What is an AIRA?

AIRA stands for **A**llocated **I**nsurance **R**eserve **A**ccount (AIRA).

Who is eligible to receive distributions?

The Farm Credit System Reform Act of 1996 (1996 Act) calls for the creation of an AIRA for each insured Farm Credit Bank and an additional special account for the benefit of Financial Assistance Corporation (FAC) stockholders.

What is the purpose of the AIRA policy?

The 1996 Act allows the FCSIC to revolve funds above the statutorily required 2% Secure Base Amount (SBA) to the insured System banks and the FAC stockholders. The AIRA policy establishes a framework for the periodic determination of the SBA and a mechanism for allocating excess funds above the SBA into the various AIRA accounts.

Why is the AIRA policy being issued now?

The 1996 Act establishes an AIRA for each Farm Credit Bank and a special account for holders of FAC stock. The 1996 Act provides that the first distribution of funds from the AIRAs will occur no earlier than 8 years after the date on which the aggregate of the amounts in the Insurance Fund exceeded the secure base amount.

The Insurance Fund first reached the SBA during the first quarter of 1998; therefore funds can be distributed no earlier than after the first quarter of 2006. During the remainder of 1998 System growth outpaced the growth of the Insurance Fund. Consequently the Insurance Fund dropped back below the SBA.

Throughout 1999 the Insurance Fund has continued to build back towards the SBA and there is a good chance the Insurance Fund will be at or near the 2% level when audited yearend debt numbers are available. If the SBA has been reached, FCSIC will allocate any excess funds to the account holders.

How will the AIRA policy work?

The Farm Credit System Insurance Fund was established to safeguard investors in Farm Credit System securities. The law sets the target level for the Insurance Fund at 2% of current outstanding System borrowings. The 2% SBA target level fluctuates according to changing levels of total System borrowings. In other words, for every $100 the System raises by selling additional securities the SBA goes up by $2.

FCSIC invests the money in the Insurance Fund in U.S. Government securities until needed to pay insurance claims. When the System is growing, the interest earned on these investments is used to reduce future premiums. However, during periods of slow System growth, and no insurance claims, the investment earnings may increase the level of the Insurance Fund beyond what is required. When this occurs, the excess monies will be allocated into the AIRAs and will be revolved back to the System banks and FAC stockholders in accordance with the policy.

When could the first distribution occur?

As noted above, the earliest date for distribution is after the first quarter of 2006. However, it is important to remember that the funds allocated into the individual accounts remain part of the Insurance Fund until actually distributed and may be tapped in the event of an insurance claim.

How are funds allocated?

The 1996 Act reserves 10% of the available funds for the FAC account. This will continue until $56 million has been disbursed to the FAC stockholders. The remaining available funds are distributed to the other account holders on a pro rata basis, using their 3-year average loan balances for comparison.

Did the System participate in the development of this policy?

Yes. A proposed policy statement was published for comment last fall. We received comments from the Farm Credit Bank of Texas, the System's Presidents Finance Committee (PFC), and from two Associations that are FAC stockholders. There was general agreement on the following items:

1. The Policy Statement accurately reflects the statutory formula for determining the SBA as well as the statutory formula for allocating excess fund balances.
2. An estimate of future growth is an appropriate factor to consider when setting premiums.
3. The Policy Statement accurately reflects the statutory formula for allocating excess fund balances.
4. The formula for reduction of excess fund balances is reasonable.
5. Distribution may begin after the first quarter of 2006.
6. The FCSIC Board has the authority to change or restart the 8-year cycle if the Insurance Fund drops below the SBA.
7. When Congress established the AIRAs. it did not intend for them to be a "secondary insurance reserve."

What were the concerns of those who commented?

The comment letters raised five primary concerns about the proposed Policy Statement. The final version of the Policy Statement was modified to include two of commenters' alternatives.

1. To reduce the amount and likelihood of future premiums, the proposed Policy Statement called for the recalculation of AIRA balances at the end of each year. The

commenter(s) agreed that this method would likely result in lower premiums; however, it would also reduce the probability of future distributions. The commenter(s) recommended that FCSIC fix the amounts in the AIRAs each yearend, using those monies only in the event of an insurance claim or to pay higher than anticipated expenses. The FCSIC Board adopted the commenters' alternative.

2. FCSIC is required by statute to insure accrued interest on System obligations. Consequently the proposed Policy Statement included accrued interest in the SBA calculation. The commenter(s) suggested that doing so is not required by statute and FCSIC should not include interest in calculating the SBA. The FCSIC Board disagreed with this position, noting that because the Act requires the repayment of both principal and interest to investors, it is reasonable and prudent to include both principal and interest when calculating the SBA.

3. The proposed Policy Statement included anticipated growth in insured obligations when calculating the amount of excess funds. The commenter(s) suggested that if an estimate for growth was going to be deducted there should be an offsetting adjustment for estimated Insurance Fund earnings. As an alternative they recommended that neither be included in the yearly calculation. The FCSIC Board adopted the commenters' alternative.

4. After a review of the statute and legislative history, the FCSIC Board decided that the statute requires the Insurance Fund to achieve and maintain the SBA. The proposed Policy Statement calls for the collection of premiums when the actual level of the Insurance Fund drops below the 2% target level. The commenter(s) proposed using interest earnings rather than premiums to grow the Fund back to the SBA. The Board agrees with this position for cases when the Insurance Fund drops slightly below the target, risk of insurance claims is low, and interest earnings would restore the Fund within a reasonable time period. However, if the Insurance Fund falls significantly below the SBA, the Board will review the overall risks to the Insurance Fund to determine if premiums are necessary.

5. The proposed Policy Statement does not include the AIRA balances when calculating the SBA as the statute differentiates the AIRAs as separate from the base Insurance Fund. The commenter(s) recommended that the amounts allocated to the AIRAs count towards the 2% Secure Base. The FCSIC Board disagreed as the statute clearly established the AIRAs as excess accounts above the 2% SBA, not part of the SBA calculation.