Farm Credit System Insurance Corporation

# 1999

# Annual Report

Protecting Investors in Agriculture and Rural America

The Farm Credit System Insurance Corporation was established by the Agricultural Credit Act of 1987 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 the seven Farm Credit 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 keep a dependable source of funds for farmers, ranchers, and other System borrowers.

In accordance with the Government Performance and Results Act of 1993, this report discusses the Corporation's operations for 1999, including management of the Insurance Fund, the level of insured debt outstanding, and risk management activities. The key performance measures used to evaluate the success of operations are also highlighted.

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# A Message from the Chair

During my tenure as Chair, my focus will be on the Corporation's primary mission — to protect investors in System debt securities. Maintaining investor confidence is essential to ensuring that System institutions have continuing access to capital markets at a reasonable cost. Last year, investors purchased $321 billion in insured debt—funds the System used to finance the nation's agricultural producers and their cooperatives.

The first line of investor protection to buffer losses is the System's own capital and reserves. The Insurance Fund provides an extra cushion to ensure that investors are repaid on a timely basis should an insured System bank be unable to do so. Overall, both the System and the Insurance Corporation entered the new millennium in sound financial condition.

This was a year of significant progress for the Insurance Corporation and the Farm Credit System. The Corporation reached a milestone with more than $1.5 billion in assets under management. The Insurance Fund finished the year at $1.37 billion, just slightly below the 2 percent secure base amount as required by statute.

The System achieved a high level of financial performance, earning more than $1.0 billion in net profits for the seventh consecutive year, while growing more than 5 percent. Asset quality remained sound at most System institutions and capital levels have improved for the past 12 years.

I wish to thank my colleague on the Board, Michael Reyna, and the dedicated staff of the Corporation for their contributions during the year.

Ann Jorgensen

Ann Jorgensen
May 2000

# Investor Protection and the Farm Credit System

The Corporation's mission is defined by the Farm Credit Act of 1971 as amended (the Act). It is to ensure the repayment of investors who purchase the bonds and notes issued by the System's banks. Investors provide funds the System uses to lend to agriculture and rural America. Sound management of the Insurance Fund helps maintain investor confidence. Investor willingness to purchase System debt ensures ready access to the nation's capital markets to serve the credit needs of agricultural producers and their cooperatives.

In 1999, System lending to agriculture continued to grow. Loans outstanding rose to $70 billion from $68 billion. Asset quality remained good at most System institutions despite weak conditions in agriculture resulting from low commodity prices and reduced export sales. The System continued to generate solid earnings and build capital. The table below presents selected financial statistics for the System.

| Farm Credit System Statistics ($ in billions) | 1999 | 1998 |
|---|---|---|
| Insured Debt Outstanding | $ 72.2 | $ 68.4 |
| Farm Mortgage Loans | 32.4 | 30.9 |
| Agricultural Production Loans | 16.7 | 17.4 |
| Loans to Agricultural Cooperatives | 8.7 | 9.5 |
| International Loans | 2.6 | 2.3 |
| Rural Utilities Loans | 5.1 | 4.7 |
| Rural Home Loans | 1.5 | 1.4 |
| Net Income | 1.23 | 1.25 |
| Nonperforming Assets as % of Loans and Other Property | 1.6% | 2.1% |
| Surplus (excluding Insurance Fund) as % of Total Assets | 11.6% | 11.1% |

# Insurance Corporation Highlights

- During the second quarter of 1999, the Insurance Fund again reached the secure base amount of 2 percent of adjusted insured debt outstanding.
- The Insurance Fund grew 9 percent in 1999 and was slightly below the secure base amount at yearend.
- Insurance premium rates for accrual loans were reduced to zero beginning in January 2000.
- Operating costs remained low at 0.1 percent of average assets.

| **Selected Financial Statistics** ($ in millions) | **1999** | **1998** |
|---|---|---|
| Total Assets | $ 1,534 | $ 1,408 |
| Total Liabilities | 160 | 149 |
| Insurance Fund Balance | 1,374 | 1,259 |
| **Operations:** | | |
| Revenues | 127.3 | 99.5 |
| Operating Expenses | 1.6 | 1.5 |
| Insurance Expense | 10.4 | 9.7 |
| Net Income | 115.3 | 88.3 |
| Insurance Fund as % of Adjusted Insured Debt | 1.99% | 1.94% |

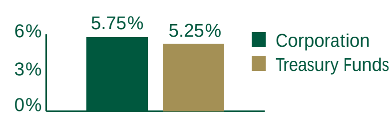
# Strategic Goals and Performance Measures

The Corporation's Strategic Plan has three broad goals:

1. Effectively manage the Insurance Fund to achieve and maintain the 2 percent secure base amount (SBA).
2. Detect, evaluate and manage risks to the Insurance Fund.
3. Maintain the capability to manage any receiverships or conservatorships.

Each goal has performance measures designed to evaluate the overall effectiveness of operations.

| Corporate Performance Measures | 1999 Results |
|---|---|
| **Insurance Fund Management** | |
| • Maintain the 2 percent secure base amount | 1.99% |
| • Achieve investment return comparable with peer group of Treasury Bond Funds | Average Investment Yield |




| Corporate Performance Measures | 1999 Results |
|---|---|
| **Risk Management** | |
| • Detect risk by screening institutions | Evaluated institutions posing risk |
| • Identify institutions requiring special examinations | Completed one special examination |
| • Evaluate potential insurance losses | Evaluated insurance loss allowance quarterly |
| **Receivership/Conservatorship Capability** | |
| • Complete processing of 90 percent of all claims in specified period | No current receivership/ conservatorship activity |
| • Manage operating costs and asset recovery rates within experienced norms | Corporate readiness maintained through training and evaluation of contractor capabilities |

# Board of Directors

**The Farm Credit System Insurance Corporation** is managed by a three-member board of directors composed of the members of the Farm Credit Administration Board. The Chair of the Corporation's Board of Directors, however, must be an FCA Board Member other than the Chairman of the FCA Board.

### Ann Jorgensen

Ann Jorgensen became a member of the Corporation's Board in May 1997 and was elected as the Chair in January 2000. 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 marketed 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 six 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 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.

### Michael M. Reyna

Michael M. Reyna became a member of the Corporation's Board in October 1998 and served as Chairman from November 1998 to January 2000, when he was appointed by President Clinton as the Chairman of the Farm Credit Administration. Prior to joining the Board, he served as President Clinton's director of USDA Rural Development (formerly known as Farmers Home Administration) in California from November 1993 to October 1998. In this capacity, Mr. Reyna was responsible for growing and managing a diversified portfolio of housing, business, and infrastructure loans totaling more than $2.6 billion. He implemented a number of significant initiatives in California on behalf of the Clinton-Gore Administration, including the Northwest Economic Adjustment Initiative, the Rural Empowerment Zone-Enterprise Community program, the AmeriCorps program, and several Reinventing Government Initiatives. Previously, Mr. Reyna served as a principal advisor to the California State Legislature for 11 years, working on financial service industry regulation, and a wide range of issues including housing, economic development, local government finance and political reform. While serving as a private consultant to the Texas 2000 Project, an initiative of the Governor's Office of Budget and Planning, he developed and implemented a computer-based simulation model of the Texas economy which estimated employment and population trends through the year 2000. He was an appointed member of several local commissions, including the Sacramento City Planning Commission, of which he served as Chairman in 1993. Mr. Reyna holds a bachelor's degree in business administration from the University of Texas at Austin and a master's degree in public policy and administration from the LBJ School of Public Affairs at the University of Texas.

In January 2000, Board Member **Marsha Pyle Martin** passed away, leaving one vacant position on the Board.

# 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;

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.

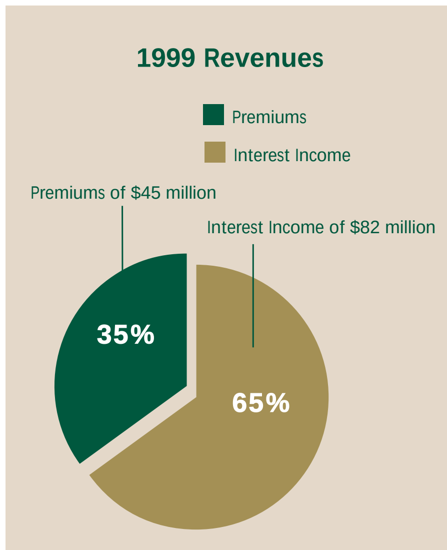
*The Corporation uses the Farm Credit Insurance Fund to carry out its mission. The money comes from investment earnings on the assets in the Insurance Fund and insurance premiums assessed on System banks.*

# Insurance Fund Management

## The Corporation's net income in 1999 was $115 million, an increase of 31 percent from 1998.

### Revenues

Corporate revenues include income from investments and insurance premiums.  Total revenues for 1999 were $127 million.  Revenues were 28 percent greater than in 1998 as a result of higher levels of investment income and insurance premium rates in effect during the year.




### Expenses

Corporation expenses totaled $12 million in 1999.  Insurance expense was $10.4 million consisting entirely of the annual provision for the liability to repay the Farm Credit System Financial Assistance Corporation (FAC). *(See Note 5 to the Corporation's financial statements.)*

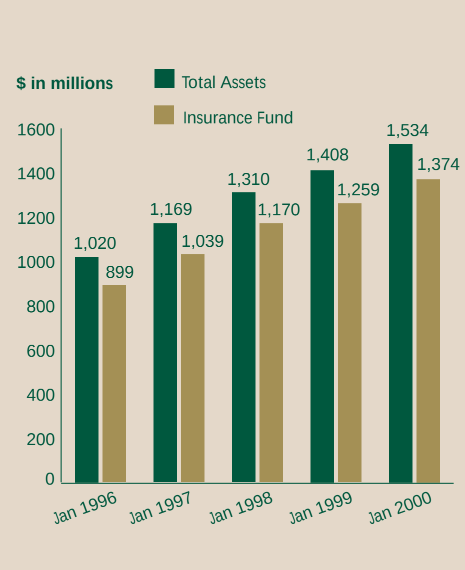
The Corporation operates with a small core staff and uses contractors with specialized expertise when necessary.  Using external resources offers the Corporation flexibility while keeping operating costs low. For example, the FCA provides examination and certain administrative services to the Corporation on a reimbursable fee basis. The Corporation also has contracts with other Federal agencies for specialized services should the need arise.

Operating costs for 1999 were $1.6 million. Of this amount, the Corporation's fixed costs for staff, travel, rent, and miscellaneous expenses totaled $1.3 million.  Purchased services represented the balance of operating expenses of $0.3 million; this includes amounts reimbursed to the FCA and other contractors.

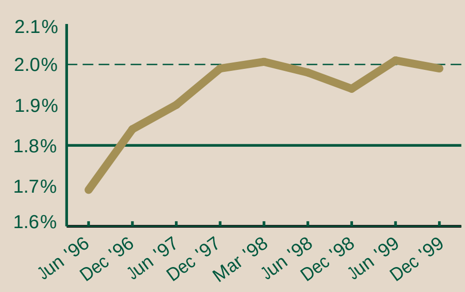
Operating costs represented 0.11 percent of average assets, level with 1998.  This ratio has improved over the past five years, declining from 0.14 percent in 1995.

## Growth in the Insurance Fund

During 1999, the Insurance Fund grew to $1.37 billion, a 9 percent increase from 1998. The Insurance Fund represents the Corporation's equity, i.e., the difference between its total assets ($1.53 billion) and its total liabilities, including its insurance obligations ($160 million).



Growth in the Insurance Fund



Insurance Fund Relative to 2% Secure Base Amount

## The Secure Base Amount

The Act established the secure base amount for the Insurance Fund as 2 percent of outstanding insured obligations or such other percentage determined by the Corporation, in its sole discretion, to be actuarially sound. When the Insurance Fund is at or above the secure base amount, the Corporation is required to reduce insurance premium rates to the level needed to maintain the Fund at the secure base amount.

Because the secure base amount is a percentage of insured debt outstanding, it fluctuates depending upon System funding trends. The Insurance Fund began the year at 1.94 percent and reached the secure base amount at the end of the second quarter. It remained slightly above the secure base amount through the third quarter and dropped slightly below at yearend to 1.99 percent due to an increase in insured debt in December.

### Premium Assessment

Premium revenues increased to $45 million in 1999 from $20 million in 1998 because of higher premium rates in effect during the year. The Board reviews insurance premiums on a semiannual basis. Premiums can be assessed on four classes of System loans when the Fund is below the 2 percent secure base amount:

- Accrual loans (non-government guaranteed balance) – from zero to 15 basis points;
- Nonaccrual loans – from zero to 25 basis points;
- Portions of Federal Government-guaranteed accrual loans – from zero to 1.5 basis points; and
- Portions of state government-guaranteed accrual loans – from zero to 3 basis points.

*(See Note 4 to the Corporation's financial statements.)*

Consistent with the Act, the Corporation adopted a Policy Statement on Adjustments to Insurance Premiums in 1996 that sets out the 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
- Risk in the financial environment.

During 1999, the Corporation expanded its review of premium rates to include input from System institutions on trends in their financial condition and expected loan growth. The Corporation also changed the time frame of the reviews to September and March to accommodate the budget process of System institutions. In September the rates will be set for the coming year. In March, the rates will be reviewed and adjusted, if necessary.

For the first half of 1999, insurance premium rates on accrual loans were set at 9 basis points. This was an increase from 3 basis points in 1998. This increase was approved because the Insurance Fund had dropped to 1.94 percent at the beginning of the year as a result of rapid growth in insured debt during late 1998. Also the System faced increased credit risk due to operating weaknesses experienced by some System borrowers.

Premium rates on accrual loans were reduced to 4.5 basis points for the second half of 1999, when the secure base amount was reached again. Insurance premium rates were maintained at 25 basis points on nonaccrual loans and zero basis points on government-guaranteed loans.

## Investment of Insurance Fund Assets

The Corporation had cash and investments totaling $1.46 billion at December 31, 1999, up 7.4 percent from yearend 1998. Funds are invested in U.S. Treasury securities in accordance with section 5.62 of the Act, and the Corporation's Investment Policy. Under the Policy, the Corporation seeks the maximum return consistent with its liquidity needs and with minimum exposure to loss of principal. Investment revenues earned in 1999 were $82 million, up from $80 million in 1998. The increase in investment income resulted from a higher level of invested assets during 1999.

As a measure of investment management performance, the Corporation compares its average yield with the average yield of seven similar U.S. Treasury investment funds in the private sector. The Corporation earned a competitive return on its investment portfolio (5.75 percent) during the year compared with the peer group (5.25 percent).

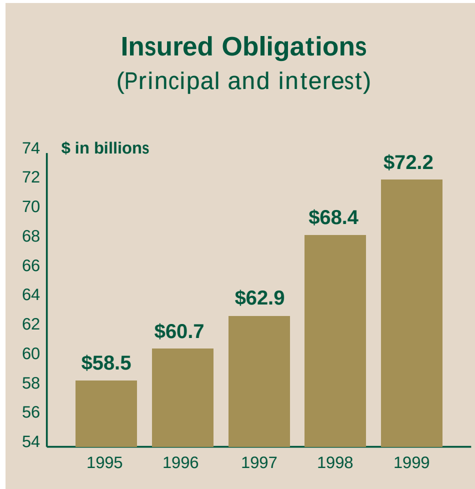
Consistent with its Investment Policy, the Corporation purchases a ladder of maturities and holds investments to maturity. The Policy requires the portfolio to be divided into a liquidity pool and an investment pool. The liquidity pool may only be invested in securities with maturities of one year or 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 securities with maturities from one to 10 years, with no more than 25 percent of the investment pool invested longer than five years.

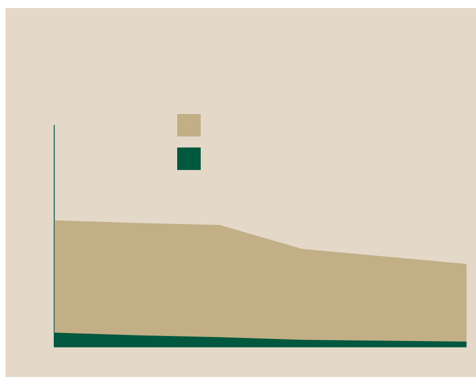
The table below shows the balances and maturities of the liquidity pool and investment pool at December 31, 1999. The weighted average portfolio maturity at yearend was 2.9 years.

**Investment Portfolio**
$ in millions

| | | | % of Portfolio |
|---|---|---|---|
| Liquidity Pool | One Year or Less | $ 281 | 19% |
| Investment Pool | One Year to Five Years | $ 947 | 65% |
| | Five Years to Ten Years | $ 234 | 16% |
| Total | | $ 1,462 | 100% |

## Insured and Other Obligations



The Corporation insures Systemwide and Consolidated notes, bonds and other obligations issued under section 4.2 of the Act. Currently, only Systemwide obligations have been issued and are outstanding. Insured obligations increased by 5.6 percent in 1999 to $72 billion. Insured obligations are issued through the Federal Farm Credit Banks Funding Corporation on behalf of the System banks.

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.

During 1999, other obligations declined significantly as the FAC called and retired $157 million in high coupon assistance bonds in April. In addition, System banks have been providing funds to FAC for the repayment of other outstanding FAC assistance bonds. At December 31, 1999, the System had provided for the repayment of approximately $0.4 billion of the $0.9 billion of FAC assistance bonds still outstanding. Other obligations also declined as further retirement of outstanding eligible borrower stock occurred during the year. At yearend, eligible borrower stock outstanding at System institutions totaled $64 million.

The Corporation's principal liability for insurance obligations at December 31, 1999, was $159 million, which represents the liability to repay the FAC for financial assistance to the Federal Land Bank of Jackson in Receivership. This bank was closed in 1988. The liability to the FAC for the related financial assistance must be paid in 2005. *(See Note 5 to the Corporation's financial statements.)*

### Allocated Insurance Reserve Accounts

A 1996 amendment to the Act requires the Corporation to establish reserve accounts for each bank and the stockholders of the Financial Assistance Corporation. If at the end of any calendar year, the Insurance Fund is at the secure base amount, the Corporation is to segregate any excess balances into these allocated insurance reserve accounts (AIRAs).

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 no sooner than eight years after the aggregate Insurance Fund balance attains the secure base amount, but not before 2006. The law provides for this authority to be exercised at the sole discretion of the Corporation's Board. Because the Insurance Fund was below the secure base amount at yearend 1999, there were no excess balances to allocate. In December 1999 the Corporation's Board issued a policy statement governing the operation of the AIRAs.

# Risk Management

The Corporation's program to identify and manage risk to the Insurance Fund minimizes exposure to potential losses through early detection. Special examination procedures are used to evaluate the condition of weaker System institutions. The majority of the fieldwork for these examinations is performed by FCA on a reimbursable basis. In addition, the Corporation assesses risk exposure to the Insurance Fund through its ongoing review and analysis of the financial condition of System institutions, operation of analytical models, review of corporate actions approved by FCA for System institutions, Reports of Examination of System institutions, and by serving as a nonvoting participant on FCA's Regulatory Enforcement Committee. Corporation staff also monitor the development of legislative, judicial, regulatory, and economic trends that could affect the Insurance Fund.

High levels of government payments played a major role in 1998 and 1999 in maintaining farm income during this period of weak demand for agricultural commodities and low prices. USDA forecasts for 2000 anticipate continuing weakness in agricultural prices, export markets and lower farm income. Whether government payments will continue to buffer agricultural producers is uncertain. The Corporation will monitor the effect of such policy changes on System borrowers.

### Financial Assistance and Receivership

The Insurance Corporation is authorized to provide assistance under certain circumstances 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 a statutory responsibility to serve as receiver or conservator for a System institution when appointed by the FCA. To fulfill this responsibility, the Corporation uses outside contractors, including private firms and other Federal agencies. This allows us to contain costs during periods of limited or no activity while providing the capacity to deal effectively with potential receiverships or conservatorships. At the present time, there are no institutions in receivership or conservatorship.

During 1999, Corporation staff evaluated the capability of several contractors to provide the kinds of specialized services to maintain its readiness to serve as receiver or conservator. In December the Corporation conducted a training exercise that focused on issues that arise in managing receiverships.

# Other Corporation Activities

### Corporate Internet Site

The Corporation launched a site on the World Wide Web in 1999. The web site will provide customers and the public with information about the Corporation as well as updates on the financial condition of the Insurance Fund.

The new Internet site currently contains:

- The Corporation's Mission Statement
- An overview of the Corporation
- A graph tracking the growth of the Insurance Fund
- The Corporation's current regulations and policy statements
- Biographic information on the Board of Directors and a list of Corporate Officers
- Copies of press releases, the Strategic Plan, and Annual Report
- Links to other Internet sites

As development of our Internet site continues, we welcome input on the types of information and services that would be useful.

### "Computers for Learning"

In April, the Corporation donated surplus computers to education in accordance with the Clinton-Gore administration's "Computers for Learning" program. This program is a unique partnership between Federal agencies, schools and non-profits across the country to move surplus computers into our nation's classrooms.

Several of the computers were donated to "HEADS UP – A University Neighborhood Initiative." One of the missions of HEADS UP is to provide low-income children in the District of Columbia with academic and computer skills. In 1999 more than 300 children participated in after-school tutoring, mentoring and summer learning programs. The University Neighborhood Initiative was founded in 1996 and has been awarded an AmeriCorps grant from the Corporation for National Service for its family-focused, school-linked approach to community service. Other computers were donated to Lanier Middle School in Fairfax, Virginia.

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## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors
Farm Credit System Insurance Corporation

In our opinion, the accompanying statements of financial condition and the related statements of income and expenses and changes in insurance fund, and cash flows present fairly, in all material respects, the financial position of the Farm Credit System Insurance Corporation (the Corporation) as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States. 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 of these statements in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 1, 2000 on our consideration of the Corporation's internal control over financial reporting and our tests of its compliance with laws, regulations, contracts and grants.

PricewaterhouseCoopers LLP

Washington, DC
February 1, 2000

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# REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Farm Credit System Insurance Corporation

We have audited the financial statements of the Farm Credit System Insurance Corporation (the Corporation) as of and for the year ended December 31, 1999, and have issued our report thereon dated February 1, 2000. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

## Compliance

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.*

## Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the design of internal control over financial reporting or its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors and management of the Corporation, and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

Washington, DC
February 1, 2000

# Financial Statements

**Statements of Financial Condition as of December 31, 1999 and 1998**
($ in thousands)

| | 1999 | 1998 |
|---|---|---|
| **ASSETS** | | |
| Cash and Cash Equivalents | $ 5,506 | $ 61,959 |
| Investments in U.S. Treasury Obligations (Note 3) | 1,456,480 | 1,298,433 |
| Accrued Interest Receivable | 26,054 | 27,511 |
| Premiums Receivable (Note 4) | 45,496 | 19,966 |
| Other Receivables | 3 | — |
| **TOTAL ASSETS** | **$ 1,533,539** | **$ 1,407,869** |
| **LIABILITIES AND INSURANCE FUND** | | |
| Accounts Payable and Accrued Expenses (Note 7) | 221 | 178 |
| Liability for Estimated Insurance Obligations (Note 5) | 159,345 | 148,921 |
| Total Liabilities | 159,566 | 149,099 |
| Farm Credit Insurance Fund | 1,373,973 | 1,258,770 |
| **TOTAL LIABILITIES AND INSURANCE FUND** | **$ 1,533,539** | **$ 1,407,869** |

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

## Statements of Income and Expenses and Changes in Insurance Fund for the Years Ended December 31, 1999 and 1998

($ in thousands)

| | 1999 | 1998 |
|---|---|---|
| **INCOME** | | |
| Premiums (Note 4) | $ 45,496 | $ 19,972 |
| Interest Income | 81,719 | 79,545 |
| Other Income | 43 | — |
| **TOTAL INCOME** | **$ 127,258** | **$ 99,517** |
| **EXPENSES** | | |
| Administrative Operating Expenses (Note 7) | 1,631 | 1,525 |
| Provision for Estimated Insurance Obligations (Note 5) | 10,424 | 9,743 |
| **NET INCOME** | **115,203** | **88,249** |
| **Farm Credit Insurance Fund, Beginning of Year** | **1,258,770** | **1,170,521** |
| **Farm Credit Insurance Fund, End of Year** | **$ 1,373,973** | **$ 1,258,770** |

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

## Statements of Cash Flows for the Years Ended December 31, 1999 and 1998

($ in thousands)

| | 1999 | 1998 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Net Income | $ 115,203 | $ 88,249 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| – Decrease in Accrued Interest Receivable | 1,457 | 2,930 |
| – (Increase) Decrease in Premiums Receivable | (25,530) | 51,276 |
| – Net Amortization and Accretion of Investments | 15,217 | 10,991 |
| – (Increase) in Accounts Receivable | (3) | — |
| – Increase in Accounts Payable and Accrued Expenses | 43 | 14 |
| – Increase in Liability for Estimated Insurance Obligations | 10,424 | 9,743 |
| **Net Cash Provided by Operating Activities** | **116,811** | **163,203** |
| **Cash Flows from Investing Activities** | | |
| Payments for Purchase of U.S. Treasury Obligations | (410,386) | (336,871) |
| Proceeds from Redemption of U.S. Treasury Obligations | 237,122 | 233,879 |
| **Net Cash Used in Investing Activities** | **(173,264)** | **(102,992)** |
| **Net Change in Cash and Cash Equivalents** | (56,453) | 60,211 |
| **Cash and Cash Equivalents, Beginning of Year** | 61,959 | 1,748 |
| **Cash and Cash Equivalents, End of Year** | **$ 5,506** | **$ 61,959** |

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

# Notes to Financial Statements

as of December 31, 1999 and December 31, 1998

## 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, as amended (Act), (insured obligations). Each bank in the Farm Credit System (System) participating in insured obligations is an insured System bank. At December 31, 1999, there were seven insured System banks and 157 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, 1999, for each of the components of the Corporation's insurance responsibilities were $72.2 billion of insured obligations, $864 million of FAC bonds (of which $386 million in repayments have been provided for), and $64 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, as required by section 4.4 (2) of the Act.

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 and disclosure of contingent 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. At December 31, 1999, the Corporation held $5.5 million in overnight Treasury Certificates maturing on January 3, 2000, with an investment rate of 2.7 percent.

**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 amortized cost. Premiums and discounts are amortized or accreted using the straight-line method, which approximates the interest method, over the terms of the respective issues. Fair value is estimated based on quoted market prices for those or similar instruments.

**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.

**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 $103,319 in 1999 and $99,668 in 1998.

## Note 3 — Investments

At December 31, 1999, and at December 31, 1998, investments in U.S. Treasury obligations consisted of the following:
($ in thousands)

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
|---|---|---|---|---|
| **December 31, 1999** | | | | |
| U.S. Treasury Notes | $ 1,456,480 | $ 2,114 | ($ 19,170) | $ 1,439,424 |
| **December 31, 1998** | | | | |
| U.S. Treasury Notes | $ 1,298,433 | $ 43,360 | ($ 570) | $ 1,341,223 |

The amortized cost and estimated market value of U.S. Treasury obligations at December 31, 1999, by contractual maturity, are shown below.
($ in thousands)

| | Amortized Cost | Estimated Market Value |
|---|---|---|
| Due in one year or less | $ 275,745 | $ 276,139 |
| Due after one year through five years | 946,813 | 936,206 |
| Due after five years through 10 years | 233,922 | 227,079 |
| | $ 1,456,480 | $ 1,439,424 |

### 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.

In February 1999, the Board established insurance premium rates for 1999 at 0.0009 for accrual loans, 0.0025 for nonaccrual loans and zero for Government-guaranteed loans. In August 1999, the Corporation's Board approved reducing the rate for accrual loans for the second half of 1999 to .00045 while retaining the rates of .0025 for nonaccrual loans and zero for Government-guaranteed loans. In September, the Corporation's Board reduced rates on accrual loans to zero beginning January 1, 2000, following the Insurance Fund's attainment of the secure base amount at the end of the second quarter, while retaining the other two rates.

The Act sets 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 as 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. In the second quarter of 1999, the Insurance Fund attained the secure base amount for the first time since the first quarter of 1998. At December 31, 1999, the Insurance Fund was 1.99 percent of adjusted insured obligations outstanding.

A 1996 amendment to the Act requires the Corporation to establish reserve accounts for each System bank and an account for the stockholders of the FAC. If at the end of any calendar year the Insurance Fund is at the Secure Base Amount, the Corporation is to segregate any excess Insurance Fund balances into these allocated insurance reserve accounts (AIRAs). In December, the Corporation's Board adopted a final Policy Statement on the Secure Base Amount and Allocated Insurance Reserve Accounts which provides guidelines for implementing this statutory authority. At December 31, 1999, because the Insurance Fund was slightly below the secure base amount, there were no excess balances to allocate.

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

The 1987 Act required that the FCA charter the Farm Credit System Assistance Board (Assistance Board) and the FAC (see Note 1) to carry out a program of financial assistance to the Farm Credit System. In order to raise funds to provide this assistance, the FAC had the authority to issue debt obligations with a maturity of 15 years. During 1988 to 1992, the FAC issued $1.26 billion in bonds. These funds were used to provide assistance to certain System banks experiencing financial difficulty and for other statutory authorized purposes.

#### Financial Assistance to Certain System Banks

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 totaling $374 million was provided to the Federal Land Bank of Jackson in Receivership to facilitate its closing and liquidation. Subject to Assistance Board approval, these assistance funds were used by the FAC to purchase preferred stock issued by an institution experiencing financial difficulty.

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 $107 million and $101 million at December 31, 1999 and 1998, 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, 1999, 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.

### Estimated Insurance Obligation

The Corporation estimated the present value of its liability to provide funds for payment of the $374 million non-callable 15-year maturing debt to be approximately $159 million and $149 million at December 31, 1999 and 1998, 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 (6.6 percent for 1999 and 4.8 percent for 1998). The fair value was approximately $163 million and $171 million as of December 31, 1999 and 1998, respectively. Provisions for changes in the Corporation's liability are reflected in the statements of income and expenses in the amount of $10.4 million and $9.7 million for the years ended December 31, 1999 and 1998, 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 Farm Credit Banks and Associations Safety and Soundness Act of 1992 (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 1999, 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.

### Early Redemption of Certain FAC Bonds

In November 1998 and April 1999, System banks provided the necessary funds to allow the FAC to call and retire early $397 million of the $1.26 billion in FAC bonds issued during 1988 to 1992 (see paragraph 1, Note 5). Repayment of the remaining FAC bonds in accordance with the Act is being provided for by System banks and the Insurance Corporation.

## Note 6 — Operating Lease

On November 20, 1997, the Corporation executed a new six-year lease with the Farm Credit System Building Association for office space. The terms of the lease provide for an annual base rent for office space for the remaining term of $89,571 for 2000, $92,252 for 2001, $95,020 for 2002 and $98,134 for 2003. The Corporation recorded lease expense of $87,854 and $85,859 for 1999 and 1998, respectively.

## 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 $90,526 at December 31, 1999, and $55,819 at December 31, 1998. The Corporation purchased services for 1999 which totaled $177,625 compared with $152,185 for 1998.

The Corporation provided financial modeling assistance to the FCA under a related Inter-Agency Agreement, recognizing revenue in 1999 of $42,439. At December 31, 1999, the Corporation had a receivable from the FCA for $3,653.

## INCOME AND EXPENSES FARM CREDIT SYSTEM INSURANCE CORPORATION BY YEAR

($ in thousands)

| | INCOME | | EXPENSES | | NET INCOME |
|---|---|---|---|---|---|
| | Premiums | Investment | Provision for Insurance Obligations | Administrative Operating Expenses | Changes in Insurance Fund |
| 1989 | $65,000 | $16,041 | — | $ 118 | $ 80,923 |
| 1990 | $72,000 | $25,705 | $140,000 | $ 243 | ($ 42,538) |
| 1991 | $77,463 | $31,483 | $15,555 | $ 953 | $ 92,438 |
| 1992 | $73,902 | $37,198 | $12,062 | $ 1,200 | $ 97,838 |
| 1993 | $74,100 | $41,277 | ($39,444)[1] | $ 1,278 | $153,543 |
| 1994 | $76,526 | $46,389 | $ 8,890 | $ 1,482 | $112,543 |
| 1995 | $79,394 | $54,688 | ($14,329)[2] | $ 1,379 | $147,032 |
| 1996 | $85,736 | $61,471 | $ 8,509 | $ 1,469 | $137,229 |
| 1997 | $71,242 | $71,088 | $ 9,105 | $ 1,511 | $131,714 |
| 1998 | $19,972 | $79,545 | $ 9,743 | $ 1,525 | $ 88,249 |
| 1999 | $45,496 | $81,719 | $10,424 | $ 1,631 | $115,203 |

[1] In 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.

[2] In 1995, this provision was adjusted to reflect a change in the FAC Trust Fund's investment strategy and the termination of the FLB Jackson receivership making available additional funds to reduce the Insurance Corporation's related FAC obligation.

# 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 |
| **Vivian L. Portis** | Secretary to the Board |

Corporate Office:

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# References

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 two 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

The Farm Credit Administration's Accountability Report for Fiscal Year 1999 is 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 1999 Annual Report of the Farm Credit System Insurance Corporation coordinated by Anna Lacey with assistance from Rebecca Young and Christine Quinn.

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