

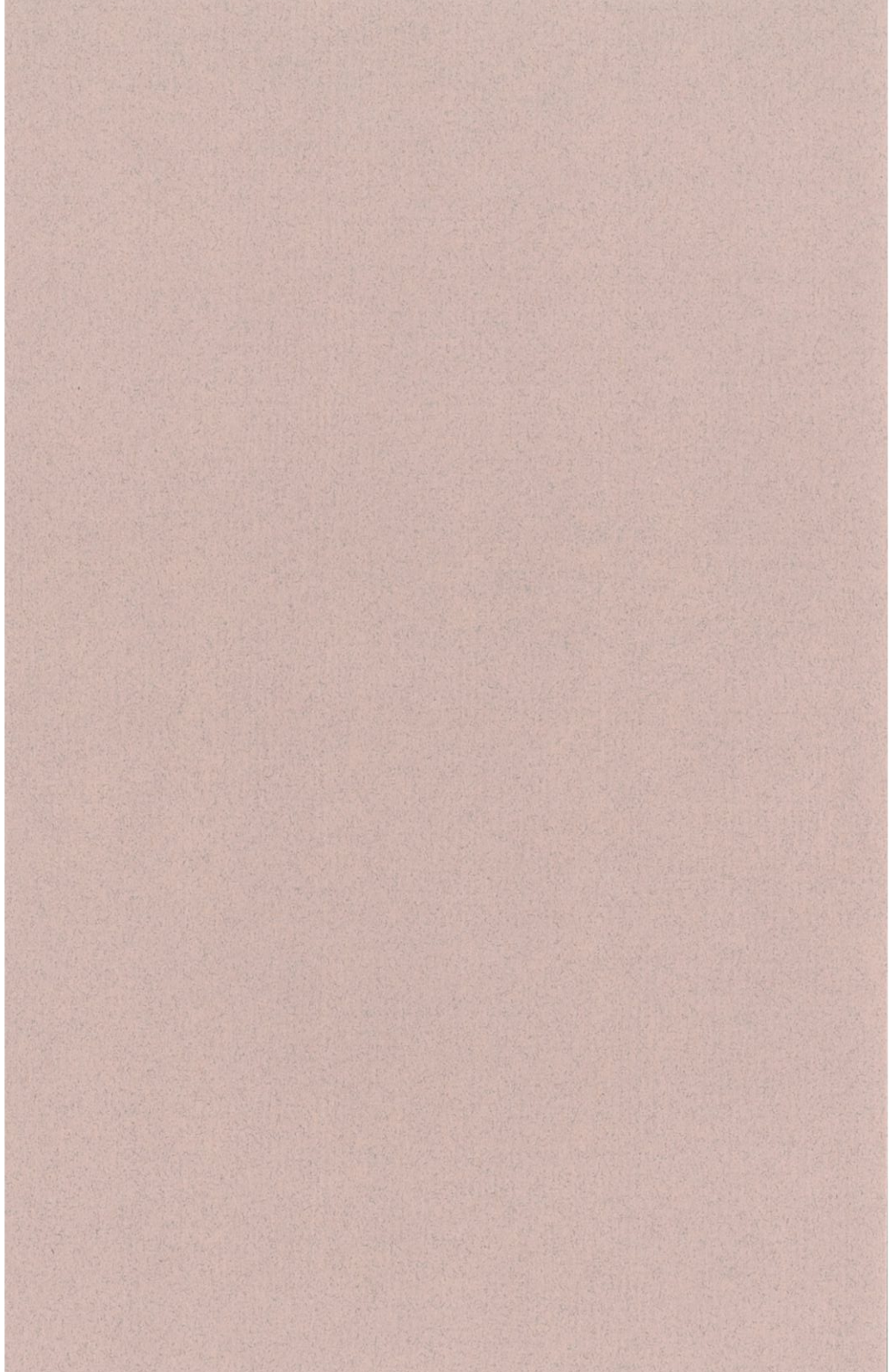
FOID

1990 Annual Report



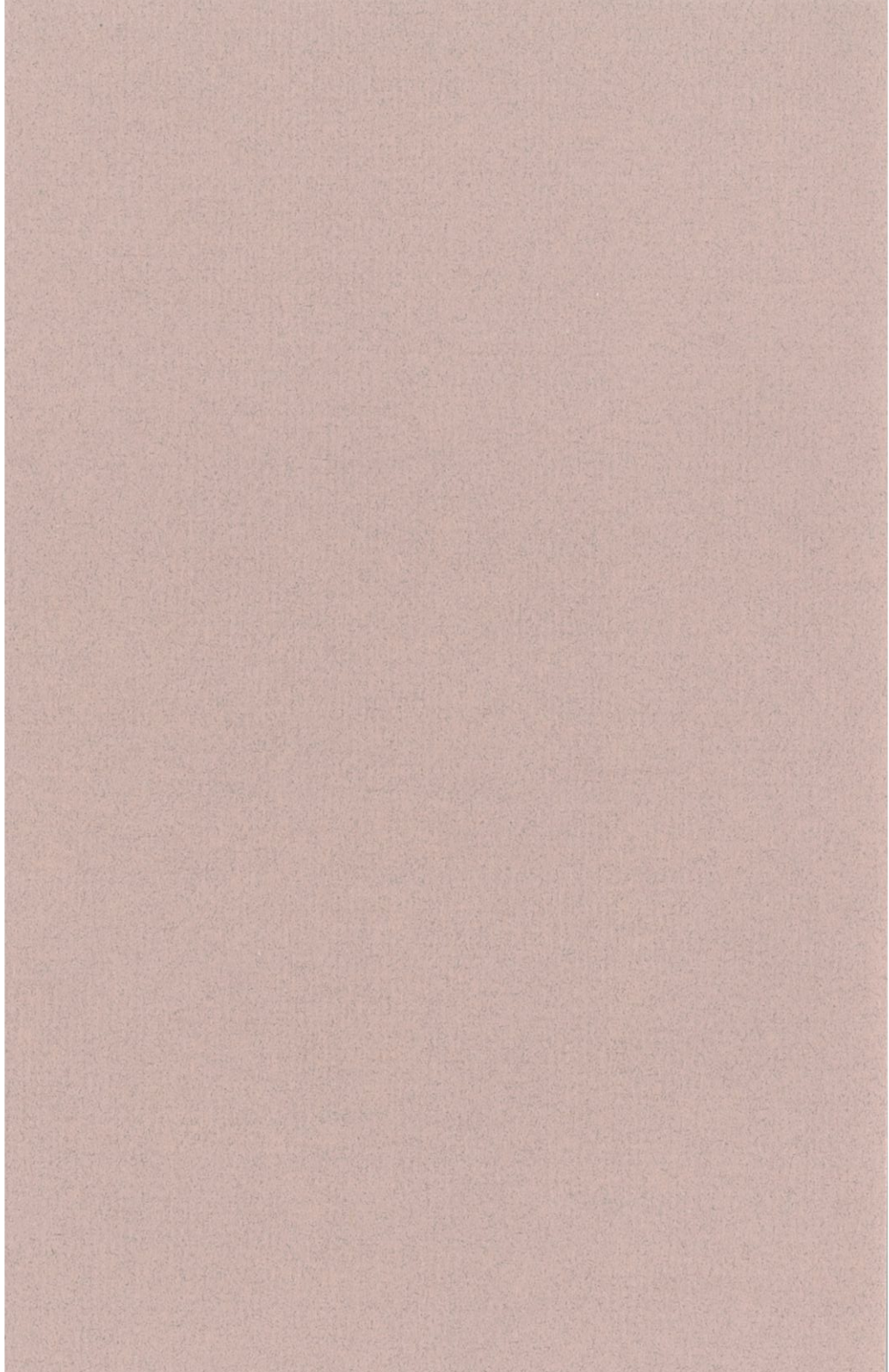
*Farm Credit
System Insurance Corporation
1990 Annual Report*

Farm Credit System
Insurance Corporation
McLean, VA 22102-0826



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Farm Credit System Insurance Corporation

Billy Ross Brown

Chairman
(Shown on left)

Harold B. Steele

Member of the Board
(Shown on right)

Curtis M. Anderson

Secretary

Anne E. Dewey

General Counsel



A Message from the Board of Directors of the FCSIC

We are pleased to transmit the 1990 annual report of the Farm Credit System Insurance Corporation (FCSIC). Since its inception in 1988, the FCSIC has been in its formative phase. Efforts are continuing to prepare the FCSIC to assume its full statutory authorities, which become effective on January 1, 1993. Until that time, the FCSIC's authorities are limited. For example, the FCSIC cannot provide assistance or make payments on defaulted Farm Credit System obligations. Congress gave the FCSIC a period of time to contemplate, plan for, and implement its operations. The FCSIC will take full advantage of that opportu-

nity to be well prepared to assume its full authorities on the date Congress specified.

Despite the fact that the FCSIC Board of Directors was without a quorum for nearly half of 1989 and 1990, much has been accomplished. These accomplishments were facilitated by research done by Farm Credit Administration (FCA) staff relating to the legislative history of the Agricultural Credit Act of 1987, studying similar Government

insurance corporations, and analyzing organizational issues. Following is a summary of the major accomplishments to date:

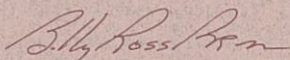
- The revolving fund under the administration of the FCA was transferred to the Farm Credit Insurance Fund and invested in U.S. Treasury securities.
- Regulations governing the organization of the FCSIC were adopted.
- Bylaws for the FCSIC were approved by the Board of Directors.
- Proposed regulations governing the payment and collection of premiums were adopted.

- An organizational structure was approved that will ensure the FCSIC's considerations are independently taken into account in actions by the FCA.

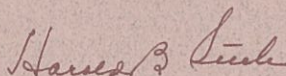
With respect to the organizational structure, we believe it is essential to create a structure that will ensure independence of the FCSIC. However, for reasons of economy and efficiency, to the extent possible, the FCSIC should continue to rely on the FCA for resources rather than creating another bureaucracy. We are pleased that the FCSIC has been able to use the expertise

within the FCA and we expect that practice to continue in large part.

Over the next 2 years, the FCSIC will complete the development of and implement a strategic plan that will enable it to assume its full statutory role in 1993 in a cost-effective, efficient, and timely fashion.



Chairman



Member of the Board of Directors

Board of Directors

Billy Ross Brown

is a prominent farmer, cattleman, and conservationist from Oxford, Mississippi. In 1969, he was elected to the board of directors of the Oxford Production Credit Association (PCA). He served as chairman of the Oxford PCA board from 1976 to 1985. From 1985 to 1990, he served as a member of the board of the First South Production Credit Association in Jackson, Mississippi.

Mr. Brown also has been active in state and national agriculture and conservation organizations.

He served as area vice president for the Mississippi Association of Conservation Districts for more than 20 years and, for more than 30 years, as commissioner of the Lafayette County Soil and Water Conservation District. He also served as chairman of the Mississippi Soil and Water Conservation Commission and as a member of the U.S. Forest Service's National Advisory Committee.

In recognition of his work in conservation, forestry, wildlife, and agriculture, Mr. Brown has received a number of national and state awards. In 1982 and 1988 he received the Presidential Award from the Mississippi Association of Conservation Districts, in 1985 he

was selected as a member of the Hall of Fame by the Mississippi Agriculture and Forestry Museum, and in 1976 he was a recipient of the U.S. Forest Service's 75th Anniversary Award for significant contributions to forestry and conservation.

Mr. Brown is a graduate of the University of Mississippi with a bachelor's degree in business administration.

Harold B. Steele

is from Princeton, Illinois, where he and his son produce grain and pork on a 665-acre farm. In addition to his farming interests, Mr. Steele has been a member of the board of directors of the Midwest Financial Group, Inc., a holding company comprised of 19 member banks in northern Illinois. He was appointed by the President to the National Commission on Agricultural Finance and served as chairman.

From 1970 through 1983, Mr. Steele served as president of the Illinois Farm Bureau (IFB). As IFB president, he served as a full-time executive officer of the

state's largest general farm organization, with 315,000 member families. During that period, he served as president of the IFB-affiliated group of insurance companies and investment firms. He also served on the board of the American Farm Bureau Federation from 1971 to 1983. Mr. Steele served as a member of the board of directors of the National Livestock Producers Association and was a member of the National Livestock and Meat Board.

During his career as an agricultural producer and leader, Mr. Steele received many awards and honors. He was named Outstanding Young Farmer in Illinois by the Jaycees in 1956. In 1970 he was named Master Farmer by the *Prairie Farmer* magazine. The Land of Lincoln Award was presented to him in 1972 by the Illinois Pork Producers Association, and in 1984 he received the University of Illinois Distinguished Service Award.

During World War II, Mr. Steele served his country, rising to the rank of captain in the U.S. Army.

He attended the University of Illinois' College of Agriculture.

Chronology of Significant Events

- January 6, 1988** The Farm Credit System Insurance Corporation was established with the enactment of the Agricultural Credit Act of 1987.
- January 6, 1989** The resignation of Jim R. Billington was effective, leaving the FCSIC Board of Directors without a quorum. Each FCS bank became insured.
- May 5, 1989** Funds totaling \$260 million were transferred from a revolving fund administered by the FCA to the Farm Credit Insurance Fund and invested in United States Treasury securities.
- October 12, 1989** Harold B. Steele joined the FCSIC Board of Directors, restoring a quorum.
- February 27, 1990** Marvin R. Duncan was elected chairman of the FCSIC Board of Directors. The Board of Directors adopted bylaws.
- August 28, 1990** The Board of Directors adopted proposed premium regulations and final organizational regulations. The Board of Directors also approved reimbursement to the FCA for all expenses incurred in order to operate the FCSIC.
- September 18, 1990** The resignation of Marvin R. Duncan was effective, leaving the FCSIC Board of Directors without a quorum.
- October 30, 1990** Billy Ross Brown joined the FCSIC Board of Directors, restoring a quorum.
- December 18, 1990** Billy Ross Brown was elected chairman of the FCSIC Board of Directors. An organizational structure was approved.

Operations of the FCSIC

The FCSIC was created on January 6, 1988, the date of enactment of the Agricultural Credit Act of 1987. Its corporate responsibilities are similar to those of the Federal Deposit Insurance Corporation. The FCSIC's statutory authorities and responsibilities include:

1. Insuring the timely payment of interest and principal on insured notes, bonds, debentures, and other obligations issued by Farm Credit System (FCS) banks.

On January 6, 1989, each FCS bank became an insured bank. The insurance extends to all consolidated and Systemwide notes, bonds, debentures, or other obligations issued by

FCS banks. All of the banks are jointly and severally liable for Systemwide obligations. For consolidated obligations, the joint and several liability extends only to the bank group, such as the Banks for Cooperatives, issuing the obligation. Obligations issued by individual institutions are not insured. Beginning on January 1, 1993, the FCSIC will be authorized and required to make any payments that would be necessary as a result of a default by an FCS bank on an insured obligation. As of December 31, 1990, the FCS had \$53.9 billion in insured obligations outstanding.

2. Satisfying FCS institution defaults on certain obligations related to issuance of bonds by the Farm Credit System Financial Assistance Corporation (FAC).

The FCSIC is obligated to make payments to satisfy any interest due on certain FAC obligations which the FAC has for 12 months been unable to recover from a defaulting FCS institution. Further, if an FCS institution which has issued preferred stock to the FAC is unable to redeem or does not redeem such stock, and the FAC does not have funds to satisfy the principal of the maturing obligation related to that stock, the FCSIC must purchase the preferred stock from the FAC. Any FCS institution

which is unable to redeem any of its preferred stock issued to the FAC must ultimately repay the FCSIC for its purchase.

As of December 31, 1990, there were five FCS institutions with preferred stock outstanding to the FAC, totaling \$808 million.

The first of the obligations which funded the purchase of this stock matures on July 21, 2003. With the exception of the stock issued by the Federal Land Bank of Jackson in Receivership, discussed in the footnotes to the financial statements, there is presently no reason for anticipating any lack of redemption by the respective institutions.

3. To ensure the retirement of each FCS institution's protected borrower capital.

Protected borrower capital includes borrower capital stock, participation certificates, and allocated equities which were outstanding as of January 6, 1988, or which were issued or allocated prior to October 6, 1988. This

capital has been steadily declining as loans to holders of such capital have been repaid. The amount of this capital which will be outstanding in 1993, when the FCSIC's responsibility to ensure retirement becomes effective, is expected to be a minimal amount of its potential obligations. As of September 30, 1990, FCS institutions had \$1.4 billion in protected capital outstanding.

4. Acting as receiver or conservator for FCS institutions.

Prior to 1993, the FCSIC may act as receiver or conservator for an FCS institution if so designated by the FCA. Beginning

in 1993, the FCA must appoint the FCSIC as the receiver or conservator for any FCS institution placed in receivership or conservatorship.

As of December 31, 1990, 12 FCS institutions were in receivership. The FCSIC is not the receiver for any of these institutions. No FCS institutions are in conservatorship.

5. Providing assistance to financially distressed FCS institutions.

Beginning January 1, 1993, the FCSIC will have the authority to provide assistance to troubled FCS institutions. The FCSIC may, in its sole discretion and on such terms and conditions as it may prescribe,

provide assistance to FCS institutions by purchasing assets, making loans, or assuming the liabilities of an institution. The FCSIC may take such action in order to prevent an institution from being placed in receivership, to restore an institution to normal operation, or to reduce certain other risks to the FCSIC. The amount of such assistance may not exceed an amount determined by the FCSIC to be the cost of liquidating the institution.

The Farm Credit Insurance Fund

To provide funds to meet the FCSIC's responsibilities, the law provided for the transfer of \$260 million from a revolving fund to the Farm Credit Insurance Fund (Insurance Fund) as the initial capital of the FCSIC. The revolving fund, which had been under the jurisdiction of the FCA, consisted of funds which were initially appropriated to provide startup capital for FCS institutions. Over time, the startup capital was retired and the funds repaid and deposited in the revolving fund.

Since the transfer to the Insurance Fund, the funds have been invested in obligations of the U.S. Treasury.

On January 6, 1989, each FCS bank became responsible for paying annual premiums to the FCSIC. These premiums will be deposited in the Insurance Fund after final regulations become effective. The annual premium rate for collection is set by law with the following rates in effect:

- 15 basis points of the annual average principal outstanding on loans in accrual status, excluding the guaranteed portions of State and Federal Government-guaranteed loans;
- 25 basis points of the annual average

principal outstanding on loans that are in nonaccrual status (the law provides that premiums on nonaccrual loans are payable beginning with calendar year 1990);

- 3 basis points of the annual average principal outstanding on the guaranteed portions of State government-guaranteed loans that are in accrual status; and
- 1.5 basis points of the annual average principal outstanding on the guaranteed portions of Federal Government-guaranteed loans that are in accrual status.

Premiums for 1989 and 1990 have been accrued on the books of FCS banks. These are reported as premiums receivable in the financial statements contained in this report. Regulations governing the payment of premiums have been proposed and premium payments for 1989 and 1990 are scheduled to be collected in the first quarter of 1991. Premiums to be collected in 1991 should be approximately \$137 million.

Premiums will continue to be paid at the rates specified by law until the Insurance Fund reaches the secure base amount. That is defined as 2 percent of aggregate insured obligations adjusted downward by a percentage of the

guaranteed portions of state and federally guaranteed loans. However, that percentage can be adjusted to other levels based on what the FCSIC determines is actuarially sound. When the secure base amount is reached, premiums must be reduced to a level that will maintain that amount.

Money of the FCSIC not otherwise employed is invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. These investments are discussed in the financial statements.

Organization of the FCSIC

At its December 18, 1990 meeting, the Board of Directors of the FCSIC elected Billy Ross Brown as chairman. In that capacity, he will preside at all meetings of the Board, be responsible for all procedural matters arising at Board meetings, and certify all acts, orders, and proceedings of the Board.

To enable the FCSIC to carry out its statutory and regulatory responsibilities, the chairman is responsible for identifying the need for the development of appropriate policies and for assuring that any necessary economic and financial studies are available to assist in making policy decisions. The chairman also acts as a spokesman for and repre-

sentative of the Board in its official relations with other Government agencies and the FCS.

The Board also approved the FCSIC corporate structure and its relationship to the FCA. The chief executive officer (CEO) of the FCA, currently Harold B. Steele, will be the chief executive officer of the FCSIC. A chief operating officer may be designated. The CEO will

perform duties consistent with and comparable to the responsibilities discharged as CEO of the FCA. He will be responsible for directing the implementation of policies and regulations of the FCSIC and for the execution of administrative duties.

One or more persons will be appointed and responsible for the following functions:

- Risk Management—The review of FCA examination, corporate, and regulatory activities to assess and quantify the risk to the Insurance Fund.

- **Financial Management**—All financial matters, including the collection of premiums, investments, and monitoring the Insurance Fund to ensure the FCSIC is able to fulfill its statutory responsibilities.

- **Administration**—Bookkeeping, payroll, and other administrative functions.

- **Receiverships and Conservatorships**—Administration and oversight of receiverships and conservatorships.

- **Auditor**—Monitoring and auditing internal activities of the FCSIC for compliance with applicable laws, rules, and regulations.

Other FCSIC functions will be performed by individuals serving in similar capacities at the FCA.

These include a General Counsel, a Secretary to the Board, a Federal Register Officer, a Freedom of Information Officer, a Privacy Act Officer, a Contracting Officer, an Equal Employment Opportunity Officer, and an Ethics in Government Officer.

Relationship Between the FCSIC and the FCA

Among the principal objectives of the FCSIC is the protection of funds invested in the Systemwide and consolidated securities issued by FCS institutions to obtain loan funds. The responsibilities of the FCA in examining and regulating the institutions of the FCS further the goals of the FCSIC. The overall goal of each organization is the same—to provide for the safe and sound operation of a permanent system of borrower-owned cooperatives that supply credit for American agriculture.

Even for those functions that concern the FCSIC particularly, the cooperation of the FCA in carrying out those functions is essential. The FCSIC generally must rely on the FCA for the enforcement of its regulations. The FCSIC has no explicit

statutory grant of enforcement authority, with minor exceptions. In contrast, the FCA has the authority to issue an enforcement action based on any violation of the statute or regulations, including those pertaining to the FCSIC's statutory and regulatory provisions, as well as to address safety and soundness issues.

By giving the FCA broad enforcement authority and limiting the FCSIC's enforcement authority to matters relating to premium collections, close coordination between the FCA and the FCSIC was apparently envisioned. The mandate that the same three Board mem-

bers serve each organization is further evidence of the intentions for a high degree of joint responsibility and cooperation.

The existing FCA examination process will be relied on to protect the interests of the FCSIC. That process will be reviewed to determine the extent to which the scope of examinations may require supplementation to incorporate any additional needs of the FCSIC. It is also important that the independent FCSIC point of view is incorporated into the FCA's analysis of matters that could affect the FCSIC.

Coupled with the full sharing of information between the FCA and the FCSIC, this will maximize the resources of both organizations and minimize the regulatory burden on the FCS institutions.

The FCSIC in the Future

The FCSIC projects that it will incur approximately \$898,000 in operating costs in 1991. Following is the implementation plan for the FCSIC to ensure it is fully operational by January 1, 1993.

FCSIC Preliminary Development Plan

Implementation Strategy to Achieve FCSIC's Full Operations by 1993

Objective	Completion Target
Adopt Organizational Regulations and Select the Chairman	Completed
Inventory Applicable Legislation; Assess Requirements; and Develop Legislative Agenda	Completed
Develop/Adopt Bylaws	Completed
Select CEO	Completed
Design Draft Organizational Structure	Completed
Adopt Proposed Premium Regulations	Completed
Adopt Final Premium Regulations	1st Quarter 1991
Collect Premiums for 1989 & 1990	1st Quarter 1991
Develop Interim Staffing Plan as Prescribed	1st Quarter 1991
Develop Investment Policy	1st Quarter 1991
Develop Organizational Plan	2nd Quarter 1991
Develop Strategic Plan and Mission Statement	2nd Quarter 1991
Design and Plan an Operating Budget	3rd Quarter 1991
Define Relationship with FCA and Services Provided, Including Examination Services	4th Quarter 1991
Develop Strategy to Monitor Assistance Board's Assistance Agreements for Implementation Sufficiently in Advance of 12/31/92	4th Quarter 1991
Develop and Implement Policies and Procedures for Risk Management, Financial Operations, and Administration	4th Quarter 1991
Collect Premiums for 1991	1st Quarter 1992
Define Receiver/Conservator Responsibilities	4th Quarter 1992
Full Implementation	4th Quarter 1992

Report of Independent Public Accountants

ARTHUR ANDERSEN & CO.
WASHINGTON, D. C.

Report of Independent Public Accountants

To the Board of Directors
Farm Credit System Insurance Corporation:

We have audited the accompanying statements of financial condition of the Farm Credit System Insurance Corporation (FCSIC) as of December 31, 1990 and 1989, and the related statements of income and expense, changes in insurance fund, and statements of cash flows for the years ended December 31, 1990 and 1989. These financial statements are the responsibility of FCSIC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards, and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Farm Credit System Insurance Corporation as of December 31, 1990 and 1989, and the results of its operations and its cash flows for the years ended December 31, 1990 and 1989, in conformity with generally accepted accounting principles.

Arthur Andersen & Co.

January 25, 1991

Financial Statements

Statements Of Financial Condition As Of December 31, 1990 and 1989 (In Thousands)

	1990	1989
Assets		
Cash and Cash Equivalents	\$ 47,504	\$ 24,822
Investments in U.S. Treasury Obligations, net (Note 5)	251,255	248,435
Accrued Interest Receivable	2,583	2,583
Premiums Receivable (Note 3)	137,000	65,000
Total Assets	\$438,342	\$340,840
Liabilities and Insurance Fund		
Accounts Payable and Accrued Expenses	\$ 158	\$ 118
Liability for Estimated Insurance Obligations (Note 4)	140,000	—
Farm Credit Insurance Fund	298,184	340,722
Total Liabilities and Insurance Fund	\$438,342	\$340,840

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

Statements Of Income And Expense For The Year Ended December 31, 1990 And The Period From Inception To December 31, 1989
(In Thousands)

	1990	1989
Income		
Premiums (Note 3)	\$ 72,000	\$ 65,000
Interest Income	25,705	16,041
Total Income	97,705	81,041
Expenses		
Administrative Operating Expenses	243	118
Provision for Estimated Insurance Obligations (Note 4)	140,000	—
Net Income (Loss)	(\$ 42,538)	\$ 80,923

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

Statements Of Changes In Insurance Fund For The Year Ended December 31, 1990 And The Period From Inception To December 31, 1989
(In Thousands)

	1990	1989
Balance, Beginning of Period	\$340,722	—
Initial Funding from U.S. Treasury (Note 3)	—	\$259,799
Net Income (Loss)	(42,538)	80,923
Balance, End of Period	\$298,184	\$340,722

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

**Statements Of Cash Flow For The Year Ended December 31, 1990 And
The Period From Inception To December 31, 1989**

(In Thousands)

	1990	1989
Cash Flows from Operating Activities		
Net Income (Loss)	(\$ 42,538)	\$ 80,923
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Increase in Premiums Receivable	(72,000)	(65,000)
Increase in Accrued Interest Receivable	—	(2,583)
Net Amortization and Accretion	(2,820)	(1,893)
Increase in Accounts Payable and Accrued Expenses	40	118
Increase in Liability for Estimated Insurance Obligations	140,000	—
Net Cash Provided by Operating Activities	22,682	11,565
Cash Flows from Investing Activities:		
Net Increase in Investments in U.S. Treasury Obligations	—	(246,542)
Net Cash Used in Investing Activities	—	(246,542)
Cash Flows from Financing Activities:		
Initial Funding from U.S. Treasury	—	259,799
Net Cash Provided by Financing Activities	—	259,799
Net Increase in Cash and Cash Equivalents	22,682	24,822
Cash and Cash Equivalents, Beginning of Period	24,822	—
Cash and Cash Equivalents, End of Period	\$ 47,504	\$ 24,822

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

FCSIC Notes to the Financial Statements, December 31, 1990 and December 31, 1989

Note 1—Insurance Fund: Statutory Framework

The Agricultural Credit Act of 1987 (the 1987 Act) established the Farm Credit System Insurance Corporation (FCSIC) for the purpose of insuring the timely payment of principal and interest on notes, bonds, debentures, and other obligations (insured obligations) issued under subsection (c) or (d) of section 4.2 of the Farm Credit Act of 1971, as amended (Act). All provisions

of the 1987 Act pertaining to the FCSIC have been incorporated into the Act. Effective January 6, 1989, each bank in the Farm Credit System (FCS) participating in insured obligations issued under subsection (c) or (d) of section 4.2 of the Act became an insured FCS bank subject to the requirements of and entitled to the benefits of insurance under Title V, Part E of the Act. The FCSIC is managed by a board of directors consisting of the same members making up the Farm Credit Administration (FCA) Board except that the chairman of the FCA Board may not serve

as the chairman of the FCSIC Board of Directors.

The FCSIC is funded from three sources: (1) all amounts in the revolving fund established by section 4.0 of the Act were transferred to the FCSIC's account from the U.S. Treasury, (2) the interest earned from investments, and (3) annual premium payments received from insured FCS banks.

Beginning on January 1, 1993, the FCSIC will be required to expend amounts to the extent necessary to:

If the FCSIC does not have sufficient funds to insure payment on obligations in item (1), FCS banks will be

required to make payments under joint and several liability.

If the FCSIC does not have sufficient funds to retire obligations in item (2), the U.S.

Treasury must retire those obligations. The U.S. Treasury would then be reimbursed by the FCSIC as funds become available from the payment of premiums.

Additionally, beginning on January 1, 1993, the FCSIC, in its sole discretion, will be authorized to expend amounts to provide financial assistance to certain insured institutions. Prior to January 1, 1993, the FCSIC may not make payments for any purpose except to pay for operating expenses of the FCSIC.

Millions Outstanding Dec. 31,	1990	1989
1. Insure the timely payment of interest and principal on insured obligations,	\$53,872	\$55,895
2. Satisfy System Institution defaults on obligations related to the issuance of bonds by the Farm Credit System Financial Assistance Corporation (FAC) under section 6.26(d)(3) of the Act, and	808	394
3. Ensure the retirement of eligible borrower stock at par value.	1,392	1,683
Total	\$56,072	\$57,972

Note 2—Summary of Significant Accounting Policies

Accounting Principles and Reporting Practices—The accounting and reporting policies of the FCSIC conform to generally accepted accounting principles and, as such, the financial statements have been prepared using the accrual basis of accounting.

Cash and Cash Equivalents—Cash and cash equivalents include investments in U.S. Treasury obligations with original maturities of 90 days or less.

Investments in U.S. Treasury Obligations—An investment portfolio is maintained as is required by section 5.62 of the Act. The Act requires that funds of the FCSIC,

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. Investments are stated at cost, adjusted for amortization of premiums and accretion of discounts. Premiums and discounts are amortized or accreted using the straight-line method, which approximates the interest method, over the terms of the respective issues.

Liability for Estimated Insurance Obligations—The liability for estimated insurance obligations is the present value of estimated probable insurance payments, net of anticipated premiums, to be made in the future based on the FCSIC's analysis of economic conditions of insured FCS banks. The insured FCS banks' primary lending markets are borrowers in the farming and marine market segments. Economic weaknesses in these market segments and the effect of general market conditions on the insured FCS banks' borrowers could result in difficulties in certain borrowers meeting their obligations. As a result, insured FCS banks may experience

increased levels of nonaccrual loans and other nonperforming assets which may adversely affect their financial condition and profitability. Therefore, adverse changes in the financial condition and profitability of insured FCS banks 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. Premiums increase the Insurance Fund.

Administrative Operating Expenses—The FCSIC has no employees or fixed assets. FCA employees assist in the administering of the FCSIC. As such, employee salaries and the related costs for space and services are allocated to the FCSIC based on time incurred or estimated percentage use.

Note 3—Premiums

By statute, the annual premium due from each insured FCS bank for the calendar year is equal to the sum of (1) the annual average principal outstanding for the year on loans of the bank that are in accrual status, other than Government-guaranteed portions of these

loans, multiplied by 0.0015; (2) the annual average principal outstanding for the year on loans of the bank that are in nonaccrual status multiplied by 0.0025; (3) the annual average principal outstanding on the guaranteed portions of Federal Government-guaranteed loans that are in accrual status, multiplied by 0.00015; and (4) the annual average principal outstanding on the guaranteed portions of State government-guaranteed loans that are in accrual status, multiplied by 0.0003. The 1989 calculation excludes loans in nonaccrual status.

Each insured FCS bank will continue to make these annual premium payments until the aggregate amount in the Insurance Fund exceeds the secure base amount. The secure base amount is equivalent to 2 percent of the aggregate outstanding insured obligations of all insured FCS banks (adjusted downward by a percentage of the guaranteed portions of State and Federal Government-guaranteed loans in accrual status) or other such percentage or amount determined by the FCSIC Board, in its sole discretion, to be actuarially sound. When the amount of the Insurance Fund exceeds the secure base amount, the FCSIC will reduce the

premium to a percentage necessary to maintain the level of the Insurance Fund at the secure base amount.

As stated previously, the annual premium due from an insured FCS bank is based on the annual average principal outstanding for the calendar year. For a Farm Credit Bank (FCB), this means that the principal outstanding will be based on direct loans. In accordance with the Act, the principal outstanding on loans made by an FCB will be based on (1) all loans made by a Production Credit Association

(PCA), or any other association making direct loans under authority provided under section 7.6 of the Act, (2) loans made by other financing institutions (OFIs) which resulted from funding provided through the FCB and which are pledged to or discounted by the FCB, and (3) direct loans made by the FCB, other than loans to the entities described in (1) and (2).

Effective January 6, 1989, each FCS bank participating in insured obligations issued under subsection (c) or (d) of section 4.2 of the Act became an insured System bank and was required to pay premiums to the FCSIC. The FCSIC recorded \$72 million and \$65 million in revenues in

1990 and 1989, respectively, for estimated premiums earned and to be received from insured FCS banks. The estimated premium is based on certain loan information contained in System institutions' Call Reports submitted to the FCA. As of December 31, 1990, no premiums have been collected; however, these premiums are due March 29, 1991. Insured FCS banks have recorded accruals for premiums payable to the FCSIC related to these premiums.

Note 4—Financial Assistance to Insured FCS Banks

The Act required that the FCA charter the Farm Credit System Financial Assistance

Corporation (FAC) for the purpose of carrying out a program to provide capital to institutions of the FCS that are experiencing financial difficulty. In order to raise funds to provide this capital, the FAC has the authority to issue debt obligations with a maturity of 15 years. The FAC can then use these funds to purchase preferred stock in an institution experiencing financial difficulty. When this 15-year debt matures, the institution can redeem, upon FCA approval, the preferred stock 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 the retirement 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 doing so will prevent the institution from remaining viable and competitive. If this occurs, then the FAC must use funds maintained in its Trust Fund, to the extent available, to retire the debt. The FAC Trust Fund totaled approximately \$56 million

and \$38 million at December 31, 1990 and 1989, respectively. If the FAC Trust Fund is not sufficient to retire the debt, then the FCSIC must purchase the preferred stock from the FAC to provide funds to retire such debt. Additionally, if the FCSIC does not have sufficient funds, the U.S. Treasury must retire the debt. Then the FCSIC is required to repay the U.S. Treasury as funds become available from the payment of premiums.

On May 20, 1988, the FCA, at the request of the Farm Credit System Assistance Board (Assistance Board), placed the Federal Land Bank of Jackson and the Federal Land Bank Association of Jackson in receivership (FLBJR) and ap-

pointed a receiver to liquidate its assets. As of April 27, 1990, the FCSIC, the FCA, the receiver of the FLB of Jackson, the FAC, the banks of the Farm Credit System, and the Assistance Board reached an agreement for the sale of substantially all of the remaining assets of the FLBJR. In June 1990, the above parties consummated the transactions contemplated by the agreement.

The agreement called for the FAC to issue 15-year U.S. Treasury-guaranteed debt to purchase preferred stock in the FLBJR.

Upon the maturity of the FAC debt used to

purchase preferred stock in the FLBJR, the FCSIC will provide funds to repay the principal of these debt obligations, to the extent that the FAC Trust Fund is not sufficient for such purpose. Assistance given by the FAC to the FLBJR totaled \$388 million.

As a result of this agreement, it is probable that the FCSIC will have to retire at least a portion of the FAC debt. It is not clear, however, to what extent the FCSIC can rely on the availability of any funds from the Trust Fund. The availability of the Trust Fund depends on the ability of other Farm Credit banks to redeem preferred stock purchased by the FAC with proceeds from

FAC bonds. Based on this information, the FCSIC estimated the present value of its liability, net of premiums, for payment of the \$388 million of 15-year maturing debt to be approximately \$140 million at December 31, 1990. This liability is reflected in the accompanying statement of financial condition.

There are four other FCBs with preferred stock outstanding and responsible, therefore, for repayment of FAC bonds. As of December 31, 1990 and 1989, there was \$420 million and \$331 million, respectively, of FAC bonds and related preferred stock outstanding. These bonds, also 15-year bonds, will mature prior to the 15-year bonds issued in

relation to the FLBJR. As a result, if these FCBs cannot redeem the stock so that the bonds can be retired, the FAC Trust Fund may be exhausted prior to the maturity of the FAC bonds that were issued in relation to the FLBJR. At the present time, the FCSIC is not aware of any information that would indicate these FCBs will not be able to redeem such stock.

The FCSIC actively monitors the creditworthiness and finan-

cial position of the insured FCS banks. Based on an assessment by the FCSIC Board of Directors, other than obligations that have occurred as a result of closing out the FLBJR as described above, the FCSIC is not aware of any events or circumstances which would require a liability for estimated insurance obligations to be recorded.

Note 5—Investments

At December 31, 1990 and 1989, the FCSIC investment portfolio consisted of one U.S. Treasury note maturing on May 15, 1991. The yield to maturity is 8.125 percent. The market value was \$251,711,000 and \$249,039,000 at December 31, 1990 and 1989, respectively.

References

For additional information about the Farm Credit System, its financial condition and performance, and activities of the Farm Credit Administration, the following publications are recommended.

Farm Credit System Annual Reports to Investors and Quarterly and Annual Information Statements for the current fiscal year and the two preceding fiscal years. These are available without charge from:

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

Annual Reports of the Farm Credit Administration for the past five fiscal years.

These are available without charge from:

Office of Congressional and
Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
(703) 883-4056

Reports for previous years are subject to availability, but copies are available for inspection.