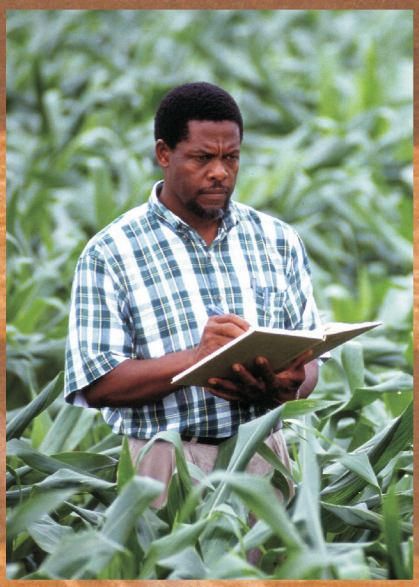
Farm Credit System Insurance Corporation



2006 Annual Report

Mission Statement

The Farm Credit System Insurance 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.*

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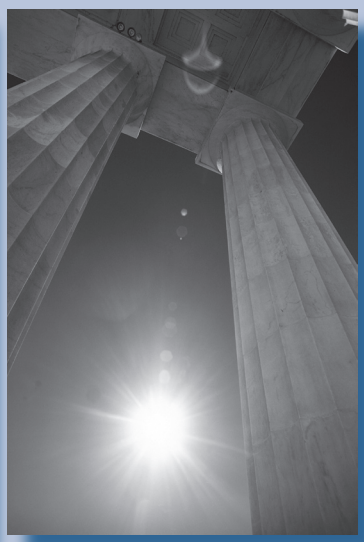


Protecting Investors in Agriculture and Rural America

April 30, 2007

Gentlemen:

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 2006.

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, 2006, was $2.31 billion. The Corporation collected $164 million in insurance premiums from Farm Credit System banks for 2006, and expects to incur $2.8 million in operating costs in 2007.

Sincerely,

Leland A. Strom
Chairman

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

Board of Directors

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

Leland A. Strom

Leland A. Strom, Chairman of FCSIC, was appointed to a six-year term on the FCA Board by President George W. Bush on December 12, 2006. He was elected as the Chairman of FCSIC on December 15, 2006. His term expires on October 13, 2012.

Mr. Strom has more than 30 years of experience in the agriculture industry. Until recently, he served on the board of 1st Farm Credit Services, an FCS institution in Illinois. He was a member of this board for more than 25 years, serving in a variety of positions, including that of chairman. During the agriculture crisis of the 1980s, he was selected to serve on the Restructuring Task Force of the Sixth Farm Credit District.

From 1996 to 2005, he was on the board of AgriBank, FCB, an FCS bank serving farmers and ranchers in 15 states. Mr. Strom also served on the board of the Farm Credit Council, the national trade organization representing the FCS in Government affairs.

From 2000 to 2006, Mr. Strom served on the Federal Reserve Bank of Chicago's Advisory Council on Agriculture, Labor, and Small Business. His input was frequently sought on issues affecting the agriculture sector. In addition, Mr. Strom served for many years on the Agriculture Advisory Committee for Congressman J. Dennis Hastert.

During 2005 and 2006, Mr. Strom served on the Country Mutual Fund Trust Board, an investment fund of the Illinois Farm Bureau and its Country Financial organization. From 1994 to 2006, Mr. Strom was president of Country Home and Land Realty, Inc., a real estate brokerage company in Northern Illinois specializing in agricultural land and investment services. In the early 1980s, he was a board member of Northern F.S., Inc., a multimillion-dollar farm service and supply cooperative serving farmers in Northern Illinois.

Over the years, Mr. Strom served in several capacities with the Illinois Farm Bureau. As a member of the State Young Farmer Committee from 1981 to 1985, he helped build a better statewide young farmer information network. For his overall involvement in agriculture he received an Outstanding Young Farmer Award. He also served on his county Farm Bureau board.

In his community of Kane County, Illinois, which lies at the edge of Chicago's suburban sprawl, 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, and the Strom family set the tone for what has become the first funded, successful county farmland preservation program in the Midwest. His other community involvement has included serving as vice president of his local K–12 school district, chairman of his church council, a 4-H parent leader, and a coach of various boys' and girls' sports teams.

In the mid-1970s, he studied agriculture business at Kishwaukee College and business administration at Northern Illinois University. He was a member of the Illinois Agricultural Leadership Program Class of 1988.

Mr. Strom owns a third-generation family farm in Illinois that produces corn, soybeans, and livestock. He and his wife, Twyla, have two sons and a daughter.

Nancy C. Pellett

Nancy C. Pellett is Chairman of the Board and CEO of FCA. Ms. Pellett was appointed to a six-year term on the FCA Board by President George W. Bush on November 14, 2002, and she was designated Chairman on May 22, 2004. Her term expires on May 21, 2008.

Ms. Pellett also serves as a member of the Board of Directors of the Farm Credit System Insurance Corporation.

Ms. Pellett brings to her position extensive experience in production agriculture and agribusiness. In partnership with her husband, she managed Prairie Hills, Ltd., a feedlot, cow-calf, and row-crop operation in Atlantic, Iowa, from 1966 until her appointment to the Board. While she serves her term as FCA Chairman and CEO, her husband, son, and daughter-in-law continue to operate this fifth-generation family farm.

In addition, for more than 20 years, she served as president and treasurer of Fredrechsen Farms, Ltd., a family-owned swine and row-crop operation in Walnut, Iowa.

A long-time beef industry leader, Ms. Pellett has held State and national leadership positions in cattle industry organizations. As a member of the National Cattlemen's Beef Association, she has served as the chairman of the Check-Off Division, as chairman of the Consumer Marketing Group, and most recently as a member of the Cattlemen's Beef Board. She has also been president of the Iowa Beef Industry Council.

She is a partner in Premium Quality Foods, Inc., which markets precooked beef entrees.

Previously, she served as president and consumer marketing director for the company.

Ms. Pellett served a six-year term as a member of the Board of Regents for the State of Iowa, which oversees the three State universities, as well as the University of Iowa Hospital and its affiliated clinics. She was also selected as a member of the Governor's Student Aid Commission.

She is on the Iowa State University (ISU) Foundation Board of Governors and has been a member of the advisory committees for the College of Agriculture and the College of Family and Consumer Sciences. She is past president of the ISU Alumni Association and was awarded the Alumni Medal in 1987. The Pellett family was honored as the "Family of the Year" by the university in 1997.

Dedicated to the future of agriculture, she worked with 4-H and FFA at the local and State levels, and served on the Iowa 4-H Foundation Board. She is a founding member of the 4-H/FFA "Sale of Champions" committee for the Iowa State Fair.

A native of Walnut, Iowa, she holds a B.S. from Iowa State University at Ames. She and her husband have four children. The Pellett family received the "Friends of Youth Award" in 2000 from the Knights of AkSarBen, a foundation that supports education, youth programs, and rural development in Nebraska and western Iowa.

Dallas P. Tonsager

Dallas P. Tonsager was appointed to the FCA Board by President George W. Bush on December 1, 2004, for a term that expires May 21, 2010 and serves as a member of the Board of Directors of the Farm Credit System Insurance Corporation.

Mr. Tonsager brings to his position extensive experience as an agriculture leader and producer, and a commitment to promoting and implementing innovative development strategies to benefit rural residents and their communities. As executive director of the South Dakota Value-Added Agriculture Development Center in Huron from 2002 until his appointment to the FCA Board, he coordinated initiatives to better serve producers interested in developing value-added agricultural projects. Services provided by the center include project facilitation, feasibility studies, business planning, market assessment, technical assistance, and education.

In 1993, he was selected by President William J. Clinton to serve as the State director in South Dakota for rural development for the U.S. Department of Agriculture. Mr. Tonsager oversaw a diversified portfolio of housing, business, and infrastructure loans in South Dakota totaling more than $100 million. In 1999, he was recognized as one of two outstanding State directors in the nation by then-USDA Under Secretary Jill Long Thompson. His term concluded in February 2001.

A long-time member of the South Dakota Farmers Union, Mr. Tonsager served two terms as president of the organization from 1988 to 1993. He served on the board of National Farmers Union Insurance from 1989 to 1993, and he was a member of the advisory board of the Commodity Futures Trading Commission from 1990 to 1993.

From 1988 to 1993, Mr. Tonsager was a board member of Green Thumb, Inc., a nationwide job training program for senior citizens. He currently serves on the board of Lutheran Social Services of South Dakota.

Mr. Tonsager grew up on a dairy farm near Oldham, South Dakota. In partnership with his brother, he owns Plainview Farm in Oldham, a family farming operation that includes corn, soybeans, wheat, and hay. Mr. Tonsager is a graduate of South Dakota State University where he earned a B.S. in agriculture in 1976. He and his wife, Sharon, have two sons and a daughter-in-law.

2006 – Year in Review

In 2006, a new FCSIC Board Chairman was elected, a new Chief Operating Officer and General Counsel were selected, and the Corporation's Strategic Plan was revised and updated.

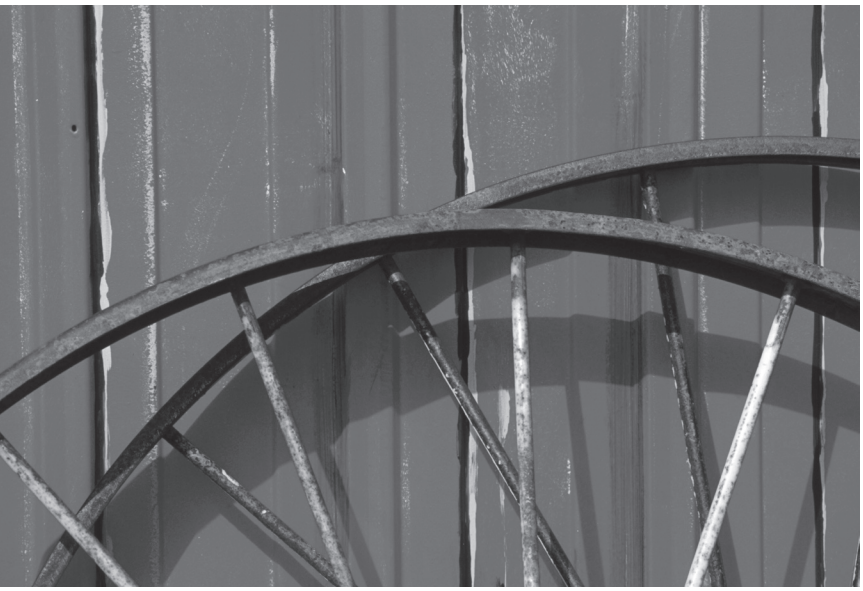
For the FCS, insured obligations outstanding grew by double digits during 2006. At December 31, 2006, insured obligations grew approximately $21 billion to $135 billion, up from $114 billion at year-end 2005. The rate of growth for 2006 was 18.3 percent, which is the highest annual growth rate in insured obligations since 1980. This is the first time since 1980 and 1981 that FCS bank obligations grew by double digits for two consecutive years. Insured obligations grew 14.3 percent in 2005.

On August 1, 2006, President George W. Bush nominated Leland A. Strom to become a member of the FCA Board and he was confirmed by the U.S. Senate on December 9. Mr. Strom was elected Chairman of the FCSIC on December 15, succeeding Douglas L. "Doug" Flory.

Doug Flory served as FCSIC's Chairman from December 4, 2002 to December 14, 2006. During his four-year tenure, the Insurance Fund grew 41 percent from $1.64 billion at year-end 2002 to $2.31 billion at year-end 2006. Chairman Flory played a leadership role in FCSIC's legislative initiative regarding the Corporation's insurance premium assessment authority.

On February 19, 2006, Dorothy L. Nichols became the Corporation's Chief Operating Officer, succeeding Mary Creedon Connelly. Ms. Nichols has been with the Corporation since 1995 and previously served as the General Counsel. She has more than 20 years of bank regulatory and insurance experience.

Ms. Connelly served with distinction as the first Chief Operating Officer. When she joined FCSIC in 1991, the Insurance Fund totaled $548 million. She guided the Corporation through its formative stages, establishing many of the strong risk management policies and procedures that remain in place today. During her 15-year tenure, she also steered the Investment Committee which actively managed the Fund's investments to obtain meaningfully higher rates of returns for the Corporation. She retired in March 2006 with more than 33 years of service with the Federal Government.



James M. Morris became General Counsel on October 29, 2006. Prior to this, he was Executive Assistant and Counsel to FCA Chairman Nancy Pellett. Mr. Morris has extensive experience with legal issues involving the Corporation and the FCS, having served as an attorney for FCA since 1987. He is a member of the New York, Illinois, and District of Columbia Bars, and was in private practice from 1977 until joining FCA.

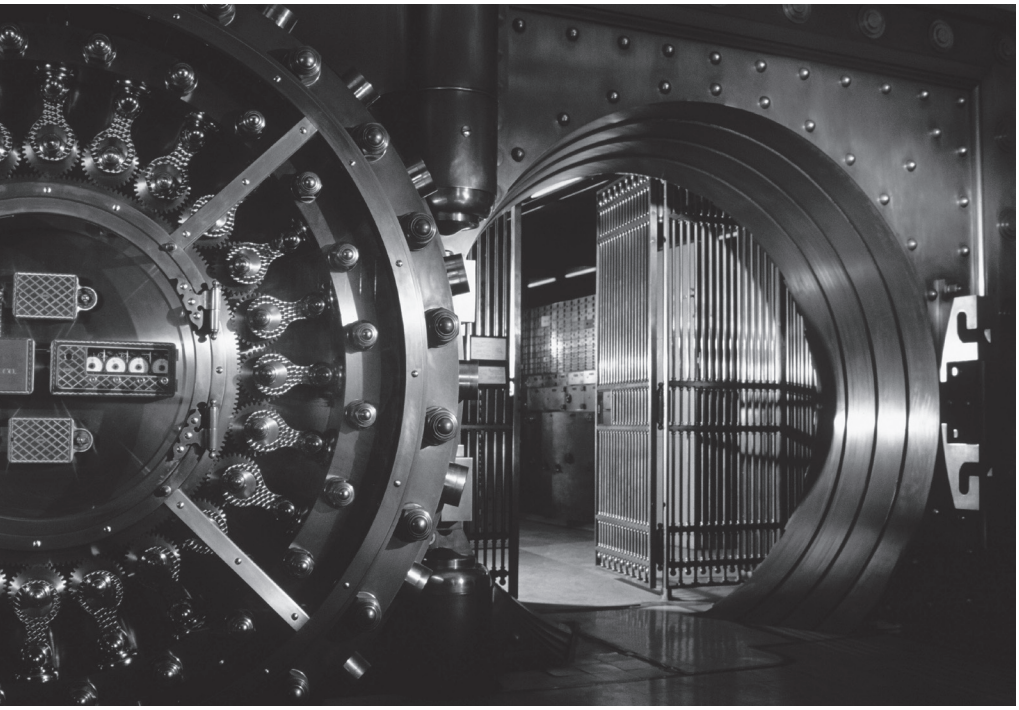
In accordance with the Government Performance and Results Act of 1993, the Corporation was required to update and revise its Strategic Plan during 2006. The previous Strategic Plan was adopted by the Board in September 2003. In May, management and staff met to review key assumptions that impact the Corporation's mission and developed business activities to support its strategic goals over the next five fiscal years. The FCSIC Board of Directors approved the Strategic Plan for FY 2007–2012 at its September 2006 Board meeting. The plan can be viewed in its entirety at the Corporation's Web site, www.fcsic.gov, under Strategic Plans. Strategic Plan initiatives for FY 2007–2012 include the following:

- Conducting an external review of the Corporation's investment program.
- Evaluating the effect of emerging alternative forms of System financing and capital instruments.
- Studying trends in the System's balance sheet over time to determine whether they have created risks to the Insurance Fund.
- Pursuing a statutory change that would allow the Corporation to assess premiums on insured debt outstanding and to increase premiums to enhance investor protection.
- Reviewing the risk management program to determine whether additional tools will improve assessments of Fund adequacy.

Selected Financial Statistics

Farm Credit System Insurance Corporation
($ in millions)

	2006	2005	2004
BALANCE SHEET:			
Total Assets	$ 2,311.9	$ 2,061.8	$ 2,164.0
Total Liabilities	0.3	0.4	224.8
Insurance Fund Balance			
Allocated Insurance Reserves Accounts	39.9	39.9	39.9
Unallocated Insurance Fund Balance	2,271.7	2,021.5	1,899.3
OPERATIONS:			
Revenues	252.3	130.6	133.1
Operating Expenses	2.1	2.2	2.3
Insurance Expense	-0-	6.2	14.7
Net Income	250.2	122.2	116.1



The Farm Credit System

Structure and Funding

The System is owned by the rural customers it serves, including farmers, ranchers and other agricultural producers. There are 95 Farm Credit System associations that lend directly to these owner-borrowers and provide a consistent source of agricultural and rural credit throughout the United States and the Commonwealth of Puerto Rico. Five FCS banks provide funding to the 95 associations within their chartered territories. The banks generally 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

The Corporation's primary purpose, as defined by the Farm Credit Act of 1971 as amended (the Act), is to insure timely payment of principal and interest on insured Systemwide Debt Securities. Investors provide the funds the System lends to agriculture and rural America.

Regulatory Oversight

The Farm Credit Administration (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 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.

Combined Farm Credit System Statistics
($ in billions)

	2006	2005[3]	2004[3]
Insured Debt Outstanding	$135.2	$114.2	$100.0
Production Agriculture:			
Real Estate Mortgage Loans	56.5	51.7	47.7
Production and Intermediate-term Loans	28.7	24.9	22.8
Agribusiness Loans[1]	21.1	14.7	12.0
Communication Loans	3.3	2.6	2.4
Energy and Water/Waste Disposal Loans	6.3	5.5	4.8
Rural Residential Real Estate Loans	3.4	3.0	2.5
International Loans	2.2	2.3	2.6
Lease Receivables	1.5	1.3	1.2
Loans to Other Financial Institutions	0.4	0.4	0.4
Cash and Investments	33.1	28.4	24.2
Net Income	2.38	2.10	2.99[2]
Nonperforming Loans as a Percentage of Total Loans	0.5%	0.6%	0.8%

1. At December 31, 2006, agribusiness loans consisted of loans to cooperatives of $12.2 billion, processing and marketing loans of $6.8 billion, and farm-related business loans of $2.1 billion.
2. Includes a one-time loss reversal of $1.167 billion, net of taxes. Excluding this amount, net income would have been $1.826 billion for 2004.
3. Includes post year-end adjustment by the Federal Farm Credit Banks Funding Corporation for prior years.

Insured and Other Obligations

The Corporation insures Systemwide and Consolidated bonds, notes, and other obligations issued by the System banks through the Funding Corporation. Last year, insured obligations outstanding increased by just over 18 percent to $135.2 billion. For the five-year period from 2002 to 2006, insured debt outstanding grew at an average annual rate of approximately 11 percent.

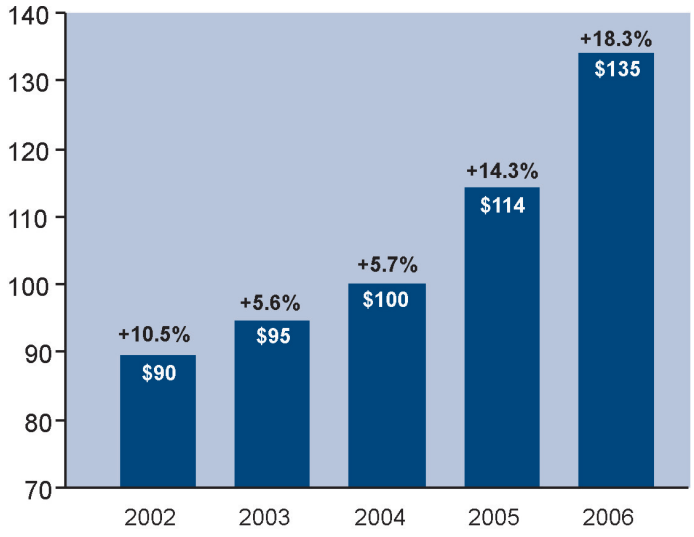
The Corporation is also required by statute to ensure the retirement of eligible System borrower stock at par value. This stock, also known as protected borrower stock, was outstanding prior to October 6, 1988. At year-end, eligible borrower stock outstanding at System institutions totaled $13 million, down from $16 million at year-end 2005.

Farm Credit System Capital

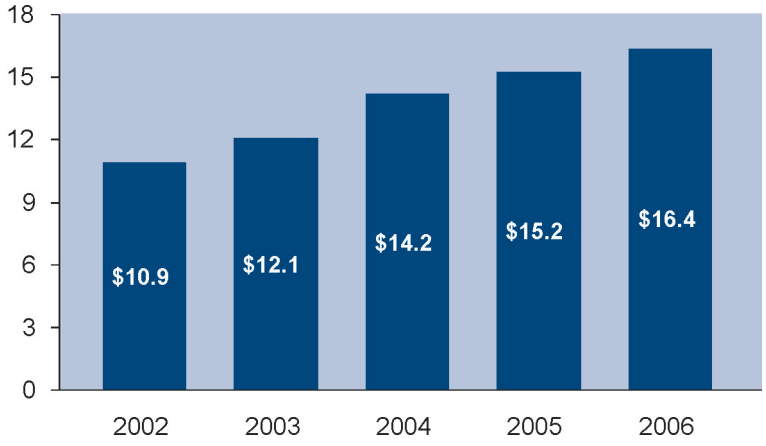
Over the past five years, FCS associations have been building capital through net income earned and retained at the associations. The rise in capital at the associations reduces the credit exposure the insured banks have on loans to each of their affiliated associations.

Since 2002 combined association capital has increased 50 percent from $10.9 billion to $16.4 billion at year-end 2006.

Insured Obligations Outstanding
($ in billions)



Association Capital
($ in billions)

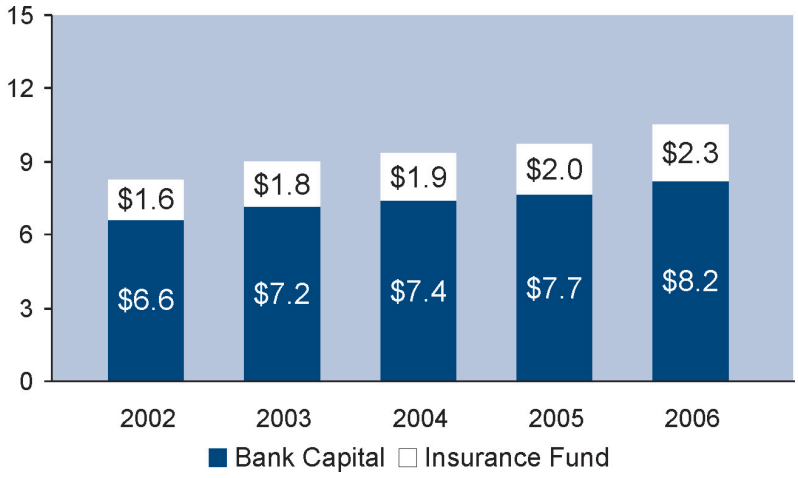


Since 2002, combined bank capital plus the Insurance Fund has increased 28 percent from $8.2 billion to $10.5 billion at year-end 2006.

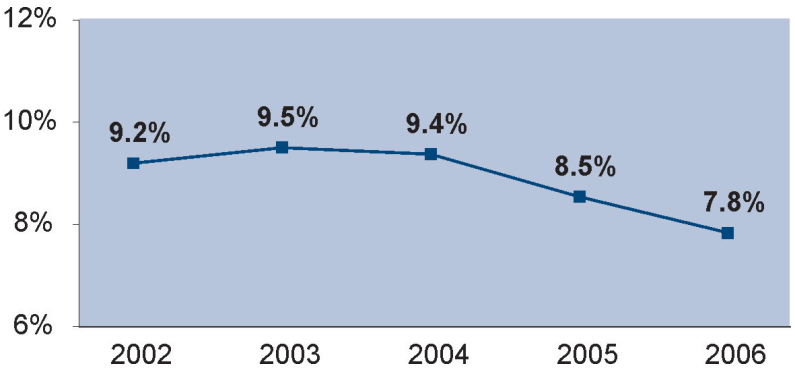
The primary source of funds to repay Systemwide Debt Securities is the System's borrowers. Each borrower is required to have certain minimum levels of net worth and, in most cases, collateral posted in connection with loans made to the borrower. These borrowers make payments on their loans to the lending bank or association. Each lending association in turn makes payments to its affiliated bank on its loan. Both the banks, which ultimately repay Systemwide Debt Securities, and the associations exceed minimum capital regulatory requirements as protection and support for the repayment of the outstanding debt. If a bank participating in an issue of Systemwide Debt Securities was unable to repay its portion of that security, the Insurance Fund would be required to 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 a percentage of outstanding debt, bank capital plus the Insurance Fund decreased from 9.2 percent in 2002 to 7.8 percent in 2006. This decline is due to the

Bank Capital Plus Insurance Fund
($ in billions)



Bank Capital Plus Insurance Fund as a Percentage of Insured Debt



rate of growth in outstanding debt outpacing growth in bank capital and the Insurance Fund.

Additional Elements of Strength

The System has additional risk management tools that protect investors. The banks have entered into the Contractual Interbank Performance Agreement (CIPA). This agreement measures the financial condition and performance of each System bank using various ratios considering capital, asset quality, earnings, interest rate risk, and liquidity. CIPA contains economic incentives whereby financial penalties are applied if the performance standards are not met.

The banks and the Funding Corporation have also entered into a Market Access Agreement (MAA) that 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, its participation in future debt issues could be limited or curtailed. The criteria used under the MAA are the CIPA scores and two capital ratios.

The System also has in place a Common Minimum Liquidity Standard. The standard requires each bank to maintain a minimum of 90 days of liquidity on a continuous basis, assuming no access to the capital markets. All banks have exceeded this liquidity standard since June 30, 2003.

These measures, in conjunction with bank capital and the Insurance Fund, provide protection for investors who purchase Systemwide bonds and notes.

Insurance Fund Management

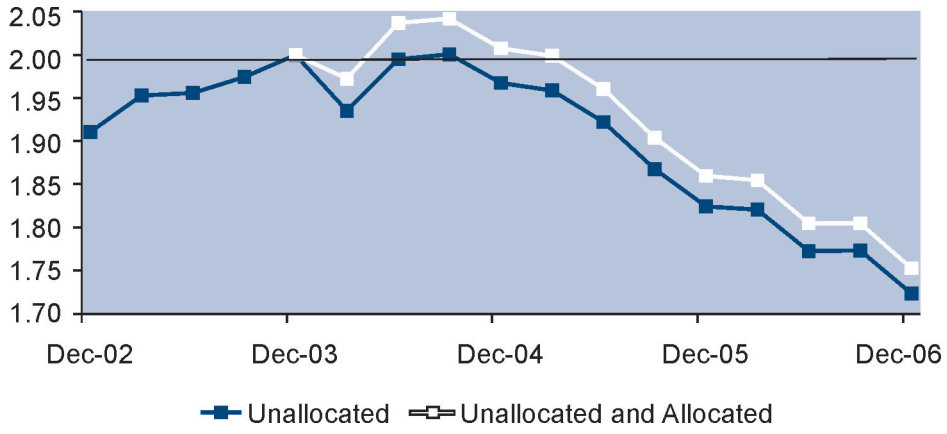
The Insurance Fund and the Secure Base Amount

In 2006, both the total Insurance Fund and total assets grew 12.1 percent to $2.3 billion. Over the last five years, the Corporation's total Insurance Fund and total assets grew at an annual rate of 8.6 percent and 6.3 percent, respectively. In 2005, total assets declined 4.7 percent as a result of the use of $231 million to pay off a portion of the maturing Farm Credit System Financial Assistance Corporation (FAC) obligation (see Note 5 to the financial statements). In 2006, the Corporation did not accrue a provision for insurance obligations.

The Insurance Fund represents the Corporation's equity, the difference between total assets and total liabilities, including insurance obligations. The Insurance Fund is comprised of an unallocated Insurance Fund and an allocated Insurance Fund. Premiums are due until the assets in the Insurance Fund for which no specific use has been identified or designated (i.e., the unallocated portion of the Insurance Fund) reach the secure base amount (SBA). The SBA established by the Act is 2 percent of all outstanding insured obligations or another percentage that the Board determines to be actuarially sound.

The unallocated Insurance Fund continued to trend downward below the SBA in 2006 due to high growth in insured debt. During 2006, insured debt grew just over 18 percent, surpassing the previous year's rate of growth of just over 14 percent. The unallocated Insurance Fund finished 2006 below the 2 percent SBA at 1.72 percent or $364 million below the SBA. Including the Allocated Insurance Reserves Accounts (AIRAs) raises the level to 1.75 percent or $324 million below the SBA.

Insurance Fund Relative to 2 Percent Secure Base Amount By Quarter
(Percent)



Allocated Insurance Reserves Accounts

The unallocated Insurance Fund finished the year below the SBA; therefore, no excess funds were available for transfer to the AIRAs at December 31, 2006. By statute, at any year-end, if the unallocated Insurance Fund is above the SBA, the Corporation must recalculate the SBA using an average daily debt balance method. This amount is then subtracted from the year-end unallocated Insurance Fund balance, less projected insurance and operating expenses for the coming year, to determine the excess amount for transfer to the AIRAs.

In 2003, for the first time, the Corporation closed the year above the SBA. As a result, the Corporation was required to transfer $39.9 million to the AIRAs. By statute, the Corporation is required to use AIRAs first for insurance claim payments. Separate AIRA accounts have been established for each bank and a special account for the holders of FAC stock. The first 10 percent of calculated excess funds are deposited to the FAC stockholders' AIRAs. The remaining 90 percent is prorated into the banks' AIRAs. The earliest possible payout date was April 2006; however, any AIRA payments are at the discretion of the Corporation's Board.

Premiums

The Board reviews premium accrual rates as often as necessary but at least semiannually. The review focuses on five factors:

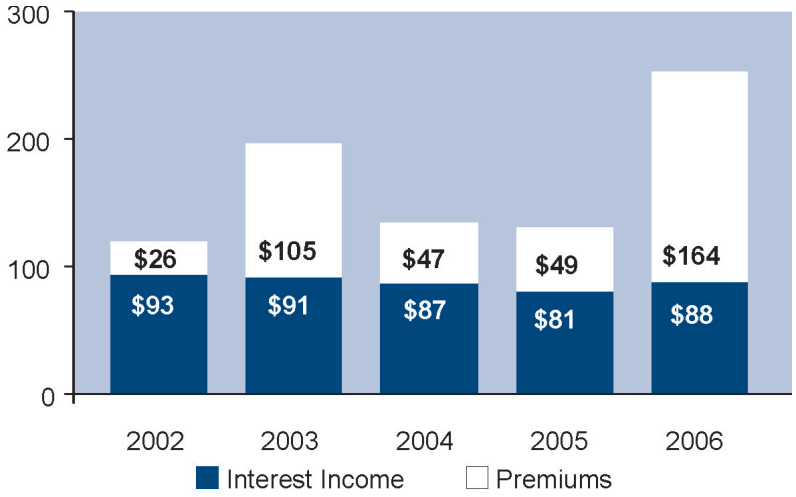
1. The level of the Insurance Fund relative to the secure base amount;
2. Projected losses to the Insurance Fund;
3. The condition of the System;
4. The health of the agricultural economy; and
5. Risks in the financial environment.

Although the Corporation insures repayment to investors who purchase System debt, by law it is limited to collecting premiums based on the loans made by System banks and associations. Allowable premium rates vary by type of loan. (See Note 4 to the Corporation's financial statements.)

Type of Loan	Premium Range (in basis points)
Accrual	0 – 15
Nonaccrual	0 – 25
Federal Government-guaranteed accrual	0 – 1.5
State government-guaranteed accrual	0 – 3
Government-sponsored enterprise-guaranteed accrual	0 – 15

The most important factor in determining premium rates for 2006 was the level of the Insurance Fund relative to the secure base amount. Higher than expected growth in insured debt outstanding has caused the Insurance Fund to trend further away from the SBA. As a result, the Board increased the premium assessment to 15 basis points on accrual loans for 2006. By statute, this is the maximum rate that can be charged. The Corporation continued to assess 25 basis points on non-accrual loans. In September 2006, the Board, in order to allow System institutions to budget for 2007, notified the System that the 2007 premium assessment rate for accrual loans would remain at 15 basis points. The rates for the other loan types, 25 basis points for nonaccrual loans and 0 basis points for Federal and State government-guaranteed loans, remained the same as in 2006.

Corporation Revenues
($ in millions)



Revenues and Expenses

Net income in 2006 increased 105 percent to $250 million, up from $122 million in 2005. The increase in net income resulted primarily from higher premiums. Interest income increased 8.2 percent in 2006 to $88 million, up from $81 million in 2005, due to an increase in the return on investments held in the Corporation's portfolio.

The Corporation's operating costs as a percentage of total assets represented 9 basis points for 2006. Fixed costs for staff, travel, rent, and miscellaneous expenses were $1.7 million of the $2.1 million total for the year. The remaining expenses of $0.4 million were for contract services.

Investments

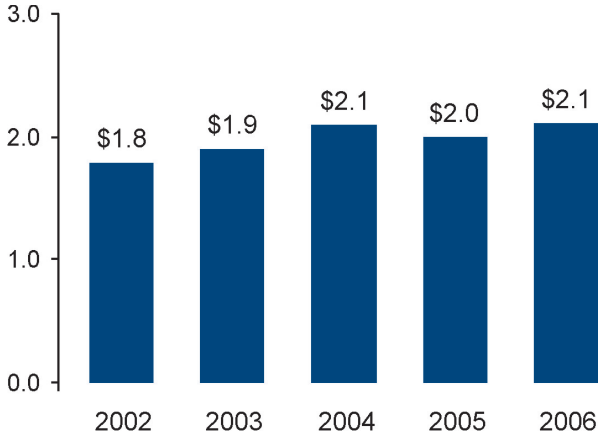
Investments increased 7 percent during the year from $2.0 billion at December 31, 2005 to $2.1 billion at year-end 2006.

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 Act and the Corporation's Investment Policy.

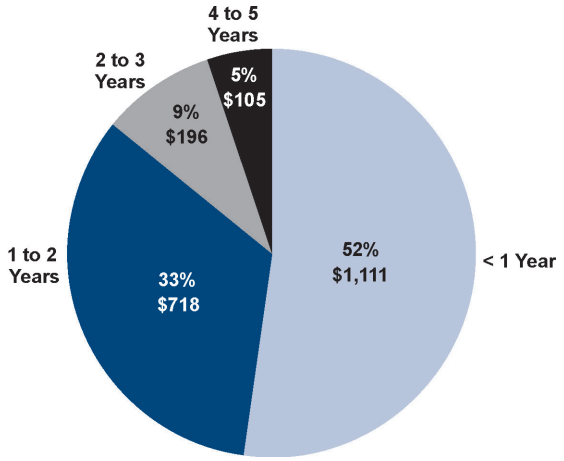
The average portfolio yield was 4.23 percent, up from 3.96 percent the prior year. The return on the Insurance Fund continued to outperform the benchmark index the Corporation uses to measure performance. This index is comprised of private sector mutual funds with holdings of similar type and duration to the Corporation's portfolio. The average return of the benchmark group was 3.53 percent for 2006.

Per the Corporation's Investment Policy, the portfolio is comprised of a liquidity and investment pool. The liquidity pool consists of short-term securities maturing in less than two years. The investment pool component is comprised of maturities from two to ten years. At least 20 percent of the portfolio shall be maintained in the liquidity pool and a maximum of 25 percent can be invested with maturities between five and ten years. The weighted average portfolio maturity at year-end was 1.04 years. The investment portfolio at December 31, 2006, is illustrated in the chart shown on the right.

Growth in Investment Portfolio
($ in billions)



Investment Portfolio Average Yield of 4.23%
$2.13 Billion at December 31, 2006



Risk Management

The Corporation actively monitors and manages insurance risk. This program focuses on minimizing the Fund's exposure to potential losses through early detection. Corporation staff regularly monitors key ratios and financial trends; weaker System institutions undergo special examination procedures as needed.

The Corporation monitors trends in the System's growth, structure, financial performance and condition through continual dialogue with FCA examiners and review of reports of examination. On a quarterly basis, the Corporation screens all System institutions against key performance criteria to identify institutions that may pose increasing insurance risk. The Corporation also assesses risk to the Insurance Fund by:

- Reviewing corporate actions approved by FCA for System institutions;
- Monitoring legislative, judicial, regulatory, and economic trends that could affect the agricultural or financial services industries;
- Using analytical models; and
- Participating as a nonvoting member on FCA's Regulatory Enforcement Committee.

The Corporation continued to work with an insurance risk tool initially developed in 2004 by FCSIC's contractor, Mercer Oliver Wyman. From their earlier work, Mercer concluded that the most significant factors affecting the Corporation's insurance risk exposure were as follows:

1. System balance sheet growth;
2. The financial condition and performance of the System's insured banks and associations; and
3. Capital levels at the five insured System banks.

In 2006, staff worked with Mercer to evaluate the sensitivity of certain assumptions used in the insurance risk model, including the probability of default and the amount of loss given default.

Regulations and Policy

In December, the Corporation's Board of Directors considered the need for inflation adjustments to the civil money penalties that the Corporation may impose under the Farm Credit Act of 1971 as amended. The Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, requires all Federal agencies with statutory civil money penalty authority to periodically evaluate and adjust civil money penalties for inflation, so that these penalties maintain their deterrent value. In a notice published in the Federal Register, the Corporation determined that the required calculation did not provide any adjustment to its civil money penalties.

In 2006, the FCA issued a regulation clarifying the process by which a FCS bank or association could terminate its FCS charter. These regulations require that an FCS institution seeking to terminate its status notify, and in some circumstances consult with, the Corporation. The regulations also require that any terminating institution pay an exit fee to the Farm Credit Insurance Fund.

Financial Assistance and Receivership

The Insurance 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. Before financial assistance may be provided, the statute requires the Corporation to ensure that the proposed assistance is the least costly method for resolving a troubled System institution. Financial assistance cannot be provided if the cost of liquidation is determined to be lower. During the year, the Corporation field-tested an update to its special examination procedures and Cost Test model at a healthy institution to ensure its readiness for this responsibility.

There are no active receiverships or conservatorships currently in the System. When appointed by FCA, the Corporation has the statutory responsibility to serve as receiver or conservator for System institutions. To fulfill this role and continue to operate with a small core staff, the Corporation uses contractors on an as-needed basis. These contractors provide knowledgeable and readily available resources, while allowing the Corporation to contain costs during periods of limited or no activity. Corporation staff also maintains ongoing contact with the receivership staff of the Federal Deposit Insurance Corporation and the National Credit Union Administration to exchange information and stay abreast of best practices in receivership management.

During the year, staff initiated a project to ensure FCSIC readiness to respond to a potential default at a bank or large association. An interagency work group was formed with FCA staff and several independent advisors to consider potential scenarios that might require use of the Insurance Fund. This project will:

- Review lessons learned from the past to improve FCSIC monitoring and forecasting;
- Identify response options and strategies for staff and the Board; and
- Ensure our processes are adequate to recommend and implement effective resolution strategies.

Strategic Goals and Performance Measures

Three broad goals with performance measures are used to evaluate the effectiveness of the Corporation's operations.

1. Manage the Insurance Fund to maintain the 2 percent secure base amount to protect investors.

The Corporation assesses the effectiveness of its performance by:

- Reviewing premium rates semiannually and making necessary adjustments; and
- Comparing the investment portfolio's average yield to peer investment funds with similar quality and maturity.

In 2006, the total Insurance Fund trended below the 2 percent SBA. Throughout the year, the total Insurance Fund ranged from 1.863 to 1.747, and finished the year at 1.754. Premium rates were reviewed three times and the rate on accrual loans was adjusted from 5 basis points in 2005 to 15 basis points in 2006 due to high growth in insured debt. By statute, 15 basis points is the maximum that FCSIC can assess on accrual loans. The Corporation is pursuing a legislative proposal to amend the statutory framework for insurance premium assessment to make certain technical but important changes to the Farm Credit Act. The changes would enhance investor protection by increasing the amount FCSIC can collect to recapitalize the Fund. Key amendments would base premium assessments on outstanding insured debt obligations, instead of basing them on loans. FCSIC ensures timely payment of principal and interest on insured debt obligations, and this change would align its premiums with the risks it insures. Also, the proposal would permit the FCSIC Board to impose premiums ranging from 0 to 20 basis points on insured debt obligations.

The investment return on the Corporation's portfolio (4.23 percent) exceeded the average return on the benchmark (3.53 percent) that is used to measure performance. The benchmark consists of private sector mutual funds that have the same characteristics as the Corporation's investment objectives. The Corporation, as part of its Strategic Plan, contracted with Evaluation Associates in December to conduct an external review of its investment program. The firm is reviewing our policies, procedures, internal controls and investment performance. The review is scheduled for completion in June 2007.

2. Detect, evaluate, and manage risks to the Insurance Fund to protect it from losses.

Program effectiveness is measured by:

- Evaluating how promptly emerging risks are detected;
- Determining the accuracy of the evaluation of risk; and
- Appraising the extent of loss minimization, if applicable.

The Corporation assesses the need for any insurance loss allowance quarterly. The financials of all System institutions are proactively screened to detect risk and identify institutions that may require special examinations. As an additional tool to evaluate risks, the Corporation continued development of a model for dynamically evaluating the adequacy of the current Insurance Fund under various scenarios.

3. Maintain the capability to manage receiverships and/or conservatorships.

The standards used to measure the effectiveness of receivership operations are:

- Completing 90 percent of initial claims processed within a specified period, depending on the size and complexity of the failed institution;
- Keeping the ratio of operating costs to total assets comparable with that of other insurers; and
- Keeping the ratio of asset recovery values to asset values comparable with that of other insurers.

No receiverships or conservatorships existed in the Farm Credit System in 2006.

Corporation personnel are trained periodically to maintain readiness, ensuring proficiency in the performance of receivership responsibilities. The next receivership readiness exercise is scheduled for 2007–2008.

The President's Management Agenda

The Corporation, one of 35 agencies designated as a significant Government entity for reporting purposes, is required to submit data for the Financial Report of the United States using the Government-wide Financial Report System and the Federal Agencies' Centralized Trial-Balance System.

In 2001, President Bush established a policy for improving the management and performance of the Federal Government. The President's Management Agenda focuses on five Government-wide goals to encourage improvements in specified areas of operations. The Corporation's accomplishments in those five areas are as follows:

1. Strategic Management of Human Capital

    - Operated with a small core staff, contracting for specialized expertise when necessary, which kept operating costs low while offering flexibility to leverage resources.
    - Continued to provide cross-training to ensure continuity of operations by empowering multiple staff members to fulfill a variety of critical roles in day-to-day operations.
    - Participated in the 2006 Federal Human Capital Survey (FHCS), which satisfied the annual requirement established by the National Defense Authorization Act of 2004 and provided agency metrics within the human capital accountability system.
    - Consistently scored higher than the Government-wide average on the 2006 FHCS in job satisfaction and leadership.

2. Competitive Sourcing

    - Continued the extensive use of competitively sourced public and private sector contractor support to perform administrative functions including personnel, information systems, and financial systems support.
    - Reduced contracting expenses for 2006 by 6 percent from 2005 while maintaining the same level of service and quality.
    - Competitively sourced the external review of the Corporation's investment program by conducting market research that focused on firms capable of completing the requirements outlined in the Statement of Work and by using a Technical Evaluation Panel to select the contractor that offered the best value in terms of cost and technical ability.

3. Improved Financial Performance

    - Managed an investment portfolio with an average yield exceeding benchmarks.
    - Kept actual operating expenses 21 percent below budgeted

operating expenses due to unexpended contingency funds to deal with potential insurance issues, the use of cost-effective shared services and a staff vacancy during part of the year.

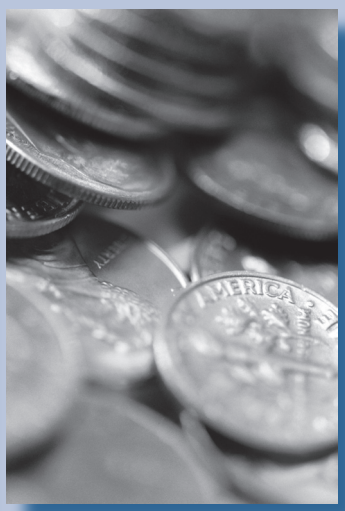
4. Expanded Electronic Government

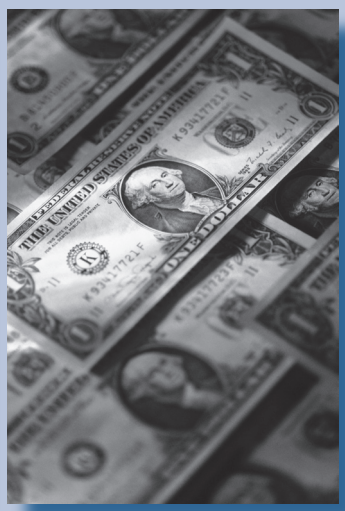
- Continued to use the Corporation's Web site as the primary vehicle for providing information to our stakeholders, other Government entities and the public.
- Sent all communications to the Farm Credit System electronically.
- Used the Internet to conduct market research to find responsive and responsible firms to conduct an external review of the Corporation's investment program. Corresponded by e-mail to reduce mailing costs and increase turn-around time to select a contractor.

5. Budget and Performance Integration

- Continued to provide timely and accurate financial information to assist senior management and the Board in making decisions on strategic programs and key operations.
- Evaluated programs on an ongoing basis to determine efficiency, measuring results against Annual Performance and Strategic Plan objectives and reporting quarterly to the Board. Met new and growing demands without increasing permanent staff levels.
- Received an unqualified opinion on the Corporation's financial statements from our external auditor.
- The annual report on FCSIC's control over Reporting and Compliance did not disclose any internal control weaknesses or any instances of noncompliance.
- The agreed-upon procedures performed in accordance with instructions provided by the U.S. Treasury with respect to Federal Intergovernmental Activity and Balances for FY 2006 did not disclose any exceptions.

2nd
CAPS
SPACE




THE UNITED STATES OF AMERICA
ONE DOLLAR

Reports of Independent Public Auditors

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Report of Independent Auditors

To the Board of Directors
Farm Credit System Insurance Corporation:

In our opinion, the accompanying statements of financial condition and the related statements of income and expenses and changes in insurance fund, and cash flows present fairly, in all material respects, the financial position of Farm Credit System Insurance Corporation (the "Corporation") at December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 9, 2007 on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations for the year ended December 31, 2006. 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.

PricewaterhouseCoopers LLP

March 9, 2007

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Report of Independent Auditors 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:

We have audited the financial statements of Farm Credit System Insurance Corporation (the "Corporation") as of and for the year ended December 31, 2006, and have issued our report thereon dated March 9, 2007. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 and regulations, 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 Corporation's Board of Directors and management, and is not intended to be and should not be used by anyone other than those specified parties.

PricewaterhouseCoopers LLP

March 9, 2007

FARM CREDIT SYSTEM INSURANCE CORPORATION

Statements of Financial Condition as of December 31, 2006 and 2005
($ in thousands)

	2006	2005
ASSETS		
Cash and Cash Equivalents	$ 700,839	$ 273,887
Investments in U.S. Treasury Obligations (Note 3)	1,428,746	1,715,586
Accrued Interest Receivable	17,908	22,856
Premiums Receivable (Note 4)	164,402	49,493
TOTAL ASSETS	**$ 2,311,895**	**$ 2,061,822**
LIABILITIES AND INSURANCE FUND		
Accounts Payable and Accrued Expenses (Note 7)	$ 300	$ 440
TOTAL LIABILITIES	**300**	**440**
Farm Credit Insurance Fund		
Allocated Insurance Reserves Accounts	39,888	39,888
Unallocated Insurance Fund Balance	2,271,707	2,021,494
TOTAL INSURANCE FUND	**2,311,595**	**2,061,382**
TOTAL LIABILITIES AND INSURANCE FUND	**$ 2,311,895**	**$ 2,061,822**

(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, 2006 and 2005
($ in thousands)

	2006	2005
INCOME		
Premiums (Note 4)	$ 164,417	$ 49,393
Interest Income	87,927	81,253
Other Income	–	20
TOTAL INCOME	**$ 252,344**	**$ 130,666**
EXPENSES		
Administrative Operating Expenses (Note 7)	$ 2,131	$ 2,202
Provision for Estimated Insurance Obligations (Note 5)	–	6,228
TOTAL EXPENSES	**$ 2,131**	**$ 8,430**
NET INCOME	**$ 250,213**	**$ 122,236**
Farm Credit Insurance Fund – Beginning of Year	**$ 2,061,382**	**$ 1,939,146**
Farm Credit Insurance Fund – End of Year	**$ 2,311,595**	**$ 2,061,382**

(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, 2006 and 2005
($ in thousands)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 250,213	$ 122,236
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Increase in Premium Receivable	(114,909)	(2,973)
Decrease in Accrued Interest Receivable	4,948	4,649
Net Amortization and Accretion of Investments	12,956	17,378
(Decrease) Increase in Accounts Payable and Accrued Expenses	(140)	69
Decrease in Liability for Estimated Insurance Obligations	-	(224,489)
Total Net Cash Provided by Operating Activities	153,068	(83,130)
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for Purchase of U. S. Treasury Obligations	$ (99,204)	$ -
Proceeds from Maturity of U.S. Treasury Obligations	373,089	354,737
Total Net Cash Provided by Investing Activities	273,885	354,737
Net Change in Cash and Cash Equivalents	426,953	271,607
Cash and Cash Equivalents – Beginning of Year	273,886	2,279
Cash and Cash Equivalents – End of Year	$ 700,839	$ 273,886

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

Notes to the Financial Statements

AS OF DECEMBER 31, 2006 AND DECEMBER 31, 2005

Note 1—Insurance Fund: Statutory Framework

The Agricultural Credit Act of 1987 (1987 Act) established the Farm Credit System Insurance Corporation (Corporation) for the purpose of ensuring the timely payment of principal and interest on notes, bonds, debentures, and other obligations issued under subsection (c) or (d) of section 4.2 of the Farm Credit Act of 1971, as amended (Act), (insured obligations). Each bank in the Farm Credit System (System) participating in insured obligations is an insured System bank. At December 31, 2006, there were five insured System banks and 95 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;

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

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

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

The balances outstanding at December 31, 2006, for each of the components of the Corporation's insurance responsibilities were $135 billion of insured obligations, and $13 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 (2) of the Act.

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

Note 2—Summary of Significant Accounting Policies

Accounting Principles and Reporting Practices—The accounting and reporting policies of the Corporation conform to 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, 2006, the Corporation held $700.79 million in overnight Treasury Certificates maturing on January 2, 2007, with an investment rate of 4.83 percent. In addition, the Corporation maintained cash reserve of $50,000 for daily operations.

Investments in U.S. Treasury Obligations—Section 5.62 of the Act requires that funds of the Corporation, not otherwise employed, shall be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. The Corporation has classified its investments as held to maturity in accordance with the Statement of Financial Accounting Standard (SFAS) 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. (Also see Note 5.)

The insured System banks' primary lending markets are borrowers engaged in farming, ranching, and producing or harvesting of aquatic products, and their cooperatives. Financial weaknesses in these market segments and the effect of general market conditions on the 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.

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 2006 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 $165,029 in 2006 and $155,572 in 2005.

Note 3—Investments

In addition to the amounts referenced in Note 2, Cash and Cash Equivalents, at December 31, 2006 and 2005, investments in U.S. Treasury obligations which are carried at amortized cost consisted of the following:

($ in thousands)

December 31, 2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. Treasury Notes	$ 1,428,746	$ 610	$ (25,660)	$ 1,403,696
December 31, 2005				
U.S. Treasury Notes	$ 1,715,586	$ 5,689	$ (28,426)	$ 1,692,849

The amortized cost and estimated market value of U.S. Treasury obligations at December 31, 2006, by contractual maturity, are shown below.

($ in thousands)

	Amortized Cost	Estimated Market Value
Due in one year or less	$ 410,012	$ 408,019
Due after one year through five years	1,018,734	995,677
	$ 1,428,746	$ 1,403,696

During 2006 the yield curve was either flat or inverted. The narrow spreads between overnights and Treasuries in the first half of the year resulted in the decision to invest funds from maturing securities into overnight U.S. Treasury securities. Due to the inverted shape of the interest rate yield curve during the latter part of 2006, the Corporation continued to pursue a strategy of investing maturing funds, as well as interest income and revenues, in overnight U.S. Treasury securities. The Corporation continues to actively monitor the interest rate environment and make adjustments as appropriate.

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 Act is an insured System bank and may be required to pay premiums to the Corporation.

The Act establishes the range of insurance premium rates that the Corporation's Board may assess for any calendar year based on five classes of an insured bank's loan assets. The asset classes and the range that may be assessed for each are: (1) average annual accrual loans outstanding (other than the guaranteed portions of Government-guaranteed accrual loans) for the year may be assessed from zero to 0.0015; (2) average annual nonaccrual loans outstanding may be assessed from zero to 0.0025; (3) average annual portions of Federal Government-guaranteed accrual loans may be assessed from zero to 0.00015; (4) average annual portions of state government-guaranteed accrual loans may be assessed from zero to 0.0003; and (5) average annual portions of GSE-guaranteed loans in accrual status may be assessed from zero to 0.0015.

The Act sets a base amount for the Insurance Fund to achieve. The statutory secure base amount 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 government guaranteed loans in accrual status) 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 (unallocted insurance fund) exceed the secure base amount, the Corporation is required to reduce the premiums. However, the reduced premium level must be sufficient to maintain the unallocated Insurance Fund at the secure base amount.

Insurance premium rates are reviewed semiannually. For 2006, the Board set premium rates at its January 2006 meeting at 15 basis points for accrual loans, 25 basis points for nonaccrual loans and zero for Federal and state government-guaranteed loans, and did not exercise its discretionary authority to grant a lower rate for GSE-guaranteed loans. The Board again reviewed premiums at its June and September 2006 meetings. Due to continued high growth levels, the Board voted to maintain the premium rate on accrual loans at 15 basis points, the rates for nonaccrual loans at 25 basis points and for government-guaranteed loans, zero basis points. In 2006, outstanding insured obligations increased by $20.6 billion or 18 percent. At December 31, 2006, the unallocated Insurance Fund was 1.72 percent as a percentage of adjusted insured debt. Including the Allocated Insurance Reserves Accounts (AIRAs) raised the level to 1.75 percent.

On January 11, 2007, the Board set premium rates for 2007, leaving unchanged the premium rate for accrual loans at 15 basis points, the maximum allowed by statute. The rates for nonaccrual loans remained at 25 basis points and for government-guaranteed loans, zero basis points. Again, the Board did not exercise its discretionary authority to grant a lower rate for GSE-guaranteed loans.

A 1996 amendment to the Act requires the Corporation to establish reserves accounts 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 secure base amount, the Corporation is to segregate any excess balances into these allocated insurance reserves accounts. In 1999, the Corporation's Board adopted 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 amount in the unallocated Insurance Fund exceeds the 2 percent secure base target, the statute requires the Corporation to recalculate the secure base amount on an average daily balance basis and compare that amount with the year-end Insurance Fund balance adjusted downward by the Corporation's estimated expenses for the following year. At year-end 2003, this resulted in the transfer of $39.89 million to the AIRAs. The amount was allocated as follows:

FAC Stockholders	(10%)	$ 3.99 million
Farm Credit System Banks	(90%)	$ 35.90 million

The AIRA balances are recorded as part of the Insurance Fund until approved for payment by the Corporation's Board. The statute provides that amounts in the AIRAs may not be paid prior to April 2006 (eight years after the Insurance Fund first attained the secure base amount). The Corporation's Board of Directors has discretion to adopt a later payment cycle. AIRA balances may be used to absorb any insurance losses and claims.

Furthermore, the Board of Directors has discretion to limit or restrict the AIRA payments. In accordance with the Corporation's policy statement, any AIRA balances do not count in measuring the Insurance Fund's compliance with the secure base amount. No AIRA payments were made during 2006.

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

The 1987 Act required that the FCA charter the Farm Credit System Assistance Board (Assistance Board) and the FAC (see Note 1) to carry out a program of financial assistance to the Farm Credit System. In order to raise funds to provide this assistance, the FAC had the authority to issue debt obligations with a maturity of 15 years. During 1988 to 1992, the FAC issued $1.261 billion in bonds. These funds were used to provide assistance to certain System banks experiencing financial difficulty and for other statutorily authorized purposes. From 1998 through 2004, $936 million in FAC bonds were retired, leaving one remaining issue of $325 million outstanding which matured and was repaid on June 10, 2005. Repayment of the remaining FAC bond in accordance with the Act was provided for by the FAC Trust Fund, FAC Assistance Fund and the Insurance Corporation. See Insurance Obligation below.

Insurance Obligation

On June 10, 2005, the FAC repaid its remaining outstanding issue of $325 million. Funding for the payment was provided as follows:

FAC Trust Fund	$ 80 million
FAC Assistance Fund	$ 14 million
FCSIC	$ 231 million
	$ 325 million

Other Financial Assistance Provided to System Institutions

From 1988 to 1998, the U.S Treasury paid interest on certain FAC bonds totaling $440 million. The 1992 Amendment to the Act expanded the potential uses of the Trust Fund to satisfy System institution defaults on the principal and interest of other FAC obligations and required System banks to make annual annuity payments to the FAC to provide funds for the retirement of the Treasury-paid interest at maturity. The Corporation was required to satisfy defaults on the annual payments to the FAC to permit the repayment of Treasury-paid interest. System banks repaid Treasury for this obligation on June 10, 2005 as required.

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.

Note 6—Operating Lease

On October 21, 2003, 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 $122,181 for 2007, $123,262 for 2008 and $124,344 for 2009. The Corporation recorded lease expense (including operating cost assessments) of $139,007 and $122,245 for 2006 and 2005, respectively.

Note 7—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 $17,530 at December 31, 2006 and $28,250 at December 31, 2005. The Corporation purchased services for 2006 which totaled $64,938 compared with $109,589 for 2005.

The Corporation provides assistance to the FCA under the same Interagency Agreement, recognizing revenue in 2006 of zero and in 2005 of $1,125. At December 31, 2006, and 2005, the Corporation did not have any receivables from the FCA.

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Income and Expenses

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

	Income		Expenses		Net Income
	Premiums	Investment	Provision for Insurance Obligations	Administrative and Operating Expenses	Changes in Insurance Fund
1989	$ 65,000	$ 16,041	$ 0	$ 118	$ 8,923
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

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.

Corporate Staff

Dorothy L. Nichols	Chief Operating Officer
Alan J. Glenn	Director of Risk Management
C. Richard Pfitzinger	Chief Financial Officer
James M. Morris	General Counsel
Phyllis Applebaum	Financial Analyst
William Fayer	Financial Analyst/Asset Assurance Manager
Gary Stover	Financial Analyst
Pam Ngorskul	Accountant
Anna Lacey	Administrative Specialist
Molly Sproles	Clerical Assistant

Contact Information

Copies of Farm Credit System Annual Reports to Investors and Quarterly and Annual Information Statements may be obtained from:

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

Copies of the Annual Performance and Accountability Reports of the Farm Credit Administration and of 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
McLean, VA 22102
703-883-4056