

2002 Annual Report



A Decade of Growth, Stability & Progress

FARM CREDIT SYSTEM INSURANCE CORPORATION

Mission Statement

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

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

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May 19, 2003

Gentlemen:

In accordance with the provisions of section 5.64(a) of the Farm Credit Act of 1971, as amended, the Farm Credit System Insurance Corporation is pleased to submit its annual report for calendar year 2002. The Corporation began operations in 1993 and last year successfully completed its first decade of serving investors in agriculture and rural America.

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 Farm Credit System debt securities. The balance in the Insurance Fund at December 31, 2002, was \$1.64 billion. The Corporation collected \$26 million in insurance premiums from Farm Credit System banks for 2002, and expects to incur \$2.3 million in operating costs in 2003.

Sincerely,

A handwritten signature in black ink, appearing to read "Doug Flory". The signature is written in a cursive, flowing style with a large initial "D".

Douglas L. "Doug" Flory
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 (Corporation or FCSIC) is managed by a three-member board of directors composed of the members of the Farm Credit Administration (FCA) Board. The FCA is the independent Federal agency responsible for the regulation and examination of the Farm Credit System (System), a nationwide financial cooperative that lends to agriculture and rural America. The Chair of the Corporation's Board of Directors must be an FCA Board Member other than the Chair of the FCA Board.

Douglas L. "Doug" Flory,

Chairman of FCSIC, was appointed to the three-member FCA Board by President Bush on August 1, 2002, for a term that expires October 13, 2006. He also serves as a Member of the Board of Directors of the Corporation and was elected Chairman on December 4, 2002.

Mr. Flory brings to his position extensive experience in production agriculture, agribusiness, and both commercial bank and Farm Credit lending. His own farming operation includes Bunker Hill Farm, where he annually produces some 120,000 tom turkeys. He also is half-owner of S & F, L.L.C., a general livestock, grain, and hay farm of 1,600 owned and leased acres in Augusta County, Virginia. Before his appointment to the FCA Board, Mr. Flory was a member of the board of directors of AgFirst Farm Credit Bank in Columbia, South Carolina,

and a director of Farm Credit of the Virginias, ACA.

Mr. Flory was executive vice president of Dominion Bank from 1971 to 1988, and president, CEO, and director of Dominion Farm Loan Corporation. During his banking career, he chaired the Virginia Bankers Association Committee on Agriculture and was a member of the Executive Committee of the American Bankers Association's agricultural division. From 1989 to 1992 he was executive vice president, chief operating officer, and a member of the board of WLR Foods, Inc., a publicly traded poultry food company (which is now part of Pilgrim's Pride). Having also served on several governing boards for the State of Virginia, Mr. Flory was appointed to the Virginia Agricultural Council, a state advisory board, and the Virginia Agriculture Credit

Committee, which he chaired. He also served as chairman of the Virginia Agricultural Development Authority, which uses "aggie bonds" to finance Virginia farmers.

Throughout his career, Mr. Flory has been an active participant in agricultural industry associations. He was president of the Virginia Turkey Association and president and director of the Rockingham County Fair Association. He also served as a director of the Virginia Poultry Federation, the Virginia Agribusiness Council, the Virginia Beef Cattle Association, and the Virginia Sheep Association. A native of Augusta County, Virginia, Mr. Flory attended Bridgewater College in Bridgewater, Virginia, and earned a bachelor's degree from Virginia Polytechnic Institute and State University in Blacksburg. He did graduate work at James Madison University

and is a graduate of the Maryland-Virginia School of Bank Management at the University of Virginia. He and his wife, Avery, are the parents of two daughters and a son. ■



■ BOARD OF DIRECTORS

Michael M. Reyna

became a member of the Corporation's Board in October 1998 and served as Chairman from November 1998 to January 2000, when he was appointed by President Clinton as the Chairman of the Farm Credit Administration.

Prior to joining the Board, he served as President Clinton's director of USDA Rural Development (formerly known as Farmers Home Administration) in California from November 1993 to October 1998.

In this capacity, Mr. Reyna was responsible for growing and managing a diversified portfolio of housing, business, and infrastructure loans totaling more than \$2.6 billion. He implemented a number of significant initiatives in California on behalf of the Clinton-Gore Administration, including the Northwest Economic Adjustment Initiative, the Rural Empowerment Zone-Enterprise Community program, the AmeriCorps program, and several

Reinventing Government Initiatives.

Previously, Mr. Reyna served for 11 years as a principal advisor to the California State Legislature, working on financial service industry regulation and a wide range of issues including housing, economic development, local government finance, and political reform. He was also an appointed member of several local commissions, including the Sacramento City Planning Commission, of which he served as Chairman in 1993. While serving as a private consultant to the Texas 2000 Project, an initiative of the Governor's Office of Budget and Planning, he developed and implemented a computer-based simulation model of the Texas economy, which estimated employment and population trends through the year 2000.

Mr. Reyna holds a bachelor's degree in business administration

from the University of Texas at Austin and a master's degree in public policy and administration from the LBJ School of Public Affairs at the University of Texas. He and his wife, Karen, have two sons. ■



Nancy C. Pellett

was appointed to the FCA and FCSIC Boards by President George W. Bush on November 14, 2002, for a term that expires May 21, 2008. Ms. Pellett brings extensive experience in production agriculture and agribusiness to her position on the Board. For 23 years she was vice president and secretary of Prairie Hills, Ltd., a feedlot, cow-calf, and row crop operation in Atlantic, Iowa. She was president and treasurer of Fredrehsen Farms, Ltd., a family-owned swine and row crop operation in Walnut, Iowa, for more than 20 years.

A long time leader in the beef industry, Ms. Pellett has held state and national leadership positions in a range of cattlemen's industry organizations. As a member of the National Cattlemen's Beef Association she served as the Chairman of the Check-Off Division, Chairman of the Consumer Marketing Group, and most recently as a member of the Cattlemen's Beef Board.

She also served as President of the Iowa Beef Industry Council. Ms. Pellett was a partner in Premium Quality Foods, Inc., based in Red Oak, Iowa, which markets branded fresh beef and pre-cooked beef entrees. She served as president and director of consumer marketing 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 currently 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.

Ms. Pellett's dedication to the future of agriculture is reflected in her personal

involvement with 4-H and Future Farmers of America at the local and state levels. She has served on the Iowa 4-H Foundation Board and is a founding member of the 4-H/FFA "Sale of Champions" Committee for the Iowa State Fair.

A native of Walnut, Iowa, Ms. Pellett holds a B.S. from ISU at Ames. She is also Past President of the ISU Alumni Association, and was awarded the Alumni Medal in 1987. The Pellett family was honored as "Family of the Year" by the University in 1997. The family also received the "Friends of Youth Award" in 2000 from the Knights of AkSarBen, a foundation supporting education, youth programs, and rural development in Nebraska and western Iowa. She and her husband have four children. Together with a son and daughter-in-law, Ms. Pellett and her husband operate a fifth generation family farm in Atlantic, Iowa. ■



A Decade of Growth,



This year marks the completion of the Corporation's first ten years of full operations. Its primary purpose is to ensure the timely repayment of debt securities sold to investors on behalf of Farm Credit System banks. The insurance program helps the System maintain a dependable source of financing for agricultural borrowers. The Corporation was established by the Agricultural Credit Act of 1987. Congress authorized a

five-year phase-in period before full operations began on January 1, 1993, allowing the Corporation time to build its new organization, policies, and the Insurance Fund.

The Corporation began collecting insurance premiums from System banks in January 1991. Starting in January 1993, the Insurance Fund became available for payment on System obligations if a System bank defaulted on its primary liability. Also at that time,

Congress authorized the Corporation to provide financial assistance to reduce the Insurance Fund's exposure to losses. ■

1988



■ The Corporation is established, making each System bank an insured bank.

1989

■ Funds totaling \$260 million are transferred from a revolving fund to the Farm Credit Insurance Fund and invested in US Treasury securities.

1990

■ The Corporation enters into an agreement with the banks of the Farm Credit System to provide funds to the Farm Credit System Financial Assistance Corp. to retire certain bonds that assisted the closing of the Federal Land Bank of Jackson, Mississippi.



Stability & Progress

Then and Now

Over the past ten years, both the Corporation and the System grew significantly in their financial strength. Today, their combined capital and reserves provide enhanced protection to investors who purchase the System's obligations. Since 1993, the Insurance Fund increased 236 percent, from \$488 million to \$1.64 billion. In the same period, System capital – the front line defense for investors – grew 250 percent. Also, by yearend 2002, a majority of the System capital was composed of retained

earnings. For example, earned surplus as a percentage of total assets increased from 6.5 percent to 12.5 percent over the decade.

Today, the operating stability of the System is also vastly improved. In 1993, 65 institutions, holding more than 50 percent of the System's assets, were under some form of regulatory enforcement action. Now, no System institution operates under an enforcement action. In 1993, two of the System's 14 banks were operating with

financial assistance. Presently there are no outstanding financial assistance agreements. As a final sign of its recovery from the past period of financial stress, the System is providing for the retirement of all remaining financial assistance in 2005. ■

1991

- The Board of Directors adopts an investment policy for the Insurance Fund.
- Regulations governing the collection of premiums to build the Insurance Fund are adopted.
- System banks pay the first insurance premiums of \$66.5 million for 1989 and \$73.4 million for 1990.

1992

- A risk management system to monitor FCS institutions is developed and implemented.
- A plan for operating and managing receiverships is developed.
- Management of assistance agreements for the Farm Credit Banks of Louisville and Spokane are transferred to the Corporation from the Farm Credit System Assistance Board, which terminates December 31, 1992.
- Congress grants the Corporation back-up authority to examine System institutions.



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■ INSURANCE CORPORATION SELECTED FINANCIAL STATISTICS



| (\$ in millions) | 2002 | 2001 | 2000 |
|--|----------|----------|----------|
| Total Assets | \$ 1,839 | \$ 1,718 | \$ 1,626 |
| Total Liabilities | 196 | 183 | 171 |
| Insurance Fund Balance | 1,643 | 1,535 | 1,455 |
| OPERATIONS: | | | |
| Revenues | 123.0 | 94.1 | 93.8 |
| Operating Expenses | 1.9 | 2.1 | 1.8 |
| Insurance Expense | 13.6 | 11.9 | 11.1 |
| Net Income | 107.5 | 80.1 | 80.9 |
| Insurance Fund as a Percentage of Adjusted Insured Debt | 1.92% | 1.98% | 1.98% |



1993

- The Corporation's first full year of operation.
- First payout of insurance claims takes place when claimants at the Richmond, Texas PCA are paid \$1.2 million for eligible borrower stock.
- The Farm Credit Bank of Louisville retires its financial assistance early. The Federal Intermediate Credit Bank of Jackson, merges successfully without the need for financial assistance from the Fund.

1994

- The Board of Directors adopts a reserve policy that focuses on potential losses to the Insurance Fund resulting from payment on insured obligations or financial assistance.
- The Corporation endorses the System's Market Access Agreement, a self-policing mechanism that established financial thresholds intended to stop a troubled System bank from borrowing in the debt market.
- The remaining open assisted bank, the Farm Credit Bank of Spokane, provides for the early repayment of its financial assistance.



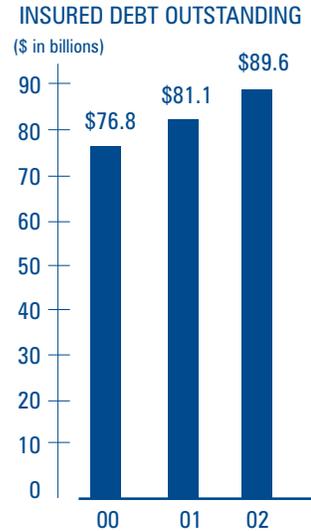
INVESTOR PROTECTION AND THE FARM CREDIT SYSTEM

The Corporation's primary purpose, as defined by the Farm Credit Act of 1971 (referred to in this report as "the Act"), is to ensure the repayment to investors who purchase the bonds and notes issued by the System's banks. Investors provide the funds the System lends to agriculture and rural America.

Below are selected financial statistics for the Farm Credit System on a combined basis.

Farm Credit System Statistics

| (\$ in billions) | 2002 | 2001 | 2000 |
|---|----------------|----------------|----------------|
| Insured Debt Outstanding | \$ 89.6 | \$ 81.1 | \$ 76.8 |
| Farm Mortgage Loans | 43.5 | 37.7 | 34.0 |
| Agricultural Production Loans | 20.5 | 20.0 | 17.5 |
| Loans to Agricultural Cooperatives | 8.9 | 8.6 | 9.5 |
| International Loans | 3.1 | 2.8 | 2.5 |
| Loans to Rural Utilities | 7.7 | 7.3 | 6.3 |
| Rural Home Loans | 2.3 | 2.6 | 2.0 |
| Net Income | 1.77 | 1.79 | 1.42 |
| Nonperforming Assets as a percentage of Loans and Other Property | 1.3% | 1.2% | 1.2% |
| Surplus (excluding Insurance Fund) as a percentage of Total Assets | 12.5% | 12.5% | 12.0% |



1995



■ An insurance risk simulation model is implemented to evaluate the adequacy of the 2 percent secure base amount.

■ Corporation management negotiates changes to the investment policy of the Financial Assistance Corporation (FAC) Trust Fund. By restructuring the Trust Fund's investment strategy into longer term investments, these changes allow the Corporation to

significantly reduce its estimate of the present value of the Corporation's insurance liability to the FAC. The Corporation will also benefit from the termination of the receivership for the Federal Land Bank of Jackson as remaining funds are transferred to the FAC. As a result of these two initiatives, the Corporation will reduce its provision for insurance liabilities by more than \$14 million for the year.

■ The Board of Directors adds additional screening tools to enhance the reserve policy adopted in 1994.



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■ STRATEGIC GOALS AND PERFORMANCE MEASURES

The Farm Credit System is the only Government-Sponsored Enterprise (GSE) with an insurance fund that provides extra protection for investors who purchase its debt. Sound management of this fund has enabled the Corporation to operate efficiently and grow over time, while continuing to develop and upgrade its systems and processes to remain current in a changing environment.

The Corporation established three broad goals with performance measures to evaluate the effectiveness of its operations:

- **Manage the Insurance Fund to maintain the 2 percent secure base amount**

To maintain the secure base, the Corporation assesses insurance premium rates as necessary. Rates were reviewed twice in 2002. Throughout most of the year, the secure base amount ranged from 1.92 to 1.98 percent, and finished the year at 1.92 percent.

The Corporation's goal is to achieve an investment return on fund assets comparable with its peer group of Treasury Bond Funds. The Corporation's average investment yield in 2002 was 5.39 percent compared to 3.38 percent for the Treasury Funds.

- **Detect, evaluate, and manage risks to the Insurance Fund**

The Corporation proactively screens all institutions to detect risk and identify institutions that may require special examinations. There were no special examinations required in 2002.

The need for potential insurance loss allowance was evaluated on a quarterly basis. Legislative, judicial, regulatory, and economic developments affecting insurance risk were monitored regularly. The Corporation continued to monitor trends in the System's structure and activities, and completed special analyses of new forms of capital and derivatives last year.

- **Maintain the capability to manage receiverships and/or conservatorships**

The Corporation may provide assistance to System institutions to prevent default, restore normal operations, or facilitate a merger or consolidation. Additionally, when appointed by FCA, the Corporation is responsible for serving as receiver or conservator for System institutions.

Management goals are to: 1) complete the processing of 90 percent of all claims within a specified period, and 2) achieve operating costs and asset recovery rates comparable to other Federal insurers. Corporate readiness is maintained through periodic training of personnel to ensure they remain proficient in the performance of receivership responsibilities. No active receiverships or conservatorships existed in the Farm Credit System in 2002.

1996

■ The Farm Credit System Reform Act grants the Corporation the flexibility to reduce insurance premiums before reaching the 2 percent secure base amount; allows refunds of excess insurance balances; adds a cost test to the requirements for assistance and new oversight authority on debt issuance by troubled banks.



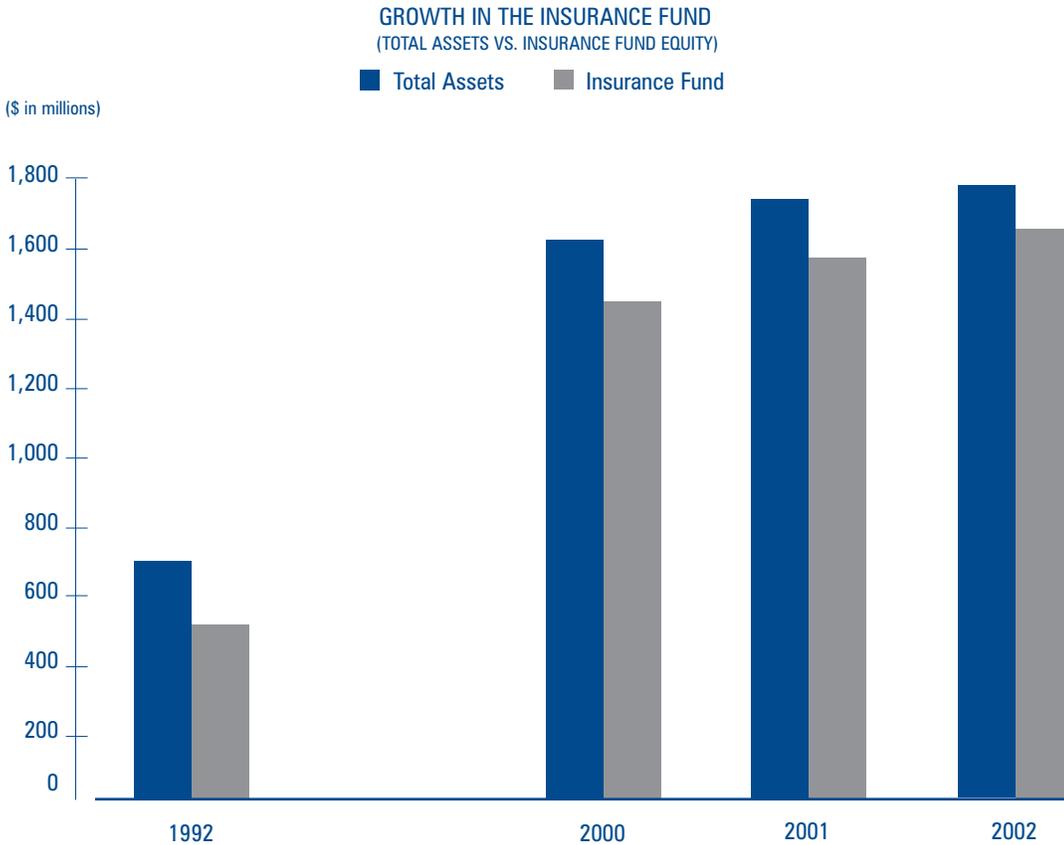
■ The Board of Directors approves a major revision to the investment policy, dividing the portfolio into a short-term liquidity pool and long-term investment pool so the Corporation can purchase a ladder of maturities up to 10 years and increase investment income.

■ A policy is adopted implementing new discretionary authority to reduce insurance premiums before reaching the statutory 2 percent secure base amount.

■ INSURANCE FUND MANAGEMENT

Growth in the Insurance Fund

In 2002, the Insurance Fund grew 7 percent to \$1.64 billion. The Fund represents the Corporation's equity – the difference between its total assets of \$1.84 billion and its total liabilities, including insurance obligations – of \$196 million.



1997

■ First receivership training session is held as part of a program to assure readiness.



■ The Corporation adopts a five-year Strategic Plan.

■ The Board of Directors revises the reserve policy on potential insurance loss exposure to include the more stringent capital ratios applied by the Farm Credit Administration to insured institutions.

■ Guidelines are adopted for special examinations to be used if a troubled System institution seeks assistance from the Insurance Fund.

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■ INSURANCE FUND MANAGEMENT

Revenues and Expenses

In 2002, net income increased 34 percent to \$108 million, up from \$80 million in 2001. Most of the increase resulted from the assessment of insurance premiums during the year. No insurance premiums were assessed in 2001.

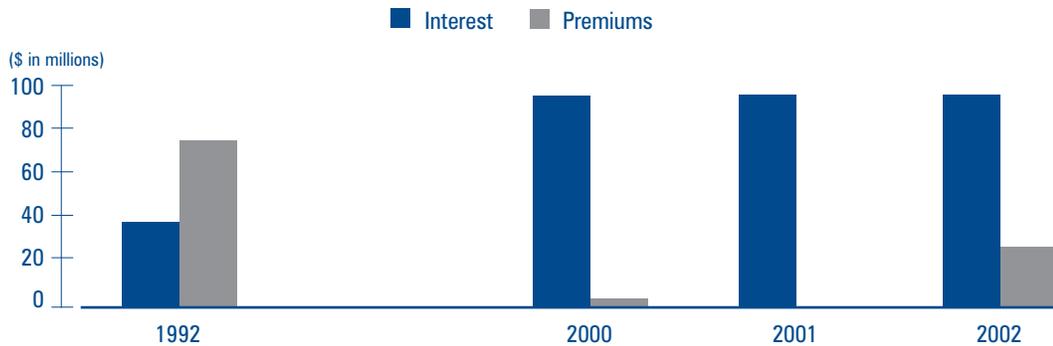
The mix of corporate revenues has changed over the past several years, with interest from investments rather than premiums now representing the primary source of the Fund's revenue. A decade ago, insurance premium assessments accounted for 67 percent of total revenue.

The Corporation operates with a small staff and contracts for specialized expertise when necessary. This approach keeps operating costs low and offers the flexibility to leverage resources.

In 2002, the Corporation's operating costs declined ten percent to \$1.9 million. As a percentage of assets, operating costs dropped from 0.13 in 2001 to 0.11 in 2002. Fixed costs for staff, travel, rent, and miscellaneous expenses were flat at \$1.5 million for the year. The remaining expenses of \$0.4 million were for contract services.

Insurance expenses increased to \$13.6 million from \$11.9 million in 2001. All of the increase was caused by the annual provision for the insurance liability to repay the Farm Credit System Financial Assistance Corporation (FAC) for assistance related bonds, which mature in 2005. (See Note 5 to the financial statements.)

CORPORATION REVENUES 1992-2002



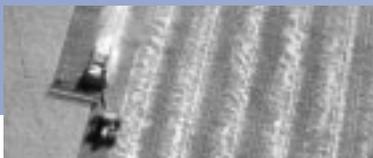
1998

FCSIC CHRONOLOGY

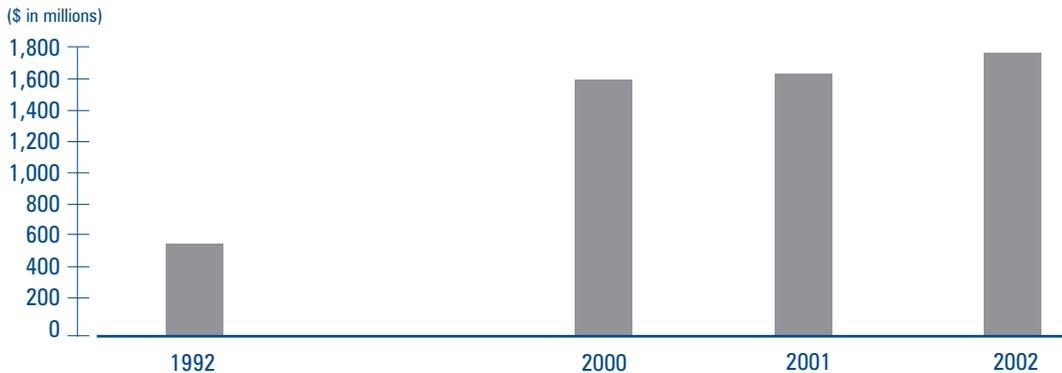
■ In the first quarter, the Insurance Fund attains its statutory secure base amount of 2 percent of insured debt outstanding (\$1.17 billion) for the first time in its history.

■ The System retires early a \$240 million issue of assistance bonds, reducing a significant corporate contingent liability.

■ A Memorandum of Understanding is executed with the Federal Deposit Insurance Corporation providing access to specialized contractor expertise.



GROWTH IN FCSIC INVESTMENT PORTFOLIO



Investments

The amount of investments and cash, which represents the Corporation's liquid resources for protecting investors, continued to grow in 2002. Total investments increased 6 percent during the year to \$1.78 billion at December 31, 2002.

The level of investments managed by the Corporation over the past ten years has grown significantly. At yearend 1992, investments totaled \$562 million. In the decade since, investments increased by more than 217 percent, rising by \$1.2 billion.

Funds are invested in U.S. Treasury securities in accordance with the Act and the Corporation's Investment Policy. The Policy's objective is to maximize returns consistent with the Corporation's liquidity needs and minimize exposure to loss of principal. The average portfolio yield for 2002 was 5.39 percent, down from 5.72 percent the prior year. The drop in investment yield resulted from the reinvestment of maturing investments in the lower interest rate environment that prevailed throughout the year.

The Corporation's investment strategy is to purchase a ladder of maturities and then hold the investments to maturity. The Investment Policy divides the portfolio into a liquidity pool and an investment pool. The purpose of the liquidity pool is to maintain some short-term investments while investing the balance of the portfolio in longer-term maturities of up to ten years.

1999

- In the second quarter, the Insurance Fund again reaches the secure base amount of 2 percent of adjusted insured debt outstanding.
- Corporate assets exceed \$1.5 billion.



- Web site is launched.
- Benchmarking of performance results against targeted Corporate Performance Measures is initiated.
- The System retires early a second issue of \$157 million of assistance bonds, further reducing a significant corporate contingent liability.
- After receiving public comment, the Board of Directors adopts a policy on allocated reserve accounts that explains how and when excess insurance funds may be refunded to System institutions.
- The Corporation holds a training exercise on liquidation preparedness to ensure that staff remains current on liquidation policies and procedures.

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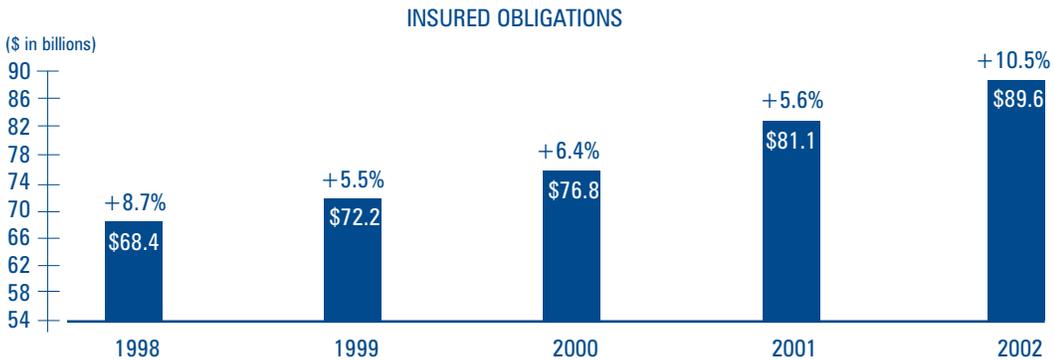
■ INSURANCE FUND MANAGEMENT

The following chart shows the balances and maturities of the liquidity pool and investment pool at December 31, 2002. The weighted average portfolio maturity at yearend was three years.

| | | INVESTMENT PORTFOLIO | |
|-----------------|-------------------------|----------------------|----------------|
| | | \$ in millions | % of portfolio |
| Liquidity pool | Two Years or Less | \$ 634 | 36 |
| Investment Pool | Two Years to Five Years | 917 | 51 |
| | Five Years to Ten Years | 233 | 13 |
| Total | | \$1,784 | 100% |

Insured and Other Obligations

The Corporation insures Systemwide and Consolidated notes, bonds, and other obligations issued under the Act. Insured obligations are issued to investors through the Federal Farm Credit Banks Funding Corporation on behalf of System banks. System banks enjoyed a favorable lending environment in 2002. Growth of insured debt outstanding accelerated last year by more than ten percent to \$90 billion. Insured debt outstanding since 1997 grew at an average annual rate of more than seven percent.



The statute requires the Corporation use the Insurance Fund to satisfy any defaults related to FAC-issued bonds and to ensure the retirement of eligible borrower stock. These obligations declined slightly in 2002, resulting from the continued retirement of eligible borrower stock. At yearend, eligible borrower stock outstanding at System institutions totaled \$36 million, down from \$44 million in 2001.

2000

FCSIC CHRONOLOGY

■ An insurance risk study of recent trends in agriculture and financial services is completed.

■ The System retires early a third issue of \$89 million of assistance bonds, further reducing a significant Corporate contingent liability.

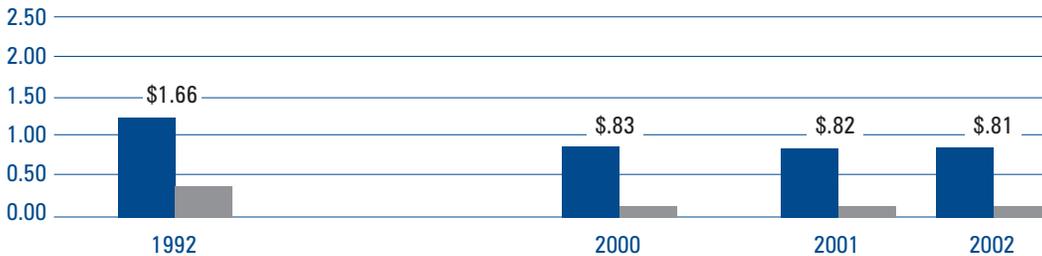
■ The investment policy is revised to eliminate the ceiling on the liquidity pool so larger amounts can be invested short term at higher rates.



OTHER OBLIGATIONS

■ FAC Assistance Bonds ■ Eligible Borrower Stock

(\$ in billions)



The remaining issues of FAC bonds outstanding mature in 2003 (\$450 million) and 2005 (\$325 million). System banks continued making annual payments to FAC to provide funds for the repayment of the remaining bonds. At December 31, 2002, the System had provided for the repayment of approximately \$346 million of the \$775 million of assistance bonds still outstanding. The funds for retirement of the remaining bonds will come from System banks, the FAC Trust Fund, and the Insurance Fund. The Corporation estimates its liability to FAC at December 31, 2002, was \$196 million. (See Note 5 to the financial statements.)

The Secure Base Amount

The secure base amount (SBA), as established by the Act, is 2 percent of all outstanding insured obligations or another percentage that the Board determines is actuarially sound.

The Insurance Fund began the year at 1.98 percent then declined to 1.92 percent as growth of insured debt accelerated. As the graph on the following page shows, the last time the Fund was at the 2 percent SBA was March 2001. The Board considered the lack of progress toward the secure base amount when it reviewed premium rates in September 2002.

Because the Insurance Fund has been below the secure base since early 2001 and because the System has experienced rapid growth, in September 2002 the Board of Directors approved an increase in insurance premiums beginning in January 2003. Premium rates for 2003 are 12 basis points on accrual loans and 25 basis points on nonaccrual loans. No premiums will be assessed on Federal or state government guaranteed loans.

2001

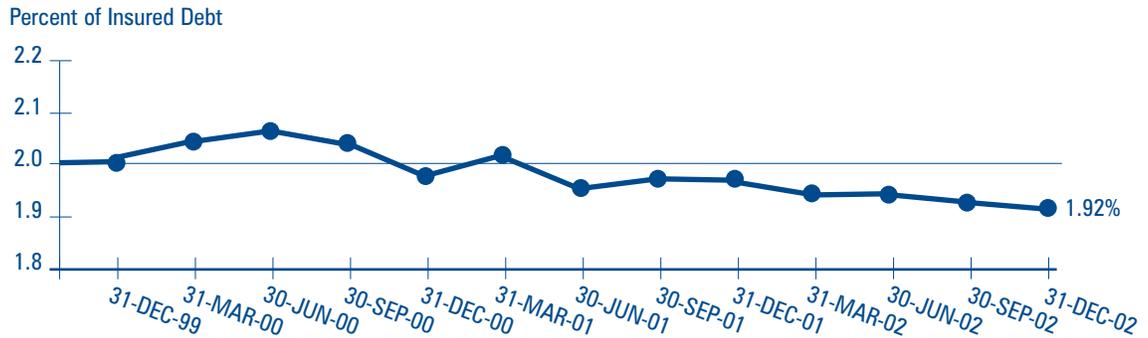
- The Board of Directors amends the reserve policy to streamline the definition of critical mass institutions that pose significant risk to the Insurance Fund.



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■ INSURANCE FUND MANAGEMENT

TREND OF INSURANCE FUND RELATIVE TO 2% SECURE BASE AMOUNT 1999-2002



Premium Assessment

The Board reviews the adequacy of premium assessments semiannually in September and March. Consideration is given to the interests of investors in System insured debt as well as the cost of premiums to System institutions.

Premiums may be assessed on four classes of loans:

- Accrual loans (non-government guaranteed balance) – from zero to 15 basis points
 - Nonaccrual loans – from zero to 25 basis points
 - Federal Government-guaranteed accrual loans – from zero to 1.5 basis points
 - State government-guaranteed accrual loans – from zero to 3 basis points
- (See Note 4 to the Corporation’s financial statements.)

During 2002, Congress amended the Farm Credit Act to provide the Corporation’s Board with additional discretion on setting premiums. The premium authority was changed to allow reductions in insurance premium rates on loans guaranteed by Government-Sponsored Enterprises.

Five factors are considered in setting premium rates:

- Level of the Insurance Fund relative to the secure base amount
- Projected losses to the Insurance Fund
- Condition of the System
- Health of the agricultural economy
- Risk in the financial environment

2002

■ The Corporation completes 10 years of operations highlighted by continued growth in the Insurance Fund.



■ The System revises the financial performance standards in the Contractual Interbank Performance Agreement (CIPA) to conform to changes in Standard & Poor’s criteria for rating commercial banks’ debt securities. These changes strengthen the protection for investors by raising the financial standards for System banks.

■ RISK MANAGEMENT

The Corporation's program to identify and manage risk to the Insurance Fund minimizes the Fund's exposure to potential losses through early detection. Special examination procedures are used, as needed, to evaluate the condition of weaker System institutions. FCA examination staff perform the majority of the fieldwork for these examinations on a reimbursable basis. The Corporation also assesses risk to the Insurance Fund through:

- Ongoing review and analysis of the financial condition of System institutions
- Operation of analytical models
- Review of corporate actions approved by FCA for System institutions
- Serving as a nonvoting participant on FCA's Regulatory Enforcement Committee

The Corporation also monitors the development of legislative, judicial, regulatory, and economic trends that could affect insurance risk. During the year, the Corporation continued to monitor trends in the System's structure and activities, including consolidations and new forms of financing.

For 2003, the USDA forecasts increased net farm income compared to last year. However, the general economy remains fragile, and the outlook for U.S. agricultural trade volume remains uncertain due to strong export competition and the comparative strength of the U.S. dollar.

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.

When appointed by the FCA, the Corporation also has 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. At present, there are no active receiverships or conservatorships in the Farm Credit System. The Corporation conducts periodic training to help its personnel maintain proficiencies should they be called upon to perform receivership responsibilities.

■ Congress gives the Board of Directors discretion to lower premiums on loans guaranteed by a Government-Sponsored Enterprise.





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Report of Independent Accountants

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 the Farm Credit System Insurance Corporation (the "Corporation") at December 31, 2002 and 2001, 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 the 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, which 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.

As discussed in Note 2 to the financial statements, the Corporation changed its method of computing amortization of premiums and discounts on investments in 2002.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 6, 2003 on our consideration of the Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

February 6, 2003

**Report of Independent Accountants on Compliance and on Internal Control Over
Financial Reporting 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 the Farm Credit System Insurance Corporation (the "Corporation") as of and for the year ended December 31, 2002, and have issued our report thereon dated February 6, 2003. 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.

Compliance

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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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 assurance 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 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 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.

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



February 6, 2003

■ FINANCIAL STATEMENTS

FARM CREDIT SYSTEM INSURANCE CORPORATION

Statements of Financial Condition as of December 31, 2002 and 2001

(\$ in thousands)

| | 2002 | 2001 |
|---|---------------------|---------------------|
| ASSETS | | |
| Cash and Cash Equivalents | \$ 81,107 | \$ 2,849 |
| Investments in U.S. Treasury Obligations (Note 3) | 1,702,681 | 1,687,165 |
| Accrued Interest Receivable | 28,642 | 27,654 |
| Premiums Receivable (Note 4) | 26,355 | — |
| TOTAL ASSETS | \$ 1,838,785 | \$ 1,717,668 |
| LIABILITIES AND INSURANCE FUND | | |
| Accounts Payable and Accrued Expenses (Note 7) | \$ 261 | \$ 332 |
| Liability for Estimated Insurance Obligations (Note 5) | 196,077 | 182,434 |
| TOTAL LIABILITIES | 196,338 | 182,766 |
| Farm Credit Insurance Fund | 1,642,447 | 1,534,902 |
| TOTAL LIABILITIES AND INSURANCE FUND | \$ 1,838,785 | \$ 1,717,668 |

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

Statements of Income and Expenses and Changes in Insurance Fund for the Years Ended December 31, 2002 and 2001

(\$ in thousands)

| | 2002 | 2001 |
|---|--|---------------------|
| INCOME | | |
| Premiums (Note 4) | \$ 26,355 | \$ — |
| Interest Income | 93,499 | 94,112 |
| Other Income | 18 | 1 |
| | TOTAL INCOME | \$ 94,113 |
| EXPENSES | | |
| Administrative Operating Expenses (Note 7) | \$ 1,906 | \$ 2,127 |
| Provision for Estimated Insurance Obligations (Note 5) | 13,643 | 11,935 |
| | INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE | \$ 80,051 |
| Cumulative effect on prior years (to December 31, 2001) of changing to a different investment amortization method (Note 2) | \$ 3,222 | \$ — |
| | NET INCOME | \$ 80,051 |
| Farm Credit Insurance Fund, Beginning of Year | 1,534,902 | 1,454,851 |
| Farm Credit Insurance Fund, End of Year | \$ 1,642,447 | \$ 1,534,902 |

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

■ FINANCIAL STATEMENTS

FARM CREDIT SYSTEM INSURANCE CORPORATION

Statements of Cash Flows for the Years Ended December 31, 2002 and 2001

(\$ in thousands)

| | 2002 | 2001 |
|--|------------------|------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Income | \$ 107,545 | \$ 80,051 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| (Increase) Decrease in Premiums Receivable | (26,355) | 1,040 |
| (Increase) in Accrued Interest Receivable | (988) | (610) |
| Net Amortization and Accretion of Investments | 19,113 | 19,094 |
| Decrease in Other Receivables | — | 7 |
| (Decrease) Increase in Accounts Payable and Accrued Expenses | (71) | 133 |
| Increase in Liability for Estimated Insurance Obligations | 13,643 | 11,935 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 112,887 | 111,650 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Payments for Purchase of U.S. Treasury Obligations | (317,372) | (561,230) |
| Proceeds from Maturity of U.S. Treasury Obligations | 282,743 | 312,589 |
| Net Cash Used in Investing Activities | (34,629) | (248,641) |
| Net Change in Cash and Cash Equivalents | 78,258 | (136,991) |
| Cash and Cash Equivalents, Beginning of Year | 2,849 | 139,840 |
| Cash and Cash Equivalents, End of Year | \$ 81,107 | \$ 2,849 |

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

NOTES TO FINANCIAL STATEMENTS

FARM CREDIT SYSTEM INSURANCE CORPORATION

AS OF DECEMBER 31, 2002 AND DECEMBER 31, 2001

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, 2002, there were seven insured System banks and 103 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, 2002, for each of the components of the Corporation's insurance responsibilities were \$90 billion of insured obligations, \$775 million of FAC bonds (of which \$346 million in repayments have been provided for), and \$36 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.

■ NOTES TO FINANCIAL STATEMENTS

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, disclosure of contingent assets and liabilities, and the reported amount of revenues and expenses during the period covered. 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, 2002, the Corporation held \$81 million in overnight Treasury Certificates maturing on January 2, 2003, with an investment rate of 1.09 percent.

Investments in U.S. Treasury Obligations —

Section 5.62 of the Act requires that funds of the Corporation, not otherwise employed, 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 in 2002. Amortization of premium and accretion of discount was computed by the straight-line method in prior years. The new method was adopted to more precisely recognize interest income based on the effective yield of the investments. The effect of the change was to increase interest income by \$31,000 in 2002. The cumulative effect of this change for years prior to January 1, 2002 was \$3.2 million and is shown in the accompanying statements of income and expense in 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 primary lending markets for insured System banks are borrowers engaged in farming, ranching, and the 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 and have a material effect on the liability for estimated insurance obligations.

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

Retirement Plan — All permanent Corporation employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The Corporation's contribution to the CSRS plan during 2002 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 \$129,271 in 2002 and \$122,782 in 2001.

■ NOTES TO FINANCIAL STATEMENTS

Note 3 — Investments

At December 31, 2002 and 2001, investments in U.S. Treasury obligations consisted of the following:

(\$ in thousands)

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
|--------------------------|---------------------------|---------------------------------------|--|---------------------------------------|
| December 31, 2002 | | | | |
| U.S. Treasury Notes | \$ 1,702,681 | \$ 125,398 | — | \$ 1,828,079 |
| December 31, 2001 | | | | |
| U.S. Treasury Notes | \$ 1,687,165 | \$ 69,565 | (\$ 2,684) | \$ 1,754,046 |

The amortized cost and estimated market value of U.S. Treasury obligations at December 31, 2002, by contractual maturity, are shown below.

(\$ in thousands)

| | Amortized Cost | Estimated Market Value |
|--|---------------------------|-----------------------------------|
| Due in one year or less | \$ 260,799 | \$ 267,777 |
| Due after one year through five years | 1,208,469 | 1,313,802 |
| Due after five years through ten years | 233,413 | 246,500 |
| | \$ 1,702,681 | \$ 1,828,079 |

Note 4 — Premiums, the Secure Base 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 four 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 from zero to 0.0015 percent; (2) average annual nonaccrual loans outstanding may be from zero to 0.0025 percent; (3) average annual portions of Federal Government-guaranteed accrual loans may be from zero to 0.00015 percent; and (4) average annual portions of state government-guaranteed accrual loans may be from zero to 0.0003 percent.

Insurance premium rates for 2002 were set at the Board's September 2001 meeting at 3 basis points for accrual loans, 25 basis points for non-accrual loans, and zero for Federal and state government guaranteed loans. The Board again reviewed premiums at its

March 2002 meeting and left premium rates unchanged. Due to accelerating growth in insured debt outstanding, the Board increased the insurance premium rate on accrual loans to 12 basis points beginning January 1, 2003, and left rates unchanged on nonaccrual loans at 25 basis points.

Insurance premium rates are reviewed semiannually in March and September. In May 2002, Congress amended the Farm Credit Act to provide the Corporation's Board with discretionary authority to reduce premium rates on certain loans that are guaranteed by Government-Sponsored Enterprises (GSEs). The Board decided not to exercise this new authority at its September meeting.

The Act sets a base amount for the Insurance Fund to achieve. The statutory secure base amount is equivalent to 2 percent of the aggregate outstanding insured obligations of all insured System banks (adjusted downward by a percentage of the guaranteed portions of principal outstanding on Government-guaranteed loans in accrual status) or such other percentage as determined by the Corporation, in its sole discretion, to be actuarially sound. When the amount of the Insurance Fund exceeds the secure base amount, the Corporation is required to reduce the premiums, but it still must ensure that reduced premiums are sufficient

■ NOTES TO FINANCIAL STATEMENTS

to maintain the level of the Insurance Fund at the secure base amount.

Due to growth in insured obligations during the year, the Insurance Fund was below the secure base amount during 2002. At December 31, 2002, the Insurance Fund was 1.92 percent of adjusted insured obligations outstanding.

A 1996 amendment to the Act requires the Corporation to establish reserve accounts for each System bank and an account for the stockholders of the FAC. If at the end of any calendar year the Insurance Fund is at the secure base amount, the Corporation is to segregate any excess balances into these allocated insurance reserve accounts (AIRAs). In 1999, the Corporation's Board adopted a Policy Statement on the Secure Base Amount and Allocated Insurance Reserve Accounts, which provides guidelines for implementing this statutory authority. At December 31, 2002, because the Insurance Fund was below the 2 percent secure base amount, there were no excess balances to allocate.

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 \$1.26 billion in bonds. These funds were used to provide assistance to certain System banks experiencing financial difficulty and for other statutory authorized purposes.

Financial Assistance to Certain System Banks

During the period from 1988 to 1992, assistance was provided to four open banks through the purchase by the FAC of \$419 million in preferred stock issued by these institutions. Similar assistance totaling \$374 million was provided to the Federal Land Bank of Jackson in Receivership to facilitate its closing and liquidation. Subject to Assistance Board approval, these assistance funds were used by the FAC to purchase preferred stock issued by institutions experiencing financial difficulty.

Prior to the maturity of the related 15-year debt obligations, each institution can redeem its preferred stock pursuant to Section 6.26 of the Act, so as to allow the FAC to pay the principal of the maturing obligation. While an institution that issues preferred stock to the FAC is primarily responsible for providing funds for payment of the FAC

bonds (through redemption of the preferred stock purchased with the proceeds of the FAC bonds), the institution may be prohibited from redeeming, or may elect not to redeem, the preferred stock pursuant to section 6.26 of the Act. If this occurs, the FAC must then use funds from its trust fund, to the extent available, to retire the debt. The FAC Trust Fund (Trust Fund) represents the funds received from System institutions' purchase of stock in the FAC. The Trust Fund totaled approximately \$131 million and \$123 million at December 31, 2002 and 2001, respectively. If the Trust Fund is not sufficient to retire the debt, the Corporation must then purchase preferred stock from the FAC to provide funds to retire such debt. If the Corporation does not have sufficient funds, the U.S. Treasury must retire the debt. If this should occur, the Corporation is required to repay the U.S. Treasury as funds become available from the payment of premiums. At December 31, 2002, the only preferred stock held by the FAC was associated with the assistance provided to the Federal Land Bank of Jackson.

On May 20, 1988, the FCA placed the Federal Land Bank of Jackson and the Federal Land Bank Association of Jackson in receivership (collectively the FLBJR) and appointed a receiver to liquidate their assets. As of April 27, 1990, the FCA, the Receiver of the FLBJR, the FAC, the System banks, the Assistance Board, and the Corporation entered into an agreement which called for

the FAC to issue 15-year U.S. Treasury-guaranteed bonds to purchase preferred stock in the FLBJR. Upon the maturity in 2005 of the FAC bonds used to purchase preferred stock in the FLBJR, the Corporation will provide funds to repay the principal of these debt obligations, to the extent that the Trust Fund is not sufficient for such purpose. In January 1995, the FLBJR was terminated by the FCA and the receiver was discharged after transferring the remaining receivership assets to the FAC.

Estimated Insurance Obligation

The Corporation estimated the present value of its liability to provide funds for payment of the \$374 million non-callable 15-year maturing debt to be approximately \$196 million and \$182 million at December 31, 2002 and 2001, respectively. This liability is reflected in the accompanying statements of financial condition. The present value of this obligation is based on a discount rate of seven percent to maturity, which was established at the time this liability was originally recorded. In accordance with SFAS No. 107, the fair value of this liability has been estimated by management using discount rates based upon U.S. Treasury securities of similar durations (1.7 percent for 2002 and 4.0 percent for 2001). The fair value was approximately \$222 million and

■ NOTES TO FINANCIAL STATEMENTS

\$200 million as of December 31, 2002 and 2001, respectively. Provisions for changes in the Corporation's liability are reflected in the statements of income and expenses in the amount of \$13.6 million and \$11.9 million for the years ended December 31, 2002 and 2001, respectively.

The Corporation cannot predict the effects of future events upon System operations and upon the amount of the Trust Fund that will ultimately be available to reduce the Corporation's liability for FLBJR-related FAC bonds. The Corporation will annually reassess the likelihood of earlier use of the Trust Fund, changes in Trust Fund earnings, and other assumptions underlying its estimate of the liability for FLBJR-related FAC bonds.

Other Financial Assistance Provided to System Institutions by the FAC

The Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 Act) expanded the Corporation's responsibility to insure defaults by System institutions on payments related to other assistance funded by FAC bonds. These FAC bonds, aggregating \$454 million, were issued to pay System Capital Preservation Agreement accruals, retire eligible borrower stock of certain liquidating System institutions, and

pay the operating expenses of the Assistance Board.

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

The 1992 Act expanded the potential uses of the Trust Fund to satisfy System institution defaults on the principal and interest of other FAC obligations. It also required System banks to make annual annuity payments to the FAC to provide funds for the retirement of the Capital Preservation Agreement-related FAC bonds aggregating \$417 million and Treasury-paid interest at maturity. The Corporation is additionally required to satisfy defaults on the annual payments to the FAC to permit the repayment of Treasury-paid interest. During 1992 through 2002, all System banks made

their annual annuity payments as scheduled. The Corporation is not aware of any events or circumstances which will prevent System banks from meeting their FAC obligations.

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

Early Redemption of Certain FAC Bonds

In November 1998, April 1999, and September 2000, System banks provided the necessary funds to allow the FAC to call and retire early \$486 million of the \$1.26 billion in FAC bonds issued during 1988 to 1992 (see paragraph 1, Note 5). Repayment of the remaining FAC bonds in accordance with the Act is being provided for by System banks and the Insurance Corporation.

Note 6 — Operating Lease

On November 20, 1997, the Corporation executed a new 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 \$98,134 for 2003. The Corporation recorded lease expenses (including operating cost assessments) of \$103,855 and \$99,175 for 2002 and 2001, respectively.

Note 7 — Related Parties

The Corporation purchases services from the FCA under an Inter-Agency Agreement. These include examination and administrative support services. The Corporation had payables due to the FCA of \$1,650 at December 31, 2002, and \$100,350 at December 31, 2001. The Corporation purchased services for 2002, which totaled \$64,926, compared with \$535,075 for 2001. Included in 2001 purchased services was \$350,000 for reimbursement of conversion costs incurred by the FCA in implementing a new financial management system that FCA used to provide accounting services to the Corporation. The Corporation provided assistance to the FCA under a related Inter-Agency Agreement, recognizing revenue in 2002 of \$17,793 and in 2001 of \$1,106. At December 31, 2002, and 2001, the Corporation had a receivable from the FCA of zero and \$369, respectively.

■ NOTES TO FINANCIAL STATEMENTS

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 | — | \$ 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 |

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 of 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

| | |
|------------------------------|------------------------------------|
| Mary Creedon Connelly | <i>Chief Operating Officer</i> |
| Dennis M. Pittman | <i>Director of Risk Management</i> |
| Alan J. Glenn | <i>Chief Financial Officer</i> |
| Dorothy L. Nichols | <i>General Counsel</i> |
| C. Richard Pfitzinger | <i>Asset Assurance Manager</i> |
| Phyllis Applebaum | <i>Financial Analyst</i> |
| William Fayer | <i>Financial Analyst</i> |
| Pam Ngorskul | <i>Accountant</i> |
| Anna Lacey | <i>Administrative Specialist</i> |
| Molly Sproles | <i>Clerical Assistant</i> |

REFERENCES

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 may be obtained from:

**Office of Congressional and
Public Affairs**
Farm Credit Administration
1501 Farm Credit Drive
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