Farm Credit System Insurance Corporation

1992
Annual Report

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May 5, 1993

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 the calendar year 1992.

The aggregate amount in the Insurance Fund at December 31, 1992, was $488 million. The Corporation expects to incur $1.92 million in operating costs and $1.17 million in Insurance Fund obligations during calendar year 1993. On February 1, 1993, the Corporation collected $74 million in premiums from the insured Farm Credit System banks.

Sincerely,

Gary C. Byrne

Gary C. Byrne
Chairman

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

McLean, Virginia 22102-0826
703/883-4380

Mission Statement

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

- *Protect investors in insured Farm Credit System obligations and taxpayers through sound administration of the Farm Credit Insurance Fund (Insurance Fund);*
- *Exercise its authorities to minimize exposure to the Insurance Fund; and*
- *Promote safe and sound operations of a permanent system for delivery of credit to agricultural borrowers.*

Contents

Board of Directors

Gary C. Byrne, Chairman of the Corporation, is a former Administrator of the Rural Electrification Administration (REA) and Governor of the Rural Telephone Bank. As Administrator of the REA, he managed an agency that approved more than $62 billion in loans to 2,116 rural electric and telephone utilities in 47 states and several U.S. territories and possessions. A native of California, Mr. Byrne served as Chairman of the Bank of Alex Brown in Sacramento and also served as President and Chief Executive Officer of the Alex Brown Financial Group, a multibank holding company. He holds a B.A. from the University of the Redlands, and a Ph.D. from the University of North Carolina.

Harold B. Steele, Chief Executive Officer and Member of the Corporation's Board, is also Chairman and Chief Executive Officer of the Farm Credit Administration. From 1970 to 1983 he served as President and Chief Executive Officer of the 315,000-member Illinois Farm Bureau Federation, and from 1971 to 1973 he also served on the board of the American Farm Bureau Federation. Mr. Steele was also a director of the Midwest Financial Group, a 19-bank holding company. He and his son are engaged in the production of pork and grain on a 1,000-acre farm in Princeton, Illinois. Mr. Steele attended the University of Illinois College of Agriculture. During World War II, serving as an infantry captain in the U.S. Army, he was awarded the Silver Star and the Purple Heart.

Billy Ross Brown, a Member of the Corporation's Board and former Chairman of the Corporation, served as a director of Production Credit Associations in the Fifth Farm Credit District for 20 years, 9 of them as Chairman of the Board of Directors of the Oxford (Mississippi) Production Credit Association. He is a prominent farmer, cattleman, and conservationist, has been active in a number of state and national agricultural and conservation organizations, and has been honored by the Mississippi Association of Conservation Districts and the U.S. Forest Service. In 1985, he was inducted into the Hall of Fame by the Mississippi Agriculture and Forestry Museum. Mr. Brown received a bachelor's degree in business administration from the University of Mississippi.

Overview

The Farm Credit System Insurance Corporation (Corporation) is an independent U.S. Government controlled corporation. It is managed by a board of directors comprised of the Members of the Farm Credit Administration (FCA) Board. The Chairman of the Corporation's Board, however, must be a Board Member other than the Chairman of the FCA Board.

The Corporation's mission is to ensure the timely payment of principal and interest on insured notes, bonds, debentures and other obligations issued on behalf of Farm Credit System (System) banks. This mission is accomplished through the sound management of the Insurance Fund and by the appropriate exercise of the Corporation's authority to minimize the Insurance Fund's exposure to risk. By ensuring the repayment of System securities to investors, the Corporation contributes to the maintaining of a dependable source of funds to the farmers, ranchers and other borrowers of the Farm Credit System.

The Corporation completed its start-up phase during 1992. Highlights of the past year include:

- Growth of $98 million in the Insurance Fund to $488 million;
- Hiring of permanent staff;
- Implementation of a risk management system;
- Successful transition with the Farm Credit System Assistance Board; and
- Development of receivership capability.

In the coming year, the Corporation will focus on implementing provisions of the Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 Act) and maintaining its program capabilities.

Corporation Activities

Insurance Fund Management

The Insurance Fund is managed to ensure timely payment of principal and interest on insured obligations. Premiums are collected annually from the insured System banks. Funds received are invested in accordance with the Farm Credit Act of 1971 as amended (Act) and a Board-approved corporate investment policy.

Corporation funds may be used only as authorized in the statute. Sufficient liquidity must be maintained to fulfill the Corporation's statutory obligations, as well as to pay its operating expenses.

Premium Collection

The Corporation assesses and collects premiums from each insured System bank. The premiums are based on each bank's (and its related associations') retail loan volume (see Note 4).

The Corporation had accrued $74 million on December 31, 1992, representing the estimated premiums that were earned but not yet collected for calendar year 1992. The Corporation collected these premiums from each insured bank on February 1, 1993.

Investment of Insurance Fund Assets

The Insurance Fund grew to $488 million at December 31, 1992, an increase of 25 percent. The Insurance Fund represents the Corporation's equity (assets less liabilities). Growth in the Fund results from collection of premiums and interest on investments. Accrual and payment of expenses including Corporation insurance obligations reduce the size of the Insurance Fund.

Total assets of the Corporation at December 31, 1992, were $656 million—an increase of 19.8 percent from December 31, 1991. Total assets included cash and investments of $562 million and accrued interest and premiums receivable of $94 million. All funds not needed for Corporation operations are invested in U.S. Treasury securities in accordance with 12 U.S.C. 2277a-11 and the Corporation's investment policy.

The policy's primary objective is to provide the Corporation with adequate liquidity to meet its statutory obligations. Secondarily, the policy provides that the Corporation will seek the maximum return consistent with its liquidity needs and a minimum exposure to loss of principal. The Corporation does not trade for capital gains purposes.

The Corporation's investment policy permits flexibility to make investments with maturities from 0 to 5 years. There must be a minimum of 15 percent and a maximum of 25 percent invested in any 1-year maturity. At December 31, 1992, the actual portfolio maturities were:

Maturity Schedule	$ Millions	% of Portfolio
1 Day to 1 Year	$ 133	23.6
1 Year to 2 Years	$ 95	16.9
2 Years to 3 Years	$ 137	24.4
3 Years to 4 Years	$ 91	16.3
4 Years to 5 Years	$ 106	18.8
Total	$ 562	100.0

At December 31, 1992, the portfolio's market value exceeded book value by $18 million. This appreciation resulted from some of the Corporation's longer term investments, which were purchased when market interest rates were significantly higher than in 1992. The weighted average portfolio maturity at yearend was 2.4 years. For 1992, the average portfolio yield was 6.63 percent compared with 7.86 percent for 1991. The decline in the average yield resulted from investments at the significantly lower interest rates prevailing in 1992 than in 1991.

Insured and Other Obligations

Obligations insured by the Corporation are statutorily defined as any note, bond, debenture or other obligation issued on behalf of System banks under subsection (c) or (d) of section 4.2 of the Act, 12 U.S.C. 2153. Section 4.2(c) authorizes a System bank to join with any or all banks organized and operating under the same title of the Act to issue consolidated notes, bonds, debentures or other obligations. Section 4.2(d) authorizes a System bank to join with the other banks of the System to issue Systemwide notes, bonds, debentures or other obligations. Issuance of insured obligations is done through the Federal Farm Credit Banks Funding Corporation on behalf of the System banks. The outstanding principal and interest balances of insured obligations at December 31 for the past 5 years were:

	1988	1989	1990 ($ billions)	1991	1992
Systemwide obligations	$51.9	$53.8	$53.1	$52.1	$52.1
Consolidated bank obligations	1.5	1.5	1.0	.7	.7
Interest payable	1.1	1.1	.9	.7	.5
Total	$54.5	$56.4	$55.0	$53.5	$53.3

The Corporation is also required by statute to use the Insurance Fund to (a) 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 (b) ensure the retirement of eligible borrower stock. The outstanding balances of these obligations at December 31 for the past 5 years were:

	1988	1989	1990 ($ billions)	1991	1992
FAC Assistance	$ .7	$ .8	$1.3	$1.3	$1.3
Eligible Borrower Stock	3.3	1.7	1.2	.7	.4

During the fourth quarter of 1992, the Corporation established a liability of $1.17 million to ensure the expected retirement of eligible borrower stock outstanding at an association receivership in Texas. Since the Farm Credit System Assistance Board (Assistance Board) was in the process of terminating, the Corporation's Board determined that providing the necessary funds to retire this stock would be an early obligation of the Corporation following January 1, 1993 (see Note 5). The Corporation developed the necessary procedures and, following verification of the stockholder balances, the Board approved, in January 1993, the expenditure of funds to fulfill this obligation.

Risk Management

Assessment of risk is a critical requirement in order for the Corporation to minimize Insurance Fund loss exposure. Corporation staff have implemented special examination procedures utilizing FCA examiners to evaluate the condition of weaker System institutions (those institutions with FCA ratings of 4 or 5 or other institutions identified as likely to expose the Insurance Fund to risk of loss). The FCA Rating System is based on the Uniform Financial Institutions Rating System used by other bank regulatory agencies to rate financial institutions under their supervision.

The Corporation utilizes FCA's monitoring systems and examination reports. The Corporation also has implemented a program for assessing the impact of specific FCA prior approval transactions on the Insurance Fund. Such transactions have included mergers and other restructuring and financial assistance between institutions.

Financial Assistance Agreement Management

The Assistance Board terminated on December 31, 1992. At that time, the responsibility for managing the Assistance Board's agreements with the two remaining assisted banks transferred to the Corporation. During 1992, Corporation staff worked closely with the Assistance Board in successfully preparing for this transition. The Corporation has implemented a program to continue managing the assistance agreements with the Farm Credit Banks of Spokane and Louisville. Managing compliance with these agreements involves review and approval of bank business plans, monitoring reports of financial condition and performance and periodic meetings with each institution's board and senior management to assess overall progress and compliance with the agreements. The purpose of this effort is to protect the Insurance Fund and taxpayers by assuring repayment of $178 million of Financial Assistance Corporation debt.

Receivership/Conservatorship Capability

Beginning January 1, 1993, the FCA must appoint the Corporation to act as conservator or receiver where one is required. To prepare for this contingency, the Corporation has developed a program to utilize contractor assistance to operate any necessary receiverships or conservatorships. By developing a pool of eligible contractors, the Corporation will preserve the ready capability to perform this function when needed, but not incur the excessive cost associated with having permanent Corporation staff dedicated to this contingency.

Highlights of 1992 Legislation

The Farm Credit Banks and Associations Safety and Soundness Act of 1992 (1992 Act) included several key provisions affecting the Corporation. The legislation:

- Creates a full-time 3-member Corporation Board independent of the FCA Board by 1996;
- Strengthens requirements for System repayment of FAC obligations and expands the Corporation's obligation to satisfy defaults of System banks in repaying FAC obligations (see Notes 5 and 6);
- Requires the Federal Intermediate Credit Bank of Jackson (FICB) to merge with a Farm Credit Bank (FCB) and imposes potential obligations on the Corporation to provide assistance to facilitate a merger (see Note 6); and
- Mandates several General Accounting Office studies to investigate the feasibility of granting the Corporation new authority to assess System association capital, collect supplemental premiums and establish a risk-based premium structure.

Report of Independent Public Accountants

Coopers
&Lybrand

certified public accountants

1800 M Street, NW
Washington, DC 20036

telephone (202) 822-4000
facsimile (202) 296-8933

in principal areas of the world

Report of Independent Public Accountants

To the Board of Directors of the
Farm Credit System Insurance Corporation:

We have audited the accompanying statements of financial condition of the Farm Credit System Insurance Corporation (Corporation) as of December 31, 1992, the related statements of income and expenses and changes in the Insurance Fund, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of the Corporation for the year ended December 31, 1991, were audited by other auditors, whose report, dated February 11, 1992, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards, and generally accepted government auditing standards. 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 audit provides 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, 1992, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand

Washington, D.C.
February 24, 1993

Financial Statements

Farm Credit System Insurance Corporation
Statements of Financial Condition as of December 31, 1992 and 1991
(In Thousands)

	1992	1991
Assets		
Cash and Cash Equivalents	$ 832	$ 1,569
Investments in U.S. Treasury Obligations (Note 3)	561,100	454,548
Accrued Interest Receivable	20,203	17,285
Premiums Receivable (Note 4)	74,082	74,257
Other Assets	7	16
Total Assets	$656,224	$547,675
Liabilities and Insurance Fund		
Accounts Payable and Accrued Expenses (Note 8)	$ 147	$ 95
Refund Payable to System Banks (Note 4)	—	1,403
Liability for Eligible Borrower Stock, Richmond PCA (Note 5)	1,173	—
Liability for Estimated Insurance Obligations (Note 5)	166,444	155,555
Farm Credit Insurance Fund	488,460	390,622
Total Liabilities and Insurance Fund	$656,224	$547,675

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

Farm Credit System Insurance Corporation
Statements of Income and Expenses and Changes in Insurance Fund for the Years Ended December 31, 1992 and 1991
(In Thousands)

	1992	1991
Income		
Premiums (Note 4)	$ 73,902	$ 77,463
Interest Income	36,982	31,483
Realized Gain on Sale of Investment	216	—
Total Income	**$111,100**	**$108,946**
Expenses		
Administrative Operating Expenses (Note 8)	$ 1,200	$ 953
Provision for Eligible Borrower Stock (Note 5)	1,173	—
Provision for Estimated Insurance Obligations (Note 5)	10,889	15,555
Net Income	**97,838**	**92,438**
Farm Credit Insurance Fund, Beginning of Year	**390,622**	**298,184**
Farm Credit Insurance Fund, End of Year	**$488,460**	**$390,622**

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

Farm Credit System Insurance Corporation
Statements of Cash Flows for the Years Ended December 31, 1992 and 1991
(In Thousands)

	1992	1991
Cash Flows from Operating Activities		
Net Income	$ 97,838	$ 92,438
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
(Increase) in Accrued Interest Receivable	(2,918)	(14,702)
Decrease in Premiums Receivable	175	62,743
(Increase) Decrease in Other Assets	9	(16)
Net Amortization and Accretion of Investments	6,844	2,239
Realized Gains on Sale of Investments	(216)	
Increase (Decrease) in Accounts Payable and Accrued Expenses	52	(63)
Increase (Decrease) in Refund Payable to System Banks	(1,403)	1,403
Increase in Liability for Eligible Borrower Stock, Richmond PCA	1,173	—
Increase in Liability for Estimated Insurance Obligations	10,889	15,555
Net Cash Provided by Operating Activities	112,443	159,597
Cash Flows from Investing Activities		
Payments for Purchase of U.S. Treasury Obligations	(243,953)	(457,849)
Proceeds from Sale and Redemption of U.S. Treasury Obligations	130,773	252,317
Net Cash Used in Investing Activities	(113,180)	(205,532)
Net Decrease in Cash and Cash Equivalents	(737)	(45,935)
Cash and Cash Equivalents, Beginning of Year	1,569	47,504
Cash and Cash Equivalents, End of Year	$ 832	$ 1,569

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

Farm Credit System Insurance Corporation—Notes to the Financial Statements as of December 31, 1992 and December 31, 1991

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 insuring 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, (Act) (insured obligations). Effective January 6, 1989, each bank in the Farm Credit System (System) participating in insured obligations became an insured System bank. The Corporation 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 Corporation's Board of Directors.

Beginning on January 1, 1993, the Corporation has the responsibility to expend amounts to the extent necessary to:

1. Insure 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.

At December 31, 1992, there were balances outstanding of $53.3 billion of insured obligations, $1.3 billion of FAC bonds (of which $0.3 billion in repayments have been provided for), and $401 million of eligible borrower stock.

If the Corporation does not have sufficient funds to insure payment on obligations in item (1), System banks will be required to make payments under joint and several liability.

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

Note 2—Summary of Significant Accounting Policies

Accounting Principles and Reporting Practices—The accounting and reporting policies of the Corporation 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 required by section 5.62 of the Act. The Act requires that funds of the Corporation, not otherwise employed, shall be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. 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 to be made in the future based on the Corporation's analysis of economic conditions of insured System banks (see Note 5.)

The insured System banks' primary lending markets are borrowers engaged in farming, ranching and production or harvesting of aquatic products and their cooperatives. Economic weaknesses in these market segments and the effect of general market conditions on the insured System banks' borrowers could result in difficulties for certain borrowers to meet their obligations. As a result, insured System 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 System 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. All premiums are due on January 31 of the year subsequent to the year in which they are earned.

Retirement Plan—All permanent full-time 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 equals the 7 percent of base pay contributed by employees covered by that system. For those employees covered by FERS, the Corporation's contribution is 12.9 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.

The retirement plan expenses amounted to $55,000 in 1992 and $23,000 in 1991.

Note 3—Investments

At December 31, 1992, investments in U.S. Treasury obligations consisted of the following:
(In Thousands)

	Book Value	Market Value	Face Rate	Maturity Date
U.S. Treasury Notes	$ 83,364	$ 84,879	7.250%	7/15/93
	3,606	3,670	7.250%	7/15/93
	44,951	45,212	7.250%	7/15/93
	90,982	94,978	8.000%	7/15/94
	3,632	3,799	8.000%	7/15/94
	92,464	98,353	8.875%	7/15/95
	44,696	44,828	8.875%	7/15/95
	85,164	91,269	7.875%	7/15/96
	425	456	7.875%	7/15/96
	5,992	6,443	7.875%	7/15/96
	1,812	1,809	8.500%	7/15/97
	99,546	99,463	8.500%	7/15/97
	4,466	4,453	8.500%	7/15/97
	$ 561,100	$ 579,612		

At December 31, 1991, the Corporation's investment portfolio consisted of U.S. Treasury notes and bills with a book value of $454.5 million and a market value of $476.3 million.

Note 4—Premiums

Effective January 6, 1989, each System 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 Corporation.

In accordance with the Act, the annual premium due from each insured System bank for the calendar year is equal to the sum of (1) the annual average principal outstanding for the year on loans made by the bank that are on accrual status, other than Federal Government-guaranteed portions of these loans, multiplied by 0.0015; (2) the annual average principal outstanding for the year on loans made by the bank that are on nonaccrual status multiplied by 0.0025; (3) the annual average principal outstanding on the guaranteed portions of Federal Government-guaranteed loans of the bank that are on accrual status, multiplied by 0.00015; and (4) the annual average principal outstanding on the guaranteed portions of State government-guaranteed loans of the bank that are on accrual status, multiplied by 0.0003.

Each insured System 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 System banks (adjusted downward by a percentage of the guaranteed portions of State and Federal Government-guaranteed loans on accrual status) or other such percentage or amount determined by the Corporation's Board, 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 premium to a percentage necessary to maintain the level of the Insurance Fund at the secure base amount. At December 31, 1992, the Insurance Fund was 0.9 percent of insured obligations outstanding.

Premiums receivable at December 31, 1990, were based on certain loan information contained in System institutions' Call Reports submitted to the FCA. The 1990 premiums, along with those for 1989, were collected on March 29, 1991. Based on the resolution of certain issues related to interpretation of requirements for the treatment of certain classifications of loans in the premium base, it was determined that the System banks overpaid 1989 and 1990 premiums by a total of $1.4 million. This amount was classified as "Refund Payable to System Banks" in the accompanying statement of financial condition as of December 31, 1991.

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

The 1987 Act required that the FCA charter the Farm Credit System Assistance Board (Assistance Board) and the FAC (see Note 1) for the purpose of carrying out a program to provide assistance to institutions of the System experiencing financial difficulty. In order to raise funds to provide this assistance, the FAC had the authority to issue debt obligations with a maturity of 15 years. Subject to Assistance Board approval, these funds were used by the FAC to purchase preferred stock issued by 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 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 (Trust Fund) represents the funds received from the purchase of stock by System institutions in the FAC. The Trust Fund totaled approximately $72.7 million and $70 million at December 31, 1992 and 1991, respectively. If the Trust Fund is not sufficient to retire the debt, then the Corporation must purchase the preferred stock from the FAC to provide funds to retire such debt. Additionally, if the Corporation does not have sufficient funds, the U.S. Treasury must retire the debt. The Corporation 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 Assistance Board, 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 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 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. Assistance given by the FAC to the FLBJR totaled $388 million.

As a result of the April 27, 1990 agreement, it is probable that the Corporation will have to retire at least a portion of the FAC bonds. It is not clear, however, to what extent the Corporation can rely on the availability of the Trust Fund to pay a portion of the FLBJR-related FAC bonds. Availability of the Trust Fund is dependent on the ability of other Farm Credit banks to redeem preferred stock purchased by the FAC with proceeds from FAC bonds.

As of December 31, 1992 and 1991, there were $419 million of FAC bonds outstanding related to assistance provided to four other System banks. These bonds, also 15-year bonds, will mature in 2003, 2004, and 2005. During 1992, two of the four banks (AgriBank FCB and the Omaha FCB) placed the necessary funds in an irrevocable trust with FAC to allow the retirement of the related $240 million of FAC bonds at maturity.

At the present time, the Corporation is not aware of any information that would indicate the two remaining FCBs (Louisville FCB and the Spokane FCB) will not be able to redeem their preferred stock. If these FCBs cannot redeem the stock so that the bonds can be retired, the Trust Fund may be exhausted prior to the maturity of the FAC bonds that were issued in relation to the FLBJR. In addition, the Farm Credit Banks and Associations Safety and Soundness Act of 1992 expanded the uses of the Trust Fund. The Trust Fund may now be used to satisfy System institution defaults on the principal and interest of all other FAC obligations. Therefore, because the availability of the Trust Fund is uncertain, the Corporation estimated the present value of its liability for payment of the entire $388 million of 15-year maturing debt to be approximately $166 million and $156 million at December 31, 1992 and 1991, respectively. This liability is accrued in the accompanying statements of financial condition. The $10.9 and $15.5 million provisions for estimated insurance obligations for the years ended December 31, 1992 and 1991, respectively, represent the accrued increase in the Corporation's obligation for FLBJR-related FAC bonds. The discount rate used for 1992 and 1991 was 7 percent.

The Corporation has also recorded a liability for providing funds to ensure the retirement of eligible borrower stock of the Richmond, Texas, PCA in Receivership. The amount of eligible borrower stock to be retired at December 31, 1992, was $1.17 million. On January 1, 1993, the Corporation will have the legal obligation to provide funds to ensure the retirement of eligible borrower stock in System institutions (see Note 1).

The Corporation actively monitors the creditworthiness and financial position of the insured System banks. Other than obligations that have occurred as a result of closing out the FLBJR and having to provide funds to retire the eligible borrower stock at the Richmond PCA in Receivership, as described above, Corporation management is not aware of any events or circumstances which would require a liability for estimated insurance obligations to be recorded.

Note 6—1992 Act

The Farm Credit Banks and Associations Safety and Soundness Act was enacted in 1992, (1992 Act) amending the Farm Credit Act of 1971. One provision of the 1992 Act requires the Federal Intermediate Credit Bank of Jackson (FICB), Mississippi, to merge with the Farm Credit Bank (FCB) of Texas unless the FICB merges voluntarily with another FCB by June 30, 1993. The deadline can be extended one time by FCA to no later than October 31, 1993, provided the parties to the merger submit to FCA evidence of a good faith intent to merge. If the FICB fails to merge by the deadline or any extension, the FICB is required to merge with the Farm Credit Bank of Texas subject to terms and conditions determined by an arbitrator. In the event of an arbitrated merger, the Corporation is required to expend amounts necessary to facilitate the merger. Such assistance would be in amounts not to exceed that required to maintain the book value per share of stockholders' equity at the same value reflected on the most recent audited financial statements of the FICB and the FCB of Texas, prior to, or effective with, the date of the merger. The Corporation is also required to guarantee any loss to the merged bank, caused by the default of any association that was a stockholder of the FICB immediately prior to the merger or its successor, on any obligation of principal or interest owed to the merged bank. In the event such assistance is necessary, the Corporation would determine the terms and conditions.

The 1992 Act also authorizes the FCA to require the FICB to merge with an FCB at any time prior to the completion of the required merger if the FCA determines that the FICB is being operated in an unsafe and unsound manner. In the event of an FCA-directed merger resulting from unsafe and unsound conditions, the Corporation is required to expend amounts necessary to facilitate the merger including guaranteeing the other insured System bank against loss resulting from its merger or consolidation with the FICB. In the event such assistance becomes necessary, the Corporation would determine the terms and conditions.

On February 3, 1993, the FCA received a letter of intent to merge from the FICB and the FCB of Columbia, South Carolina. On February 10, 1993, the FCA Board approved an extension of the voluntary merger deadline to October 31, 1993. At this time, Corporation management is not aware of any events or circumstances which would prevent this merger from occurring, or that any assistance from the Corporation will be required.

The 1992 Act expanded the Corporation's liability for defaults of System institutions on payments related to FAC bonds. Previously, the Corporation had only been required (1) to satisfy defaults on the repayment of Treasury-paid interest and (2) to purchase preferred stock of an assisted institution when the institution does not retire it at the maturity of the FAC bonds issued to purchase it. The 1992 Act made the Corporation responsible for defaults of System institutions on obligations related to the repayment of all other FAC bonds outstanding (aggregating $0.45 billion) 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 required annual annuity-type payments to be made to the FAC by all System banks to permit the repayment of Treasury-paid interest and to permit the repayment of principal of bonds issued related to System capital preservation agreements. In addition, assisted banks are now required to make annual appropriations of earnings to an unallocated surplus account designated for the redemption of preferred stock issued to the FAC. The Corporation is required to satisfy defaults on the annual payments to the FAC to permit the repayment of Treasury-paid interest.

Note 7—Operating Lease

On September 1, 1991, the Corporation entered into an agreement with the FCS Building Association to lease office space for a term of 3 years. The lease requires payment of an annual base rent plus the Corporation's proportionate share of operating expenses. The base rent also will increase based on a percentage of change in the Consumer Price Index on an annual basis. The Corporation recorded $75,132 and $20,000 in operating expenses related to the lease in 1992 and 1991, respectively. Remaining minimum future payments under the terms of the lease are $73,116 and $48,744 for 1993 and 1994, respectively.

Note 8—Related Parties

The Corporation purchases services from the FCA under an Inter-Agency Agreement. Such services include examination, administrative, and legal support services. The Corporation had payables due to the FCA of $50,880 at December 31, 1992 and $50,066 at December 31, 1991. The Corporation's total purchased services for 1992 was $361,705 compared with $767,836 for 1991. During most of 1991, the Corporation had no permanent employees and purchased all of its services from the FCA.

References

For additional information about the System, its financial condition and performance, and activities of the FCA, 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.