



June 12, 2014

To: Chairman, Board of Directors
Chief Executive Officer
Each Farm Credit System Institution

From: Kenneth A. Spearman *KAS*
Chairman

Subject: Mid-Year 2014 Premium Review

Insured debt reported by the Federal Farm Credit Banks Funding Corporation through May 31, 2014 was \$210.9 billion, up from \$206.9 billion at year-end 2013. Using preliminary results, at May 31, 2014 the Farm Credit Insurance Fund (Insurance Fund) was 1.96 percent of adjusted insured debt or \$82 million below the 2 percent secure base amount (SBA) (See Attachment A).

Based on our May survey of System institutions, we anticipate growth in insured debt of 5 to 7.5 percent in 2014, which is slightly higher than the growth range projected by System institutions in December 2013. Nevertheless, the Board of Directors is maintaining the insurance premium assessment rate on adjusted insured debt at 12 basis points for 2014. In addition, the Board has decided to continue assessing 10 basis points on nonaccrual loans and other-than-temporarily impaired investments.

The Board considers the following factors in setting premiums:

- Current level of the Insurance Fund and projections for growth in insured obligations;
- Likelihood and probable amount of any losses to the Insurance Fund;
- Financial condition of the Farm Credit System banks and associations;
- Health and prospects for the agricultural economy; and,
- Risks in the financial environment that could cause problems, including volatility of interest rates, increased competition, and use of sophisticated investment securities and derivatives.

In addition to growth, the other factor influencing the level of adjusted insured debt is the level of deductions (i.e. government-guaranteed loans and investments).

Deductions from the SBA increased significantly since the passage of the Food, Conservation, and Energy Act of 2008, which permits the deduction of a portion of performing Federal government-guaranteed and state government-guaranteed investments that are backed by the full faith and credit of the United States or one of the states. Prior to passage, at March 31, 2008, full faith and credit loan deductions totaled \$3.4 billion compared to similarly backed loan and investment deductions of \$27.4 billion at March 31, 2014, the most recent reporting period. These deductions lowered the SBA by \$548 million.

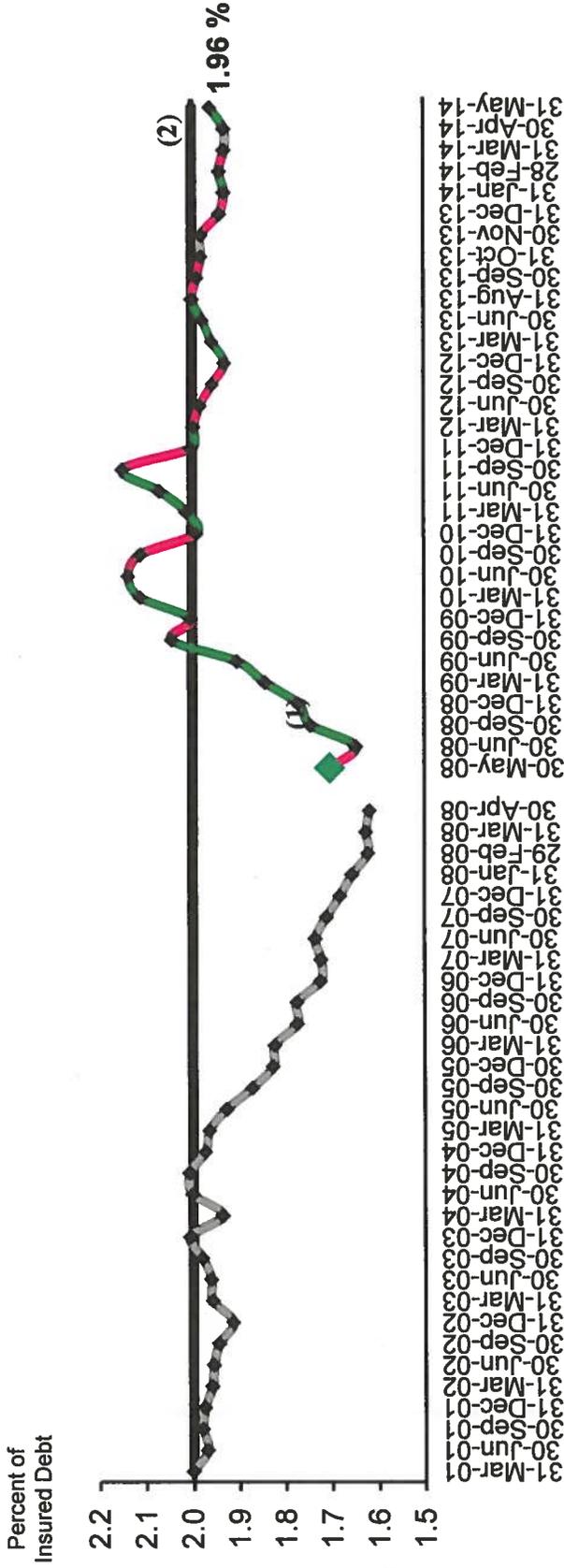
The Corporation's most recent allowance for loss review of all banks and associations concluded that no allowances are recommended at this time. Overall, the System remains fundamentally safe and sound and liquidity risk to the Insurance Fund remains low. The current agricultural lending environment is increasingly competitive and earnings may diminish as net interest margin compresses, but FCSIC staff believes the System is well-positioned to appropriately adjust to changes in its operating environment to remain competitive and profitable.

The Board will meet again in September 2014 to provide guidance for 2015 premium assessments.

If you have any questions concerning this matter please contact FCSIC's Chief Financial Officer, Emily Dean, at deanew@fcsic.gov or (703) 883-4387.

Attachment A: Secure Base Graph

Preliminary Trend of the Unallocated Insurance Fund Relative to the 2% Secure Base Amount May 31, 2014



- (1) A change in the secure base amount (SBA) calculation methodology requested by the Insurance Corporation was included in the Food, Conservation and Energy Act of 2008. The methodology allows the deduction of Federal and state-guaranteed investments from the SBA in a manner similar to that used for Federal and state-guaranteed loans.
- (2) Insurance premiums are assessed with the objective of maintaining the SBA which is defined in the Farm Credit Act as 2% of adjusted insured obligations. At year-end 2009, additional excess funds above the SBA of \$165.4 million were transferred to the Allocated Insurance Reserves Accounts (AIRAs). In February 2010, the \$39.9 million that was transferred to the AIRAs in 2003 was paid to the accountholders. In April 2010, the \$165.4 million that was transferred to the AIRAs in 2009 also was paid to the accountholders. The AIRAs balance is recorded as part of the Insurance Fund and is available to satisfy insurance obligations until the Corporation disburses payment to the Farm Credit Banks and FAC stockholders. At year-end 2011, excess funds above the SBA of \$222 million were transferred to the AIRAs and paid to the accountholders in May 2012.