FCSIC

1995 Annual Report

Farm Credit System Insurance Corporation

Farm Credit System Insurance Corporation

April 29, 1996

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 1995.

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. The balance in the Farm Credit Insurance Fund at December 31, 1995, was $902 million. The Corporation expects to incur $1.9 million in operating costs during calendar year 1996. On January 31, 1996, the Corporation collected $79.4 million in premiums from the insured Farm Credit System banks.

Sincerely,

Doyle L. Cook

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

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.*

Contents

Board of Directors

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 a Board Member other than the Chairman of the FCA Board. One position on the Board of Directors is vacant following the March 31, 1995 resignation of Gary C. Byrne.

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 34 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. 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, including the Texas Agricultural Loan Mediation Program Advisory Board, the Texas Department of Commerce's Credit Advisory Committee, the Board of Directors of Texas Agricultural Lifetime Leadership, and the Texas Agricultural Cooperative Council. In 1990, she received the Cooperative Communicators Association's H.E. Klinefelter Award, the association's highest honor, in recognition of her distinguished contributions to cooperative communications.

Corporate Officers

Mary A. Creedon .... 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

Overview

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 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 nationwide system of privately owned banks and affiliated associations that serve borrowers and related entities in the agricultural sector. 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 1995, there were 8 insured System banks.

During the past year, the System's financial condition continued to improve, increasing the resources available to cushion any potential loss to the Insurance Fund. The System, with $71 billion in assets on a combined basis, achieved $1.2 billion in net income and increased its capital-to-assets ratio from 13.2 percent to 13.6 percent at yearend. System asset quality also improved with nonperforming assets declining from 2.9 percent of total loans and other property owned in 1994 to 2.1 percent at yearend.

Other significant highlights for 1995 include:

- Growth in the Insurance Fund to $902 million, an increase of $147 million from 1994;
- Sizeable reduction in the Corporation's insurance liability to the Farm Credit System Financial Assistance Corporation (FAC);
- Implementation of the insurance risk simulation model; and
- Implementation of additional screening criteria for the Corporation's allowance for loss process.

The Farm Credit System Reform Act was enacted in early 1996. Major provisions affecting the Corporation include:

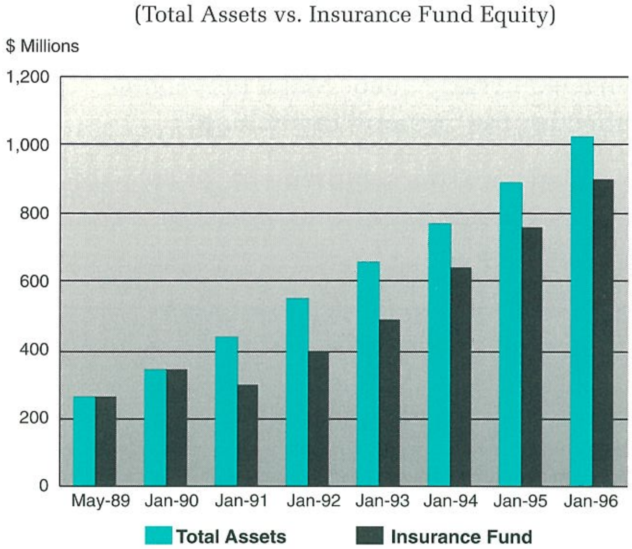
- Repeal of the requirement for an independent full-time Board of Directors;
- Flexibility to reduce insurance premiums before reaching the secure base amount, which is 2 percent of outstanding insured obligations;
- Authority to make refunds of excess Insurance Fund balances beginning 8 years after reaching the secure base amount but not before 2005; and
- Changes in the Corporation's authority to provide financial assistance, adding new cost test requirements.

Insurance Fund Management

Growth in the Insurance Fund

The Corporation had net income for 1995 of $147 million. The Insurance Fund balance at December 31, 1995, was $902 million, an increase of 19 percent from 1994. The Insurance Fund represents the Corporation's equity, i.e., the difference between its total assets ($1,023 million) and its total liabilities, including its insurance obligations ($121 million). The following graph depicts the growth in the Corporation's total assets and the Insurance Fund.

GROWTH IN THE INSURANCE FUND
(Total Assets vs. Insurance Fund Equity)



The Corporation's principal liability for insurance obligations at December 31, 1995, was $121 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 (FLBJR). This liability was revised significantly downward in 1995.

Early in 1995, management took advantage of an exceptional opportunity presented by the continuing gains in the financial strength of System banks and the peaking of the interest rate cycle. The System's financial progress and the provision for early repayment of all of the FAC open bank assistance provided additional evidence that use of the FAC Trust Fund (Trust Fund) for purposes other than repaying the long-term FAC assistance provided to the Federal Land Bank of Jackson was unlikely. Corporation management initiated a dialogue with the FAC seeking to explore ways to modify its strategy for the investment of the Trust Fund's assets in order to increase earnings and reduce the burden on the Insurance Fund. Prior to 1995, the FAC had invested Trust Fund assets in short-term Treasury bills to maintain a high degree of liquidity.

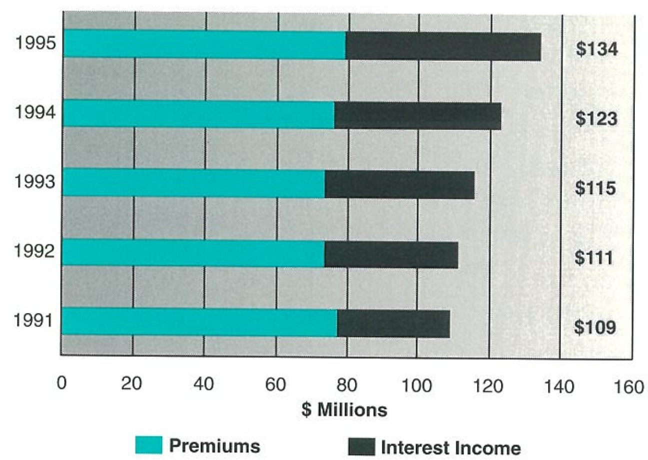
Subsequently, the FAC revised its investment strategy for the Trust Fund to extend investment maturities into 5-year zero coupon U.S. Treasury securities. The lengthening of maturities resulted in the FAC locking in significantly higher interest rates for the Trust Fund's investments. The increased investment returns, which the Trust Fund will receive on these investments, lower the amount of money that the Insurance Fund will have to pay in 2005 to ensure the repayment of the FAC bonds that were issued to provide the FLBJR-related assistance.

Also, early in 1995 the Federal Land Bank of Jackson Receivership was closed and the remaining assets were transferred to the FAC. Modification of the FAC Trust Fund investment strategy and the closing of the FLBJR provided for substantial additional funds to repay the FLBJR FAC bonds. As a result, management made a sizable reduction in its estimate of the Corporation's liability to the FAC in the first quarter of 1995 (see Note 5 to the Corporation's financial statements).

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 increased 9 percent, from \$123 million in 1994 to \$134 million in 1995. Revenues for the past 5 years are depicted in the following graph.

CORPORATION REVENUES



Premium Collection and Secure Base Amount

Premium revenue increased by 4 percent in 1995 to \$79.4 million, reflecting growth in the volume of System loans outstanding. Premiums are collected annually from System banks based on the retail loan volume at each bank and its related associations (see Note 4 to the Corporation's financial statements).

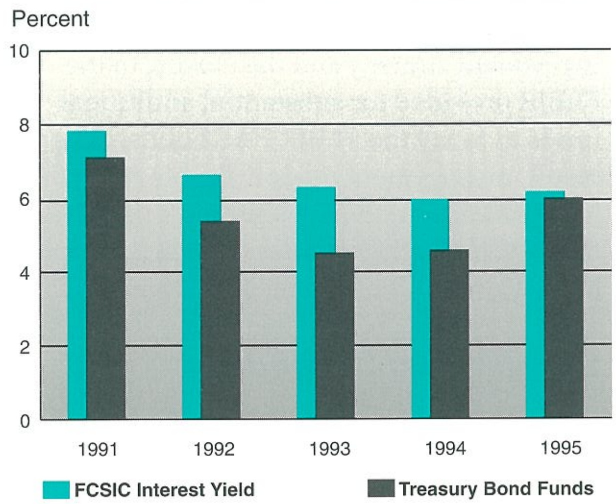
Premium revenue is accrued at December 31, 1995, representing the estimated premiums that were earned but not yet collected for calendar year 1995; these premiums were collected on January 31, 1996. All insured System banks will continue to pay insurance premiums until the aggregate amount in the Insurance Fund reaches the secure base amount. The secure base amount is 2 percent of the insured obligations issued and outstanding by all System banks or such other percentage determined by the Corporation, in its sole discretion, to be actuarially sound.

Investment of Insurance Fund Assets

The Corporation had cash and investments of $915 million at December 31, 1995, up 16 percent from yearend 1994. Funds are invested in U.S. Treasury securities in accordance with section 5.62 of the Farm Credit Act of 1971, as amended (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 1995 was 6.12 percent compared with 6 percent for 1994.

As a measure of investment management performance, the Corporation's average yield was compared with the interest yield of five comparable investment funds available in the private sector. These funds were selected because they invest in short-term U.S. Treasury securities. This comparison for the past 5 years is shown in the following table.

FCSIC INTEREST YIELD COMPARED WITH SIMILAR BOND FUNDS' INTEREST YIELD



The Corporation's average yield is higher than the peer group, primarily as a result of the slightly longer weighted average portfolio maturity maintained by the Corporation during the period. During 1995, the yield difference narrowed as more of the peer group's shorter maturity portfolios were reinvested at the higher interest rates prevailing throughout 1994 and early 1995. The Corporation maintains an investment strategy of purchasing a ladder of maturities and holding investments to maturity, while several of the funds in the peer group trade their securities before maturity.

The Corporation's investment policy permits flexibility to make investments with maturities from 0 to 5 years. There must be a minimum of 15 percent and a maximum of 25 percent invested in any maturity range. At December 31, 1995, the actual portfolio maturities at amortized cost were:

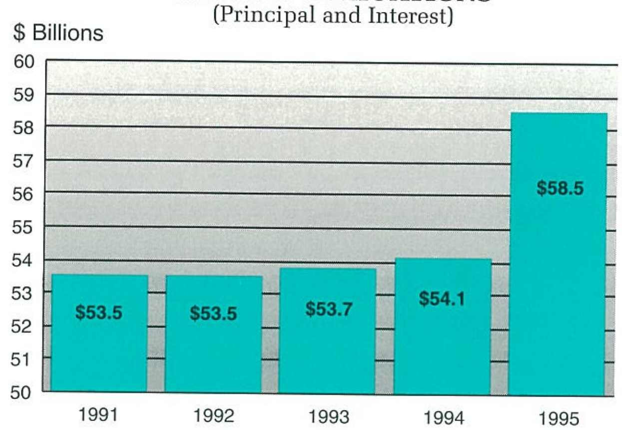
Maturity Schedule	$ Millions	% of Portfolio
1 Day to 1 Year	$179	19
1 Year to 2 Years	225	25
2 Years to 3 Years	224	25
3 Years to 4 Years	147	16
4 Years to 5 Years	140	15
Total	**$915**	**100.0**

At December 31, 1995, the portfolio's market value exceeded book value by $15 million. This appreciation resulted from some of the Corporation's longer term investments that were purchased when market interest rates were significantly higher than in 1995. The weighted average portfolio maturity at yearend was 2.4 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. 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 interest balances of insured obligations at December 31 for the past 5 years are shown in the following graph.

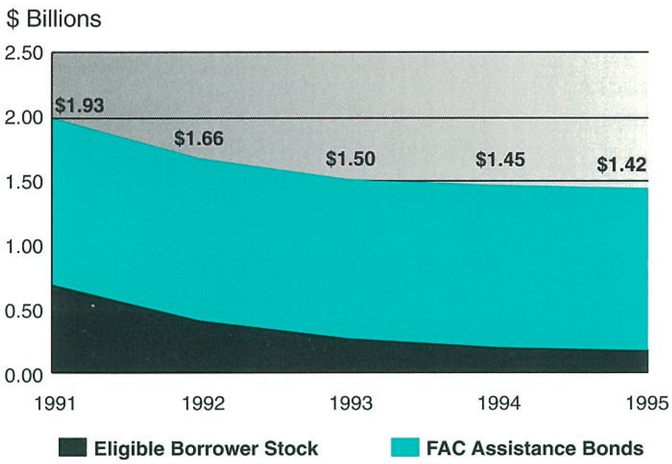
INSURED OBLIGATIONS
(Principal and Interest)



During 1995, the level of insured obligations increased 8 percent. 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: (a) satisfy System institution defaults on obligations related to FAC-issued bonds under section 6.26(d)(3) of the Act; and (b) ensure the retirement of eligible borrower stock. The outstanding balances of these obligations at December 31 for the past 5 years are illustrated in the following graph.

OTHER OBLIGATIONS



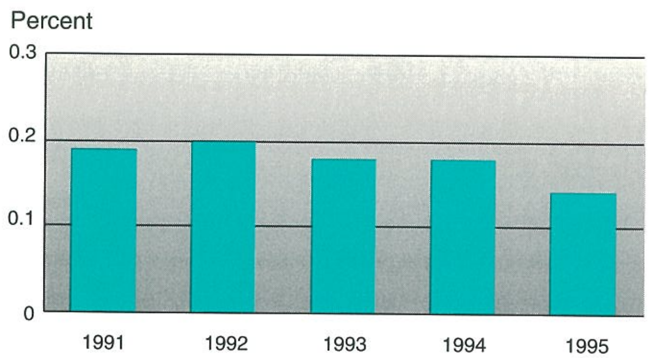
Other obligations continued to decline during 1995 as a result of the further retirement of outstanding eligible borrower stock. In addition, System banks have been providing for the repayment of outstanding FAC assistance bonds. At December 31, 1995, the System had provided for the repayment of approximately $0.6 billion of the $1.3 billion FAC assistance bonds outstanding.

Operations

The Corporation operated with a staff of 10 employees in 1995. The small staff leverages its resources by using the Farm Credit Administration for examination and certain other services. Other specialized services are available through contractual arrangements on an as-needed basis. The Corporation had $1.4 million in operating costs for 1995, representing 0.14 percent of average assets. Of this amount, the Corporation's fixed costs for its permanent staff, travel, rent, and miscellaneous expenses totaled $1.0 million. Contract services represented the balance of operating expenses of $0.4 million. These expenses include amounts reimbursed to the FCA for examination and other support and amounts paid to other contractors for purchased services.

The Corporation's operating costs as a percentage of average assets have declined over the past 5 years as shown in the following graph.

CORPORATION OPERATING EXPENSES AS A PERCENTAGE OF ASSETS



Risk Management

The Corporation's program to identify and manage risk to the Insurance Fund minimizes the Fund's exposure to potential losses through early detection. Corporation staff uses special examination procedures to evaluate the condition of weaker System institutions. FCA examination staff performs these special examinations 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, corporate actions approved by FCA for System institutions, Reports of Examination of System institutions, and by serving as a nonvoting participant on FCA's enforcement committee. Corporation staff also monitors the development of legislative, judicial, regulatory and economic trends that could impact the various risks to the Insurance Fund.

During 1995, the Corporation completed development of an insurance risk simulation model that is now being used, along with other monitoring tools, to help evaluate insurance risk. The model's input parameters include financial characteristics of the insured System banks, such as capital levels and allowances for loan losses, operating expenses, interest rates and loan volume relationships. Output from the model provides a measure of the relative changes in aggregate insurance risk and an estimated probability of Insurance Fund adequacy against prescribed insurance claims scenarios. The model is designed to perform sensitivity analyses by varying input assumptions.

Financial Assistance and Receivership Capability

The Insurance Corporation is authorized to provide assistance to a Farm Credit 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 should the need arise. To contain costs while providing the statutorily mandated capacity to deal effectively with any potential receiverships or conservatorships, the Corporation has qualified a pool of private sector vendors who can be called upon to provide specialized support if needed. These contractual arrangements effectively leverage permanent staff resources while maintaining low overhead during periods of limited or no activity.

National Performance Review

During early 1995, the Corporation participated with Federal Government institutions in the second phase of the National Performance Review (NPR). In this phase of the NPR, all Federal agencies reexamined their basic missions and programs to ensure that they were appropriate functions for government and were operating efficiently. The Corporation also reviewed its limited regulatory authorities for opportunities to streamline and reduce unnecessary regulations. The Corporation issued a report in March 1995 recommending amendment of the Farm Credit Act to modify the requirement for a full-time three-member Board of Directors separate from the FCA Board which was authorized beginning in 1996. Implementing a separate Board structure would have significantly increased cost and staff levels for the Corporation. Congress examined the Corporation's Board structure during its consideration of the Farm Credit System Reform Act of 1996 and included a provision repealing the independent Board structure requirement (see Legislation). The Corporation supports and is guided by the central theme of the NPR of ensuring that the Federal Government performs functions which should be appropriately performed by the government and does so in the most cost-effective manner.

Legislation

Major legislation affecting the Corporation was enacted in early 1996. The Farm Credit System Reform Act of 1996 (Act) includes several major provisions that provide the Corporation with additional authorities. The Act also repeals the requirement for a independent three-member full-time Board of Directors for the Corporation which was authorized beginning in 1996. The Corporation will continue to be governed under its current Board structure composed of the FCA Board Members.

New authorities included in the Act include the flexibility to reduce insurance premium rates and to segregate Insurance Fund balances in excess of the secure base amount for the benefit of System banks and FAC stockholders. Excess Insurance Fund balances may be paid to System banks and FAC stockholders beginning at least 8 years after the Insurance Fund reaches the secure base amount, but not before 2005. The law provides for these new authorities to be exercised at the sole discretion of the Corporation's Board.

The law also provides the Corporation with the authority to regulate "golden parachute" arrangements and certain indemnification payments made by troubled System institutions. The Corporation's authority to provide financial assistance to open System institutions was changed so that any assistance must be the "least costly" approach of all alternatives available to the Corporation in all cases.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

Coopers & Lybrand

Coopers & Lybrand L.L.P.

a professional services firm

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, 1995 and 1994, 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, 1995 and 1994, 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.
February 2, 1996

Farm Credit System Insurance Corporation
Statements of Financial Condition as of December 31, 1995 and 1994
($ in thousands)

	1995	1994
Assets		
Cash and Cash Equivalents	$ 307	$ 530
Investments in U.S. Treasury Obligations (Note 3)	914,643	786,132
Accrued Interest Receivable	29,011	27,463
Premiums Receivable (Note 4)	79,392	76,556
Other Assets	—	6
Total Assets	**$1,023,353**	**$890,687**
Liabilities and Insurance Fund		
Accounts Payable and Accrued Expenses (Note 7)	$ 211	$ 249
Liability for Eligible Borrower Stock, Richmond PCA	—	2
Liability for Estimated Insurance Obligations (Note 5)	121,564	135,890
Farm Credit Insurance Fund	901,578	754,546
Total Liabilities and Insurance Fund	**$1,023,353**	**$890,687**

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

Farm Credit System Insurance Corporation
Statements of Income and Expenses and Changes in Insurance Fund for the Years Ended December 31, 1995 and 1994

($ in thousands)

	1995	1994
Income		
Premiums (Note 4)	$ 79,394	$ 76,526
Interest Income	54,688	46,389
Total Income	**$134,082**	**$122,915**
Expenses		
Administrative Operating Expenses (Note 7)	$ 1,379	$ 1,482
Provision for Estimated Insurance Obligations (Note 5)	(14,329)	8,890
Net Income	**147,032**	**112,543**
Farm Credit Insurance Fund, Beginning of Year	**754,546**	**642,003**
Farm Credit Insurance Fund, End of Year	**$901,578**	**$754,546**

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

Farm Credit System Insurance Corporation—Statements of Cash Flows for the Years Ended December 31, 1995 and 1994

($ in thousands)

	1995	1994
Cash Flows from Operating Activities		
Net Income	$147,032	$112,543
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
(Increase) in Accrued Interest Receivable	(1,549)	(3,451)
(Increase) in Premiums Receivable	(2,836)	(2,475)
Decrease (Increase) in Other Assets	5	(6)
Net Amortization and Accretion of Investments	12,090	12,902
(Decrease) Increase in Accounts Payable and Accrued Expenses	(37)	64
(Decrease) in Liability for Eligible Borrower Stock, Richmond PCA	(2)	—
(Decrease) Increase in Liability for Estimated Insurance Obligations	(14,326)	8,890
Net Cash Provided by Operating Activities	**140,377**	**128,467**
Cash Flows from Investing Activities		
Payments for Purchase of U.S. Treasury Obligations	(311,432)	(245,388)
Proceeds from Redemption of U.S. Treasury Obligations	170,832	116,923
Net Cash Used in Investing Activities	**(140,600)**	**(128,465)**
Net Change in Cash and Cash Equivalents	**(223)**	**2**
Cash and Cash Equivalents, Beginning of Year	**530**	**528**
Cash and Cash Equivalents, End of Year	**$ 307**	**$ 530**

The accompanying notes are an integral part of these financial statements

NOTES TO FINANCIAL STATEMENTS

Farm Credit System Insurance Corporation—Notes to the Financial Statements as of December 31, 1995 and December 31, 1994

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, 1995, there were 8 insured System banks and 158 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 balances outstanding at December 31, 1995, for each of the components of the Corporation's insurance responsibilities were $58.5 billion of insured obligations, $1.3 billion of FAC bonds (of which $0.6 billion in repayments have been provided for), and $161 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.

The Corporation, in its sole discretion, is authorized to expend amounts to provide financial assistance to certain insured institutions.

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 — An investment portfolio is maintained as required by section 5.62 of the Act. The Act requires that funds of the Corporation, not otherwise employed, shall be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. In 1994 the Corporation adopted Statement of Financial Accounting Standard (SFAS) Number 115, "Accounting for Certain Investments in Debt and Equity Securities." The Corporation classified its investments as held to maturity and carried them at cost, adjusted for amortization of premiums and accretion of discounts in 1995 and 1994. This is consistent with the Corporation's investment policy and its positive intent and ability to hold its investments to maturity. Premiums and discounts are amortized or accreted using the straight line method, which approximates the interest method, over the terms of the respective issues. Management reviews the portfolio classifications at least quarterly in accordance with the Corporation's Investment Policy to ensure the classifications are consistent with Corporation liquidity requirements and SFAS 115.

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 $79,382 in 1995 and $79,500 in 1994.

Note 3—Investments

At December 31, 1995, and at December 31, 1994, 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, 1995				
U.S. Treasury Notes	$914,643	$15,296	($596)	$929,343
December 31, 1994				
U.S. Treasury Notes	$786,132	$625	($31,760)	$754,997

The amortized cost and estimated market value of U.S. Treasury obligations at December 31, 1995, by contractual maturity, are shown below.
($ in thousands)

	Amortized Cost	Estimated Market Value
Due in one year or less	$179,185	$180,535
Due after one year through five years	735,458	748,808
	$914,643	$929,343

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.

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

Beginning in 1996, the Corporation may, in its sole discretion, reduce the premiums by a percentage uniformly applied to all System banks. Each insured System bank will continue to make annual premium payments until the aggregate amount in the Insurance Fund exceeds the secure base amount. The secure base amount is equivalent to 2 percent of the aggregate outstanding insured obligations of all insured System banks (adjusted downward by a percentage of the guaranteed portions of 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, 1995, the Insurance Fund was 1.6 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) for the purpose of carrying out a program 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 $83 million and $78 million at December 31, 1995 and 1994, 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, 1995, 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 in 2005 of the FAC bonds used to purchase preferred stock in the FLBJR, the Corporation will provide funds to repay the principal of these debt obligations, to the extent that the Trust Fund is not sufficient for such purpose. 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 $122 million and $136 million at December 31, 1995 and 1994, 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 Statement of Financial Accounting Standards 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 (5.7 percent for 1995 and 7.9 percent for 1994). The fair value was approximately $136 million and $124 million as of December 31, 1995 and 1994, respectively.

Provisions for changes in the Corporation's liability are reflected in the statements of income and expenses in the amount of ($14.3) million and $8.9 million for the years ended December 31, 1995 and 1994, respectively. The ($14.3) million provision for 1995 reflected a change in management's estimate of the liability. Two events occurred in 1995 which caused management to reevaluate this liability. The January, 1995, termination of the FLBJR receivership resulted in the transfer of surplus funds in the receivership estate to the FAC, lowering the total amount of financial assistance provided to the FLBJR. The second event was the repositioning of the FAC Trust Fund investment portfolio into longer maturity investments.

Prior to the first quarter of 1995, the FAC had invested the Trust Fund in short-term U.S. Treasury securities to maintain a high degree of liquidity. After consultation with Corporation management, the FAC lengthened the maturity of Trust Fund investments by repositioning the portfolio into 5-year zero coupon U.S. Treasury securities. This change was made to achieve additional interest earnings from the Trust Fund's assets which in 2005 are expected to be available to reduce the amount that would otherwise have to be paid by the Insurance Fund to extinguish its FLBJR FAC liability.

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 the Corporation's estimate of its 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 1995, 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

On September 2, 1993, the Corporation's lease agreement with the Farm Credit System Building Association for office space and furniture rental was modified to extend the term to September 30, 1996. The agreement requires payment of an annual base rent for office space, with fixed annual increases of 2 percent. The Corporation recorded $76,146 and $64,280 in operating expenses related to the lease in 1995 and 1994, respectively. The remaining minimum future payment under the terms of the lease is $53,289 for 1996.

Note 7 — Related Parties

The Corporation purchases services from the FCA under an Inter-Agency Agreement. Such services include examination, administrative, and legal support services. The Corporation had payables due to the FCA of $62,479 at December 31, 1995, and $70,951 at December 31, 1994. The Corporation purchased services for 1995 which totaled $263,479 compared with $300,064 for 1994.

Income and Expenses
Farm Credit System Insurance Corporation
By Year

($ in thousands)

	Income		Expenses		Net Income
	Premiums	Investment	Provision for Insurance Obligations	Administrative and 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

[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 of Jackson receivership making available additional funds to reduce the Insurance Corporation's related FAC obligation.

References

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

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

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

Annual Reports of the Farm Credit Administration for the past 5 fiscal years. These are available without charge from:

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

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