Contents

4 Board of Directors
6 Corporate Officers
7 Overview
9 Insurance Fund Management
15 Risk Management
16 Report of Independent Public Accountants
17 Financial Statements
20 Notes to Financial Statements
28 References
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 (Insurance Fund);

**Exercise its authorities** to minimize loss to the Insurance Fund; and

**Help ensure the future** of a permanent system for delivery of credit to agricultural borrowers.
Date, 1998

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 (Corporation) is pleased to submit its annual report for calendar year 1997.

The report highlights the Corporation’s role as the Federal entity that ensures the timely payment of principal and interest to the investors in the Farm Credit System debt obligations. I am particularly pleased to announce that early in 1998, the Insurance Fund attained its statutory secure base amount of 2 percent of insured debt outstanding ($1.17 billion). Achievement of this milestone strengthens the Insurance Fund’s ability to protect investors.

The report discusses the Corporation’s operations for 1997, including management of the Insurance Fund, the level of insured debt outstanding and risk management activities. Also included are the 1997 audited financial statements. The Corporation expects to incur $1.77 million in operating costs during calendar year 1998. On January 30, 1998, the Corporation collected $71.2 million in premiums from the insured Farm Credit System banks.

Sincerely,

Doyle L. Cook
Chairman

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

McLean, Virginia 22102
(703) 883-4380
The Farm Credit System Insurance Corporation (Corporation) is managed by a three-member board of directors composed of the members of the Farm Credit Administration (FCA) Board. The Chairman of the Corporation’s Board of Directors, however, must be an FCA Board Member other than the Chairman of the FCA Board.

Doyle L. Cook joined the Corporation’s Board in October 1994 and was elected Chairman in March 1995. He brings to this position 33 years of experience in agricultural lending, 19 of which were with various Farm Credit System institutions. Preceding his appointment to the Board, Mr. Cook served as President and Chief Executive Officer of the Farm Credit Bank of Spokane and as an active participant on various committees of the banks of the Farm Credit System, a director of the Federal Agricultural Mortgage Corporation, and a member of the Chicago Mercantile Exchange Lender Advisory Committee. Previously, he served as President and Chief Executive Officer of Farm Credit Services of Mid-America, Senior Vice President for Credit for the Federal Intermediate Credit Bank of Texas, and Senior Vice President of the Federal Intermediate Credit Bank of Louisville. He began his career with Ralston Purina, where he worked in credit, marketing, finance, and general management for 13 years before joining the Farm Credit System. Mr. Cook, a native of Star City, Arkansas, holds a B.S. in agricultural business and an M.S. in agricultural economics from the University of Arkansas.
Marsha Pyle Martin, a member of the Corporation’s Board since October 1994, is also Chairman and Chief Executive Officer of the Farm Credit Administration. She brings to her position 35 years of experience in agriculture and agricultural finance. The Texas native, who holds a B.A. from Texas Woman’s University and an M.S. from Texas A&M University, joined the Federal Intermediate Credit Bank of Texas in 1970 and in 1979 earned the distinction of being the first woman appointed to a senior officer position in the Farm Credit System. During her career with the Farm Credit Bank of Texas she gained broad management experience, providing leadership and direction for the bank’s corporate relations, legal, operations and supervision, management information, human resources, marketing, and public and legislative affairs departments. She has held leadership positions with various agricultural councils and advisory committees in the State of Texas. In 1995, she received the Academy of Honor in Agricultural Credit, awarded the Texan making the most significant contribution to agricultural credit. She holds the Texas Woman’s University Distinguished Alumna Award for 1996 and was the 1990 recipient of the Cooperative Communicators Association’s H.E. Klinefelter Award, the association’s highest honor, in recognition of her distinguished contributions to cooperative communications.

Ann Jorgensen became a member of the Corporation’s Board in May 1997. She brings to her position extensive experience in production agriculture and accounting. She started farming in partnership with her husband in 1963. Their farming enterprise now includes a cropping operation, Jorg-Anna Farms, and a hog operation, Timberland Hogs Ltd. She has worked as a tax accountant and as a licensed commodity broker. In 1981, she started Farm Home Offices, a mail-order catalog company, which markets farm management products to help farmers improve their financial and production management systems. She served on a number of governing boards for the State of Iowa, including 6 years as a member of the Board of Regents. The Board of Regents is responsible for the state’s three universities, including the University of Iowa Hospital, a world renowned teaching hospital, and its affiliated clinics. She is a co-author of a producer’s guide entitled The Farmer’s Guide to Total Resource Management and is the author of a book Put Paperwork in its Place. She was honored as the Outstanding Young Woman for the State of Iowa in 1976 and was inducted into the Iowa Volunteer Hall of Fame in 1989. She and her husband were recognized by Farm Futures magazine in 1983 as the owners of one of the Top 10 Best Managed Farms. In 1997, she was one of the national agricultural leaders named by Alpha Zeta, the national honorary agricultural fraternity, to its Centennial Honor Roll. A native of Iowa, she holds a B.A. from the University of Iowa.
Corporate Officers

Mary Creedon Connelly
Chief Operating Officer

Dennis M. Pittman
Director of Risk Management

Alan J. Glenn
Chief Financial Officer

Dorothy L. Nichols
General Counsel

C. Richard Pfitzinger
Asset Assurance Manager

Floyd Fithian
Secretary to the Board

Corporate Office
Farm Credit System Insurance Corporation
1501 Farm Credit Drive
McLean, VA 22102
(703) 883-4380
FAX (703) 790-9088
The Farm Credit System Insurance Corporation was established by the Agricultural Credit Act of 1987 (1987 Act) as an independent U.S. Government-controlled corporation. The Corporation’s primary purpose is to ensure the timely payment of principal and interest on insured notes, bonds, and other obligations issued on behalf of Farm Credit System (System) banks.

The System is a privately owned, nationwide financial cooperative that lends to agriculture and rural America. By ensuring the repayment of System debt securities to investors, the Corporation helps to maintain a dependable source of funds for the farmers, ranchers, and other borrowers of the System. The 1987 Act provided for all System banks to be insured. At yearend 1997, there were eight insured System banks paying premiums to the Corporation.

Significant highlights for 1997 include:
- Growth in the Insurance Fund to $1.17 billion;
- Reduction of insurance premiums on accrual loans by 20 percent;
- Adoption of a five-year Strategic Plan;
- Revision of criteria for Corporation allowance for insurance loss procedure; and
- Review of Corporation contingent contracts for conservator and receivership support.

The System finished 1997 in strong condition, having experienced annual growth in insured obligations outstanding of $2 billion or 3.5 percent. Levels of capital also increased Systemwide, and asset quality remained high. The System, with $78 billion in assets on a combined basis, achieved $1.27 billion in net income. Surplus as a percentage of total assets (excluding the Insurance Fund) increased from 10.1 percent in 1996 to 10.8 percent at yearend. System asset quality also improved, with nonperforming assets decreasing from 1.6 percent of total loans and other property owned in 1996 to 1.4 percent at yearend.

During the first quarter of 1998, the Insurance Fund attained its secure base amount of 2 percent of adjusted insured debt outstanding. Achievement of this milestone strengthens the Insurance Fund’s ability to protect investors.
Growth in the Insurance Fund

Chart 1

Corporation Revenues

Chart 2
Growth in the Insurance Fund
The Corporation’s net income in 1997 was $132 million. The Insurance Fund grew to $1.17 billion at yearend, an increase of 13 percent from 1996. Since its inception in 1989, the Insurance Fund has increased 4.5 times in value (see Chart 1). The Insurance Fund represents the Corporation’s equity, i.e., the difference between its total assets ($1.309 billion) and its total liabilities, including its insurance obligations ($139 million).

The Corporation’s principal liability for insurance obligations at December 31, 1997, was $139 million, which represents the liability to repay the Farm Credit System Financial Assistance Corporation (FAC) for financial assistance to the Federal Land Bank of Jackson in Receivership.

Corporation Revenues
The Corporation’s revenues are derived from two sources, premiums collected from insured System banks and interest income earned on the Corporation’s investment portfolio. Total revenues decreased 3 percent, from $147 million in 1996 to $142 million in 1997. This reduction was the result of a decision by the Corporation’s Board to decrease insurance premiums. Revenues for the past five years are depicted in Chart 2.

Premium Collection and Secure Base Amount
The Corporation earned $71.2 million in premium revenue in 1997, a 17 percent decrease that reflects the effect of a reduction in insurance premium rates approved by the Corporation’s Board in January 1997.

The Corporation’s Board sets insurance premium rates on a semiannual basis in accordance with its Policy Statement on Adjustments to Insurance Premiums. The Policy sets out the following five factors the Board will consider in determining whether to adjust premiums:

- Level of the Insurance Fund relative to the secure base amount;
- Any projected losses to the Insurance Fund;
- Condition of the System;
- Health of the agricultural economy; and
- Any risks in the financial environment.

Premiums are collected annually from all System banks based on the retail loan volume at each bank and its related associations. The Farm Credit Act of 1971, as amended (the Act) provides for insurance premiums to be assessed on four classes of System loan assets. (For more information, see Note 4 to the Corporation’s financial statements.)

As noted, in January 1997, the Board reduced insurance premiums for the first half of the year. The rate on accrual loans was reduced from 15 to 12 basis points, a 20 percent reduction, and on Federal and state government-guaranteed accrual loans to zero. The Board left the premiums on nonaccrual loans at 25 basis points. At mid-year, the Board affirmed these rates for the second half of 1997.

Premium revenue is accrued at December 31, 1997, representing the estimated premiums that were earned but not yet collected for calendar year 1997; these premiums were collected on January 30, 1998.
Farm Credit System Insurance Fund in Relation to the Secure Base Amount

Corporation Interest Yield Compared with Similar Bond Funds’ Interest Yield
Chart 3 illustrates the growth in the Insurance Fund toward the secure base amount since the Insurance Fund’s inception. At yearend 1997, the Insurance Fund was 1.99 percent of adjusted insured obligations outstanding. Because the secure base amount is a percentage of the amount of insured debt issued and outstanding, it can fluctuate depending upon System bank funding trends. The Corporation monitors trends in System debt levels monthly.

Allocated Insurance Reserve Accounts

After the secure base amount is reached and maintained, the Act provides for the Corporation to annually determine and segregate any excess Insurance Fund balances into allocated insurance reserve accounts established for each System bank (90 percent) and stockholders of the FAC (10 percent).

This annual allocation is determined by the amount by which the Insurance Fund exceeds the secure base amount calculated on an average daily balance basis, after adjustment for estimated operating and insurance expenses for the immediately succeeding calendar year. Excess Insurance Fund balances may be paid to System banks and FAC stockholders beginning at least eight years after the aggregate Insurance Fund balance attains the secure base amount, but not before 2005. The law provides for this authority to be exercised at the sole discretion of the Corporation’s Board.

Investment of Insurance Fund Assets

The Corporation had cash and investments of $1.208 billion at December 31, 1997, up 15 percent from yearend 1996. Funds are invested in U.S. Treasury securities in accordance with section 5.62 of the Act, 12 U.S.C. 2277a-11, and the Corporation’s Investment Policy. 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 average portfolio yield for 1997 was 6.06 percent.

As a measure of investment management performance, the Corporation’s average yield was compared with the interest yield of seven comparable investment funds available in the private sector. These funds were selected because they also invest in short-term U.S. Treasury securities. The comparison for the past five years is shown in Chart 4.

The Corporation’s average yield over time has exceeded the peer group, primarily as a result of slightly longer weighted average portfolio maturity maintained by the Corporation. During periods of rising interest rates this differential narrows, while the opposite occurs during periods of falling interest rates.

The Corporation maintains an investment strategy of purchasing a ladder of maturities and holding investments to maturity in accordance with its Investment Policy. The Policy provides for the portfolio to be divided into a liquidity pool and an investment pool.

In January 1998, the Board further reduced insurance premium rates on accrual loans to 3 basis points, a 75 percent reduction, effective for the first half of 1998. This reduction reflected the continuing strong financial condition of the System and the near attainment of the Insurance Fund’s secure base amount (2 percent of insured obligations issued and outstanding.)
Farm Credit System Insurance Corporation
Investment Portfolio

<table>
<thead>
<tr>
<th></th>
<th>$ Millions</th>
<th>% of Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liquidity Pool</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>One Year or Less</td>
<td>$ 238</td>
<td>20%</td>
</tr>
<tr>
<td><strong>Investment Pool</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>One Year to Five Years</td>
<td>$ 745</td>
<td>62%</td>
</tr>
<tr>
<td>Five Years to Ten Years</td>
<td>$ 225</td>
<td>18%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$1,208</td>
<td>100%</td>
</tr>
</tbody>
</table>

1Includes cash equivalents

---

Insured Obligations

<table>
<thead>
<tr>
<th>Year</th>
<th>$ Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>$53.7</td>
</tr>
<tr>
<td>1994</td>
<td>$54.1</td>
</tr>
<tr>
<td>1995</td>
<td>$58.5</td>
</tr>
<tr>
<td>1996</td>
<td>$60.7</td>
</tr>
<tr>
<td>1997</td>
<td>$62.9</td>
</tr>
</tbody>
</table>

Chart 5

Chart 6
The liquidity pool may only be invested in U.S. Treasury securities with maturities of one year or less and must be no less than 15 percent or more than 25 percent of total investments. The investment pool consists of the balance of the portfolio and may be invested in U.S. Treasury securities with maturities from one to 10 years, with the limit that no more than 25 percent of the investment pool may be invested longer than five years.

Chart 5 shows the balances and maturities of the liquidity pool and investment pool at December 31, 1997. The weighted average portfolio maturity at yearend was 2.9 years.

**Insured and Other Obligations**

Obligations insured by the Corporation are statutorily defined as any note, bond, debenture, or other obligation issued on behalf of insured 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. Currently, there are no consolidated notes, bonds or other obligations outstanding. 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. Insured obligations are issued through the Federal Farm Credit Banks Funding Corporation on behalf of the System banks. The outstanding principal and accrued interest balances of insured obligations at December 31 for the past five years are shown in Chart 6.

Insured obligations increased by 3.5 percent in 1997. This increase was used primarily to finance higher levels of System loan and investment assets.

The Corporation is also required by statute to use the Insurance Fund to satisfy System institution defaults on obligations related to FAC-issued bonds under section 6.26(d)(3) of the Act and ensure the retirement of eligible borrower stock. The outstanding balances of these obligations at December 31 for the past five years are illustrated in Chart 7.

During 1997, other obligations continued to decline as a result of the further retirement of outstanding eligible borrower stock. In addition, System banks have been providing funds to FAC for the repayment of the outstanding FAC assistance bonds. At December 31, 1997, the System had provided for the repayment of approximately $0.7 billion of the $1.3 billion of FAC assistance bonds outstanding.

**Other Obligations**

![Chart 7](chart7.png)
Operations
In 1997, the Corporation’s Board adopted a five-year strategic plan in accordance with the Government Performance and Results Act of 1993 (GPRA). The strategic plan focuses on the principal program responsibilities of the Corporation and the Insurance Fund. Goals for each program area and related performance measures are linked in the plan with strategies and time horizons for attainment.

The Corporation completed its fifth year of operations in 1997 and continues to operate with a small core staff of 10 employees. Its operations benefit from the reinventing government initiative that has contributed to smaller, more effective government. This initiative provided for the greater use of outsourcing to meet operating and specialized staffing requirements. While the Corporation has few permanent employees, it retains the critically important capability to oversee all aspects of any specialized work that might be performed by outside contractors. Examples of specialized work that might be outsourced when necessary, are asset management and disposition support, due diligence reviews, financial advisory services, and accounting and taxation services.

Because of the need to understand the potential impact of future events (e.g. deregulation, globalization, consolidation, financial market innovation) on insured institutions, staff monitors emerging trends and periodically updates their analytical tools to add newly identified risk factors. This is particularly important when evaluating institutions’ viability or when determining the statutory “least cost” resolution to problem institutions.

The Corporation had $1.5 million in operating costs for 1997, an increase of 2.8 percent. Of this amount, the Corporation’s fixed costs for staff, travel, rent, and miscellaneous expenses totaled $1.3 million. Contract services represented the balance of operating expenses of $0.2 million. These expenses include amounts reimbursed to the FCA for examination and other support and amounts paid to contractors for services.

The Corporation’s 1997 operating costs represented 0.12 percent of average assets. This ratio has declined over the past five years as shown in Chart 8.

Corporation Operating Expenses as a Percentage of Assets

![Chart 8]
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 to evaluate the condition of weaker System institutions. FCA performs these examinations on a reimbursable basis. In addition, the Corporation assesses risk exposure to the Insurance Fund through ongoing review and analysis of the financial condition of System institutions, operation of analytical models, review of corporate merger applications submitted to FCA, Reports of Examination, and by serving as a nonvoting participant on FCA’s Regulatory Enforcement Committee. Staff also monitors the development of legislative, judicial, regulatory, and economic trends that could affect the Insurance Fund. During 1997, the Corporation adopted additional financial performance measures for its risk monitoring activities and its Insurance Fund Allowance for Loss guidelines.

Financial Assistance and Receivership Capability
The Insurance Corporation is authorized to provide assistance to a System institution to prevent default, restore it to normal operations, or to facilitate a merger or consolidation. At the present time, no assistance agreements are outstanding.

The Corporation has developed a program for managing receiverships and conservatorships. To contain costs while providing the statutorily mandated capacity to deal effectively with any potential receiverships or conservatorships, the Corporation has identified private firms and Federal agencies who can be called upon to provide specialized support if needed. These contingency arrangements effectively leverage permanent staff resources while maintaining low overhead during periods of limited or no activity.

In 1997, the Corporation developed guidelines for “pre-resolution” special examinations. These would be implemented if the Insurance Corporation were to become involved in resolving a troubled System institution.
Report of Independent 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 as of December 31, 1997 and 1996, and the related statements of income and expenses and changes in insurance fund, and cash flows for the years 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.

We conducted our audits in accordance with generally accepted auditing standards and generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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 Farm Credit System Insurance Corporation as of December 31, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Washington, D.C.
January 30, 1998
## FINANCIAL STATEMENTS

Statements of Financial Condition as of December 31, 1997 and 1996
($ in thousands)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>$ 1,748</td>
<td>$ 959</td>
</tr>
<tr>
<td>Investments in U.S. Treasury Obligations (Note 3)</td>
<td>1,206,432</td>
<td>1,051,709</td>
</tr>
<tr>
<td>Accrued Interest Receivable</td>
<td>30,441</td>
<td>30,771</td>
</tr>
<tr>
<td>Premiums Receivable (Note 4)</td>
<td>71,242</td>
<td>85,716</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$ 1,309,863</strong></td>
<td><strong>$ 1,169,155</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liabilities and Insurance Fund</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable and Accrued Expenses (Note 7)</td>
<td>$ 164</td>
<td>$ 275</td>
</tr>
<tr>
<td>Liability for Estimated Insurance Obligations (Note 5)</td>
<td>139,178</td>
<td>130,073</td>
</tr>
<tr>
<td>Farm Credit Insurance Fund</td>
<td>1,170,521</td>
<td>1,038,807</td>
</tr>
<tr>
<td><strong>Total Liabilities and Insurance Fund</strong></td>
<td><strong>$ 1,309,863</strong></td>
<td><strong>$ 1,169,155</strong></td>
</tr>
</tbody>
</table>

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

Statements of Income and Expenses and Changes in Insurance Fund
for the Years Ended December 31, 1997 and 1996
($ in thousands)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premiums (Note 4)</td>
<td>$71,242</td>
<td>$85,736</td>
</tr>
<tr>
<td>Interest Income</td>
<td>71,088</td>
<td>61,471</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>$142,330</td>
<td>$147,207</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative Operating Expenses (Note 7)</td>
<td>$1,511</td>
<td>$1,469</td>
</tr>
<tr>
<td>Provision for Estimated Insurance Obligations (Note 5)</td>
<td>9,105</td>
<td>8,509</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$131,714</td>
<td>$137,229</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm Credit Insurance Fund, Beginning of Year</td>
<td>$1,038,807</td>
<td>$901,578</td>
</tr>
<tr>
<td>Farm Credit Insurance Fund, End of Year</td>
<td>$1,170,521</td>
<td>$1,038,807</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these financial statements.
Statements of Cash Flows
for the Years Ended December 31, 1997 and 1996
($ in thousands)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flows from Operating Activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income</td>
<td>$131,714</td>
<td>$137,229</td>
</tr>
<tr>
<td>Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decrease (Increase) in Accrued Interest Receivable</td>
<td>330</td>
<td>(1,760)</td>
</tr>
<tr>
<td>Decrease (Increase) in Premiums Receivable</td>
<td>14,474</td>
<td>(6,324)</td>
</tr>
<tr>
<td>Net Amortization and Accretion of Investments</td>
<td>12,511</td>
<td>13,614</td>
</tr>
<tr>
<td>(Decrease) Increase in Accounts Payable and Accrued Expenses</td>
<td>(111)</td>
<td>64</td>
</tr>
<tr>
<td>Increase in Liability for Estimated Insurance Obligations</td>
<td>9,105</td>
<td>8,509</td>
</tr>
<tr>
<td><strong>Net Cash Provided by Operating Activities</strong></td>
<td>$168,023</td>
<td>$151,332</td>
</tr>
</tbody>
</table>

| **Cash Flows from Investing Activities**         |       |       |
| Payments for Purchase of U.S. Treasury Obligations | (403,332) | (329,135) |
| Proceeds from Redemption of U.S. Treasury Obligations | 236,098 | 178,455 |
| **Net Cash Used in Investing Activities**        | (167,234) | (150,680) |

| **Net Change in Cash and Cash Equivalents**      | 789   | 652   |
| **Cash and Cash Equivalents,**                   |       |       |
| Beginning of Year                                 | 959   | 307   |
| End of Year                                       | $1,748 | $959  |

The accompanying notes are an integral part of these financial statements.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 1997 and December 31, 1996

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 (Act) (insured obligations). Each bank in the Farm Credit System (System) participating in insured obligations is an insured System bank. At December 31, 1997, there were eight insured System banks and 155 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 has the responsibility to expend amounts to the extent 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, 1997, for each of the components of the Corporation’s insurance responsibilities were $62.9 billion of insured obligations, $1.3 billion of FAC bonds (of which $0.7 billion in repayments have been provided for), and $109 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.

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

Note 2
Summary of Significant Accounting Policies

Accounting Principles and Reporting Practices — The accounting and reporting policies of the Corporation conform to generally accepted accounting principles and, as such, the financial statements have been prepared using the accrual basis of accounting. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of revenues and
expenses during the reporting period. Actual results could differ from those estimates.

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

**Investments in U.S. Treasury Obligations** — Section 5.62 of the Act requires that funds of the Corporation, not otherwise employed, shall be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. The Corporation has classified its investments as held to maturity in accordance with the Statement of Financial Accounting Standard (SFAS) No. 115 and carries them at cost. Premiums and discounts are amortized or accreted using the straightline 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. (Also see Note 5.)

The insured System banks’ primary lending markets are borrowers engaged in farming, ranching, and producing or harvesting of aquatic products, and their cooperatives. Financial weaknesses in these market segments and the effect of general market conditions on the insured System banks’ borrowers could adversely affect the banks’ financial condition and profitability. Insured System banks also face risks from changing interest rate environments and the need to maintain ongoing access to financial markets. Adverse changes in the financial condition and profitability of insured System banks resulting from increased levels of credit, financial, or other risks could occur in the future which would have a material effect on the liability for estimated insurance obligations.

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

**Retirement Plan** — All permanent Corporation employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS).

The Corporation’s contribution 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 11.4 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 $94,103 in 1997 and $88,843 in 1996.
### Note 3
#### Investments

At December 31, 1997, and at December 31, 1996, investments in U.S. Treasury obligations consisted of the following: ($ in thousands)

<table>
<thead>
<tr>
<th></th>
<th>December 31, 1997</th>
<th>Gross Unrealized Gains</th>
<th>Gross Unrealized Losses</th>
<th>Estimated Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Treasury Notes</td>
<td>$1,206,432</td>
<td>$19,069</td>
<td>($843)</td>
<td>$1,224,658</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>December 31, 1996</th>
<th>Gross Unrealized Gains</th>
<th>Gross Unrealized Losses</th>
<th>Estimated Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Treasury Notes</td>
<td>$1,051,709</td>
<td>$7,396</td>
<td>($3,611)</td>
<td>$1,055,494</td>
</tr>
</tbody>
</table>

The amortized cost and estimated market value of U.S. Treasury obligations at December 31, 1997, by contractual maturity, are shown below. ($ in thousands)

<table>
<thead>
<tr>
<th></th>
<th>Amortized Cost</th>
<th>Estimated Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Due in one year or less</td>
<td>$ 236,594</td>
<td>$ 236,365</td>
</tr>
<tr>
<td>Due after one year through five years</td>
<td>744,794</td>
<td>755,114</td>
</tr>
<tr>
<td>Due after five years through 10 years</td>
<td>225,044</td>
<td>233,179</td>
</tr>
</tbody>
</table>

$ 1,206,432 $ 1,224,658
Note 4

Premiums

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 is 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 four classes of assets 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; (2) average annual nonaccrual loans outstanding may be from zero to 0.0025; (3) average annual portions of Federal Government-guaranteed accrual loans may be from zero to 0.00015; and (4) average annual portions of state government-guaranteed accrual loans may be from zero to 0.0003.

The Board established insurance premium rates for 1997 at 0.0012 for accrual loans, 0.0025 for nonaccrual loans and zero for Government-guaranteed loans. In January 1998, the Corporation’s Board approved insurance premium rates for the first half of 1998 of 0.0003 for accrual loans, 0.0025 for nonaccrual loans and zero for Government-guaranteed loans.

The 1987 Act set 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 or amount 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 to maintain the level of the Insurance Fund at the secure base amount. At December 31, 1997, the Insurance Fund was 1.99 percent of adjusted insured obligations outstanding.

Note 5

Financial Assistance to System Banks and Estimated Insurance Obligations

Financial Assistance to Certain System Banks

The 1987 Act required that the FCA charter the Farm Credit System Assistance Board (Assistance Board) and the FAC (see Note 1) to provide assistance to System institutions 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.

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 was provided to the Federal Land Bank of Jackson in Receivership.

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, then the FAC must 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 $94 million and $89 million at December 31, 1997 and 1996, respectively. If the Trust Fund is not sufficient to retire the debt, then the Corporation must 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, 1997, 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 of the FAC bonds used to purchase preferred stock in the FLBJR in 2005, 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. The final amount of assistance provided to the FLBJR by the FAC totaled $374 million.
**Estimated Insurance Obligation**

The Corporation estimated the present value of its liability to provide funds for payment of the $374 million of 15-year maturing debt to be approximately $139 million and $130 million at December 31, 1997 and 1996, 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 7 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 (5.8 percent for 1997 and 6.5 percent for 1996). The fair value was approximately $151 million and $135 million as of December 31, 1997 and 1996, respectively. Provisions for changes in the Corporation’s liability are reflected in the statements of income and expenses in the amount of $9.1 million and $8.5 million for the years ended December 31, 1997 and 1996, 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 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, to retire eligible borrower stock of certain liquidating System institutions, and to pay 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 also expanded the potential uses of the Trust Fund to satisfy System institution defaults on the principal and interest of other FAC obligations and required System banks to make annual annuity payments to the FAC to provide funds for the retirement of the Capital Preservation Agreement-related FAC bonds.
aggregating $417 million and Treasury-paid interest at maturity. The Corporation is also required to satisfy defaults on the annual payments to the FAC to permit the repayment of Treasury-paid interest. During 1992 through 1997, 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.

Note 6
Operating Lease


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 $22,093 at December 31, 1997, and $89,907 at December 31, 1996. The Corporation purchased services for 1997 which totaled $160,141 compared with $180,543 for 1996.
### Income and Expenses

#### Farm Credit System Insurance Corporation By Year

($ in thousands)

<table>
<thead>
<tr>
<th>Year</th>
<th>Premiums</th>
<th>Investment</th>
<th>Provision for Administrative Changes in Premiums</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>$65,000</td>
<td>$16,041</td>
<td>–</td>
<td>$118</td>
</tr>
<tr>
<td>1990</td>
<td>$72,000</td>
<td>$25,705</td>
<td>$140,000</td>
<td>$243</td>
</tr>
<tr>
<td>1991</td>
<td>$77,463</td>
<td>$31,483</td>
<td>$15,555</td>
<td>$953</td>
</tr>
<tr>
<td>1992</td>
<td>$73,902</td>
<td>$37,198</td>
<td>$12,062</td>
<td>$1,200</td>
</tr>
<tr>
<td>1993</td>
<td>$74,100</td>
<td>$41,277</td>
<td>($39,444)$1</td>
<td>$1,278</td>
</tr>
<tr>
<td>1994</td>
<td>$76,526</td>
<td>$46,389</td>
<td>$8,890</td>
<td>$1,482</td>
</tr>
<tr>
<td>1995</td>
<td>$79,394</td>
<td>$54,688</td>
<td>($14,329)$2</td>
<td>$1,379</td>
</tr>
<tr>
<td>1996</td>
<td>$85,736</td>
<td>$61,471</td>
<td>$8,509</td>
<td>$1,469</td>
</tr>
<tr>
<td>1997</td>
<td>$71,242</td>
<td>$71,088</td>
<td>$9,105</td>
<td>$1,511</td>
</tr>
</tbody>
</table>

1In 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.

2In 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.
For additional information about the Farm Credit System, its financial condition and performance, and activities of the Farm Credit Administration, the following publications may be helpful.

Farm Credit System Annual Reports to Investors and Quarterly and Annual Information Statements for the current calendar year and the 2 preceding calendar 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 5 fiscal years. These are available without charge from:

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

Production of the 1997 Annual Report of the Farm Credit System Insurance Corporation coordinated by Anna Lacey with assistance from Barbara Shaffer and Christine Quinn.