's related FAC obligation.
[3] In 2002, the Corporation changed its method of amortizing investment premiums and discounts from the straight line to the interest method. The cumulative effect on prior years of $3.2 million was included in 2002 net income.

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

April 24, 2012

The Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting for the FCSIC.

FCSIC is an independent U.S. Government-controlled corporation. The Corporation's primary purpose is to ensure the timely payment of principal and interest on insured debt obligations issued on behalf of System banks. The System is a nationwide Government-sponsored enterprise of privately owned banks and affiliated associations that serve borrowers and related entities in the agricultural sector. By protecting investors, FCSIC helps to maintain a dependable source of funds for the farmers, ranchers, and other borrowers of the System.

FCSIC actively monitors and manages insurance risk in order to minimize the Insurance Fund's exposure to potential losses. The Corporation also must be prepared to serve as conservator or receiver of any System bank or association when appointed by the Board of the Farm Credit Administration (FCA).

The Corporation's management has completed an assessment of the effectiveness of the internal controls and financial management systems in effect during 2011 in accordance with guidelines provided by the Office of Management and Budget (OMB) in consultation with the Comptroller General (OMB Circular A-123, "Management's Responsibility for Internal Control"). The objective of these controls and systems is to provide reasonable assurance that

- obligations and costs comply with applicable laws;
- all assets are safeguarded against waste, fraud, unauthorized use, and mismanagement;
- revenues and expenditures applicable to the Corporation's operations are recorded and accounted for properly; and
- reliable, complete, and timely financial and statistical reports may be prepared and accountability of the assets may be maintained.

Based on the assessment performed, the Corporation concluded that as of December 31, 2011, the internal control over financial reporting was effective based on the established guidelines.

In addition to management's review of internal control systems and vulnerabilities, the Corporation's independent auditor, Clifton Larson Allen LLP, as stated in their accompanying report did not identify any material weaknesses in the effectiveness of FCSIC's internal control over financial reporting as of December 31, 2011.

Dorothy L Nichols	C Richard Pfitzinger	Alan J. Glenn
Dorothy L. Nichols Chief Operating Officer	C. Richard Pfitzinger Chief Financial Officer	Alan J. Glenn Director of Risk Management

Performance Management Program

The Corporation has a mandate to ensure the timely payment of principal and interest on insured Farm Credit System debt securities, and to serve as receiver or conservator of any institution placed into conservatorship or receivership by the FCA Board. As a result, the Corporation has three fundamental program goals:

1. Building and managing the Insurance Fund to protect investors
2. Detecting, evaluating, and managing insurance risk
3. Maintaining the capability to act as receiver or conservator as the need arises

Performance Measures

1. Building and managing the Insurance Fund to protect investors

To maintain the solvency of the Insurance Fund, the Corporation must adjust insurance premium assessments when appropriate and manage assets to optimize investment returns, while maintaining appropriate liquidity to carry out its mission. Congress established a statutory requirement for the Insurance Fund to be maintained at a secure base amount equal to 2 percent of adjusted insured obligations or such other percentage as the Corporation in its sole discretion determines to be actuarially sound.

The Corporation assesses the effectiveness of its performance in achieving this goal through the following:

- Reviewing semiannually the need for adjustments to insurance premium assessments
- Measuring investment performance by comparing the portfolio's average yield with peer investment funds, which have similar investment parameters for quality and maturity
- Monitoring of the level of the Insurance Fund every month as compared with the secure base amount target level; reporting results to the Board of Directors

The ability of FCSIC to maintain the Insurance Fund at the secure base amount may be affected by events beyond the control of the Corporation, such as insurance losses.

2. Detecting, evaluating, and managing insurance risk

Progress towards this program goal is measured by the extent to which emerging problems are promptly detected and insurance losses are minimized. Financial indicators are effectively used to monitor conditions and trends, and data are analyzed and reported before losses become likely.

In periods of probable or actual insurance claims, the ratio of estimated losses to actual losses is an indicator of the Corporation's ability to assess prospective loss exposure. As guidance, management uses criteria specified in FCSIC's allowance for loss procedure and the Financial Accounting Standards Board's Accounting Standards Topic 450, Contingencies. Timely evaluation of the Fund's risk exposure is critical to preserving the Fund's solvency. The Corporation uses Farm Credit Administration reports of examination to evaluate risks to the Insurance Fund. The Corporation may independently examine and require information from System institutions.

3. Maintaining the capability to act as receiver or conservator as the need arises

The Corporation is required to serve as receiver or conservator of System banks and associations when appointed by the Farm Credit Administration. This program goal requires that corporate readiness be maintained, through periodic staff training and evaluation of contractors' capabilities, to ensure that qualified resources can be employed to manage receiverships or conservatorships in case the need arises.

FCSIC uses the following measures to determine the effectiveness of its receivership operations:

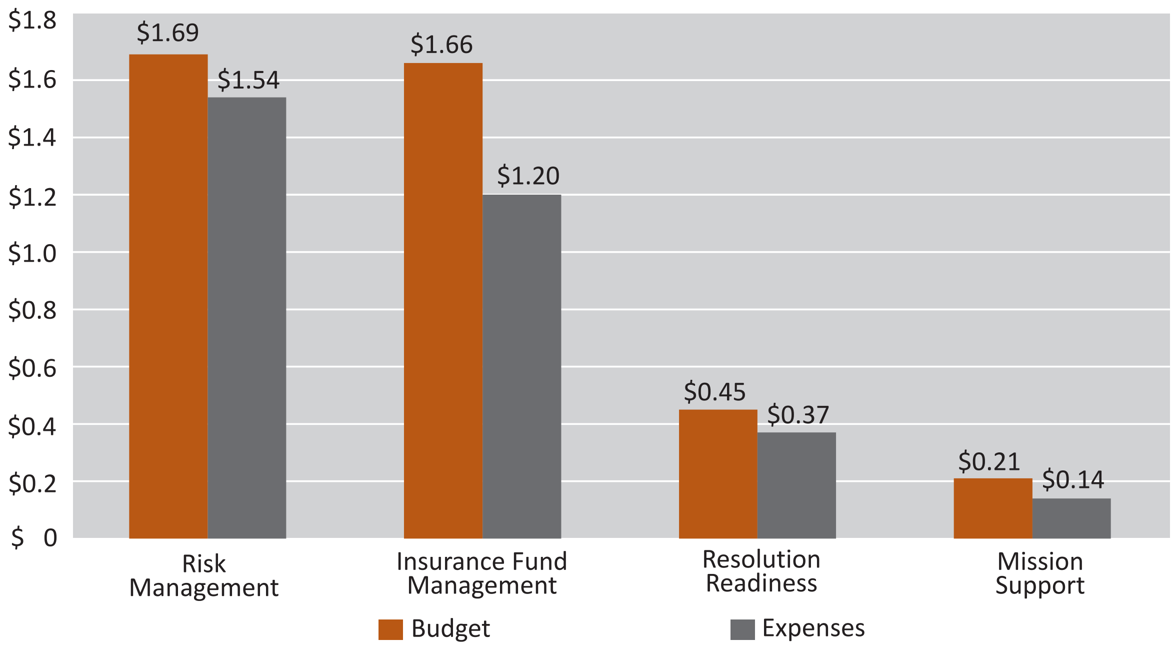
- Whether all claims received initial processing within a period specified according to the size and complexity of the individual case
- Operating costs as a percentage of total assets
- Actual asset recovery returns as a percentage of net realizable asset values

Strategic Goal	Strategic Objectives	High Priority Performance Goals	
Investors in insured debt are protected from loss without recourse to a joint and several liability call	The Farm Credit Insurance Fund remains strong and adequately financed.	Maintain the Insurance Fund at the statutory 2 percent secure base amount.	See pages 16-22 for 2011 results.
	FCSIC promptly identifies and responds to potential risks to the Insurance Fund.	Identify and address risks to the Insurance Fund.	See pages 23-25 for 2011 results.
		Disseminate data and analyses on issues to the FCSIC Board, the public, and other stakeholders.	See pages 8-9 and 23-25 for 2011 results.
		Effectively administer temporary financial assistance programs subject to the statutory least-cost requirements.	See page 26 for 2011 results.
	The FCSIC resolves failure of FCS institutions in the manner least-costly to the Insurance Fund.	Market failing institutions to qualified and interested potential bidders	See page 26 for 2011 results.
	The public, insured investors and FCS institutions have access to accurate and easily understood information about the FCSIC insurance program.	Using the FCSIC website, annual report, and other opportunities, provide information to insured institutions and their investors to help them understand the benefits of the insurance program.	See FCSIC's website for additional information.

Figure 12

2011 Budget and Expenditure by Program

(Dollars in Millions)



Glossary*

A

Adversely Classified Loans—These loans consist of the following types:

Substandard
These assets are inadequately protected by the repayment capacity, equity, or collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that could hinder normal collection of the debt. They are characterized by the distinct possibility that the lender will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets.

Doubtful
Assets classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high. Because of certain important pending factors that may work to the advantage or disadvantage of the assets, classification as substandard or loss is deferred until a more exact status can be determined. Pending factors might include a proposed merger, acquisition, liquidation, capital injection, perfection of liens on additional collateral, or plans for refinancing.

Loss
Assets classified as loss are considered uncollectible and of such little value that their continuance as bookable assets is not warranted. This classification does not mean the asset has absolutely no recovery or salvage value, but rather that deferring to write off this basically worthless asset is not practical even though the asset may eventually yield some value.

Agricultural Credit Association (ACA)—An ACA results from the merger of a Federal Land Bank Association or an FLCA and a PCA and has the combined authority of the two institutions. An ACA borrows funds from an FCB or ACB to provide short-, intermediate-, and long-term credit to farmers, ranchers, and producers and harvesters of aquatic products. It also makes loans to these borrowers for certain processing and marketing activities, to rural residents for housing, and to certain farm-related businesses.

Agricultural Credit Bank (ACB)—An ACB results from the merger of a Farm Credit Bank and a Bank for Cooperatives and has the combined authorities of those two institutions. An ACB is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. CoBank is the only ACB in the FCS.

B

Bank for Cooperatives—A Bank for Cooperatives (BC) provided lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems. It was also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. The last remaining BC in the FCS, the St. Paul Bank for Cooperatives, merged with CoBank on July 1, 1999.

F

Farm Credit Act—The Farm Credit Act of 1971, as amended, (12 U.S.C. §2001 et seq.) is the statute under which the FCS operates.

Farm Credit Bank—The Farm Credit Banks (FCBs) provide services and funds to local associations that, in turn, lend those funds to farmers, ranchers, producers and harvesters of aquatic products, rural residents for housing, and some agriculture-related businesses. On July 6, 1988, the Federal Land Bank and the Federal Interme-

*Not all terms in this glossary, or the list of acronyms, may be used in this report.

diate Credit Bank in 11 of the 12 then-existing Farm Credit districts merged to become FCBs. The mergers were required by the Agricultural Credit Act of 1987. Currently there are three FCBs: AgFirst Farm Credit Bank; AgriBank, FCB; and the Farm Credit Bank of Texas.

Farm Credit Administration (FCA)—FCA was established in 1933 to regulate the Farm Credit System. It is governed by a three-member presidentially appointed board. To ensure the safety and soundness of the System, the Agency examines and supervises System institutions and develops regulations to govern them.

Federal Farm Credit Banks Funding Corporation—Based in Jersey City, New Jersey, the Funding Corporation manages the sale of Systemwide debt securities to finance the loans made by FCS institutions. It uses a network of bond dealers to market the System's securities.

Federal Land Bank Association (FLBA)—These associations were lending agents for FCBs. Federal Land Bank Associations made and serviced long-term mortgage loans to farmers, ranchers, and rural residents for housing. The associations did not own loan assets but made loans only on behalf of the FCB with which they were affiliated. As of October 1, 2000, there were no remaining Federal Land Bank Associations serving as lending agents for FCBs.

Federal Land Credit Association (FLCA)—An FLCA is a Federal Land Bank Association that owns its loan assets. An FLCA borrows funds from an FCB to make and service long-term loans to farmers, ranchers, and producers and harvesters of aquatic products. It also makes and services housing loans for rural residents.

Financial Institution Rating System (FIRS)—The FIRS is similar to the Uniform Financial Institutions Rating System used by other Federal banking regulators. However, unlike the Uniform Financial Institutions Rating System, the FIRS was designed to reflect the nondepository nature of FCS institutions. The FIRS provides a general framework for assimilating and evaluating all significant financial, asset quality, and management factors to assign a composite rating to each System institution. The ratings are described below.

Rating 1—Institutions in this group are basically sound in every respect; any negative findings or comments are of a minor nature and are anticipated to be resolved in the normal course of business. Such institutions are well managed, resistant to external economic and financial disturbances, and more capable of withstanding the uncertainties of business conditions than institutions with lower ratings. Each institution in this category exhibits the best performance and risk management practices for its size, complexity, and risk profile. These institutions give no cause for regulatory concern.

Rating 2—Institutions in this group are fundamentally sound but may reflect modest weaknesses correctable in the normal course of business. Since the nature and severity of deficiencies are not material, such institutions are stable and able to withstand business fluctuations. Overall risk management practices are satisfactory for the size, complexity, and risk profile of each institution in this group. While areas of weakness could develop into conditions of greater concern, regulatory response is limited to the extent that minor adjustments are resolved in the normal course of business and operations continue in a satisfactory manner.

Rating 3—Institutions in this category exhibit a combination of financial, management, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to asset quality or financial condition, such institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Institutions that are in significant noncompliance with laws and regulations may also be accorded this rating. Risk management practices are less than satisfactory for the size, complexity, and risk profile of each institution in this group. Institutions in this category generally give cause for regulatory concern and require more than normal supervision to address deficiencies. Overall strength and financial capacity, however, still make failure only a remote possibility if corrective actions are implemented.

Rating 4—Institutions in this group have an immoderate number of serious financial or operating weaknesses. Serious problems or unsafe and unsound conditions exist that are not being satisfactorily addressed or resolved. Unless effective actions are taken to correct these conditions, they are likely to develop into a situation that will impair future viability or constitute a threat to the interests of investors, borrowers, and stockholders. Risk management practices are generally unacceptable for the size, complexity, and risk profile of each institution in this group. A potential for failure is present but is not yet imminent or pronounced. Institutions in this category require close regulatory attention, financial surveillance, and a definitive plan for corrective action.

Rating 5—This category is reserved for institutions with an extremely high, immediate, or near-term probability of failure. The number and severity of weaknesses or unsafe and unsound conditions are so critical as to require urgent external financial assistance. Risk management practices are inadequate for the size, complexity, and risk profile of each institution in this group. In the absence of decisive corrective measures, these institutions will likely require liquidation or some form of emergency assistance, merger, or acquisition.

Food, Conservation, and Energy Act—This law, enacted in 2008, amended the Farm Credit Act to reform the Insurance Corporation's insurance premium authority to generally assess premiums on insured FCS banks' adjusted outstanding insured debt (rather than on loans).

G

Government-Sponsored Enterprise (GSE)—A GSE is typically a federally chartered corporation that is privately owned, designed to provide a source of credit nationwide, and limited to servicing one economic sector. Each GSE has a public or social purpose. GSEs are usually created because the private markets did not satisfy a purpose that Congress deems worthy either to fill a credit gap or to enhance competitive behavior in the loan market. Each is given certain features or benefits (called GSE attributes) to allow it to overcome the barriers that prevented purely private markets from developing. In some cases, the GSE receives public assistance only to get started, as the FCS did; in other cases, the assistance is ongoing. The FCS is the oldest financial GSE.

P

Production Credit Association (PCA)—PCAs are FCS entities that deliver only short and intermediate-term loans to farmers and ranchers. A PCA borrows money from its FCB to lend to farmers. PCAs also own their loan assets. As of January 1, 2003, all PCAs were eliminated as independent, stand-alone, direct-lender associations. All PCAs are now subsidiaries of ACAs.

Acronyms and Abbreviations

ACA	Agricultural Credit Association
ACB	Agricultural Credit Bank
AIRA	Allocated Insurance Reserves Account
ARC	Administrative Resource Center
BPD	Bureau of the Public Debt
CIPA	Contractual Interbank Performance Agreement
CRS	Consolidated Reporting System
DCAT	Dynamic Capital Adequacy Testing
FAC	Farm Credit System Financial Assistance Corporation
Farm Credit Act, the Act	Farm Credit Act of 1971, as amended
FCA	Farm Credit Administration
FCB	Farm Credit Bank
FCE Act	Food, Conservation, and Energy Act of 2008
FCS	Farm Credit System
FCSIC	Farm Credit System Insurance Corporation
FDIC	Federal Deposit Insurance Corporation
FHCS	Federal Human Capital Survey
FIRS	Financial Institution Rating System
FLBA	Federal Land Bank Association
FLCA	Federal Land Credit Association
FMFIA	Federal Managers' Financial Integrity Act
Funding Corporation	Federal Farm Credit Banks Funding Corporation
GPRA	Government Performance and Results Act
GSE	Government-sponsored enterprise
MAA	Market Access Agreement
NCUA	National Credit Union Administration
PCA	Production Credit Association
SBA	Secure Base Amount
TIPS	Treasury Inflation-Protected Securities

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Contact Information

Copies of the Annual Performance and Accountability Reports of the Farm Credit Administration and FCA's Annual Report on the Farm Credit System may be obtained from

Office of Congressional and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
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(703) 883-4056
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Copies of Farm Credit System Annual Reports to Investors and Quarterly and Annual Information Statements may be obtained from

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