Farm Credit Administration

2005 Annual Report on the Farm Credit System

Contents

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Statement of the Chairman and CEO

June 2006

Dear Reader,

On behalf of the Farm Credit Administration (FCA or Agency) Board and the dedicated employees of the Agency, I am pleased to present our *2005 Annual Report on the Farm Credit System*.

The FCA is the independent Federal agency responsible for examining and regulating the Farm Credit System (FCS or System), a nationwide network of borrower-owned financial institutions and service organizations that provide credit and related services to agriculture and rural America. FCA also regulates the secondary market activities of the Federal Agricultural Mortgage Corporation.

FCA's role is to ensure that the System remains a safe, sound, and dependable source of credit for agriculture and rural communities. We accomplish this by conducting safety and soundness examinations of each System institution, including an assessment of whether it is meeting its mission to serve agriculture and rural America. The Agency also develops and adopts regulations and other guidelines that govern the activities of System institutions. This year, following a business process review, we restructured the Agency to ensure that it continues to be efficient and effective.

In 2005, the System again achieved an excellent level of performance, with sound capital levels and good asset quality, as described in this report. FCA examinations concluded that System institutions are fundamentally sound in all material respects.

As I indicated in last year's report, I will continue to be a strong advocate for agriculture and rural communities. In 2005, the Agency took several significant actions to ensure that the System appropriately serves their needs. FCA approved Investment in Rural America initiatives by which FCS institutions facilitate the flow of funds to rural areas. The Agency closely monitored the System's efforts to provide credit and related services to young, beginning, and small farmers and ranchers, and supported innovative methods of serving these producers. FCA proposed regulations concerning the method by which a System institution could terminate its System status and worked to develop regulations that ensure good governance of, and appropriate disclosure by, System institutions.

While I am happy that progress was made in 2005, I am more excited about what the future holds. My fellow Board Members and I are committed to ensuring that the Agency remains a strong yet fair regulator for the Farm Credit System. In addition, we are continually working to improve the Agency's communication with the public. If you have any comments or questions, please let us hear from you.

Sincerely,

Nancy C. Pellett

Nancy C. Pellett
Chairman and Chief Executive Officer
Farm Credit Administration

Farm Credit Administration

The Farm Credit Administration ensures a safe, sound, and dependable source of credit and related services for agriculture and rural America.

The Mission

The Farm Credit Administration (FCA or Agency) is an independent agency within the executive branch of the U.S. Government. Its mission is to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. It is responsible for regulating and supervising the banks, associations, and related entities in the Farm Credit System (FCS or System). The Agency also oversees the Federal Agricultural Mortgage Corporation (Farmer Mac).

The FCS is a nationwide network of borrower-owned financial institutions that provide credit to farmers, ranchers, and agricultural and rural utility cooperatives. Farmer Mac provides secondary market liquidity to lenders that originate agricultural mortgages.

Originally created by a 1933 Executive order of President Franklin D. Roosevelt, today's FCA derives its powers and authorities from the Farm Credit Act of 1971, as amended. The U.S. Senate Committee on Agriculture, Nutrition, and Forestry and the U.S. House of Representatives Committee on Agriculture oversee the FCA and the FCS.

The FCA is responsible for ensuring a dependable source of credit for agriculture and rural America. We do this in two specific ways. First, we conduct examinations of FCS institutions to monitor and oversee the safety and soundness of their ongoing activities. These examinations also focus on whether System institutions are meeting their public mandate to serve all eligible borrowers. Second, we approve corporate charter changes and research, develop, and adopt rules, regulations, and other guidelines that govern how System institutions conduct their business and interact with their customers.

If a System institution violates a law or regulation, or its operations are unsafe or unsound, FCA may use its enforcement authority to ensure that the problem is corrected. FCA also protects the rights of borrowers, issues and changes the charters of FCS institutions, reports to Congress on the financial condition and performance of the FCS, and approves the issuance of System debt obligations.

The FCA does not receive a Federal appropriation. It is funded through assessments paid by System institutions. The Agency maintains its headquarters and a field office in McLean, Virginia. There are also field offices in Bloomington, Minnesota; Dallas, Texas; Denver, Colorado; and Sacramento, California.

The Board

FCA policy, regulatory agenda, and examination oversight program are established by a full-time, three-person Board, whose members are appointed by the President of the United States with the advice and consent of the Senate. They serve staggered 6-year terms and may not be reappointed after serving full terms or more than 3 years of previous members' terms. The President designates one member as Chairman of the Board, who also serves as the Agency's Chief Executive Officer (CEO). The FCA Board members also serve as the board of directors of the Farm Credit System Insurance Corporation (FCSIC). A Board member other than the FCA Chairman serves as the chairman of the FCSIC.

Nancy C. Pellett

Chairman and CEO

Nancy C. Pellett was appointed to a 6-year term on the FCA Board by President George W. Bush on November 26, 2002, and she was designated Chairman on May 22, 2004. Her term expires on May 21, 2008. She also serves as a member of the Board of Directors of the FCSIC.

Ms. Pellett brings to her position extensive experience in production agriculture and agribusiness. She served as vice president and secretary of Prairie Hills, Ltd., a feedlot, cow-calf, and row-crop operation in Atlantic, Iowa, from 1979 until 2002. Ms. Pellett was president and treasurer of Fredrechsen Farms, Ltd., a family-owned swine and row-crop operation in Walnut, Iowa, for more than 20 years.

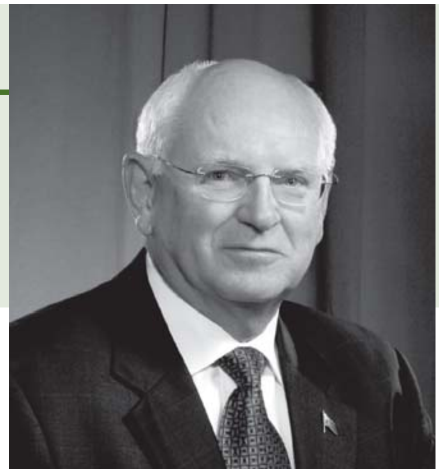
A long-time beef industry leader, Ms. Pellett has held state and national leadership positions in cattlemen's industry organizations. As a member of the National Cattlemen's Beef Association, she has served as the chairman of the Check-Off Division, chairman of the Consumer Marketing Group, and most recently as a member of the Cattlemen's Beef Board. She has also been president of the Iowa Beef Industry Council.

She is part owner in Premium Quality Foods, Inc., which markets branded pre-cooked beef entrees. Previously she served as president and consumer marketing director for the company.

Ms. Pellett served a 6-year term as a member of the Board of Regents for the State of Iowa, which oversees the three state universities, as well as the University of Iowa Hospital and its affiliated clinics. She was also selected as a member of the Governor's Student Aid Commission. She is on the Iowa State University (ISU) Foundation Board of Governors and has been a member of the advisory committees for the College of Agriculture and the College of Family and Consumer Sciences. She is past president of the ISU Alumni Association and was awarded the Alumni Medal in 1987. The Pellett family was honored as the "Family of the Year" by the university in 1997.

Dedicated to the future of agriculture, she has worked with 4-H and the National FFA Organization at the local and state levels, and has served on the Iowa 4-H Foundation Board. She is a founding member of the 4-H/FFA "Sale of Champions" Committee for the Iowa State Fair.

She holds a B.S. from ISU at Ames. She and her husband have four children. The Pellett family received the "Friends of Youth Award" in 2000 from the Knights of AkSarBen, a foundation that supports education, youth programs, and rural development in Nebraska and western Iowa. She and her husband managed a family-owned farm from 1966 until her appointment to the Board. While Ms. Pellett serves her term as FCA chairman and CEO, Mr. Pellett, together with a son and daughter-in-law, continues to operate their fifth-generation family farm in Atlantic, Iowa.



Douglas L. “Doug” Flory

Board Member

Douglas L. “Doug” Flory was appointed to the FCA Board by President George W. Bush on August 1, 2002, for a term that expires October 13, 2006. Mr. Flory also serves as chairman of the Board of Directors of the FCSIC. He was elected to this position in December 2002.

Mr. Flory brings to his position on the FCA Board extensive experience in production agriculture, agribusiness, and both commercial bank and Farm Credit System lending. His farming operation includes Bunker Hill Farm; he is also 50 percent owner of S & F, L.L.C., a beef, turkey, grain, and hay farm in Augusta County, Virginia.

Before his appointment to the FCA Board, Mr. Flory was a member of the board of directors of AgFirst Farm Credit Bank in Columbia, South Carolina, and a director of Farm Credit of the Virginias, Agricultural Credit Association (ACA), in Staunton, Virginia. He also served as a member of the Farmer Mac Appraisal Standards Committee.

He was executive vice president of Dominion Bank from 1971 to 1988 and was president, CEO, and director of Dominion Farm Loan Corporation. During his banking career, he chaired the Virginia Bankers Association Committee on Agriculture and was a member of the executive committee of the American Bankers Association’s agricultural division. From 1989 to 1992 he was executive vice president, chief operating officer, and a member of the board of WLR Foods, Inc., a publicly traded poultry food company (now part of Pilgrims Pride).

Mr. Flory has also served on several governing boards for the State of Virginia. He was appointed to the Virginia Agricultural Council, a state advisory board, and the Virginia Agriculture Credit Committee, which he chaired. He also served on the Virginia Agricultural Development Authority, which uses “aggie bonds” to finance Virginia farmers.

Throughout his career, Mr. Flory has been an active participant in agriculture industry associations. He has served as president of the Virginia Turkey Association and as president and director of the Rockingham County Fair Association. He also served as a director of the Virginia Poultry Federation, the Virginia Agribusiness Council, the Virginia Beef Cattle Association, and the Virginia Sheep Association.

Mr. Flory, a native of Augusta County, Virginia, attended Bridgewater College in Bridgewater, Virginia, and earned a bachelor’s degree from Virginia Polytechnic Institute and State University in Blacksburg, Virginia. He did graduate work at James Madison University and is a graduate of the Maryland-Virginia School of Bank Management at the University of Virginia. He and his wife, Avery, are the parents of two daughters and a son.

Dallas P. Tonsager

Board Member

Dallas P. Tonsager was appointed to the FCA Board by President George W. Bush on December 1, 2004, for a term that expires May 21, 2010. Mr. Tonsager also serves as a member of the Board of Directors of the FCSIC.

Mr. Tonsager brings to his position on the FCA Board extensive experience as an agricultural leader and producer, and a commitment to promoting and implementing rural development strategies to benefit rural residents and their communities. As executive director of the South Dakota Value-Added Agriculture Development Center in Huron from 2002 until his appointment to the FCA Board, he coordinated initiatives to better serve producers interested in developing value-added agricultural projects.

In 1993, he was selected by President Bill Clinton to serve as the South Dakota State Director for Rural Development for the U.S. Department of Agriculture (USDA). The Federal agency promotes rural economic development and helps individuals, communities, and businesses obtain financial and technical assistance for a variety of needs. Mr. Tonsager oversaw a diversified portfolio of housing, business, and infrastructure loans in South Dakota totaling more than $100 million. In 1999, he was recognized as one of two Outstanding State Directors in the nation by Jill Long Thompson, who was then Under Secretary of the USDA. His term concluded in February 2001.

Mr. Tonsager grew up on a dairy farm near Oldham, South Dakota. In partnership with his brother, he owns Plainview Farm in Oldham, a family farming operation that includes corn, soybeans, wheat, and hay.

A long-time member of the South Dakota Farmers Union, Mr. Tonsager served two terms as president of the organization, from 1988 to 1993. He served on the board of the National Farmers Union Insurance from 1989 to 1993, and he was a member of the advisory board of the Commodity Futures Trading Commission from 1990 to 1993.

From 1988 to 1993, Mr. Tonsager was a board member of Green Thumb, Inc., a nationwide job training program for senior citizens. He currently serves on the board of the Lutheran Social Services of South Dakota.

Mr. Tonsager is a graduate of South Dakota State University where he earned a B.S. in agriculture in 1976. He and his wife, Sharon, have two sons and a daughter-in-law.

Farm Credit System—
An Overview of Events and Conditions

FCS Role and Structure

The FCS is a network of borrower-owned cooperative financial institutions and related service organizations. It is the largest single agricultural lender in the country and serves all 50 states and the Commonwealth of Puerto Rico. Created by Congress in 1916 to provide American agriculture with a dependable source of credit, the FCS is the oldest Government-sponsored enterprise (GSE).

FCS institutions provide credit and financially related services to farmers, ranchers, producers or harvesters of aquatic products, and farmer-owned cooperatives. They also make credit available for agricultural processing and marketing activities, rural housing, certain farm-related businesses, agricultural and aquatic cooperatives, rural utilities, and foreign and domestic entities in connection with international agricultural trade. The System raises funds by selling securities in the national and international money markets, subject to approval by the FCA. These securities are not guaranteed by the U.S. Government. The funds are used to meet the credit needs of rural America through the FCS lending institutions.

As of December 31, 2005, the System was composed of 101 banks and associations. Five Farm Credit banks provide loan funds to 85 ACA parent organizations[1] and 11 Federal Land Credit Associations (FLCAs). ACAs make short-, intermediate-, and long-term loans; FLCAs make only long-term loans; and Production Credit Associations (PCAs), which are subsidiaries of ACAs, make only short- and intermediate-term loans.

One of the five banks is an Agricultural Credit Bank (ACB), which has a nationwide charter to make loans to agricultural and aquatic cooperatives and rural utilities, as well as to other persons or organizations that have transactions with, or are owned by, such cooperatives. The ACB finances U.S. agricultural exports and imports and provides international banking services for farmer-owned cooperatives. In addition to making loans to cooperatives, the ACB provides loan funds to five ACAs, which serve New York, New Jersey, Connecticut, Rhode Island, Maine, Massachusetts, New Hampshire, Vermont, Alaska, Oregon, Washington, Montana, and Idaho.

1. The ACA is the parent company with two wholly owned subsidiaries, a PCA and an FLCA. Although legally separated, the ACA, the PCA, and the FLCA operate an integrated lending business, with loans made through the subsidiaries appropriate to the authority of each subsidiary. The ACA, the PCA, and the FLCA are jointly and severally liable on the full amount of the indebtedness to the bank under the bank's General Financing Agreement. In addition, the three associations agree to guarantee each other's debts and obligations, pledge their respective assets as security for the guarantee, and share each other's capital. The three institutions have a common board and management and a common set of shareholders. Under the Farm Credit Act, the FLCA is exempt from Federal income taxes.

In addition to the banks and associations described above, FCA examines and regulates the following three entities:

The **Federal Farm Credit Banks Funding Corporation,** which markets debt securities that the banks sell to raise loan funds. The Funding Corporation is owned by the System banks.

The **Farm Credit System Financial Assistance Corporation,**[2] chartered in 1988, which provided needed capital to the System through the sale of $1.3 billion in 15-year bonds to the capital markets and the purchase of preferred stock. This stock was issued by certain System institutions that received financial assistance as authorized by the Farm Credit System Assistance Board.[3]

Farmer Mac,[4] which provides a secondary market arrangement for agricultural real estate and rural housing mortgage loans and provides greater liquidity and lending capacity to agricultural lenders. Under the Farmer Mac I program, Farmer Mac guarantees prompt payment of principal and interest on securities representing interests in, or obligations backed by, mortgage loans secured by first liens on agricultural real estate or rural housing; it also purchases or commits to purchase qualified loans or securities backed by qualified loans directly from lenders. Under the Farmer Mac II program, it guarantees securities backed by the "guaranteed portions" of farm ownership and operating loans, rural business and community development loans, and certain other loans guaranteed by the USDA.

FCA also examines and regulates the following five service corporations organized under Section 4.25 of the Farm Credit Act:[5]

AgVantis, Inc., which provides technology-related and other support services to the associations affiliated with U.S. AgBank, Farm Credit Bank (FCB). AgVantis, which was chartered by FCA on August 3, 2001, is owned by the bank and 17 of its affiliated associations.

Farm Credit Finance Corporation of Puerto Rico (FCFCPR), which used tax incentives offered to investors to provide low-interest funding (other than that from the Federal Farm Credit Banks Funding Corporation) to the Puerto Rico Farm Credit, ACA. Because of changes in the tax treatment of the corporation, AgFirst FCB, the sole owner of FCFCPR, suspended operations of FCFCPR as of December 31, 2005, although the charter remains outstanding.

2. The Farm Credit System Financial Assistance Corporation (FAC) will continue in existence until no later than 2 years following the maturity and full payment of its outstanding debt securities, which matured and were repaid in full in June 2005. The board of directors of the FAC is the same as the board of directors of the Federal Farm Credit Banks Funding Corporation.
3. The Farm Credit System Assistance Board was created by the Agricultural Credit Act of 1987 to provide assistance to financially troubled FCS banks, protect the stock of System borrowers, restore FCS banks to economic viability, and preserve their ability to provide credit at reasonable and competitive rates. The Farm Credit System Assistance Board terminated on December 31, 1992.
4. Farmer Mac is established in law as a part of the FCS. However, Farmer Mac has no liability for the debt of any other System institution, and the other System institutions have no liability for Farmer Mac debt. Farmer Mac is organized as an investor-owned corporation, not a member-owned cooperative. Investors in voting stock may include commercial banks, insurance companies, other financial organizations, and FCS institutions. Nonvoting stock may be owned by any investor. Farmer Mac is regulated by the FCA through the Office of Secondary Market Oversight, whose director reports to the FCA Board on matters of policy.
5. Section 4.25 of the Farm Credit Act provides that one or more FCS banks or associations may organize a service corporation to perform functions and services on their behalf. These federally chartered service corporations are prohibited from extending credit or providing insurance services.

Farm Credit Leasing Services Corporation, which provides equipment leasing services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities. It is a service corporation owned by CoBank, ACB.

Farm Credit Financial Partners, Inc., which provides support services to CoBank, ACB; CoBank's five affiliated associations; the Farm Credit Leasing Services Corporation; five associations affiliated with U.S. AgBank, FCB; two associations affiliated with AgriBank, FCB; and two System-related entities.

The **FCS Building Association,** which acquires, manages, and maintains facilities to house FCA's headquarters and field office staff. The FCS Building Association was formed in 1981 and is owned by the FCS banks. The FCA Board oversees the Building Association's activities on behalf of its owners.

When Congress established the FCS as a GSE, its purpose was to provide a permanent, reliable source of credit and related services to agriculture and aquatic producers, their cooperatives, and related businesses in rural America. Congress intended the farmer-owned cooperative FCS to improve the income and well-being of American farmers and ranchers. It further encouraged farmer- and rancher-borrower participation in the management, control, and ownership of these cooperative institutions to help them remain focused on serving their members' needs.

The System meets a broad public need by preserving liquidity and competition in rural credit markets in both good and bad economic times. The accomplishment of this public goal benefits all eligible borrowers, including young, beginning, and small (YBS) farmers, as well as rural home purchasers.

FCA's regulations, policy statements, examinations, chartering activities, and other regulatory activities (discussed in later chapters of this report) support and facilitate the accomplishment of the System's mission by ensuring that FCS institutions operate in a safe and sound manner without undue risk to taxpayers, investors in System securities, or its borrower-stockholders.

The sections in this chapter first assess the System's financial strength and then its service to rural America. Our discussion relies on commonly used measures, including trends in volume by a variety of loan types, volume of funding for non-System rural lenders and participations with other lenders, and the System's share in the marketplace. Discussion in the next chapter also covers lending activity and programs that benefit YBS farmers and ranchers and the use of government guarantee programs in supporting loans to farmers who are unable to meet normal underwriting requirements.

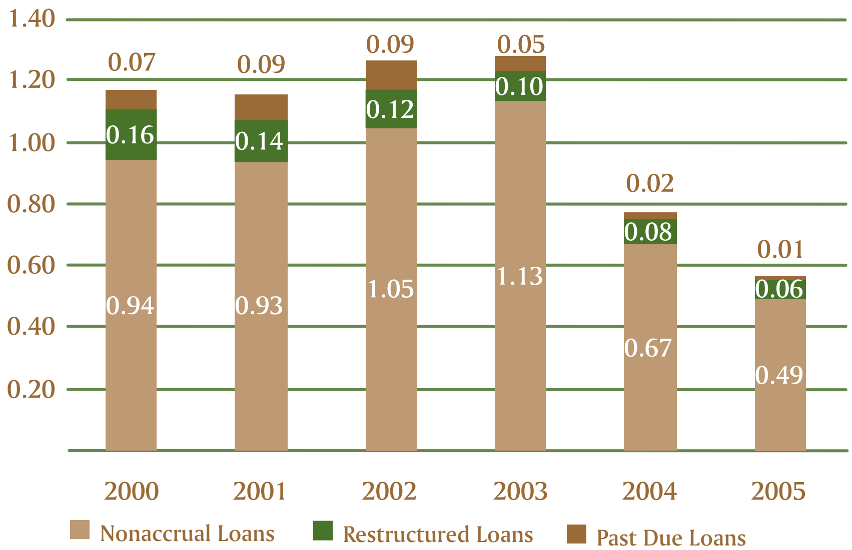
Financial Condition of the FCS[6]

FCS loan volume grew at a strong pace for the year ended December 31, 2005, (see "Borrowers Served" on page 14). Asset quality remained high and nonaccrual loans decreased over the preceding 12 months, primarily because of favorable economic conditions in the agricultural sector. System earnings continued to improve from the increased loan volume and slightly better yield spreads on earning assets. Record-high levels of government payments to the agricultural sector supplemented the incomes of borrowers and contributed to the System's financial strength.

Asset Quality—System loan volume expanded at a good rate and loan quality remained high for the year ended December 31, 2005. Gross loans increased by 10.3 percent to $106.3 billion. Nonperforming loans[7] amounted to $600 million, or 0.56 percent of gross loans, for 2005, a 19 percent decline from the previous year (see Figure 1). Nonaccrual loans totaled $524 million, or 0.49 percent of gross loans, in 2005, compared with $646 million, or 0.67 percent, in 2004. The allowance for loan losses (ALL) as a percentage of gross loans declined from $792 million, or 0.82 percent of gross loans, in 2004 to $755 million, or 0.71 percent of gross loans, in 2005.[8] Delinquencies (accrual loans 90 or more days past due) remained low, at just 0.01 percent (1 basis point) of total gross loans.

6. The information presented in this section pertains to all FCBs, the ACB, and their affiliated associations. The FCS institutions provided the data used in the overall FCS analysis to the FCA or to the Federal Farm Credit Banks Funding Corporation. The analysis in this report is based on publicly available information and, except where noted, is based on the 12-month period ended December 31, 2005. See Tables 2 and 3 on pages 22 and 23 for System measures of financial condition.
7. Nonperforming loans consist of nonaccrual loans, accruing restructured loans, and accrual loans 90 or more days past due.
8. During 2004, System institutions conducted studies to refine their ALL methodologies following FCA requirements, as well as Securities and Exchange Commission and Federal Financial Institutions Examination Council guidance. As a result, System institutions recorded a reversal of the ALL of $1.167 billion, net of a related $95 million deferred-tax expense for the year ended December 31, 2004.

Figure 1
FCS Nonperforming Loans, 2000–2005
As of December 31



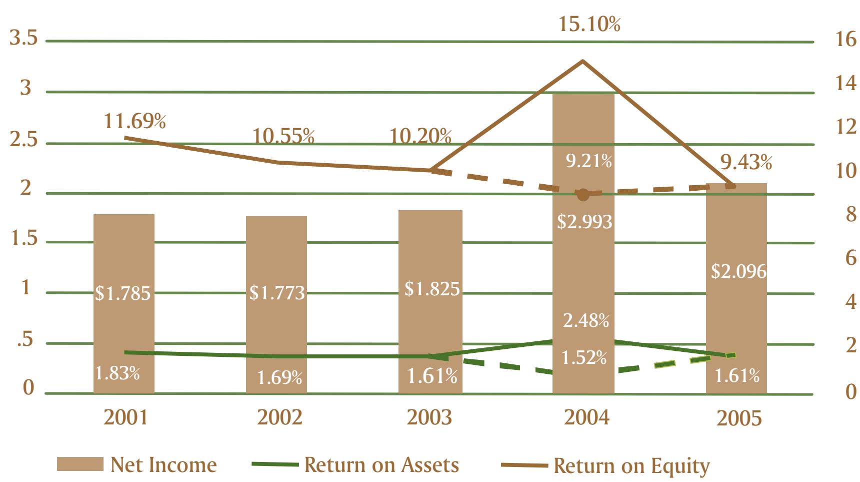
Sources: Federal Farm Credit Banks Funding Corporation, Annual Information Statements.

Earnings—Continuing favorable credit quality helped the System produce \$2.1 billion in earnings for the year ended December 31, 2005, (see Figure 2). Although System earnings in 2005 were less than the earnings in 2004,[9] earnings continued to reflect an increasing overall trend for the past 5 years. Net interest income was the principal source of earnings, equaling \$3.25 billion in 2005, compared with \$2.99 billion in 2004 (an 8.4 percent increase). In sharp contrast with 2004, when the ALL reversal was \$1.2 billion, the System's reversal in 2005 was only \$1 million. Systemwide net interest margin increased 2 basis points to 2.58 percent as of year-end 2005, compared with 2.56 percent a year earlier. Noninterest income was \$353 million in 2005, compared with \$340 million in 2004, an increase of 3.8 percent. Noninterest expense was \$1.41 billion in 2005, compared with \$1.35 billion in 2004, an increase of 4.1 percent.

9. Excluding the \$1.167 billion (net of taxes) ALL reversal in 2004, System earnings for 2005 increased 14.8 percent from the previous year.

10. Total capital includes perpetual preferred stock, capital stock and participation certificates, restricted capital, accumulated other comprehensive income, allocated surplus, and unallocated surplus. It does not include mandatorily redeemable term-preferred stock or protected capital. Restricted capital ($2.06 billion as of December 31, 2005) represents the total assets under the control of the FCSIC, including assets that have been identified for estimated insurance obligations and the Farm Credit Insurance Fund balance. Accumulated other comprehensive income (negative $242 million as of December 31, 2005) for the System consisted of unrealized holding losses on available-for-sale securities ($142 million), pension liability adjustments ($61 million), and unrealized losses on cash flow hedges ($39 million). One System bank had $225 million of mandatorily redeemable term-preferred stock outstanding. Such stock is not included in "total capital" although it qualifies for certain regulatory capital purposes. Protected capital ($17 million as of December 31, 2005) consists of borrower stock, participation certificates, and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated before October 8, 1988. Protection of certain borrower capital is provided under the Farm Credit Act of 1971, as amended, which requires FCS institutions, when retiring protected borrower capital, to retire such capital at par or stated value regardless of its book value.

Figure 2
FCS Net Income, 2001–2005
As of December 31

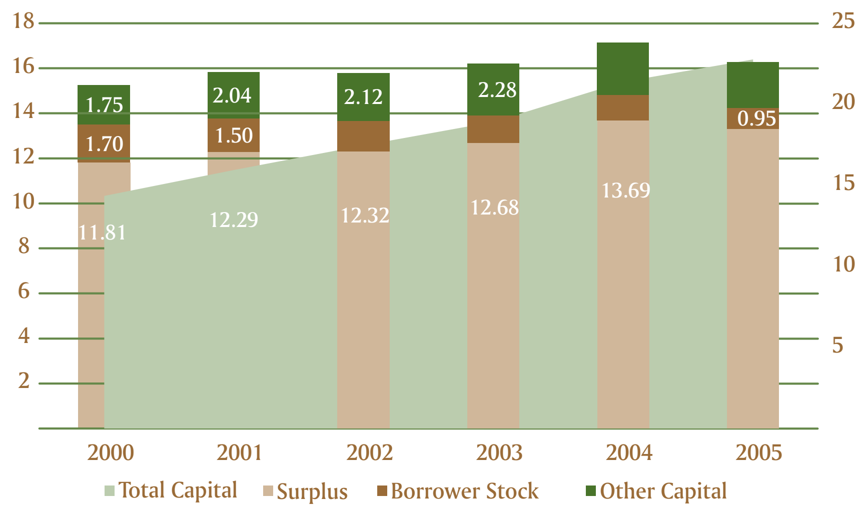


Sources: Federal Farm Credit Banks Funding Corporation, Annual Information Statements.

Note: The dotted green line and dotted brown line show the return on assets and return on equity, respectively, that System institutions would have had without the large allowance-for-loan-losses (ALL) reversal that occurred when they refined their ALL methodologies in 2004. See footnote 8.

Capital—In 2005, the System continued to strengthen its capital base through increased loan volume and earnings.[10] Total capital was $22.8 billion in 2005, compared with $21.4 billion in 2004, an increase of 6.5 percent (see Figure 3). Accumulated surplus also increased to $18.6 billion, comprising 13.3 percent of System assets and 81.7 percent of System capital. For the year ended December 31, 2005, preferred stock increased $132 million (or 14.9 percent) to $1.02 billion, which equated to 4.5 percent of total capital.

Figure 3
FCS Capital, 2000–2005
As of December 31



Sources: Federal Farm Credit Banks Funding Corporation, Annual Information Statements.

System bank and association capital ratios remained strong for 2005, well above regulatory minimum requirements.[11] Permanent capital ratios for System banks ranged from 13.7 percent to 23.9 percent; however, because many of the banks' assets are risk-weighted at less than 100 percent, the Agency uses the net collateral ratio as a key capitalization standard for the System's five banks. The minimum requirement for this ratio is 103 percent; as of December 31, 2005, no bank had a net collateral ratio of less than 105 percent.

The results for the other capital ratios were all very favorable. The permanent capital ratio for System associations ranged from 11.1 percent to 28.9 percent. Total surplus ratios for System banks ranged from 13.7 percent to 23.8 percent; they ranged from 9.8 percent to 28.1 percent for the associations. All System institutions also exceeded the regulatory minimum requirement for the core surplus ratio.

11. Banks and associations are required to maintain a regulatory minimum permanent capital ratio of 7.0 percent, a total surplus ratio of 7.0 percent, and a core surplus ratio of 3.5 percent.

12. This total does not include loans to rural homeowners, as defined in FCA regulation 613.3030, and leases.

Borrowers Served

The System fulfills its overall mission by using its authority to lend to agriculture and rural America. Since its inception in 1916, the System's authority to serve its customer base has evolved over the years to include the following loan products:

- long-term agricultural real estate loans, including rural home loans;
- short- and intermediate-term agricultural loans;
- loans to producers and harvesters of aquatic products;
- loans to certain farmer-owned agricultural processing facilities and farm-related businesses;
- loans to farmer-owned agricultural cooperatives;
- loans that finance agricultural exports and imports; and
- loans for rural utilities.

Nationwide, the System had $106.3 billion in gross loans outstanding as of December 31, 2005, (see Table 1). Agricultural producers represented by far the largest borrower group, with $76.6 billion, or 72.1 percent of the total dollar amount of loans outstanding.[12] As required by law, all borrowers also own stock in System institutions. The System had nearly 729,000 loans and approximately 460,000 stockholders in 2005.

The aggregate total of loans outstanding at FCS banks and associations (net of intra-System lending) grew by $9.9 billion, or 10.3 percent, during the year ended December 31, 2005; this was the largest annual percentage increase in the past 5 years. The second largest annual increase occurred in 2001 when the portfolio grew 9.9 percent. However, this figure dropped to as low as 3.4 percent and 3.9 percent in 2003 and 2004, respectively. Over the past 5 years, total System loans outstanding increased by $23.6 billion, or 28.6 percent.

As of December 31, 2005, about half of the System's outstanding loans (49.6 percent) were in long-term real estate loans, 22.5 percent in short- and intermediate-term loans, and 13.8 percent in agribusiness loans, of which 8.3 percent were in loans to cooperatives and 3.8 percent were in processing and marketing loans. Loans to finance rural utilities represented 7.6 percent of the System's loan volume while rural home loans made up 2.8 percent of the System's total loans. International loans (export financing) represented 2.1 percent of the System's loan portfolio, and lease receivables accounted for less than 1 percent of the overall portfolio.

Table 1
FCS Gross Loans Outstanding, 2001–2005
As of December 31
Dollars in Millions

Loan Category	2001	2002	2003	2004	2005	Percentage Change from 2001
Production Agriculture:						
Long-Term Real Estate Mortgage Loans	$37,660	$43,517	$46,480	$48,704	$52,723	40.0
Short- and Intermediate-Term Loans	20,000	20,491	21,058	21,780	23,902	19.5
Agribusiness Loans*	10,873	11,802	12,094	12,053	14,673	34.9
Rural Utility Loans	6,721	6,900	6,451	7,200	8,063	20.0
Rural Residential and Real Estate Loans	2,649	2,327	2,278	2,482	2,950	11.4
International Loans	2,780	3,062	2,795	2,624	2,277	-18.1
Lease Receivables	1,668	1,384	1,323	1,168	1,290	-22.7
Loans to Other Financing Institutions	293	289	311	356	394	34.5
Total	**$82,644**	**$89,772**	**$92,790**	**$96,367**	**$106,272**	**28.6**

Source: Federal Farm Credit Banks Funding Corporation 2005 Annual Information Statement.

* As of December 31, 2005, agribusiness loans consisted of loans to cooperatives of $8.778 billion; processing and marketing loans of $4.083 billion; and farm-related business loans of $1.812 billion.

The System's increased loan volume over the past 12 months stemmed from long-term real estate loans (up $4.0 billion, or 8.3 percent) and short- and intermediate-term loans (up $2.1 billion, or 9.7 percent). Long-term real estate loans also exhibited the largest percentage increase over the previous 5 years, with an increase of about 40.0 percent since 2001, which translated into an increase of $15.1 billion in nominal terms. Agribusiness loans exhibited the second largest overall volume increase over the previous 5 years, with an increase of $3.8 billion, or 34.9 percent, since 2001, and they grew $2.6 billion, or 21.7 percent, in 2005 alone. Several other components also experienced strong growth rates in 2005, such as loans for rural homes and rural utilities, but the volume increases for these categories were small in nominal terms, all less than $1 billion.

Several factors facilitated the System's strong loan growth in 2005. The funding environment remained favorable, allowing the System to offer competitive interest rates in a rising rate environment. System institutions also mounted effective marketing campaigns to finance more integrated operations and alternative energy production ventures, mostly ethanol, through an increased number of processing and marketing loans. Moreover, with strong capital positions, a number of System institutions used loan participations and syndications, both inside and outside the System, as a way of using their capital base while achieving portfolio diversification and risk reduction.

Of the 96 FCS associations, 22 experienced double-digit growth rates for loans to agricultural producers, the largest borrower group category, while only 5 associations experienced drops in loan volume to this group of borrowers. Moreover, the number of loans to agricultural producers increased in 45 states, indicating that the System continued to show a strong commitment to its mission of serving agriculture and rural communities.

Funding for Other Lenders

Other Financing Institutions
Under the Farm Credit Act, System banks may further serve the credit needs of rural America by providing funding and discounting services to non-System lending institutions known as "other financing institutions" (OFIs), which include commercial banks, thrifts, credit unions, trust companies, agricultural credit corporations, and other specified agricultural lenders. System banks can fund and discount short- and intermediate-term loans for OFIs that are significantly involved in lending to agricultural and aquatic producers and demonstrate a need for additional funding to meet the credit needs of eligible borrowers. As of December 31, 2005, the System served 26 OFIs, the same number as the year before. However, the number of OFI loans increased 12 percent to 317 in 2005. Outstanding loan volume to OFIs was $397.8 million for 2005, an increase of 11.1 percent from 2004. OFI loan volume represented approximately 1.66 percent of the System's production and intermediate-term loan volume in 2005, up very slightly from 1.64 percent for 2004.

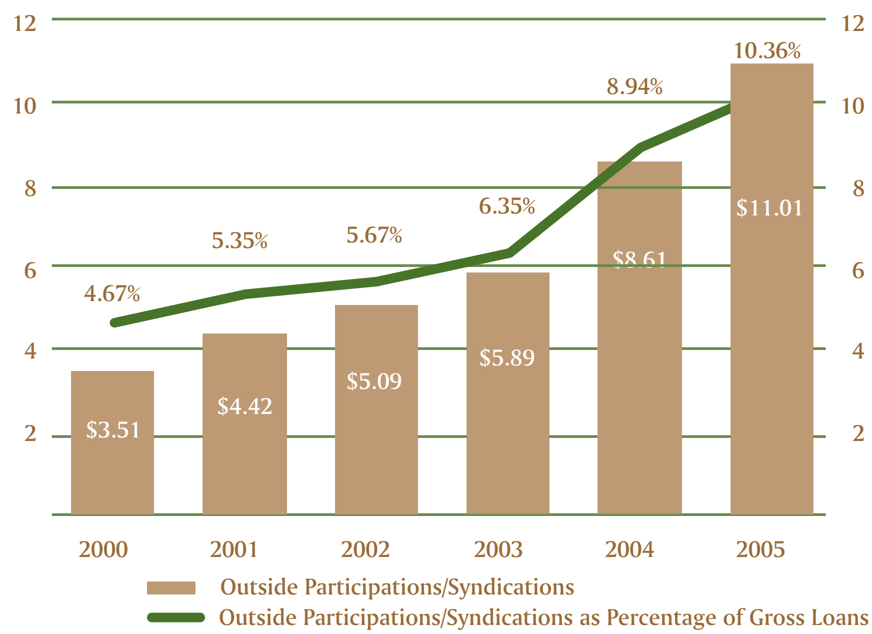
Rising Loan Participations and Syndications with Non-FCS Lenders
Under conditions prescribed by the Farm Credit Act, System banks and associations have authority to participate with commercial banks or OFIs in making loans to agriculture and rural America. Financial institutions primarily use loan participations and syndications to reduce interest rate risk and credit risk, but they also use them to enhance capital, earnings, and liquidity. Agricultural credit providers with high commodity concentrations frequently use participations and syndications to diversify their portfolios or to fund large loans when they have insufficient capital.

System gross loan participation and syndication purchases with non-FCS lenders grew by $2.4 billion, or 27.9 percent, to $11.0 billion during the year ended December 31, 2005, and by $7.5 billion, or 213.7 percent, over the past 5 years (see Figure 4).[13] These purchases continued to

13. Loan participations with non-FCS lenders include four types of asset purchases reported on Call Report Schedule RC-O: loan participations, similar entity transactions, lease interest, and other interest in loans. Loan syndications are a line item reported on Schedule RC-1 Memoranda.

14. Loan participation sales to non-FCS lenders were $1.02 billion for 2005 and $716 million for 2004.

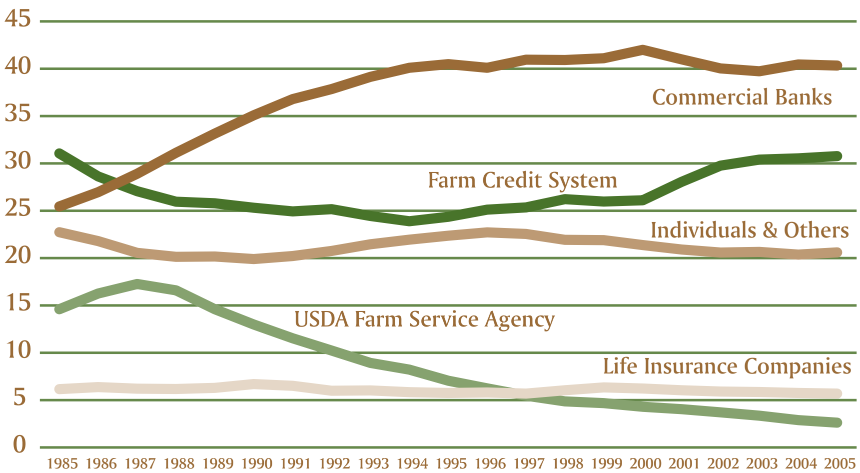
Figure 4
FCS Participations and Syndications with Non-FCS Lenders, 2000–2005
As of December 31



Source: FCS Call Reporting System.

expand rapidly in relation to the System's loan portfolio, rising from just 4.7 percent of gross loans in 2000 to 10.4 percent in 2005. Non-FCS gross loan participation purchases were $8.3 billion, or 7.8 percent of gross loans, in 2005, up from $6.7 billion, or 6.9 percent of gross loans, in 2004.[14] Loan syndication purchases were $2.7 billion, or 2.5 percent of gross loans, in 2005, compared with $2.0 billion, or 2.0 percent of gross loans, in 2004. Favorable market conditions have contributed to the increasing collaboration between System and non-FCS lenders; this collaboration has expanded the availability of credit to rural America.

Figure 5
FCS Market Share of Total Farm Business Debt, 1985–2005
As of December 31



Source: USDA, Economic Research Service. Market share data are based on farm balance-sheet debt estimates by lender on the USDA Web site, accessed February 10, 2006. Estimates for 2005 are preliminary.

Note: "Individuals & Others" includes trade credit, seller financing of real estate, Commodity Credit Corporation storage and drying facility loans, and loans sold to Farmer Mac. Loan volume guaranteed by Farmer Mac, as well as by the USDA Farm Service Agency, is treated as being with the originating lender or purchaser of the loan, not the guarantor agency.

The System's Market Share of Farm Debt

According to USDA estimates of farm sector debt, the System's growth in loans outstanding to farming operations slowed to 3.6 percent during calendar year 2005, compared with about 5 percent during 2003 and 2004. However, since 2000, the System's growth rate has outpaced all other major farm sector lenders, causing the System's share of total farm business debt to jump from 26.1 percent in 2000 (see Figure 5) to 30.8 percent in 2005.[15] The System's market share of total farm debt

15. Market share percentages are for farm business debt and are based on USDA's annual year-end estimates. The historical estimates by lender were revised in October 2003, and preliminary 2005 estimates were issued on February 10, 2006. These data are available on the USDA Economic Research Service Web site. USDA also periodically surveys debt sources used by farm cooperatives. According to the most recent survey (1997), the System provided about 54 percent of the funds borrowed by those cooperatives surveyed. Market share information is not routinely available on the nonfarmer segments of the System's lending activity—namely, the financing it provides to rural homeowners, marketing and processing firms, rural utilities, and international farm commodity sales.

reached a low of 23.9 percent in 1994, following a cyclical high of 33.6 percent in 1982. During the latter half of the 1990s, both System institutions and commercial banks generally experienced small gains in market share. Market share for "individuals and others," as well as for USDA's Farm Service Agency (FSA) direct lending program, has generally declined in recent years. Meanwhile, the market share for life insurance companies has remained relatively stable over a prolonged period. Although commercial banks continued to have the largest market share at the end of 2005, their share has moderated since December 31, 2000; it stood at 40.3 percent on December 31, 2005.

The System's share of real-estate-secured farm debt increased from 36.6 percent in 2002 to 37.8 percent at year-end 2005. Its share of non-real-estate-secured farm debt has held fairly steady, standing at 21.8 percent in 2005, compared with 21.9 percent in 2002.

While commercial banks edged ahead of the System in the farm real estate debt market in 2000 with a 32.7 percent share, their share slipped back the following 2 years. At the end of 2005, commercial banks' share of real-estate-secured farm debt was 33.7 percent. Commercial banks continue to dominate the non-real-estate-secured farm debt market with a 48.8 percent share (2005), but this figure is down from the 52.0 percent average for the 1996–2000 period.

Farmer Mac as a Secondary Market

Farmer Mac was created to provide a secondary market arrangement for agricultural real estate and rural housing mortgage loans and greater liquidity and lending capacity to agricultural lenders. In USDA's estimates of farm sector debt by lender, Farmer Mac's purchases of farm real estate loans (about $2.9 billion outstanding as of December 31, 2005) from various lenders are included as a subcategory that USDA labels "Individuals and Others."

Farmer Mac also plays a role in the farm debt market through a product known as the Long-Term Standby Purchase Commitment program, which was introduced in 1999. Under a Standby, a financial institution acquires a Farmer Mac guarantee for an annual fee on a loan pool that the institution retains. While Farmer Mac's Standby product is available to agricultural lenders generally, System institutions accounted for nearly all ($2.3 billion) of the outstanding volume in Standbys as of December 31, 2005.[16]

Since not all farm mortgages are eligible for Farmer Mac funding, Farmer Mac calculates market share achievement by estimating the portion of the total farm real estate debt market that would qualify as eligible mortgages under Farmer Mac's underwriting criteria. According to these calculations, outstanding program volume ($5.3 billion) is about 11 percent of the eligible farm real estate debt market.

16. The guaranteed amounts by Farmer Mac are reported in USDA's farm business debt estimates as being provided by the originating lender. This is also how approximately $10 billion in loans guaranteed by the FSA are treated, i.e., the share reported for USDA/FSA is just for its direct lending activity.

Table 2
FCS Major Financial Indicators
As of December 31
Dollars in Thousands

FCS Banks[1]	2001	2002	2003	2004	2005
Gross Loan Volume	$73,908,268	$80,370,840	$82,986,046	$85,411,707	$94,865,873
Accruing Restructured Loans[2]	$360,958	$17,264	$9,492	$7,050	$6,131
Accrual Loans 90 or More Days Past Due	$32,074	$54,017	$22,456	$5,420	$1,322
Nonaccrual Loans	$224,987	$353,765	$444,663	$227,003	$152,223
Nonperforming Loans/Total Loans[3]	0.84%	0.53%	0.57%	0.28%	0.17%
Cash and Marketable Investments	$14,654,508	$17,076,661	$19,908,823	$23,089,548	$27,788,225
Capital/Assets[4]	7.15%	6.70%	6.89%	6.79%	6.20%
Unallocated Retained Earnings/Assets	3.79%	3.66%	3.49%	3.54%	3.28%
Net Income	$659,469	$751,343	$613,401	$733,012	$740,785
Return on Assets[5]	0.74%	0.78%	0.68%	0.68%	0.61%
Return on Equity[5]	9.64%	10.67%	9.85%	9.82%	9.48%
Net Interest Margin	1.23%	1.15%	0.99%	0.92%	0.84%
Operating Expense Rate[6]	0.40%	0.36%	0.33%	0.36%	0.33%
Associations					
Gross Loan Volume	$59,259,300	$66,606,213	$70,897,369	$75,619,681	$83,253,781
Accruing Restructured Loans[2]	$74,629	$90,726	$83,075	$68,439	$53,885
Accrual Loans 90 or More Days Past Due	$36,568	$27,654	$20,742	$15,375	$13,156
Nonaccrual Loans	$546,179	$589,645	$607,351	$419,312	$371,703
Nonperforming Loans/Gross Loans[3]	1.11%	1.06%	1.00%	0.67%	0.53%
Capital/Assets[7]	16.38%	15.85%	16.34%	17.72%	17.19%
Unallocated Retained Earnings/Assets	13.85%	13.63%	13.96%	15.28%	14.80%
Net Income	$1,151,750	$1,187,596	$1,341,261	$2,420,251	$1,613,406
Return on Assets[5]	2.08%	1.80%	1.83%	3.10%	1.85%
Return on Equity[5]	12.71%	11.20%	11.10%	18.22%	10.55%
Net Interest Margin	2.80%	2.69%	2.72%	2.72%	2.71%
Operating Expense Rate[6]	1.59%	1.50%	1.56%	1.58%	1.53%
Total FCS[8]					
Gross Loan Volume	$82,644,000	$89,772,000	$92,790,000	$96,367,000	$106,272,000
Accruing Restructured Loans[2]	$113,000	$109,000	$94,000	$76,000	$61,000
Accrual Loans 90 or More Days Past Due	$72,000	$83,000	$43,000	$21,000	$15,000
Nonaccrual Loans	$771,000	$939,000	$1,049,000	$646,000	$524,000
Nonperforming Loans/Gross Loans[3]	1.16%	1.26%	1.28%	0.77%	0.56%
Bonds and Notes	$82,339,000	$90,980,000	$95,310,000	$100,330,000	$113,576,000
Capital/Assets[9]	15.83%	15.41%	16.19%	17.13%	16.28%
Surplus/Assets	12.29%	12.32%	12.68%	13.69%	13.30%
Net Income	$1,785,000	$1,773,000	$1,825,000	$2,993,000	$2,096,000
Return on Assets[5]	1.82%	1.67%	1.60%	2.46%	1.58%
Return on Equity[5]	11.61%	10.58%	10.11%	14.85%	9.38%
Net Interest Margin	2.82%	2.78%	2.65%	2.56%	2.58%

Sources: Call Reports received from the FCS and the *Farm Credit System Annual Information Statement* for years 2001 through 2005, provided by the Federal Farm Credit Banks Funding Corporation.

1. This category includes Federal Farm Credit Banks and the Agricultural Credit Bank.
2. This category excludes loans 90 days or more past due.
3. Nonperforming loans include nonaccrual loans, accruing restructured loans, and accrual loans 90 or more days past due.
4. Capital excludes madatorily redeemable preferred stock.
5. Income ratios are annualized.
6. Operating expense rate is determined by dividing operating expenses by average gross loans, annualized.
7. Capital excludes protected borrower capital.
8. The data provided in this category cannot be derived through summation of above categories because of intradistrict and intra-System eliminations used in the *Farm Credit System Annual Information Statement*.
9. Capital includes restricted capital (amount in Farm Credit Insurance Fund) and excludes mandatorily redeemable preferred stock and protected borrower capital.

Table 3
Farm Credit System Major Financial Indicators, by District[1]
As of December 31, 2005
Dollars in Thousands

	Total Assets	Gross Loan Volume	Nonaccrual Loans	Allowance for Loan Losses	Cash and Marketable Investments[2]	Capital Stock[3]	Surplus[4]	Total Capital[5]
FCS Banks								
AgFirst	$20,483,031	$14,411,043	$19,197	$10,114	$5,826,556	$374,555	$665,445	$1,037,429
AgriBank	39,866,527	31,608,612	8,361	3,141	7,843,091	842,505	1,288,681	2,113,842
CoBank	33,834,917	26,297,284	119,846	437,140	7,485,355	1,717,710	1,232,877	2,902,074
Texas	11,284,788	8,481,501	3,542	142	2,751,372	335,390	315,047	624,307
U.S. AgBank	18,166,979	14,067,433	1,277	1,209	3,881,851	494,761	560,535	991,996
Total	$123,636,242	$94,865,873	$152,223	$451,746	$27,788,225	$3,764,921	$4,062,585	$7,669,648
Associations								
AgFirst	$15,230,615	$14,200,192	$63,615	$77,437	$369,420	$179,375	$2,212,903	$2,391,874
AgriBank	38,033,687	35,763,097	140,753	75,539	129,176	192,629	6,367,720	6,560,304
CoBank	8,951,515	8,407,851	66,791	69,823	21,252	36,034	1,519,685	1,537,482
Texas	9,145,273	8,789,696	25,731	9,341	45,546	75,633	1,435,460	1,511,093
U.S. AgBank	17,289,266	16,092,945	74,813	64,100	390,875	240,132	3,019,406	3,240,877
Total	$88,650,356	$83,253,781	$371,703	$296,240	$956,269	$723,803	$14,555,174	$15,241,630
Total FCS	**$139,886,000**	**$106,272,000**	**$524,000**	**$755,000**	**$28,427,000**	**$1,333,000**	**$18,604,000**	**$22,774,000**

Sources: Call Reports received from the FCS and the *Farm Credit System Annual Information Statement* for years 2001 through 2005, provided by the Federal Farm Credit Banks Funding Corporation.

1. Aggregations of district data may not equal totals because of eliminations.
2. This category includes accrued interest receivable on marketable investments.
3. This category includes capital stock and participation certificates and excludes madatorily redeemable preferred stock and protected borrower capital.
4. This category includes allocated and unallocated surplus.
5. Total capital includes capital stock, participation certificates, perpetual preferred stock, surplus, accumulated other comprehensive income, and restricted capital (amount in the Farm Credit Insurance Fund for Farm Credit System total only). Excludes mandatorily redeemable preferred stock and protected borrower capital.

Serving Young, Beginning, and Small Farmers and Ranchers[17]

17. For operational and reporting purposes, the System's YBS mission is defined as service to each of the three borrower components (i.e., to the young, beginning, and small farmer categories). Thus, our focus in this discussion is on the three separate components.

Providing financially sound and constructive credit and related services to borrowers identified as YBS farmers and ranchers is a legislated mandate and a high priority for the System. Loans to YBS borrowers help ensure a smooth transition of agribusiness to the next generation and a continued diversified customer base for the FCS, which includes operators of everything from very small to large, commercial-sized operations.

The percentage of retirement-age farm operators continues to rise, increasing the importance of the System's role in helping young and beginning farmers finance the purchase of land sold by those who are exiting the business. The 2002 Census of Agriculture found that 26.2 percent of principal operators are age 65 or older, compared with 21.4 percent in 1987. The census also reported a continuing sharp decline in the percentage of young operators (i.e., principal operators who are age 34 or younger), which dropped from 13.3 percent in 1987 to 5.8 percent in 2002. Other USDA surveys and studies show that potential YBS borrowers have a heavy and increasing reliance on off-farm income, plus a wide range of credit needs beyond their agriculture production activities. Such changing demographics and economic conditions in many areas of rural America pose challenges to System institutions for meeting their YBS program goals.

Because of its GSE status, the FCS is in a unique position to develop YBS programs, to coordinate those programs with other government programs that can spread risks, and to make a continuing commitment to lend to YBS borrowers. Some YBS borrowers are assisted by the various state and Federal programs that provide interest rate reductions or guarantees to help commercial lenders and FCS institutions reduce credit risks for borrowers. Without such concessions and guarantees, credit would not be extended to some YBS borrowers because of repayment risks.

Each System bank is required (by section 4.19 of the Farm Credit Act and FCA regulation 614.4165) to adopt written policies that direct each association board to have a program for furnishing sound and constructive credit and financially related services to YBS borrowers. The associations must coordinate with other government and private sources of credit in implementing their YBS programs. In addition, each institution is required to report yearly on operations and achievements under its YBS program.

FCA's regulations and its examination activities have encouraged System institutions to evaluate their performance in YBS lending by analyzing their lending markets and assessing their own market penetration. We also encourage the association's board of directors to develop new programs, to strengthen existing programs, or to provide more incentives for YBS farmer participation. Thus, FCA's oversight increases awareness of the mission in this area and prompts associations to provide added resources to serve this market segment.

In establishing their YBS programs, institutions may use a variety of tools to fulfill their commitment to YBS lending. Associations may offer less stringent underwriting standards or reduced interest rates to make it easier for potential YBS borrowers to qualify for loans. Some institutions establish special risk pools in which capital is segregated to support YBS lending. One institution is developing a starter farmer program under investment authorities approved by the Agency (see page 46). Almost all programs involve coordinating with Federal or state sources to obtain guarantees on loans to qualifying YBS borrowers. Many YBS programs provide for financial or leadership training or related business services. In addition, associations donate to or sponsor special events for local, regional, and national young or beginning farmer groups.

YBS Loans Outstanding, 2004 and 2005[18]

As of year-end 2004 and 2005, young farmers and ranchers (defined as those who are 35 years old or younger)[19] accounted for 17.5 percent and 17.7 percent, respectively, of the total number of loans outstanding in the System (see Tables 4A and 4B). Beginning borrowers (those with 10 or fewer years of farming experience) accounted for 22.7 percent of loans in 2004 and 23.7 percent of loans in 2005. Loans to small farmers (those with annual sales of less than $250,000) accounted for 61.8 percent of all loans in 2004 and 60.6 percent in 2005.[20] As of December 31 of 2004 and 2005, the total dollar volume of loans outstanding for young farmers was 12.7 percent and 12.3 percent, respectively; for beginning farmers, it was 19.1 percent and 19.4 percent, respectively; and for small farmers, the total dollar volume of loans outstanding was 31.0 percent and 29.2 percent, respectively. The System's 2005 percentages in all six categories (i.e., the number of loans for each of the three

18. System data on service to YBS farmers and ranchers cover the calendar year and are reported at year-end. Statistics are reported on loans made during the year (counts and volume) as well as loans outstanding at year-end (counts and volume). The volume measure is the loan commitment to borrowers; this figure may exceed actual loan advances. The 2004 data became available in April 2005 and the 2005 data in May 2006.
19. The System's definition of "young" is 35 or younger; the Census of Agriculture's definition is 34 or younger.
20. YBS data are reported for individual young, beginning, or small categories. It is not meaningful to add two or three YBS categories together since the categories are not mutually exclusive. Depending on borrower characteristics, a borrower may be counted in two or even all three categories. Also, the data on the number of loans differ from the data on the number of farmers because some individual member-borrowers have multiple loans.

Tables 4A and 4B
Loans Outstanding to YBS Borrowers*

Table 4A
As of December 31, 2004

	Number of Loans	Percentage of Total Number	Volume of Loans ($ millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	125,672	17.5	$12,523	12.7	$99,644
Beginning Farmers and Ranchers	163,454	22.7	$18,821	19.1	$115,146
Small Farmers and Ranchers					
Loan Size:					
$50,000 or less	263,838	69.6	$4,897	67.3	$18,562
$50,001–$100,000	93,203	63.7	6,432	63.1	69,014
$100,001–$250,000	67,668	54.3	9,996	52.3	147,714
More than $250,000	19,582	28.3	9,211	14.9	470,384
Total Loans to Small Producers	444,291	61.8	$30,537	31.0	$68,732

Table 4B
As of December 31, 2005

	Number of Loans	Percentage of Total Number	Volume of Loans ($ millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	131,956	17.7	$13,878	12.3	$105,168
Beginning Farmers and Ranchers	176,231	23.7	$21,811	19.4	$124,163
Small Farmers and Ranchers					
Loan Size:					
$50,000 or less	263,775	68.6	$4,929	66.6	$18,686
$50,001–$100,000	94,468	62.9	6,548	62.3	69,313
$100,001–$250,000	71,350	53.6	10,595	52.0	148,498
More than $250,000	21,647	28.3	10,857	14.6	501,543
Total Loans to Small Producers	451,240	60.6	$32,929	29.2	$72,974

Sources: Annual YBS reports submitted by each System lender through the Farm Credit banks.

* A “young” farmer or rancher is defined as 35 years old or younger when the loan is made; a “beginning” farmer or rancher has been operating for not more than 10 years; and a “small” farmer generates less than $250,000 in annual sales of agricultural or aquatic products. Since the totals are not mutually exclusive, one cannot add across young, beginning, and small categories to count total YBS loans. Please note that the ranges in the tables above indicate loan size, not the amount of an operation’s annual sales.

groups and the total dollar volume of loans for each of the three groups) were moderately to slightly higher than they were at the end of 2001. As of December 31, 2005, the average loan size for YBS loans outstanding was $105,168 for young farmers, $124,163 for beginning farmers, and $72,974 for small farmers.

YBS Loans Made, 2004 and 2005

The number of loans made during the year provides a measure of the System's current performance in serving YBS borrowers (see Tables 5A and 5B). FCS institutions made 148,086 loans to small farmers in 2004 and 148,240 loans to such farmers in 2005. These loans represented 59.6 percent and 57.6 percent, respectively, of the number of all new loans made to farmers in those years. A total of $9.8 billion in loans was made to small farmers in 2004, and this increased to $10.9 billion in 2005. These figures were 25.0 percent and 24.2 percent of the dollar volume of loans made during 2004 and 2005, respectively. The average loan size of small farmer loans made during 2004 was $66,450; it increased to $73,685 in 2005. Because of the greater credit needs of larger farmers, the average size for all System farm loans made was more than twice the average for small farmer loans. All of the 2005 measures (count, volume, percentage of loans, average loan size) for the young and beginning farmers were near or higher than 2004 levels.

Assessment of YBS Results for Individual Associations and the System

As in previous years, individual associations vary significantly in their YBS lending results. No single association has the highest System percentage in all three or even two of the YBS categories. Table 6 shows the wide range in the 2005 results for individual associations using percentage-of-loan numbers for each YBS category for loans made and outstanding loans. A similar range occurs in the loan volume data. Likewise, wide ranges appear in the YBS results by association for each year.[21]

The range in association results for the number of loans to small farmers is much greater than for young or beginning farmers (from a low of 14.4 percent of loans made to a high of 88.8 percent). For young farmers, the range is considerably smaller, from 4.3 percent to 27.9 percent of loans made, while for beginning farmers the corresponding range is from 9.3 percent to 77.8 percent.

21. Additional YBS data by institution and district, and for the whole System, beginning with 1999, are available on FCA's Web site, www.fca.gov.

Tables 5A and 5B
Loans Made to YBS Borrowers*

Table 5A
As of December 31, 2004

	Number of Loans	Percentage of Total Number	Volume of Loans ($ millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	39,670	16.0	$4,416	11.2	$111,310
Beginning Farmers and Ranchers	49,636	20.0	$6,758	17.2	$136,161
Small Farmers and Ranchers					
Loan Size:					
$50,000 or less	93,907	72.1	$1,597	67.3	$17,001
$50,001–$100,000	28,175	58.4	1,861	60.4	66,038
$100,001–$250,000	19,404	47.8	2,944	49.1	151,710
More than $250,000	6,600	22.5	3,439	12.3	521,114
Total Loans to Small Producers	148,086	59.6	$9,840	25.0	$66,450

Table 5B
As of December 31, 2005

	Number of Loans	Percentage of Total Number	Volume of Loans ($ millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	42,359	16.5	$5,032	11.2	$118,801
Beginning Farmers and Ranchers	54,878	21.3	$8,246	18.3	$150,253
Small Farmers and Ranchers					
Loan Size:					
$50,000 or less	92,118	71.6	$1,575	66.9	$17,092
$50,001–$100,000	28,236	56.9	1,818	58.4	64,393
$100,001–$250,000	20,387	46.9	3,087	48.3	151,406
More than $250,000	7,499	21.0	4,444	13.6	592,560
Total Loans to Small Producers	148,240	57.6	$10,923	24.2	$73,685

Sources: Annual YBS reports submitted by each System lender through the Farm Credit banks.

* A “young” farmer or rancher is defined as 35 years old or younger when the loan is made; a “beginning” farmer or rancher has been operating for not more than 10 years; and a “small” farmer generates less than $250,000 in annual sales of agricultural or aquatic products. Since the totals are not mutually exclusive, one cannot add across young, beginning, and small categories to count total YBS loans. Please note that the ranges in the tables above indicate loan size, not the amount of an operation’s annual sales.

Table 6
Wide Range in YBS Program Results by Association, 2005[1]
Percentage of Total Loan Numbers[2]

Program	Loans	Range by Association Low	Range by Association High	Overall Average
Young	Outstanding	7.4	28.5	17.7
	Made	4.3	27.9	16.5
Beginning	Outstanding	12.3	59.6	23.7
	Made	9.3	77.8	21.3
Small	Outstanding	16.9	90.7	60.6
	Made	14.4	88.8	57.6

Sources: Annual YBS reports submitted by each System lender through the Farm Credit banks.

1. A "young" farmer or rancher is defined as 35 years old or younger when the loan is made; a "beginning" farmer or rancher has been operating for not more than 10 years; and a "small" farmer generates less than $250,000 in annual sales of agricultural or aquatic products.

2. The percentages shown are of total loan numbers outstanding as of December 31, 2005, and of total number of loans made in 2005.

Significant differences in results among institutions are to be expected given the significant differences in farming operation size and farmer demographics across the United States. For example, in 2004, the average value of farm production in four states was more than $250,000 per farm, compared with 18 other states with average production values of less than $100,000 per farm. The System's results for small farmer portfolio concentrations in these states tend to reflect these differences. Census of Agriculture data also show that the average age of farmers, and especially the percentage of operators in the "young" group, varies considerably from state to state. Such differences make comparisons among individual associations difficult and explain why our YBS regulations do not specify fixed goals but require individual institutions to establish YBS targets appropriate for their lending territory. Other factors—such as the competitiveness of the local lending market and the availability of state and USDA/FSA guarantees—play a role in individual association results.

The 2002 Census of Agriculture classified about 93 percent of all farms as small, using the same definition for a small farm as that used for YBS reporting. However, the census also found that nearly 39 percent of all farms had sales of $2,500 or less; these farms likely had little or no farm debt. The census also showed that fewer than half of all small farms had interest paid as a farm business expense, which meant that more than half of all small farms had no farm debt. The System reported that slightly more than 60 percent of the total number of loans outstanding in association portfolios were held by small farmers. When one takes into account the fact that small farms are less likely to carry debt than larger farms, this figure indicates a strong commitment by the FCS to serving the credit needs of small producers.

Five Years of Comparable YBS Data

We now have 5 years of System YBS results under the definitions and reporting requirements that became mandatory in 2001. In addition, all institutions have had examinations of their YBS reporting. In some cases, these examinations have resulted in corrections of previously reported YBS data. As illustrated in Figures 6A, 6B, and 6C, fairly strong upward trends have occurred in loan volumes outstanding for each of the three program areas from 2001 to 2005. Similar trends exist for the numbers of loans outstanding in each program area. These results are for the actual counts and dollar volumes for loans outstanding. The loan counts and volumes for loans made have been somewhat more variable.

While YBS loan volumes over the last 5 years point to a strong upward trend, YBS results as a percentage of total loans outstanding present a different picture. Slight dips have occurred in the percentages of total volumes outstanding for young and small farmers over the past 2 years, while the percentage for beginning farmers has continued to rise. However, given the downward trend in the percentages of young and small farm operators noted in recent Census of Agriculture and USDA reports, the YBS results show solid performance.

Figures 6A, 6B, and 6C
Loans Made to, and Loans Outstanding for, YBS Farmers and Ranchers, 2001–2005
As of December 31

Figure 6A
Young Farmers and Ranchers

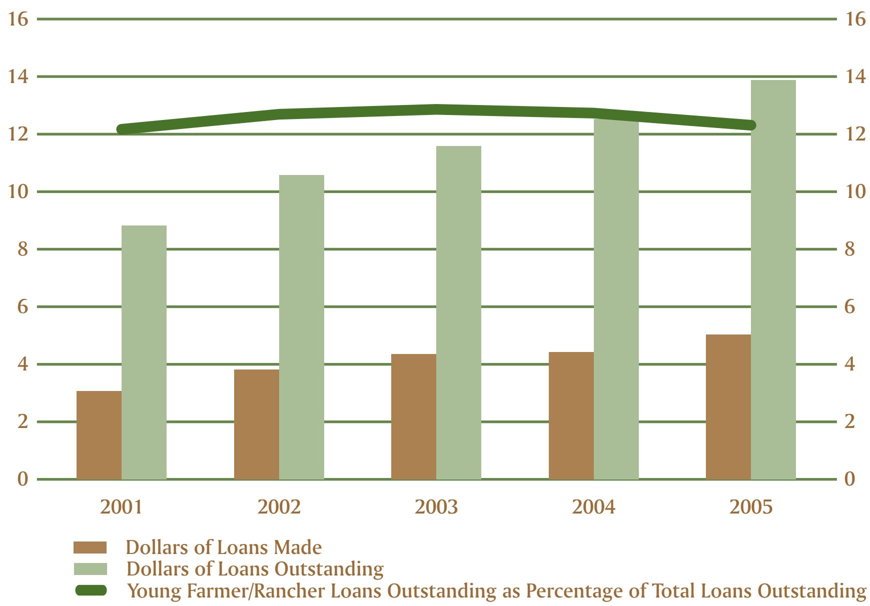
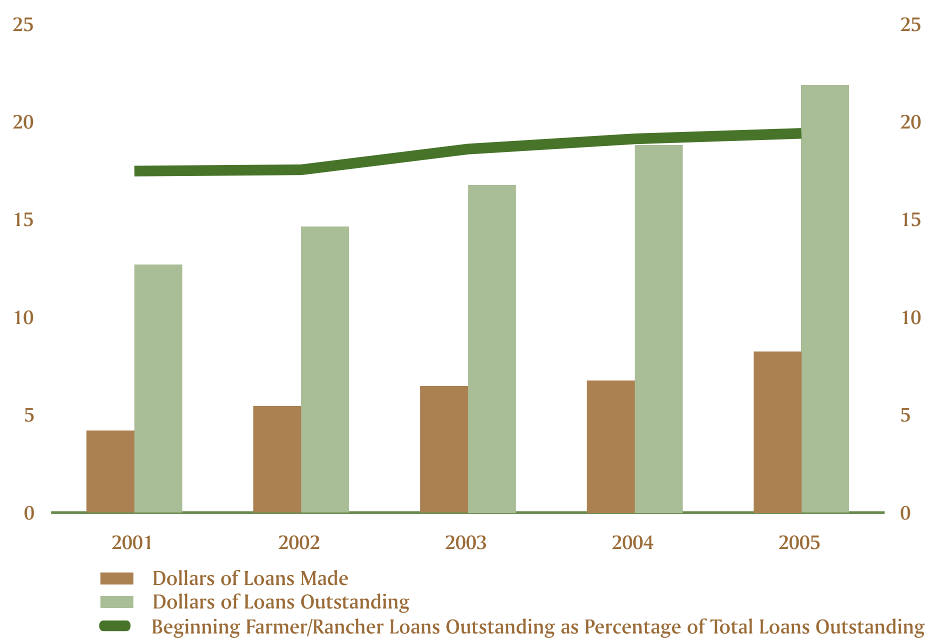
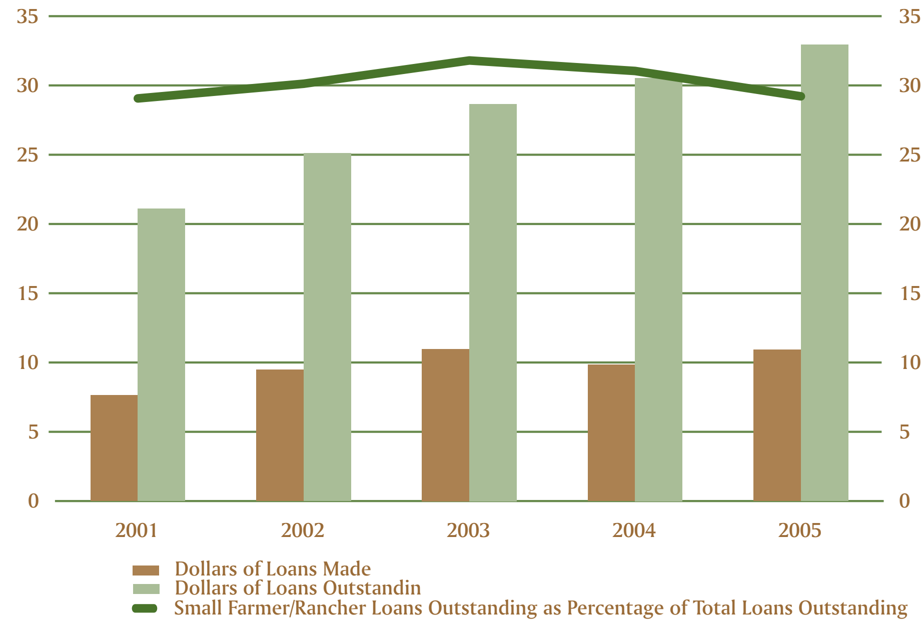


Figure 6B
Beginning Farmers and Ranchers



22. In some cases, the reported results may reflect deficiencies in YBS reporting rather than deficiencies in YBS program management. Examiners sometimes require associations to restate their results and correct reporting mechanisms. As a result, some associations now note improvements in their systems to identify YBS borrowers.
23. Because the number of associations declined by 18 over this period because of mergers, the 2001 YBS data for 14 current associations had to be developed from 32 predecessor associations.

Figure 6C
Small Farmers and Ranchers



Sources: Annual YBS Reports submitted by each System lender through the Farm Credit Banks.

With the exception of the loan volume percentage made to small farmers, more than half of the System's associations had positive 5-year trends in loans made, as well as in the percentages for all six measures for outstanding loans (including number of loans and total dollar volume of loans) to YBS farmers.[22] However, a number of individual institutions experienced declines in their percentages for the various YBS measures. When results from year-end 2005 were compared with results from year-end 2001, 39 of the 96 associations at year-end 2005 showed declines in the percentage of the number of loans made to young farmers, 30 showed declines in loans to beginning farmers, and 40 showed declines in loans to small farmers.[23]

Comparisons in YBS lending cannot be made between FCS institutions and other lenders because other Federal regulators do not require reporting on young and beginning farmer loans. While large banks are required to report on small farm loans, small farm lending is defined in terms of loan size (a loan of less than $500,000 is considered a small farm loan) rather than in terms of the borrower's annual sales. In addition, because of differences in data definitions and data collection methods, annual YBS data are not comparable with Census of Agriculture data, which are collected only once every 5 years.

YBS Programs

Each FCS association responds to an annual Agency questionnaire on the content of its YBS program. While we typically modify or refine the questions each year, the survey generally covers program goals, board reporting, YBS credit provisions, use of government guarantee programs, and use of training or other related services. As of year-end 2005, 44 institutions achieved their specific YBS goals. The goals are typically stated as a specific percentage of outstanding loans in each YBS category; they are set according to results from studies on eligible borrower demographics in the institution's territory.

YBS programs at many System associations make loan qualification easier by applying differential underwriting standards or allowing exceptions to normal underwriting standards. The differential underwriting standards often include higher loan-to-market value ratios or lower debt-coverage requirements for YBS borrowers.

During 2005, 70 percent of the associations offered differential underwriting standards, or exceptions, for YBS borrowers, up from 60 percent in 2001. Also, some associations reduced borrowing costs through lower interest rates or fees. More than half (55 percent) had programs that offered lower interest rates or offered lower loan fees for YBS borrowers. In most cases, institutions used more than one credit enhancement program.

The FSA is the primary agency offering government-guaranteed loans for farmers, although a small portion of guaranteed loans is made through the Small Business Administration and various state programs. System lending institutions use the FSA's guaranteed lending program, especially for YBS lending. In recent surveys, we asked the System for specific figures on the use of Farm Service Agency guarantees for separate YBS loan categories. About one-fourth of the overall number of the System's FSA-guaranteed loans outstanding were to young farmers; one-fourth were to beginning farmers; and about a third were to small farmers (numbers are not additive). However, the number and volume of YBS loans with FSA guarantees during 2005 and at year-end represent small percentages (roughly 2 to 3 percent) of the overall YBS program figures.

An increasing number of associations offer a growing array of training programs or other services that benefit YBS farmers and ranchers. The most common training program focuses on leadership; some 60 percent offered this training as of year-end 2005. Approximately 72 percent offered training in business and financial management skills. Most associations also offer other financial services programs, including estate planning, recordkeeping, tax planning and preparation, and farm business consulting. Sometimes associations discount or waive the cost of these programs for YBS borrowers.

Other outreach activities are offered in conjunction with such organizations as state or national young farmer groups, colleges of agriculture, state or national cooperative association leadership programs, and local chapters of 4-H or the National FFA Organization. Many associations also provide financial support for scholarships and for FFA, 4-H, and other agricultural organizations.

Regulatory Policy and Approvals

FCS Corporate Activity in 2005

In 2005, the level of corporate activity among associations dropped significantly from previous years. The parent-subsidiary structure, with the ACA as parent and a wholly owned PCA and FLCA as subsidiaries, continued as the dominant association structure in the System and accounted for 89 percent of all associations as of December 31, 2005.[24] Under this structure, the ACA and its subsidiaries operate with a common board of directors and joint employees and are obligated on each other's debts and liabilities. The structure allows the ACA to build and use capital more efficiently and enables customers to be stockholders of one entity—the ACA—and borrowers from the ACA or one or both subsidiaries. This structure gives the ACA and its subsidiaries greater flexibility in serving their customers and allows credit and related services to be delivered to borrowers more efficiently. All 85 ACAs operate with this structure. Eleven FLCAs, which are authorized to provide long-term credit only, continue as independent associations. This section describes the changes in the FCS structure that occurred during 2005.

Summary of Activity

- The number of corporate applications submitted for FCA Board approval declined from the previous year. In 2005, we analyzed and approved only one new application, compared with seven applications processed in 2004. The one application processed in 2005 was a proposed merger of two ACAs, each operating with subsidiaries. The FCA Board preliminarily approved the merger subject to approval by the voting stockholders of each ACA. However, when voting stockholders of one association voted against it, despite support for the merger by the association's board of directors, the merger did not take effect.
- FCA approved three corporate requests in 2004 that took effect on January 1, 2005, the first day of the calendar year covered in this report. The three applications involved one merger and two restructurings to form the ACA parent-subsidiary organizational

24. FCA, in approving the ACA parent-subsidiary structure, views the ACA and its wholly owned operating subsidiaries as a single entity for most regulatory and examination purposes based on their common ownership and control and cross-guarantees between and among the entities, with each entity responsible for the debts of the others and their capital and assets combined to absorb any losses.

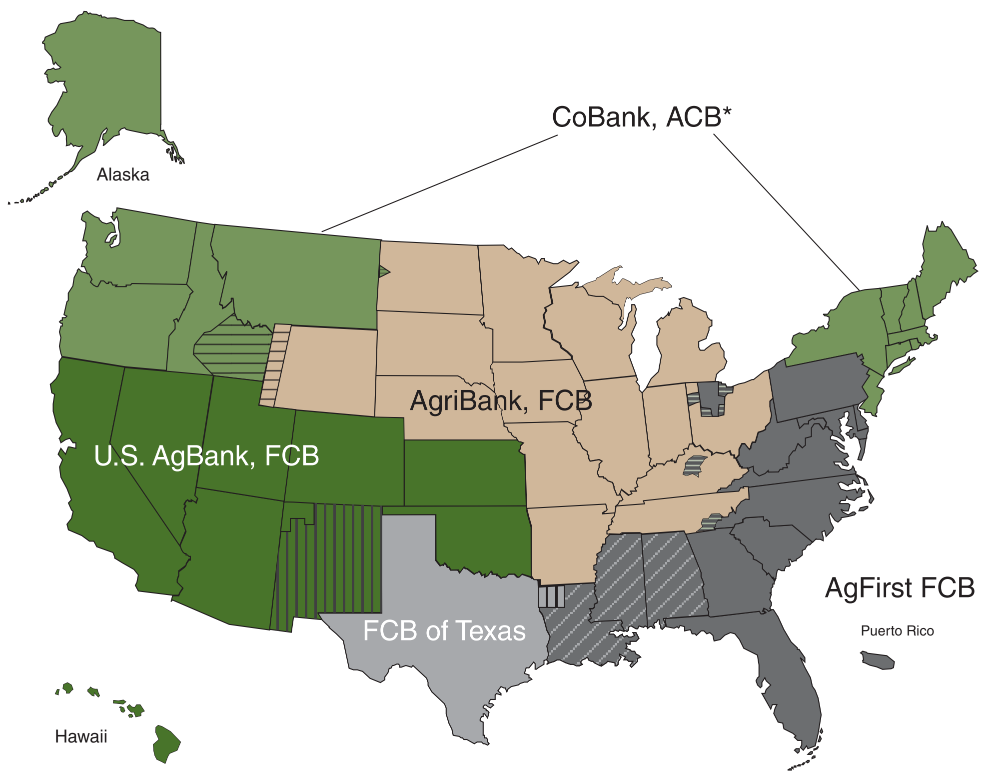
structure. The total number of associations decreased from 97 as of December 31, 2004, to 96 as of December 31, 2005. The number of banks remains at five. Figure 7 shows the chartered territory of each FCS bank. Details about specific corporate applications are available on FCA's Web site, www.fca.gov.

Regulations and Policies

FCA routinely issues regulations, policy statements, and other documents to ensure that the FCS complies with the law, operates in a safe and sound manner, and effectively carries out its statutory mission. The Agency is committed to establishing a flexible regulatory environment that enables the System to offer high-quality, reasonably priced credit and related services to farmers, ranchers, and their cooperatives; rural residents; and other entities on which farming operations depend. To meet this commitment, FCA tries to develop balanced, well-reasoned, and flexible regulations in which the benefits outweigh the costs. The intent of the Agency's regulations is to allow the System to remain competitive in the marketplace. FCA also makes proposals to encourage member-borrowers to participate in the management, control, and ownership of their institutions. The following paragraphs describe some of our regulatory efforts during 2005.

Borrower Rights Waiver on Loan Syndications
FCA completed this final rule to allow a borrower to waive borrower rights when receiving a loan under a loan syndication arrangement with a non-System lender that would otherwise be required by section 4.14A(a)(6) of the Farm Credit Act of 1971, as amended, to provide borrower rights. This rule provides needed flexibility to meet the credit needs of borrowers seeking financing as part of certain syndicated lending arrangements. Subsequently, in December 2005, the FCA Board approved a comprehensive study to determine what changes, if any, are needed in FCA's approach toward syndications and assignments. (Adopted March 10, 2005; published April 12, 2005, [70 FR 18965]; effective May 26, 2005.)

Figure 7
Farm Credit System Banks Chartered Territories
As of December 31, 2005



U.S. AgBank, FCB	FCB of Texas	AgriBank, FCB	CoBank, ACB	AgFirst FCB
26 ACA Parents♦	13 ACA Parents♦	18 ACA Parents♦	5 ACA Parents♦	23 ACA Parents♦
3 FLCAs	8 FLCAs			

Note: The lined areas indicate territories in which more than one bank is chartered.

Ag New Mexico, Farm Credit Services, ACA, is funded by the FCB of Texas. Farm Credit of New Mexico, ACA, is funded by U.S. AgBank, FCB.

The FLCAs in Alabama, Louisiana, and Mississippi are funded by the FCB of Texas. First South Farm Credit, ACA, is funded by AgFirst FCB.

Louisiana Ag Credit, ACA, is funded by the FCB of Texas.

* CoBank, ACB, is headquartered in Denver, Colorado, and serves cooperatives nationwide and ACAs in the indicated areas.

♦ Designates ACAs that have PCA and FLCA subsidiaries.

AG Credit, ACA, (Ohio); Central Kentucky, ACA, (Kentucky); and Chattanooga, ACA, (Tennessee) are funded by AgFirst FCB. Mid-America, ACA, funded by AgriBank, FCB, is also authorized to lend in this territory.

Idaho, ACA, is funded by U.S. AgBank, FCB, and Northwest Farm Credit Services, ACA, is funded by CoBank.

Teton, Lincoln, and Uinta counties in Wyoming are chartered to AgriBank, FCB, and U.S. AgBank, FCB.

Capital Adequacy—Risk-Weighting
We completed this final rule to change our regulatory capital standards on recourse obligations, direct credit substitutes, residual interests, asset- and mortgage-backed securities, claims on securities firms, and certain residential loans. The final rule modifies our risk-based capital requirements to more closely match a System institution's relative risk of loss on these credit exposures to its capital requirements. In addition, the rule makes our regulatory capital treatment more consistent with the way other financial regulatory agencies treat transactions and assets involving similar risk, and the rule addresses financial structures and transactions developed by the market since our last update. We also made a number of nonsubstantive changes to our regulations to make them easier to use. (Adopted May 12, 2005; published June 17, 2005, [70 FR 35336]; effective September 8, 2005.)

Farmer Mac Nonprogram Investments and Liquidity
We completed a final rule governing Farmer Mac's nonprogram investments and liquidity. The intent of the rule is to ensure that Farmer Mac maintains nonprogram investments at levels appropriate for a GSE as it complies with liquidity reserve and interest rate risk requirements and manages short-term surplus funds. (Adopted June 9, 2005; published July 14, 2005, [70 FR 40635]; effective September 30, 2005.)

Investments, Liquidity, and Divestiture
To ensure that FCS banks have adequate liquidity, we completed a final rule to amend the liquidity reserve requirement for FCS banks. The final rule increases the minimum liquidity reserve requirement to 90 days, raises the eligible investment limit to 35 percent of total outstanding loans, and requires FCBs to develop and maintain liquidity contingency plans. These requirements improve the ability of FCBs to remain safe and sound and to supply agricultural credit in good times and bad. (Adopted July 14, 2005; published August 31, 2005, [70 FR 51586]; effective October 24, 2005.)

Capital Adequacy—Preferred Stock
We completed a final rule to amend the rules governing preferred stock issued by FCS banks, associations, and service corporations. This final rule requires greater board involvement and oversight in the retirement of preferred stock, enhances FCA's current standards-of-conduct regulations to specifically address insider preferred-stock transactions, modifies and streamlines the FCA review and clearance process of such programs, and requires disclosure of senior officer and director pre-

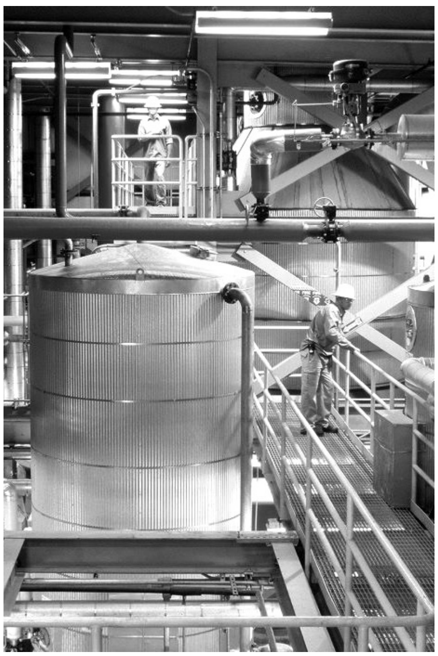
ferred-stock transactions. Lastly, we added a new provision to require FCA's prior approval of investments by FCS banks, associations, and service corporations in preferred stock of other System institutions, including Farmer Mac. (Adopted August 11, 2005; published September 13, 2005, [70 FR 53901]; effective November 3, 2005; some portions of the rule did not become effective until May 3, 2006.)

Receivership Repudiation

We completed this final rule to amend the regulations governing how FCSIC, as receiver or conservator of an FCS institution, should treat financial assets transferred by an FCS institution in connection with a securitization or a participation. This final rule will resolve issues raised by Financial Accounting Standards Board Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS 140). In accordance with this final rule, FCSIC will not seek to recover or reclaim certain financial assets in exercising its authority to repudiate or disaffirm contracts pursuant to 12 CFR 627.2725(b)(2) and (b)(14), and 627.2780(b) and (d). Also, FCSIC will not seek to enforce the contemporaneous requirement of section 5.61(d) of the Farm Credit Act of 1971, as amended (12 U.S.C. §§ 2277a-10(d)). The final rule is substantially identical to receivership rules issued by the Federal Deposit Insurance Corporation and the National Credit Union Administration. (Adopted September 8, 2005; published September 22, 2005, [70 FR 55513]; effective November 14, 2005.)

Farmer Mac Risk-Based Capital Standards

We proposed to amend regulations governing Farmer Mac's risk-based capital stress test because an analysis of the model's results identified a need for some updating. The updates would reflect changing financial markets, new business practices, and the evolution of the loan portfolio at Farmer Mac, as well as continued development of best industry practices among leading financial institutions. By modifying regulations found at 12 CFR part 652, subpart B, the proposed rule would improve the ability of the risk-based capital stress test to accurately reflect risk, which, in turn, would improve the reliability of the model's output—Farmer Mac's regulatory minimum capital level. The proposed rule also would make one clarification relating to Farmer Mac's reporting requirements at 12 CFR 655.50(c). (Adopted October 13, 2005; published November 17, 2005, [70 FR 69692], comment period ended April 17, 2006, but reopened [71 FR 24613] for comments on or before May 17, 2006.)



FCA Organization Regulation
We completed a final rule to amend the regulations describing FCA's current organization and functions; to update the statutory citation for the Farm Credit Act; and to identify those FCA employees responsible for various functions named in parts 602, 603, 604, and 606. (Adopted November 8, 2005; published November 17, 2005, [70 FR 69644]; effective February 15, 2006.)

Termination Proposed Rule
We adopted a proposed rule to amend regulations that allow an FCS bank or association to terminate its FCS charter and become a financial institution under another Federal or state chartering authority. These amendments would clarify our requirements, separate our review of stockholder disclosure information from our review of the termination itself, improve communication, strengthen the role of an institution's directors in the termination process, and make other changes. (Adopted December 8, 2005; published January 11, 2006, [71 FR 1704]; comment period ended March 13, 2006.)

Governance Standards for the System
We proposed a final rule amending our regulations affecting the governance of the FCS. The final rule would enhance impartiality and disclosure in the election of directors; would require that FCBs and associations establish policies identifying desirable director qualifications; would require boards to have a director or an advisor who is a financial expert; would require System institutions to establish director training procedures; and would ensure that boards conduct annual self-evaluations. The final rule would address the term of service and removal of outside directors. It would require all FCBs and associations with assets of more than $500 million to have at least two outside directors but would exempt associations with small boards from this requirement. The rule would further require that FCBs and associations have nominating committees and that all System institutions have audit and compensation committees. The final rule would clarify the current rule on disclosure of conflicts of interest and compensation. This rule would not apply to Farmer Mac, which operates under different statutory-based governance provisions. (Adopted January 6, 2006; published February 2, 2006, [71 FR 5740]; effective April 5, 2006, although some portions of the rule will be effective April 5, 2007.)

Disclosure and Reporting
We proposed a rule to amend the disclosure and reporting regulations for FCS institutions by clarifying and enhancing existing disclosures and reporting to System shareholders and investors. The rule would provide real-time disclosures to shareholders, investors, and the public by shortening the time allowed for filing annual and quarterly reports. It would also require the Federal Farm Credit Banks Funding Corporation to adopt policies and procedures for issuing interim reports and improving the timely and accurate distribution of Systemwide financial information. The proposed rule would also enhance financial accuracy certifications in periodic reports for all System institutions, requiring the Funding Corporation and larger System institutions (i.e., institutions with more than $500 million in assets) to review and report on internal controls. Further, the proposed rule would create a regulatory section on the independence of external auditors, add restrictions on nonaudit services and conflicts of interest, and require auditor rotation. (Adopted February 9, 2006; published March, 14, 2006, [71 FR 13040]; comment period ends June 12, 2006.)

Regulatory Burden Review
We adopted a proposed rule to reduce regulatory burden on the FCS by repealing or revising five regulations. The proposed rule would also correct outdated and erroneous cross-references in two regulations. These revisions would provide System banks and associations with greater flexibility concerning stock ownership of service corporations, employee reporting under standards-of-conduct rules, domestic lending to cooperatives, and real property evaluations for certain loans. We also published a separate notice that identified regulations on which comments were received that we elected not to change in the proposed rule. (Adopted February 9, 2006; published March 28, 2006, [proposed rule (71 FR 15343) and notice (71 FR 15413)]; comment period ended May 30, 2006.)

Policy Statement on Regulatory Philosophy
The FCA Board amended its Policy Statement 59 to more clearly state its philosophy for developing regulations. Consistent with the Farm Credit Act and other relevant statutes, the FCA Board promulgates

regulations for three purposes: (1) to implement the law, (2) to promote the mission of the FCS, and (3) to ensure the System's safety and soundness. The amendments to the policy statement also streamlined the strategies for accomplishing the FCA Board's regulatory objectives and included guidance for reporting on regulatory development achievements. (Adopted June 8, 2005; published November 25, 2005, [70 FR 71142]; effective June 8, 2005).

Policy Statement on Examination and Oversight of FCS
The Board amended its Policy Statement 53 on risk-based examination. The revised policy statement provides our philosophy for examination and oversight of the FCS. The FCA Board provided direction for a "risk-based" oversight and examination program that maximizes the Office of Examination's effectiveness and strategically addresses the System's safety and soundness and compliance with law and regulations. The Board expects the revised risk-based approach to proactively address risks and to promote effective communication with System institutions. (Adopted June 8, 2005; published November 25, 2005, [70 FR 71142]; effective June 8, 2005.)

Policy Statements Updated and Adopted in 2005
The following policy statements were updated and adopted in 2005:

1. Policy Statement 34: Disclosure of the Issuance and Termination of Enforcement Documents (adopted January 27, 2005; published November 25, 2005, [70 FR 71142]; effective January 27, 2005.)
2. Policy Statement 37: Communications during Rulemaking (adopted January 27, 2005; published November 25, 2005, [70 FR 71142]; effective January 27, 2005.)
3. Policy Statement 41: Alternative Means of Dispute Resolution (adopted January 27, 2005; published November 25, 2005, [70 FR 71142]; effective January 27, 2005.)
4. Policy Statement 44: Travel (adopted January 27, 2005; published November 25, 2005, [70 FR 71142]; effective January 27, 2005.)
5. Policy Statement 64: Rules for the Transaction of Business of the Farm Credit Administration Board (adopted June 27, 2005; published November 25, 2005, [70 FR 71142]; effective June 27, 2005.)
6. Policy Statement 65: Release of Consolidated Reporting System Information (adopted January 27, 2005; published November 25, 2005, [70 FR 71142]; effective January 27, 2005.)

7. Policy Statement 67: Nondiscrimination on the Basis of Disability in Agency Programs and Activities (adopted January 27, 2005; published November 25, 2005, [70 FR 71142]; effective January 27, 2005.)
8. Policy Statement 68: FCS Building Association Management Operations Policies and Practices (adopted April 26, 2005; published November 25, 2005, [70 FR 71142]; effective April 26, 2005.)
9. Policy Statement 72: Financial Institution Rating System (FIRS) (adopted January 27, 2005; published November 25, 2005, [70 FR 71142]; effective January 27, 2005.)

Maximum Bank Director Compensation Bookletter[25]

We issued a bookletter (BL-051) to make a one-time adjustment to the limit on bank director compensation to allow System banks to pay fair and reasonable director compensation for 2006. The adjustment, which also applies to future years, was made for safety and soundness reasons. (Issued December 15, 2005, and published on FCA's Web site).

Funding Activity

The FCS funds its loans with a combination of consolidated Systemwide debt and capital. Debt securities are sold on its behalf by the Federal Farm Credit Banks Funding Corporation, the fiscal agent for the five System banks.[26] Through this conduit, funds flow from worldwide capital market investors to agriculture and rural communities, thereby providing Main Street America efficient access to global resources. The Funding Corporation issues Systemwide debt securities as discount notes, master notes, bonds, and designated bonds. As required by the Farm Credit Act, the System must obtain FCA approval for all funding requests.

To participate in the issuance of a System debt security, a System bank must maintain, free from any lien or other pledge, specified eligible assets (available collateral) that are at least equal in value to the total amount of its outstanding debt securities. Securities subject to the available collateral requirements include Systemwide debt securities for which the bank is primarily liable; investment bonds; and other debt securities, which the bank may have issued individually. As a safe and sound practice, FCA regulations require the five System banks to maintain a net collateral ratio (primarily assets divided by liabilities) of

25. Bookletters are documents that communicate the following: (1) Agency policy; (2) Agency legal interpretations; (3) substantive Agency positions on examination, corporate, or accounting issues; and (4) no-action positions on issues that are not institution-specific.
26. The primary function of the Funding Corporation, which is headquartered in the greater New York City area, is to issue, market, and handle debt securities on behalf of the System's five banks. In addition, the Funding Corporation assists the banks with a variety of asset/liability management and specialized funding activities. The Funding Corporation is the financial spokesperson for the FCS and is responsible for financial disclosure and the release of public information concerning the financial condition and performance of the System as a whole.

27. Payment of principal and interest on Systemwide debt securities is insured by the FCSIC's Farm Credit Insurance Fund to the extent provided in the Farm Credit Act. Some FCS debt, $857 million outstanding as of December 31, 2005, was issued by individual banks of the FCS. These individual banks are solely liable for the principal payments on this uninsured debt.
28. System banks, as part of an ongoing effort to ensure their collective ability to meet their obligations under their mutual agreements concerning joint and several liability on Systemwide debt, adopted a Common Liquidity Standard that requires each bank to maintain a minimum of 90 days of liquidity assuming it has no access to the capital markets.

not less than 103 percent. Therefore, all of the banks manage their operations to achieve net collateral ratios that are higher than the required minimum. As of December 31, 2005, the System banks had collateral of $122.2 billion on a combined basis, compared with $114.5 billion of Systemwide debt securities and other obligations; this yielded an overall net collateral ratio of almost 107 percent. No bank had a net collateral ratio less than 105 percent.

Since late 2001 and 2002, when the System refinanced substantial portions of its callable debt by issuing a significant volume of debt securities at lower interest rates, the volume of new issuances has been declining. For the 12 months ended December 31, 2005, the System issued $288 billion in insured debt securities, compared with $356 billion for the prior 12 months.[27] By comparison, the System issued $533 billion and $414 billion of insured debt in 2001 and 2002, respectively. Longer debt maturities, a rising interest rate environment, and the reduced volume of called debt accounted for most of this downtrend.

The FCS continued to extend its debt maturities in a rising rate environment in 2005. The System's weighted-average remaining maturity for all outstanding insured debt increased to 3.0 years as of December 31, 2005, compared with 2.5 years as of December 31, 2004, and 2.0 years as of December 31, 2002. The weighted-average interest rates for the insured debt increased from 2.81 percent as of December 31, 2004, to 4.15 percent as of December 31, 2005.

As of December 31, 2005, outstanding Systemwide insured debt was $112.7 billion, up from $99.1 billion a year earlier, representing a 13.7 percent increase. The $13.6 billion increase in outstanding debt funded the $9.9 billion, or 10.3 percent, increase in gross loans outstanding, with the balance going primarily to fund investments for liquidity and other purposes.[28]

Mission-Related Investments: 2005 Activity

The FCA is committed to helping ensure a dependable and affordable flow of funds to agriculture and rural areas so that farmers, ranchers, and their rural communities can flourish. Rural America and agriculture face new and unique challenges that require innovative solutions. Since its inception in 1916, the FCS has been a key partner to agriculture and rural areas—as they are very much interdependent. Investments in rural communities can help ensure their economic vitality for current and future generations of American farmers who will increasingly look to them as an important source of off-farm income. Investments in rural communities also play an important role in attracting and retaining YBS farmers and other rural entrepreneurs who provide essential services for agricultural production.

Our current regulations allow Farm Credit institutions to make certain mission-related investments. Examples include investments in farmers' notes; agricultural mortgage-backed securities (AMBS), which Farmer Mac issues or guarantees; and certain debt obligations issued or guaranteed by Federal agencies or state or local municipalities for rural utilities and other economic development. We realize, however, that these investment vehicles may no longer be sufficient to help meet the growing and changing demands of agricultural and rural communities for dependable, affordable, and flexible financing in the 21st century. In particular, we recognize that rural areas have an essential and growing need for additional sources of equity capital to support economic growth and infrastructure.

In January 2005, we issued guidance that gave System institutions a provisional opportunity to make additional mission-related investments through pilot programs supporting investments in rural America (see FCA Informational Memorandum dated January 11, 2005, on Investments in Rural America—Pilot Investment Programs, available on the FCA Web site). The pilot programs are intended to strengthen the System's mission to provide for an adequate and flexible flow of funds, under specified conditions, to agriculture and rural communities across the country. Further, the pilot investment programs are intended to provide FCS institutions greater flexibility to partner with government agencies and other agricultural and rural lenders in fulfilling their mission objectives. Through these pilot investment programs, FCA is looking to gain a better understanding of the diverse financing needs of agriculture and rural communities and how FCS institution investments could help increase the availability and efficiency of funds to these markets.

FCA has placed a number of controls on these pilot investment programs to ensure their legal sufficiency, safety and soundness, and mission focus. These controls include participation criteria to ensure that only well-managed and strongly capitalized institutions may conduct pilot programs. The controls also specify the investment purposes that the programs should fulfill; impose program and risk limits; require prudent investment management standards; and limit the pilot period to 1 to 3 years. These programs are also subject to special examination and reporting.

In 2005, the FCA approved the following four pilot investment programs, which are being conducted by individual institutions or by institutions on a districtwide basis.

Rural Housing Mortgage Securities—In May 2005, FCA approved a request from AgFirst Farm Credit Bank to purchase and hold rural housing mortgage securities (RHMS) under a 3-year pilot program. (A similar request from the Farm Credit Bank of Texas was approved on March 13, 2006.) RHMS must be fully guaranteed by a Government agency or another GSE. The rural housing loans backing the RHMS must be conforming first-lien residential mortgage loans originated by non-System lenders in “rural areas” (as defined by the Farm Security and Rural Investment Act of 2002). This program is intended to provide additional liquidity for rural housing loans, resulting in more cost-effective credit to rural homeowners, by providing economic incentives to lenders to create RHMS for sale in the secondary market. As of December 31, 2005, the investment securities of the FCB participating in this program included $1.35 billion in RHMS classified as held-to-maturity.

Starter Farmer Program—YBS farmers are the agricultural entrepreneurs of the future. FCA is evaluating a variety of investment options to provide much needed start-up funds to this market segment. The starter farmer program, which is in the early development stage, aims to help starter farmers obtain greater access to funds needed to begin or continue operations. On October 24, 2005, the FCA Board authorized First Pioneer Farm Credit, ACA, headquartered in Enfield, Connecticut, to establish a state-chartered limited-liability partnership to invest up to $2 million in seed capital for starter farmer operations. As of December 31, 2005, the partnership had not made any investments in starter farmer operations.

Rural America Bonds—On October 25, 2005, the FCA Board authorized the AgFirst FCB, the Farm Credit Bank of Texas, and their affiliated associations to make investments in "Rural America Bonds" through a pilot program meeting specific legal and safety and soundness criteria. This 3-year program focuses on investments that provide funding for economic development, infrastructure, essential community facilities, and revitalization and stabilization projects that are necessary to maintain a vibrant American agriculture and strong rural communities. A key objective of this pilot program is to stimulate FCS partnerships and alliances with other agricultural and rural lenders to increase the availability of cost-effective funds to agriculture and rural communities. At year-end 2005, this pilot program was still in the early stages of its development; the total investment outstanding at that time was $1.5 million.

AgPool Securities—In June 2005, FCA authorized Farm Credit of Western New York, ACA, (WNY) to establish a 1-year pilot program under which it could invest in pass-through notes or similar instruments backed by pools of distressed agricultural loans (AgPool securities) originated by a commercial lender. This unique partnership is intended to leverage the System's extensive agricultural lending experience to help distressed agricultural borrowers and bring economic stabilization to a stressed rural community. As of December 31, 2005, WNY held $21.5 million in AgPool securities.

In addition to these four pilot programs, FCA approved several other mission-related investments in 2005, which are discussed below.

Tobacco Buyout—On October 22, 2004, Congress enacted the Fair and Equitable Tobacco Reform Act of 2004 as part of the American Jobs Creation Act of 2004. The Tobacco Act repeals the Federal tobacco price support and quota programs, provides payments to tobacco quota owners and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal payments for 10 years under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a financial institution the right to receive the contract payments "so that they (quota holders and

29. 70 *Federal Register* 17150 (April 4, 2005).

30. The Farm Security and Rural Investment Act of 2002 authorizes any FCS institution to establish and invest in RBICs provided that such investments are not greater than 5 percent of the capital and surplus of the FCS institution. Further, if FCS institutions (alone or collectively) hold more than 15 percent of the shares of an RBIC, the RBIC may not provide equity investments or financial assistance to entities that are not otherwise eligible to receive financing from the FCS under the Farm Credit Act.

producers) may obtain a lump sum or other payment." On April 4, 2005, USDA issued a final rule implementing the Tobacco Transition Payment Program.[29]

FCA determined that FCS institutions meet the Tobacco Act's financial institution criteria and are, therefore, eligible to participate in the Tobacco Transition Payment Program. FCA further recognized that the tobacco buyout has significant implications for some FCS institutions and the tobacco quota holders and producers they serve. We believe it is essential that FCS institutions be able to provide their borrowers the option to immediately receive tobacco buyout contract payments and reinvest them in future business opportunities. Thus, during 2005, we issued a bookletter, BL-050 (updated by BL-052), that provided guidance to System institutions on making loans and investments related to the tobacco buyout program. As of December 31, 2005, FCS institutions held tobacco buyout loan assignments of $85 million and investments in successor-in-interest contracts of $463 million.

Rural Business Investment Companies (RBICs)—The Farm Security and Rural Investment Act of 2002 established the Rural Business Investment Program to promote economic development and create wealth and job opportunities in rural areas through creation and licensing of RBICs.[30] These newly formed for-profit entities, or newly formed subsidiaries of existing entities, have management expertise in community development financing or venture capital financing in rural areas. RBICs are organized under the laws of a state for the purpose of providing equity investments in rural enterprises. In 2005, several FCS institutions had the opportunity to invest in the two RBICs that were licensed under the program. As of December 31, 2005, FCS institutions had invested $2.75 million in the two RBICs.

FCS institutions also made three other equity investments in 2005 approved by FCA on a case-by-case basis under FCA regulation 615.5140(e). One FCS institution invested in a renewable energy fund, while the other two institutions made de minimis investments in a start-up agribusiness. As of December 31, 2005, the aggregate amount of these equity investments was $1.25 million.

Maintaining a Dependable Source of Credit for Farmers and Ranchers

As federally chartered agricultural lending cooperatives, the institutions of the FCS are limited-purpose lenders exposed to risk in making loans to benefit their borrower-stockholders and meet their public mission. While the FCS benefits from preferred access to the capital markets as a GSE, the Federal government does not subsidize or back it directly.

For FCS institutions to maintain their presence in the marketplace as a dependable source of credit and financially related services for rural America, they must operate profitably and appropriately manage and control risk. Accordingly, FCA deploys examination and supervisory resources based on systemic risk to the overall FCS, and secondarily to the risk specific within each institution. This "risk-based" examination and supervisory program requires examiners to determine how existing or emerging issues facing an institution or the agriculture industry may affect the nature and extent of risks in that institution. The risk-based approach helps to ensure that FCA provides the most effective and efficient regulatory oversight to the System.

To evaluate whether an institution is meeting its pubic mission, examiners determine whether it is operating in compliance with applicable laws and regulations and whether it is responsive to the credit needs of all types of agricultural producers and cooperatives that have a basis for credit. As a part of their mission, FCS associations are obligated to establish programs that respond to the credit and related services needs of YBS farmers and ranchers.

Risk-Based Examination and Oversight Program

Our risk-based examination and oversight program is designed to maximize FCA's effectiveness and efficiency while strategically addressing FCS risk. During the establishment and implementation of oversight and examination plans for each FCS institution, the FCA allocates examination resources to matters of highest priority and potential risk within individual institutions and the System as a whole. This differential approach reflects the capacity of FCS institutions to identify and manage both institution-specific and systemic risks. When institutions

31. The National Consumer Cooperative Bank Act of 1978, as amended, provides for FCA to examine and report on the condition of the National Cooperative Bank. Since the passage of this law, FCA has conducted safety and soundness examinations of the National Cooperative Bank and issued reports to the bank's board.

are either unable or unwilling to address unsafe and unsound practices or to comply with applicable laws and regulations, examination efforts are supported by appropriate supervisory action.

Through our oversight practices, the Agency seeks to ensure that FCS institutions have the programs, policies, procedures, and controls to effectively identify and manage risks, and that FCA policies and regulations are effective, clear, and minimally intrusive. For example, our regulations require FCS institutions to have effective loan underwriting and loan administration processes. Our examiners then test those FCS processes, and our analysts compare banking industry trends with System results to determine relative performance. We also have specific regulations requiring FCS institutions to maintain strong asset-liability management capabilities. Over the last 15 years, FCA has developed a comprehensive regulatory and supervisory framework for ensuring System safety and soundness. FCS institutions, on their own and in response to FCA efforts, have developed strong risk management cultures.

Meeting Statutory Examination Requirements

The Farm Credit Act requires FCA to examine each FCS institution at least once every 18 months. In addition to meeting this minimum requirement, the Agency has embraced an ongoing examination approach where we conduct ongoing monitoring and interim examination activities as risk and circumstances warrant in each institution and integrate identified systemic risks into our national oversight strategies to mitigate such risks Systemwide. This approach provides differential risk-driven examination coverage to all institutions throughout their respective examination cycles. During 2005, FCA conducted oversight and examination activities for 96 FCS direct-lender associations; 4 FCBs; 1 ACB; 8 service corporations/special purposes entities; Farmer Mac (see section titled "Condition of Farmer Mac"); and the National Cooperative Bank, which is not an FCS institution.[31] Our examination approach emphasizes the importance of proactive, constructive communication with regulated institutions through a combination of communication methods. For example, we issued 81 formal Reports of Examination to FCS institutions during 2005, along with numerous face-to-face meetings with management and boards of directors, supplemented by written correspondence and telephone contact.

In addition to our FCS examination activities, the Small Business Administration (SBA) and the USDA continued to use FCA's examination expertise in 2005. SBA contracted with FCA to conduct examinations of financial companies licensed by SBA to make guaranteed loans to small businesses. USDA contracted with FCA to conduct examinations of financial companies authorized by USDA to make guaranteed loans under USDA's Business and Industry Guaranteed Loan program. FCA examiners also completed reviews of the Business and Industry Guaranteed Loan program operations at selected USDA state offices. We issued 11 Reports of Examination as part of these contracted activities during 2005. While the safety and soundness of the FCS remains our principal focus and responsibility, the use of FCA examination expertise to assist SBA and USDA broadens FCA's examination skills while increasing job satisfaction and employee retention. Moreover, reimbursable fees earned from SBA and USDA reduce assessments on FCS institutions.

Identifying and Responding to Potential Threats to Safety and Soundness

Because of the continually evolving dynamics and risks in the agricultural and financial industries, FCA must ensure that FCS institutions have the culture, policies, procedures, and management controls to effectively identify and manage applicable risks. For the Agency to be fully effective in meeting this challenge, we have processes for evaluating and responding to systemic risks that can affect an institution, a group of institutions, the System as a whole, agriculture, and the financial industry.

Based on risk assessment and analysis activities to date, FCA highlights the following four areas within its examination program for FCS institutions: (1) internal control environment and disclosures; (2) governance, with special attention to cooperative principles, capital management, and compensation practices; (3) risk management systems, especially processes related to counterparty risk and collateral risk; and (4) mission accomplishment, including investments in rural America, lending to YBS farmers and ranchers, and diversity.

32. See the Glossary for a complete description of the FIRS ratings.

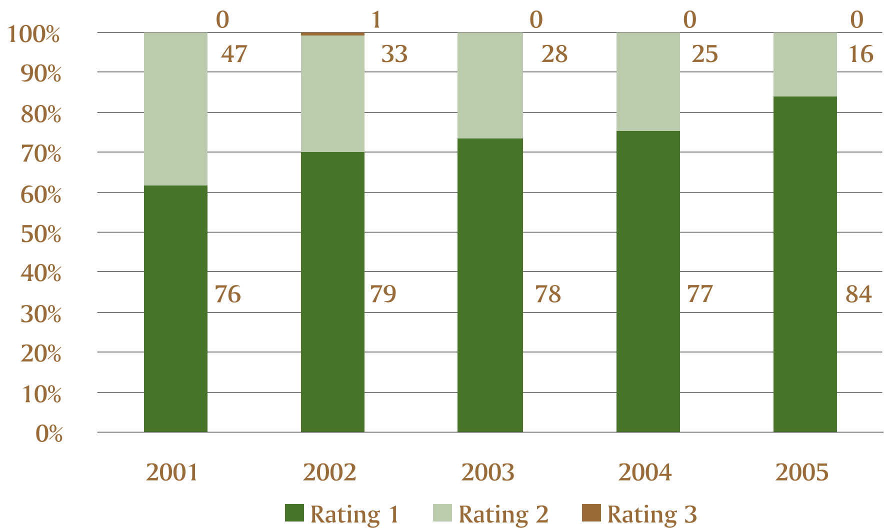
Measuring the System's Safety and Soundness

The Financial Institution Rating System (FIRS) is a key risk rating methodology used by FCA to indicate the safety and soundness threats in each institution. Similar to the systems used by other Federal financial regulators, it is a "CAMELS"-based system with component ratings for capital, assets, management, earnings, liquidity, and sensitivity, all factoring into an overall composite rating. The FIRS provides a general framework for evaluating and assimilating all significant financial, asset quality, and management factors. It assigns component and composite ratings to each institution on a scale of 1 to 5. A composite rating of 1 indicates an institution is sound in every respect. A rating of 3 means an institution displays a combination of financial, management, or compliance weaknesses ranging from "moderately severe" to "unsatisfactory." A 5 rating represents an extremely high, immediate or near-term probability of failure.[32]

Through our ongoing monitoring and oversight programs, examiners continually evaluate institutional risk and regularly review and update FIRS ratings, as needed, to reflect current risks and conditions in the FCS. The Agency maintains both quantitative and qualitative benchmarks as general examiner guidelines to facilitate consistent application of the FIRS process. FCA discloses the FIRS composite and component ratings to the institution's board to provide perspective on relative safety and soundness. Examination reports and other communication also provide the institution board with an assessment of management's performance, the quality of assets, and the financial condition and performance of the institution.

FIRS ratings continued to reflect strong FCS financial condition and performance during 2005. As shown in Figure 8, FIRS ratings have trended upward for several years. As of December 31, 2005, 84 percent of FCS institutions were rated 1, with the remainder receiving a rating of 2. Notably, there were no 3-, 4-, or 5-rated institutions. These ratings reflect a financially safe and sound FCS. The overall financial strength maintained by the System reduces the risk to investors in FCS debt, to the FCSIC, and to FCS institution stockholders.

Figure 8
Farm Credit System FIRS Composite Ratings, 2001–2005
As of December 31



Sources: Farm Credit Administration Reports of Examination.

Note: FIRS ratings are based on capital, asset quality, management performance (including the board of directors), earnings, liquidity, and sensitivity to interest-rate risk. Ratings range from 1 (a sound institution) to 5 (an institution that is likely to fail).

In addition to the FIRS process, in 2006 FCA examiners will begin using a new set of risk assessment criteria. The risk areas are credit, interest rate, liquidity, operational, compliance, strategic, and reputation. This tool will be used, along with FIRS ratings and other information, to assist in allocating resources in the most risk-based manner.

Differential Supervision and Enforcement

FCA uses a risk-based supervisory and enforcement program to differentially respond to the risks and particular oversight needs of FCS institutions. Risks are inherent in lending, and managing risks associated with a single sector of the economy, such as agriculture, presents an additional challenge for FCS lenders. If FCA discovers unwarranted risks, we take differential and corresponding supervisory action to ensure that the identified risks are appropriately mitigated. Corrective actions may include reducing risk exposures, increasing capital (i.e., risk-bearing ability), and/or strengthening risk management.

The Agency uses a three-tiered supervision program: normal supervision, special supervision, and formal enforcement. Institutions under normal supervision are generally performing in a safe and sound manner and operating in compliance with applicable laws and regulations. These institutions are able to correct identified weaknesses in the normal course of business. For those institutions displaying more serious or protracted weaknesses, we shift from normal to special supervision, and our examination oversight increases accordingly. Under special supervision, institutions are given clear and firm regulatory guidance to address identified weaknesses, and the institution is allowed time to correct the problems.

If less formal supervisory approaches have not been or are not likely to be successful, FCA will use its formal enforcement authorities to ensure that the operations of FCS institutions are safe, sound, and in compliance with laws and regulations. Enforcement action may be required for a number of reasons, including (1) a situation that threatens an institution's financial stability; (2) uncorrected safety and soundness problems or violations of laws or regulations, and (3) the inability or unwillingness of the institution's board and management to correct identified problems.

FCA's enforcement authorities include the power to enter into formal agreements; to issue orders to cease and desist; to levy civil money penalties; and to suspend or remove officers, directors, and other persons. If an enforcement action is taken, the FCS institution must operate and report back to the FCA under the Agency's enforcement program, and FCA examiners oversee the institution's performance to ensure compliance with the enforcement action. It has not been necessary for FCA to use its formal enforcement authorities during the past 7 years.

Working with Financially Stressed Borrowers

Agriculture involves significant inherent risks and volatility because of many factors, including adverse weather, changes in government programs, international trade issues, fluctuations in commodity prices, and crop and livestock diseases. Such conditions can trigger borrower loan performance problems. Unlike other lenders, the System (under provisions of the Farm Credit Act) provides borrowers certain rights when they apply for loans and when they have difficulty repaying loans. For example, the Farm Credit Act requires FCS institutions to consider restructuring an agricultural loan before initiating foreclosure. The Farm Credit Act also provides borrowers an opportunity to seek review of certain credit and restructuring decisions. If a loan is foreclosed upon, the Farm Credit Act also provides borrowers the opportunity to buy back their property at the fair market value.

FCA enforces the borrower rights provisions of the Farm Credit Act. FCA examiners routinely review borrower rights compliance during examination activities. We also receive and review complaints from borrowers regarding their borrower rights. Through these efforts, FCA ensures compliance with the law and helps the FCS institutions continue to provide sound and constructive credit and related services to eligible farmers and ranchers.

Condition of Farmer Mac

Farmer Mac is a stockholder-owned, federally chartered instrumentality of the United States, created in 1988 to establish a secondary market for agricultural real estate and rural housing mortgage loans. Farmer Mac conducts its business primarily through two core programs: Farmer Mac I and Farmer Mac II. Under the former, Farmer Mac purchases, or commits to purchase, qualified loans or obligations backed by qualified loans that are not guaranteed by any instrumentality or agency of the United States. Under the latter, Farmer Mac purchases the guaranteed portions of farm ownership and farm operating loans, rural business and community development loans, and certain other loans guaranteed by USDA.

Farmer Mac is regulated by FCA through the Office of Secondary Market Oversight, which was established in 1992 by Public Law 102-237. This office provides for the examination and general supervision of Farmer Mac's safe and sound performance of its powers, functions, and duties. The statute requires that the Office of Secondary Market Oversight constitute a separate office that reports directly to the FCA Board and that its activities, to the extent practicable, be carried out by individuals not responsible for the supervision of the banks and associations of the FCS.

Through this office, the Agency performs annual comprehensive examinations based on capital, asset quality, management, earnings, liquidity, and sensitivity; supervises Farmer Mac's operations; and evaluates its safety and soundness and mission achievement. The work of the Office of Secondary Market Oversight includes the ongoing review of Farmer Mac's compliance with the risk-based capital regulations and the ongoing supervision of its operations and condition throughout the year. Table 7 summarizes Farmer Mac's balance sheet at the end of the year for the past 6 years.

Capital

By statutory design, secondary market GSEs, such as Farmer Mac, operate with lower statutory capital margins than primary market lenders. Accordingly, monitoring the capital levels of Farmer Mac is a central component of FCA's oversight programs.

Table 7
Farmer Mac Capital Positions, 2000–2005
As of December 31
Dollars in Millions

	2000	2001	2002	2003	2004	2005
GAAP Equity	$132.7	$134.4	$183.6	$213.3	$236.9	$248.1
Core Capital	$101.2	$126.0	$184.0	$215.5	$237.7	$244.8
Regulatory Capital	NA	NA	$204.0	$237.6	$254.8	$253.4
Statutory Requirement	$96.9	$110.6	$137.1	$142.0	$128.9	$142.4
Regulatory Requirement	NA	NA	$73.4	$38.8	$37.1	$32.4
Amount in Excess of Statutory or Regulatory Requirement*	$4.3	$15.4	$46.9	$73.5	$108.8	$102.4
Percentage in Excess of Minimum Capital Requirement	4.4%	13.9%	34.2%	51.8%	84.4%	71.9%

Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-K.

* Farmer Mac is required to hold capital in an amount equal to (1) the statutory minimum capital requirement or (2) the amount required by FCA regulations as determined by the risk-based capital stress test model, whichever is higher.

NA = Not Available

33. The statute requires 2.75 percent capital coverage for on-balance-sheet assets and 0.75 percent for off-balance-sheet obligations.

On December 31, 2005, Farmer Mac's net worth (i.e., equity capital determined using generally accepted accounting principles [GAAP]) was $248.1 million, compared with $236.9 million a year earlier. Net worth was 5.7 percent of on-balance-sheet assets as of December 31, 2005. When Farmer Mac's off-balance-sheet program assets (i.e., guarantee obligations) are added to total on-balance-sheet assets, capital coverage is 3.3 percent. In August 2004, Farmer Mac established a new common stock dividend policy and a stock repurchase program. The stock repurchase program was completed in September 2005, and a new stock repurchase program was established in November 2005. While these policies affect outstanding common equity and number of shares, Farmer Mac is expected to continue to meet statutory and regulatory capital requirements.

Farmer Mac's core capital (the sum of the par value of outstanding common stock, the par value of outstanding preferred stock, paid-in capital, and retained earnings) remained above the statutory minimum requirement, and its regulatory capital (core capital plus allowance for losses) exceeded the required amount of regulatory capital as determined by the risk-based capital stress test. Farmer Mac's core capital continued its upward trend and, as of December 31, 2005, totaled $244.8 million, exceeding the statutory minimum capital requirement[33] of $142.4 million by $102.4 million. Farmer Mac's regulatory capital totaled $253.4 million as of December 31, 2005, exceeding the regulatory risk-based capital requirement of $32.4 million by $221.0 million. Regulatory capital was 5.7 percent of total Farmer Mac I program volume (on and off the balance sheet). Table 8 offers a historical perspective on capital and capital requirements for the past 6 years. In 2005, FCA published proposed revisions to the risk-based capital regulations that originally became effective in 2002. The proposed revisions are intended to update the risk-based capital model in response to changing financial markets, new business practices, and the evolution of the loan portfolio at Farmer Mac, as well as continued development of best industry practices among leading financial institutions. FCA plans to issue final revisions to the regulations during 2006.

Table 8
Farmer Mac Condensed Balance Sheets, 2000–2005
As of December 31
Dollars in Millions

	2000	2001	2002	2003	2004	2005	Growth Rate 2004–2005
Total Assets	$3,160.9	$3,415.9	$4,222.9	$4,299.7	$3,846.8	$4,340.6	12.8%
Total Liabilities	$3,028.2	$3,281.4	$4,039.3	$4,086.4	$3,610.0	$4,092.5	13.4%
Net Worth or Equity Capital	$132.7	$134.5	$183.6	$213.3	$236.8	$248.1	4.8%

Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-K.

In addition to program assets, Farmer Mac's capital supports nonprogram investment needs. Nonprogram investments provide liquidity in the event of a short-term disruption in the capital markets that prevents Farmer Mac from issuing new debt. Nonprogram investments are investment securities, cash, and cash equivalents. FCA regulations governing Farmer Mac's nonprogram investments and liquidity became effective in the third quarter of 2005. Farmer Mac has been in compliance with those regulations since their publication. Farmer Mac's policy is to maintain nonprogram investments at levels that provide liquidity for a minimum of 60 days of maturing obligations, with a target of 90 days. Farmer Mac was in compliance with its liquidity policy throughout the year.

34. Farmer Mac assumes 100 percent of the credit risk on post-1996 Act loans, whereas pre-1996 Act loans are supported by mandatory 10 percent subordinated interests that mitigate Farmer Mac's exposure. For that reason, pre-1996 Act loans are excluded from analysis for comparison purposes.

Program Activity

Farmer Mac's total program activity dropped slightly over the past year to $5.3 billion on December 31, 2005, from $5.5 billion a year earlier (see Figure 9). Farmer Mac attributes the declining program activity to high levels of available capital and liquidity of agricultural lenders; alternate sources of funding and credit enhancement for agricultural lenders; increased competition in the secondary market for agricultural mortgage loans; reduced growth rates in the agricultural mortgage market; and the lower rate of growth of the FCS mortgage portfolio.

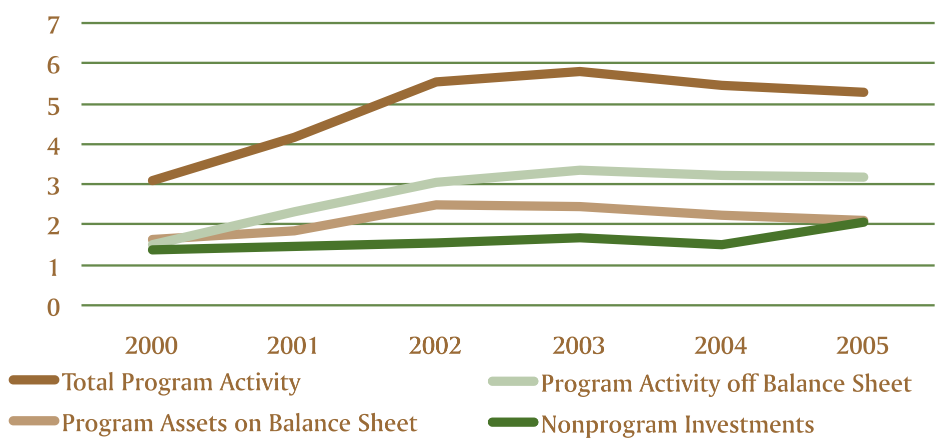
Before the recent downward trend in program activity, Farmer Mac's Long-Term Standby Purchase Commitments product was the primary source of growth in program activity. Under Farmer Mac Standbys, a financial institution pays an annual fee in return for Farmer Mac's commitment to purchase loans in a specific pool under specified conditions at the option of the institution. The Standby product has grown rapidly since its introduction in 1999, from $862.8 million as of December 31, 2000, to $2.3 billion as of December 31, 2005. Standby volume now accounts for 44.2 percent of Farmer Mac's total program activities.

Off-balance-sheet program activity is composed of agricultural mortgage-backed securities sold to investors and Standbys. At the end of December 2005, 60.2 percent of program activity consisted of off-balance-sheet obligations (see Figure 10).

Asset Quality

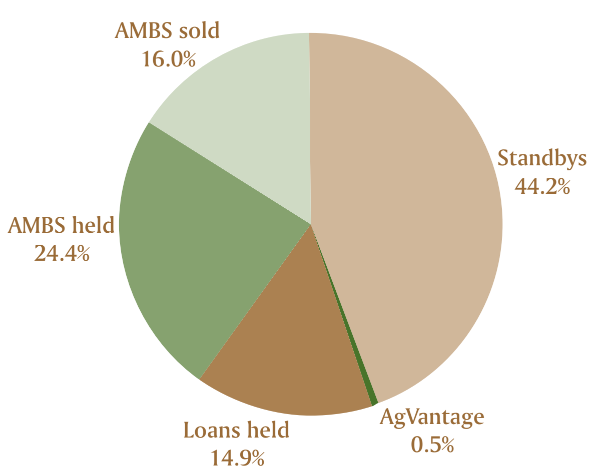
On December 31, 2005, the portion of the Farmer Mac I program portfolio that was nonperforming was $48.8 million in loan principal, or 1.11 percent of the principal balance of all loans purchased, guaranteed, or committed to be purchased since enactment of the Farm Credit System Reform Act of 1996 (1996 Act).[34] This compares with $50.6 million, or 1.09 percent, on December 31, 2004. Nonperforming assets are (1) those that are 90 or more days past due, in foreclosure, or in bankruptcy, or (2) real estate property acquired by Farmer Mac through

Figure 9
Farmer Mac Program Activity and Nonprogram Investment Trends, 2000–2005
As of December 31



Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-K.

Figure 10
Farmer Mac Total Program Activity
As of December 31, 2005



AMBS = agricultural mortgage-backed securities

Source: Farmer Mac's Annual Report on Securities and Exchange Commission Form 10-K.

35. Core earnings is a non-GAAP measure of financial results that excludes the effects of certain unrealized gains and losses and nonrecurring items. Farmer Mac began reporting core earnings to present an alternative measure of earnings performance. The components included in core earnings calculations are at the reporting entity's discretion.

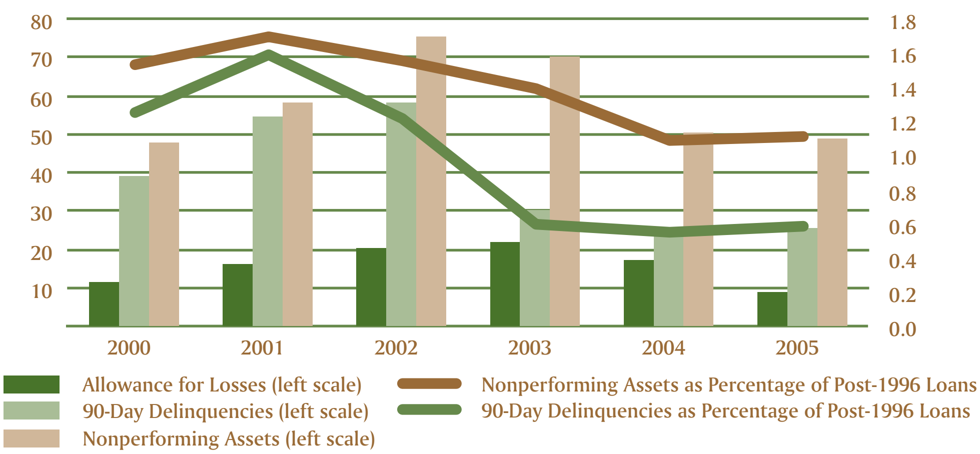
foreclosure. Real estate owned as of December 31, 2005, was $3.5 million, down from $3.8 million a year earlier. After several years of improvement, the total dollar amount and percentage of nonperforming assets have leveled out. In 2004, Farmer Mac attributed the improvement to the maturing of a significant segment of its portfolio beyond the peak default years. During 2005, a smaller segment of its portfolio moved outside the peak default years.

On December 31, 2005, Farmer Mac's allowance for losses totaled $8.7 million, compared with $17.1 million on December 31, 2004. Of the $8.7 million allowance, $0.2 million represents specific allowances related to under-collateralized nonperforming assets. Farmer Mac attributes the decrease in the allowance for losses to the overall improved credit quality of the portfolio, the strong U.S. agricultural economy, and the implementation of a new methodology to estimate probable losses in the portfolio. Figure 11 shows the level of Farmer Mac's allowance and nonperforming assets relative to outstanding post-1996 Act program volume.

Earnings

GAAP net income available to common stockholders for the year ended December 31, 2005, was $27.3 million, down $0.9 million (3.2 percent) from 2004. The decline would have been greater had Farmer Mac not reported an approximate $8.8 million reversal in its ALL. Core earnings[35] for 2005 were $28.7 million, an increase of 4.7 percent over 2004. Net interest income, which excludes guarantee fee income, was $33.2 million in 2005, unchanged from 2004. Guarantee fee income, at $19.6 million, was 6.8 percent lower in 2005 than in 2004. The decline reflects a decrease in the average balance of outstanding guarantees and Standbys. Nonprogram investments accounted for an estimated 37 percent of interest income for 2005, up from 24 percent for 2004. The increase resulted from (1) an increase in the average balance of nonprogram investments and (2) the rise in the average rates earned on the investments. Table 9 shows a 6-year trend in key income components.

Figure 11
Allowance, Nonperforming Asset, and Delinquency Trends, 2000–2005
As of December 31



Source: Farmer Mac's Annual Report on Securities and Exchange Commission Form 10-K.

Table 9
Farmer Mac Condensed Statements of Operations, 2000–2005
As of December 31
Dollars in Millions

	2000	2001	2002	2003	2004	2005	Growth Rate 2004–2005
Total Revenues	$29.5	$42.0	$51.3	$54.8	$60.7	$53.5	-11.9%
Total Expenses	$19.1	$25.7	$30.0	$29.8	$32.5	$26.2	-19.4%
Net Income Available to Shareholders	$10.4	$16.3	$21.3	$25.0	$28.2	$27.3	-3.2%
Core Earnings	NA	$17.1	$22.9	$23.0	$27.4	$28.7	4.7%

NA = Not Available

Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-K.

Challenges Facing Agriculture and the FCS

While the FCS enjoyed another year of solid earnings and capital growth in 2005, several challenges, both domestic and foreign, could affect its long-term profitability and performance. With its high capital levels, the System's capacity to grow, bear risk, absorb losses, and sustain operations is at an all-time high. However, a number of risks and uncertainties remain that are largely beyond the control of the System and FCA. The Agency uses a strong surveillance system in its regulatory and examination activities to monitor and address these challenges.

A Slowdown in the Economy

The economy generally has been good to consumers and farmers in recent years and the question now becomes, will it perform as well in the period ahead? Most of the evidence for 2005 is positive, although the forecasting lens is a bit foggy when it comes to assessing the housing market, energy prices, inflation, federal budget deficits, interest rate trends, and world trade negotiations, among other uncertainties.

In general, real gross domestic production (GDP) is expected to grow at about its long-term rate of 3.3 percent, down slightly from a 3.5 percent rate in 2005 and the robust rate of 4.2 percent in 2004. More jobs will increase wages and salaries, which would bolster consumer and business spending and possibly offset any negative wealth effects from a softer housing market. Despite the sharp run-up in energy prices after Hurricane Katrina hit the Gulf Coast in late August, core inflation (i.e., consumer prices less food and energy) remains well anchored at about 2 percent and is not expected to accelerate significantly in 2006. Thus, overall demand for food products from America's farmers and ranchers should remain strong. Plus, a good economy will help support off-farm income opportunities for many farm families who rely on this income for their livelihood.

All economic forecasts contain risks, whether the economy is heating up or cooling down. This year most of the risks appear to be associated with an economic downturn. Thus, policymakers will be judging the economy's progress very carefully, looking for any signs of a significant slowdown or accelerating inflation. More than likely, they will face a delicate balancing act as they try to find the right blend of policies.

Some of the key risk factors in the outlook are as follows:

- A slowdown in the housing market would dampen what has been a major driver of economic activity in the last 2 years. If other sectors fail to pick up the slack, real GDP growth would likely suffer. The extent to which housing markets soften will depend on future interest rate developments, a possible reversal of our nation's negative savings rate, and regional employment opportunities.
- Volatile and rising energy prices could trigger inflationary expectations and cause the Federal Reserve to tighten monetary policy beyond mid-2006. Although energy use per dollar of GDP today is half of what it was during the energy crisis period of the 1970s, a major disruption in oil supplies, or even the failure of oil prices to retreat below $70 per barrel, may be difficult for the economy to absorb without inflationary repercussions. However, high energy prices might stimulate ethanol and bio-diesel production as alternative fuels, which will help bolster crop income.
- Will the Federal Reserve continue to raise interest rates beyond midyear? After 16 consecutive hikes between June 2004 and May 2006, most observers believe the Federal Open Market Committee, starting this summer, will likely call a halt to its practice of increasing the Federal funds rate by 25 basis points each time it meets. However, as the nation's inflation watchdog, the Federal Reserve can be expected to head off any unexpected inflationary pressures that may emerge in the energy sector or elsewhere by tightening monetary policy. While rates are still relatively low by historical standards, additional increases would ripple through the economy and probably reduce off-farm income opportunities in rural areas.

Darker Clouds for Farm Income

For the past 3 years, farm income has been strong, with net cash income hitting an all-time high of $85.5 billion in 2004, followed by $82.8 billion in 2005. Most farm lenders are aware that farm income can vary widely, not only from year to year, but also from one sector or region to another within a given year. This volatility affects loan repayment ability. Lenders are also aware that most farm borrowers employ a number of risk management tools to protect themselves from the vagaries of the marketplace, including enterprise diversification; yield or revenue insurance; and, if they are eligible to receive them, countercyclical and other farm program payments.

The FCS's loan portfolio is a good snapshot of American agriculture in terms of commodities, farm size distribution, and population characteristics. For example, about 60 percent of the System's customers are small farmers, having annual sales of less than $250,000. However, most of its loan volume—about 70 percent of it—is with the operators of larger, commercial-sized farms. While off-farm income is important to both small and large farming operations, large variations in farm income can pose serious repayment issues for the latter group, which causes FCS institutions to pay close attention to these developments.

Early indications are that net cash farm income will decline around 20 percent to $65 billion in 2006, mostly because of lower prices received for farm products and higher production costs. Direct government payments are also projected to drop about $4.5 billion. From a historical perspective, however, the 2006 income estimate is in line with the average figure for the last 10 years, $64.4 billion. By commodity groups, the crop sector may fare somewhat better than the livestock sector since red meat and poultry prices will likely decline because of large supplies domestically and weak demand internationally. Although the farm income picture looks reasonably good for the next couple of years, uncertainties about the new farm bill and world trade negotiations could prove worrisome as we move through 2006 and beyond.

The 2007 Farm Bill—Government payments to farmers have been a key component of the farm safety net for more than 50 years. Although Congress decoupled payments from production and established a schedule to completely phase out subsidies with the 1996 legislation, a series of crop and livestock emergencies, as well as a budget surplus, induced Congress to reintroduce direct and countercyclical payments in the 2002 farm bill. Program payments have averaged almost $16 billion annually for the last 10 years but peaked at $23 billion in 2005, just as people were starting to think about the new farm bill.

As the debate commences in earnest on the new farm bill, observers will be watching Congress to see how it balances the demands of various domestic interest groups, not all of which will be in harmony, with the expectations of the world community to reduce agricultural subsidies. Under almost any scenario, Congress likely will try to scale back expenditures in the new farm bill to mitigate the budget deficit problem and to comply with current and future World Trade Organization (WTO) rules on subsidies. However, commodity interest groups will lobby hard to preserve their current benefits even though most of the payments go to the larger producers. Meanwhile, conservation and other interest groups will argue for a reallocation of monies to their programs. The risk to the FCS is that, if a sharp reduction in farm program benefits were to occur, it could weaken agriculture's safety net, decrease the collateral values of farm real estate, and, in the short run, reduce farm income, all of which would probably adversely affect the credit quality of the System's loan portfolio. However, given the long history of farm programs, Congress—rather than making draconian cuts in commodity program benefits—probably will take a measured approach in the new farm bill to identify ways to use insurance, "green" payments, and other innovative programs to offset some of the risks in production agriculture.

World Trade and the Doha Round—Farm exports have been a bright spot for the economy for several years. Following record sales in 2004 and 2005, agricultural exports are projected to increase again in 2006 to almost $65 billion, a 3 percent gain. As impressive as these statistics are, agricultural imports have also been on a run, climbing even more rapidly than exports and taking sharp aim at the long-term trade surplus that agriculture has enjoyed since 1959, the last time it experienced a small deficit. If consumers continue to demand value-added products from abroad—wines, cheeses, cut flowers, fruits and vegetables—the agricultural trade balance will likely turn into a deficit within the next 2 years, barring significant depreciation of the dollar.

World trade is important to U.S. agriculture because, in general, a growing proportion of our output is sold abroad; in fact, exports absorb more than 25 percent of total production. Roughly half of our wheat and rice and 60 percent of our cotton are exported and, except for wheat, these percentages are higher than in the 1990s. More than a third of our soybean crop is sold abroad and, again, this percentage has been growing. Corn is an exception: the proportion of output sold abroad has dropped slightly to around 18 percent recently, but about 15 percent of the crop now goes into ethanol production. Although livestock exports as a percentage of production are relatively small (about 8 percent for red meats and 15 percent for poultry), foreign sales were growing rapidly before being hit hard by bovine spongiform encephalopathy (BSE) and avian influenza concerns worldwide.

Against this backdrop, it is clear why the Doha Round of negotiations by the WTO is so critical to American agriculture.[36] By reducing subsidies and gaining access to more international markets, U.S. farmers presumably would be able to compete more openly and fairly in most product areas and boost their foreign sales. Unfortunately, the WTO negotiations have been both controversial and contentious and, quite conceivably, may not conclude in time for the 2007 farm bill, or in time to create Congressional support for renewing the Trade Promotion Act (fast-track authority), which expires on July 1, 2007. As a practical matter, a new WTO agreement needs to be adopted by the end of 2006 to keep the farm bill legislation on schedule. Absent this legislation, the agricultural community, including the FCS, will face an unusual set of challenges as producers try to make key investment decisions in this uncertain environment.

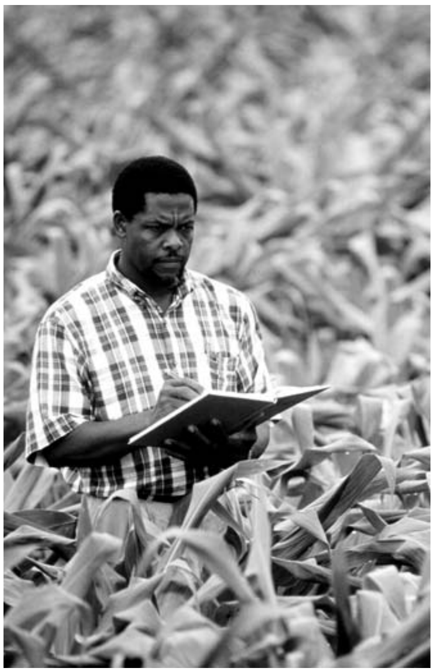
36. The WTO is a voluntary association of 149 countries that meets periodically (in what are known as "rounds" of negotiations) to set the rules by which all of its members agree to behave in international trade. The Doha Round of trade negotiations is the most recent series of meetings, which was launched in 2001 in Doha, Qatar. Although trade rounds may take several years to complete, negotiations in the Doha Round are stretching out over an unusually long time.

Risks to Land Values Inside and Outside the Farm Sector

Farm real estate is an important issue for the FCS because about 70 percent of its farm lending portfolio is collateralized by a first mortgage on farmland. The value of this collateral has been climbing continuously for 18 years, since the collapse of the farmland market in the mid-1980s. For most of these years, farm real estate values have been rising faster than net cash farm income. Farmland values have grown an average annual rate of 6.8 percent in nominal terms (4.7 percent in real terms) over the past 5 years (2001–2005). USDA expects land values to increase 6.5 percent in 2006, a gain that will again outpace total farm income. Fueling the upsurge in farm real estate values has been (1) the persistently strong demand for farmland from nonfarm investors looking for returns or recreation, (2) record farm income in 2004 and 2005, (3) significant farm program payments that both increase farm income and reduce income volatility, and (4) historically low interest rates.

The increasing imbalance between the value of farmland and the market-based income derived from it presents significant challenges. This imbalance increases lenders' collateral risk, especially as farmland values become more dependent on government payments and events in the nonfarm economy. Moreover, the persistent rise in land values, while the main source of equity growth for most farmers, does not bode well for young and beginning farmers who are finding it increasingly difficult to afford a start-up operation or expand an existing one. Increasing land values also make generational transfers more difficult to accomplish. In addition, they pose a longer-term threat to agriculture's overall profitability and competitiveness because the fixed costs for land will be high in relation to the fixed costs of foreign producers.

USDA expects farm income to decline from record levels because of lower commodity prices, a surge in energy costs, higher interest rates, and reduced government payments. Since demand from nonfarm investors has increasingly been a factor in rising land markets, any decrease in this demand will have a bigger impact than in the past. One concern is the weaknesses that might occur in the housing market and the linkages to farmland through the Section 1031 tax exchanges. These exchanges provide an opportunity for investors to roll over capital gains from sales of properties in or near metro areas into farmland as a means of postponing payment of taxes.



While farm real estate values are expected to remain firm in 2006, the above-mentioned factors could slow their rise or even reduce values in some areas. Especially vulnerable will be farming-dependent counties with declining populations, marginal lands, farms near urban areas where the housing market may soften significantly, regions with limits on water availability or affordability, and land with little or no recreational or scenic value.

These risks are being closely watched for their effect on land values. In a memorandum dated March 9, 2005, the Agency informed System institutions about the rising collateral risk in real estate loans. Fortunately, System lenders are in a much stronger financial position today than 2 decades ago and generally use conservative underwriting standards. If some rural areas were to experience moderate declines in farmland values this year, System institutions are well positioned to deal with any credit stress that may arise from this development.

Food Safety and Security—A Growing Concern

For years, the United States has been recognized as a world leader in food safety and security. U.S. agriculture benefits from this reputation by being able to move large quantities of food and fiber into various marketing channels. However, all it takes is one incident or breakdown in food safety, whether perceived or real, to harm a country's reputation and jeopardize the trust it has worked so hard to earn.

The discovery of a single case of BSE in the United States in late 2003 demonstrated how markets can respond to food safety concerns. Several countries, most notably Japan, halted beef imports from America, causing beef prices to plummet. Prices only strengthened when it became apparent that domestic consumers were still buying and eating beef. Nevertheless, beef exports are still languishing as two more BSE incidents in the United States (the latest occurred in Alabama in March 2006) have undermined USDA's efforts to persuade Japan and several other foreign countries to reopen their markets to U.S. beef.

Avian influenza is another animal disease with mounting repercussions. Although the United States has largely escaped the problem to date, with only a limited outbreak in four states in early 2004, several Asian countries have been less fortunate. Not only have a large number of flocks been destroyed, but several people have died. The most worrisome issue is the unlikely scenario in which the flu virus mutates and is transmitted from human to human. Health experts believe such an outcome could kill millions of people worldwide, with terrible economic consequences for world trade and commerce. Bird flu bears close scrutiny this year because of the growing likelihood it could resurface in the United States, despite the fact that much of our poultry is produced in confinement facilities and isolated from migratory birds. The chief risk to the industry is that an outbreak would choke off exports and cause poultry prices to drop sharply. Agency staff is monitoring this situation closely and working with FCS institutions whose loan volumes are heavily concentrated in poultry.

Other food security issues relate to the weather, plant diseases, and bioterrorism. Katrina and other hurricanes in 2005 devastated local production and uprooted lives in several regions, and weather forecasters believe 2006 could be another active hurricane year. Furthermore, drought can hurt production and is a problem that seems to show up somewhere in the United States almost every year. Soybean rust, after surfacing in the latter half of 2004, did not affect 2005 production very much, but it remains a concern because it is highly contagious and can significantly reduce yields if it spreads widely. Bioterrorism, no matter what form it may take, appears to be a growing threat to the safety of our food and water supply, although every effort is being made to keep this risk to a minimum.

Agriculture is inherently risky. As noted above, many events that can significantly affect farm income are beyond a producer's control. That is why FCS institutions and their farmer customers need to maintain capital and employ appropriate risk management tools to sustain their operations when hardships occur.

Keeping Pace with the Structure of Agriculture

Understanding agriculture today requires more than examining statistics on farm numbers, average acreage, and production concentrations. Dynamic forces are changing the structure of agriculture at a rapid pace. Among the forces reshaping agriculture are

- declining rural populations and employment opportunities in certain regions;
- shifting demographics of farm operators, including age, gender, race, tenure arrangements, and preferred lifestyles, including an increasing percentage of small, part-time farmers and others who like being rural residents;

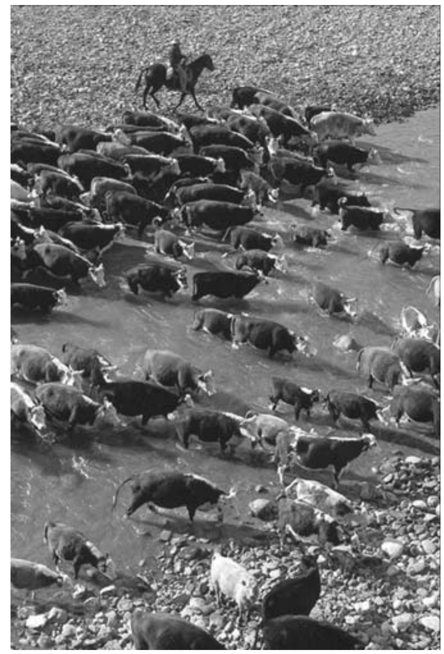
37. "21st Century Rural America: New Horizons for U.S. Agriculture," The Farm Credit Council, January 2006.

- evolving supply chains between producers, integrators, and consumers that help sustain specialized niche farming operations and large-volume producers alike;
- increasing reliance on off-farm income and value-added investment opportunities across the full spectrum of agriculture; and
- growing importance of government farm policies in influencing the welfare of the farm sector and establishing the rules of world trade.

The result of all these forces is that agriculture now has tremendous diversity in size, income and wealth, and operator characteristics. This diversity presents daunting challenges to suppliers, marketers, and other vendors offering services to the industry.

In 2005, the FCS, working with many academic experts, devoted considerable effort to conducting an in-depth study of the emerging financial and economic needs of agriculture and rural America. The key findings in its Horizons report[37] provide insight into some of the major trends in rural America and new policy solutions that will help farmers, rural businesses, and rural communities succeed in the 21st century. The chief purpose of this initiative was to develop a better understanding of the FCS's ability to contribute to the financial well-being of agriculture and rural America in the future.

A key concern for any service provider, including the FCS, is making sure it can compete in the rapidly changing environment for agriculture and rural America. As a GSE, the System provides loans and other financial services to agriculture, farmer cooperatives, farm-related businesses, and other rural activities under the authority of the Farm Credit Act of 1971, as amended. Although the Act and FCA regulations have been amended several times since 1971, the magnitude of structural change in rural America continues to challenge the System's ability to be a creative partner in meeting the financial needs of its rural customer base. As the farm economy continues to evolve, the number of traditional agricultural producers who focus solely on farming for their livelihood continues to decline. At the same time, the System has a mandate to serve the needs of the YBS producers who are increasingly dependent on the off-farm economy to sustain their financial health and ability to live in rural areas. Thus, the System needs to continue to fulfill its GSE mandate to meet the growing credit needs of YBS farmers and other elements of rural America.



For FCA, the challenge is to create an environment that promotes the confidence of customers and shareholders, investors, Congress, and the public in the System's financial strength and future viability. Although Congress expects our regulations to be consistent with the law, it also expects us to be innovative in helping the FCS fulfill its mission of providing an adequate and flexible flow of money into rural areas in a safe and sound manner. With this objective in mind, the FCA Board, in its revised Policy Statement 59, stated,

> The FCA Board intends to provide System institutions with the flexibility consistent with changes in law, agriculture, and rural America so institutions can offer high quality, reasonably priced credit and related services to farmers, ranchers, their cooperatives, rural residents, and other entities upon which farming operations are dependent.

Bringing more financial resources to agriculture and rural America is a laudable policy goal. Achieving it will likely remain a continuing challenge because it will require the combined efforts of FCA, the System, and other financial service providers to make it a reality.

Appendix

Farm Credit Administration Offices

The 257 full- and part-time employees of the FCA work together to ensure that the FCS remains a dependable source of credit for agriculture and rural America. The following paragraphs explain the functions of each of the Agency's offices.

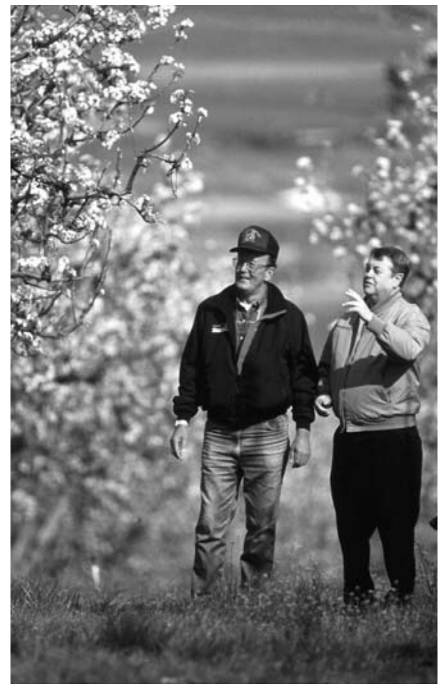
The **FCA Board** approves the policies, regulations, charters, and enforcement activities that ensure a strong FCS. The Board also provides for the examination and supervision of the FCS, including Farmer Mac, and oversees the activities of the FCS Building Association, which acquires, manages, and maintains FCA headquarters and field office facilities.

The **Secretary to the Board** ensures that the FCA Board complies with statutory, regulatory, and internal operation procedures and requirements. The Board Secretary is the Parliamentarian to the FCA and FCSIC Boards.

The **Office of the Chief Executive Officer** enforces the rules, regulations, and orders of the FCA Board. The CEO directs the implementation of policies and regulations adopted by the FCA Board. The office plans, organizes, directs, coordinates, and controls FCA operations and leads the Agency's efforts to achieve and manage a diverse workforce.

The **Office of Congressional and Public Affairs (OCPA)** serves as the Agency's principal point of contact for Congress, the media, other government agencies, FCS institutions, employees, System borrowers, and the public. OCPA develops and monitors legislation pertinent to FCA and the FCS, serves as the Agency's congressional liaison, and prepares testimony for the Chairman and other staff members. The office provides information to external audiences through news releases, information brochures and fact sheets, the annual FCA Performance and Accountability Report, and other publications. OCPA manages media relations regarding Agency activities and the content of the FCA Web site. The office also coordinates special meetings, briefings for international visitors, and field hearings.

The **Office of Examination** is responsible for programs of examination and supervision of each FCS institution, in accordance with the Farm Credit Act of 1971, as amended, and applicable regulations. The office develops oversight plans; conducts examinations; monitors the System's condition, risks, and emerging risks; and develops supervisory strategies to ensure that the System operates in a safe and sound manner and fulfills its public policy purpose. The FCA Board further defines the Office of Examination's role in Policy Statement 53.



The **Office of the General Counsel** provides the FCA Board and staff with legal counsel, as well as guidance on general corporate, personnel, ethics, and administrative matters. The office supports the Agency's development and promulgation of regulations, civil litigation, enforcement of applicable laws and regulations, and implementation of conservatorships and receiverships. The office serves as the liaison to the *Federal Register,* creates and maintains the Agency's public rulemaking files, and handles the Agency's submission of the Unified Agenda of Federal Regulatory and Deregulatory Actions. The office also handles Freedom of Information Act requests and matters pertaining to the Privacy Act.

The **Office of the Inspector General** provides independent and objective oversight of Agency programs and operations through audits, inspections, investigations, and the review of proposed legislation and regulations. The office promotes economy and efficiency within FCA and seeks to prevent and detect fraud, waste, and abuse in the Agency's programs and operations.

The **Office of Regulatory Policy** manages all policy and regulation development activities that ensure the safety and soundness of the FCS and support the System's mission as a dependable source of credit and related services for agriculture and rural America. Policy and regulation development activities include the analysis of policy and strategic risks to the System, considering economic trends and other risk factors. The office also evaluates all regulatory and statutory prior approvals for System institutions, including chartering and other corporate approvals, as well as funding approvals on behalf of the FCA Board.

The **Office of Management Services** manages and delivers the Agency's information technology, financial, human capital, and administrative services. The office coordinates planning efforts, including information resources management, security, human capital, and financial plans for the Agency. By centrally planning, managing, and delivering resource services, the Office of Management Services enables the Agency's program offices to fully focus their time and attention on their respective mission-related responsibilities.

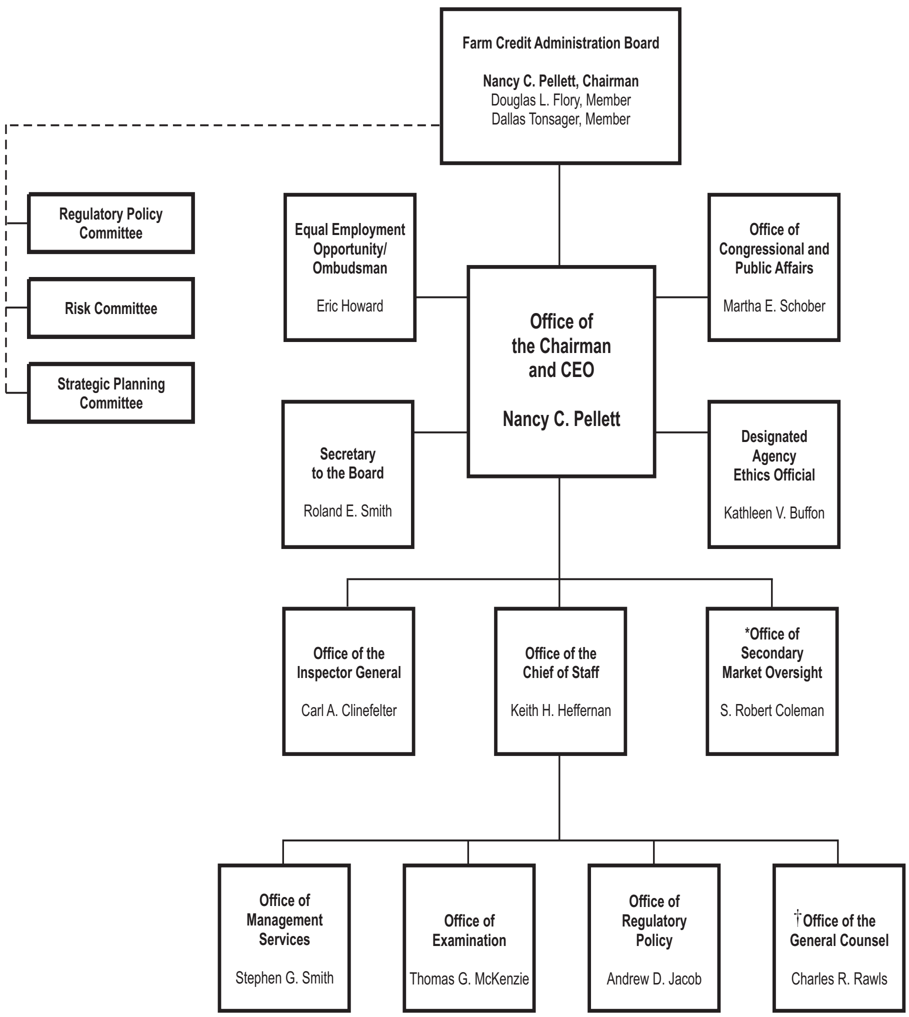
The **Office of Secondary Market Oversight** provides for the examination, regulation, and supervision of the activities of Farmer Mac to ensure its safety and soundness and the accomplishment of its public policy purpose as authorized by Congress. It also ensures that Farmer Mac complies with applicable laws and regulations, and it manages FCA's enforcement activities with respect to Farmer Mac.

The **Equal Employment Opportunity (EEO) Program** directs the Agency's efforts to achieve and manage a diverse workforce and encourages awareness of, and respect for, diversity in the workplace. The office works to prevent employment discrimination, handles employee discrimination complaints, and sponsors training and seminars on EEO issues.

The **Office of the Ombudsman** serves as a neutral and confidential resource for institutions of the FCS and other parties that may have inquiries or complaints concerning actions of the Agency. This office facilitates the resolution of problems or complaints in a fair, impartial, and timely manner, and provides recommendations to the Chairman and CEO to improve Agency policies, procedures, and practices.

The **Designated Agency Ethics Official** administers the provisions of Title 1 of the Ethics in Government Act of 1978, as modified by the Ethics Reform Act of 1989, within FCA. This office coordinates and manages FCA's ethics program and serves as liaison to the U.S. Office of Government Ethics. The responsibilities of the position include reviewing financial disclosure reports of FCA staff and prospective Presidential appointees to the FCA Board, conducting FCA's ethics training, counseling staff on ethics standards and post-employment conflicts of interest, and assisting managers and supervisors in understanding and implementing Agency ethics programs.

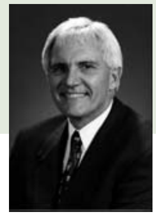
Figure 12
Farm Credit Administration Organizational Structure
As of January 3, 2006



*Reports to the Board for policy and to the CEO for administration.
† Maintains a confidential advisory relationship with each of the Board members.

Jeanette C. Brinkley

Kathleen V. Buffon



Carl A. Clinefelter

Agency Officials

Jeanette C. Brinkley was Secretary to the FCA Board through the end of 2005. She joined FCA in November 1982 as a secretary in the Office of Administration. During her tenure with FCA, Ms. Brinkley worked in the Office of Examination and Supervision, the Office of Congressional and Public Affairs, and the Office of the Chief Operating Officer. In 1995, she began working for the Office of the Board as the administrative specialist to the Secretary to the FCA Board.

Kathleen V. Buffon is the Designated Agency Ethics Official. She was first appointed to the position in 1992 when she came to FCA as associate general counsel, a position she continues to hold. Before joining FCA's Office of General Counsel, she served as assistant director for credit practices at the Federal Trade Commission. Following her graduation from law school, she clerked for the Honorable Henry H. Kennedy, Jr., an Associate Judge of the Superior Court of the District of Columbia.

Carl A. Clinefelter is the Inspector General. Before assuming this position in July 2005, he served as the acting director of the Office of Communications and Public Affairs and the acting director of the Office of Congressional and Legislative Affairs. Mr. Clinefelter has also served as the director of the Office of the Ombudsman at FCA and as director of the Office of Secondary Market Oversight. Before assuming that position in December 1998, Mr. Clinefelter was an assistant director of the Office of Policy and Analysis, a regional supervisory officer in the Office of Supervision, and an associate regional director in the Office of Examination and Supervision. Before joining FCA in 1980, he was employed by the Federal Intermediate Credit Bank of New Orleans as assistant vice president.

S. Robert Coleman

Keith H. Heffernan

Eric Howard

S. Robert Coleman is Director of the Office of Secondary Market Oversight. Before assuming this position in September 2005, Mr. Coleman served as the director of the Agency's Regulation and Policy Division. Mr. Coleman joined FCA in 1986 as an examiner in the Office of Examination. He held various positions in that office, providing technical and analytical support to the FCA field offices and in the Policy Development and Planning Division. During this period, Mr. Coleman completed the commissioning program and became a commissioned examiner in 1990. In 1994, Mr. Coleman transferred to the Office of Policy Analysis, where he served as a policy analyst specializing in regulation development, and then as a senior policy analyst. He was named director of the Regulation and Policy Division in June 2003.

Keith H. Heffernan is the Chief of Staff. Before joining FCA in July 2004, he served as Chief of Staff for the Under Secretary for Rural Development at USDA. His previous experience includes serving as assistant director of the Center for Agricultural and Rural Development at Iowa State University. From 1983 to 1989, he served the State of Iowa as deputy director of the Iowa Development Commission, as administrative assistant to Governor Terry Brandstad, and as director of the Department of Commerce. He also served as executive director of the Iowa Corn Growers Association from 1977 to 1983.

Eric Howard is the Equal Employment Opportunity Manager. He joined FCA in 1986 as an examiner in FCA's Oklahoma City field office. In 1991, he became a policy analyst for the Policy and Risk Analysis Division in the Office of Examination in McLean, Virginia. Mr. Howard became a senior policy analyst for the Regulation and Policy Division of the Office of Policy and Analysis in 1997.

Andrew D.
Jacob

Thomas G.
McKenzie

James M.
Morris

Andrew D. Jacob is Director of the Office of Regulatory Policy. Before being named to this position in July 2005, he served as the director of the Office of Secondary Market Oversight. Mr. Jacob joined the Agency in 1986 as a credit examiner in the Sacramento field office. In 1988, he transferred to FCA's headquarters in McLean, Virginia, where he served as a commissioned FCA examiner and as an information systems examiner in the Office of Examination. In 1997, he transferred to the Office of Policy and Analysis, where he served as a senior policy analyst and a senior financial analyst before becoming the assistant director of the office in 1999. He was named director of the Office of Secondary Market Oversight in 2004.

Thomas G. McKenzie is Chief Examiner and Director of the Office of Examination. He joined the Agency in 1979 and has served as director of the Office of Secondary Market Oversight and as director of the Office of Policy and Analysis; he has also held regional and division director positions in the Office of Examination and the former Office of Supervision. He headed the Agency's regional offices of examination in Denver and Atlanta, where he oversaw the field offices in Albany, New York; Atlanta; Dallas; Denver; and Sacramento, California. He began his Federal government career with FCA as a management specialist and advisor for the Agricultural Bank of Saudi Arabia in Riyadh. Before joining FCA, he was a regional manager for a Federal Land Bank; a manager and CEO of a Federal Land Bank Association; and a financial analyst for a Bank for Cooperatives, where he began his career in agricultural credit in 1971.

James M. Morris is Executive Assistant to FCA Chairman Nancy C. Pellett. Before being named to this position in October 2005, Mr. Morris served as senior counsel in FCA's Office of General Counsel. He has also served intermittently as the acting secretary to the FCA Board over the past several years. He served as acting secretary and general counsel to FCSIC in 1988. Mr. Morris joined FCA's Office of General Counsel in 1987. Before beginning his Federal service, he practiced law in Illinois from 1983 to 1987. In 1981, Mr. Morris joined the New York law firm of Carter, Ledyard & Milburn, where he remained until 1983. From 1980 to 1981, he served as senior law clerk for Justice Robert C. Underwood of the Illinois Supreme Court. From 1977 to 1980, Mr. Morris practiced law at the New York law firm of Reid & Priest.

Charles R. Rawls

Martha Schober

Roland E. Smith

Charles R. Rawls is the FCA General Counsel. Before joining FCA in March 2003, he was general counsel and vice president for legal, tax, and accounting at the National Council of Farmer Cooperatives. During the consideration of the 2002 farm bill, he served as the general counsel of the Senate Committee on Agriculture, Nutrition, and Forestry. From 1998 until 2001, he was general counsel for the USDA. He was chief of staff to the Deputy Secretary of Agriculture from 1993 to 1998. From 1988 to 1993, he was legislative director and then administrative assistant to Congressman Martin Lancaster. From 1985 to 1988, he was associate general counsel of the House Committee on Agriculture. He was counsel to the House Agriculture Subcommittee on Forests, Family Farms, and Energy from 1983 until 1985.

Martha Schober is the Director of the Office of Congressional and Public Affairs. Before joining FCA, she served as a Congressional liaison in the Office of Congressional Relations at the USDA. She also served as a confidential assistant to the administrator at USDA's Risk Management Agency. Before entering Government service, Ms. Schober was the director of Congressional Relations at the American Cotton Shippers Association.

Roland E. Smith became Secretary to the FCA Board in January 2006. He began his career with the FCS in 1974, when he became a loan officer for a System association in Greenville, North Carolina. He later served as a loan officer and credit reviewer for the Farm Credit Banks of Columbia, South Carolina. In 1979, Mr. Smith joined the FCA as an examiner in the St. Louis field office. In 1984, he was promoted to associate regional director. He later managed FCA's Oklahoma City field office and then the Denver field office. In 1996, Mr. Smith was named chief examiner and director of the Office of Examination. He served as the Agency's executive director of planning and projects from August 2004 until January 2006.

Stephen G.
Smith

Stephen G. Smith is the Director of the Office of Management Services. Before accepting this position, he had served as the Inspector General of the Agency from 2001. He joined FCA in 1981 as a technical specialist. He became an examiner in 1984 and later served as staff assistant for the Chief Examiner. In 1989, he was named associate regional director for the Agency's Albany, New York, field office. He later served as senior staff director for the Chief Examiner and was then named director of the Technical and Operations Division. In 1993, he assumed new responsibilities as director of the Information Resources Division. He was named Chief Information Officer in 1996, directing all technology and information operations for FCA. Before joining the Agency, he worked at the North Central Jersey Farm Credit Associations.

Glossary

A

Agricultural Credit Association (ACA)—An ACA results from the merger of a Federal Land Bank Association or an FLCA and a PCA, and has the combined authority of the two institutions. An ACA borrows funds from an FCB or ACB to provide short-, intermediate-, and long-term credit to farmers, ranchers, and producers and harvesters of aquatic products. It also makes loans to these borrowers for certain processing and marketing activities, to rural residents for housing, and to certain farm-related businesses.

Agricultural Credit Bank (ACB)—An ACB results from the merger of an FCB and a Bank for Cooperatives, and has the combined authorities of those two institutions. An ACB is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. CoBank is the only ACB in the FCS.

B

Bank for Cooperatives (BC)—A BC provides lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems. It is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. The last remaining BC in the FCS, the St. Paul Bank for Cooperatives, merged with CoBank on July 1, 1999.

F

Farm Credit Act—The Farm Credit Act of 1971, as amended, (12 U.S.C. §§ 2001–2279cc) is the statute under which the FCS operates. The Farm Credit Act recodified all previous acts governing the FCS.

Farm Credit Bank (FCB)—FCBs provide services and funds to local associations that, in turn, lend those funds to farmers, ranchers, producers and harvesters of aquatic products, rural residents for housing, and some agriculture-related businesses. On July 6, 1988, the Federal Land Bank and the Federal Intermediate Credit Bank in 11 of the 12 then-existing Farm Credit districts merged to become FCBs. The mergers were required by the Agricultural Credit Act of 1987. As of September 30, 2004, there were four FCBs: AgFirst Farm Credit Bank; AgriBank, FCB; Farm Credit Bank of Texas; and U.S. AgBank, FCB.

Farm Credit Leasing Services Corporation—The Leasing Corporation is a service entity owned by CoBank, ACB. It provides equipment leasing and related services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities.

Farm Credit System Insurance Corporation (FCSIC)—The FCSIC was established by the Agricultural Credit Act of 1987 as an independent U.S. government-controlled corporation. Its purpose is to ensure the timely payment of principal and interest on insured notes, bonds, and other obligations issued on behalf of FCS banks and to act as conservator or receiver of FCS institutions. The FCA Board serves ex officio as the Board of Directors for FCSIC; however, the Chairman of the FCA Board is not permitted to serve as the Chairman of the FCSIC Board.

FCA Financial Institution Rating System (FIRS)—The FIRS is similar to the Uniform Financial Institutions Rating System used by other Federal banking regulators. However, it has been modified by FCA to reflect the nondepository nature of FCS institutions. The FIRS provides a general framework for assimilating and evaluating all significant financial, asset quality, and management factors to assign a composite rating to each System institution. The ratings are described below.

> **Rating 1—**Institutions in this group are basically sound in every respect; any negative findings or comments are of a minor nature and are anticipated to be resolved in the normal course of business. Such institutions are well managed, resistant to external economic

and financial disturbances, and more capable of withstanding the uncertainties of business conditions than institutions with lower ratings. Each institution in this category exhibits the best performance and risk management practices for its size, complexity, and risk profile. As a result, these institutions give no cause for regulatory concern.

Rating 2—Institutions in this group are also fundamentally sound but may reflect modest weaknesses correctable in the normal course of business. The nature and severity of deficiencies are not considered material, therefore, such institutions are stable and able to withstand business fluctuations. Overall risk management practices are satisfactory for the size, complexity, and risk profile of each institution in this group. While areas of weakness could develop into conditions of greater concern, regulatory response is limited to the extent that minor adjustments are resolved in the normal course of business and operations continue in a satisfactory manner.

Rating 3—Institutions in this category exhibit a combination of financial, management, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to asset quality or financial condition, such institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Institutions that are in significant noncompliance with laws and regulations may also be accorded this rating. Risk management practices are less than satisfactory for the size, complexity, and risk profile of each institution in this group. Institutions in this category generally give cause for regulatory concern and require more than normal supervision to address deficiencies. Overall strength and financial capacity, however, still make failure only a remote possibility if corrective actions are implemented.

Rating 4—Institutions in this group have an immoderate number of serious financial or operating weaknesses. Serious problems or unsafe and unsound conditions exist that are not being satisfactorily addressed or resolved. Unless effective actions are taken to correct these conditions, they are likely to develop into a situation that will impair future viability or constitute a threat to the interests of investors, borrowers, and stockholders. Risk management practices are generally unacceptable for the size, complexity, and risk profile of each institution in this group. A potential for failure is present but is not yet imminent or pronounced. Institutions in this category require close regulatory attention, financial surveillance, and a definitive plan for corrective action.

Rating 5—This category is reserved for institutions with an extremely high, immediate or near-term probability of failure. The number and severity of weaknesses or unsafe and unsound conditions are so critical as to require urgent external financial assistance. Risk management practices are inadequate for the size, complexity, and risk profile of each institution in this group. In the absence of decisive corrective measures, these institutions will likely require liquidation or some form of emergency assistance, merger, or acquisition.

Federal Agricultural Mortgage Corporation (Farmer Mac)—Farmer Mac was created with the enactment of the Agricultural Credit Act of 1987 to provide a secondary market for agricultural real estate and rural housing mortgage loans.

Federal Farm Credit Banks Funding Corporation—The Funding Corporation, based in Jersey City, New Jersey, manages the sale of Systemwide debt securities to finance the loans made by FCS institutions. It uses a network of bond dealers to market its securities.

Federal Intermediate Credit Bank (FICB)—The Agricultural Credits Act of 1923 provided for the creation of 12 FICBs to discount farmers' short- and intermediate-term notes made by commercial banks, livestock loan companies, and thrift institutions. The Farm Credit Act of 1933 authorized farmers to organize PCAs, which could discount notes with FICBs. As a result, PCAs became the primary entities for delivery of short- and intermediate-term credit to farmers and ranchers. The FICBs and the Federal Land Banks in all Farm Credit districts have merged to become FCBs or the ACB. Thus, no FICBs remain within the FCS.

Federal Land Bank—The Federal Farm Loan Act of 1916 provided for the establishment of 12 Federal Land Banks to provide long-term mortgage credit to farmers and ranchers, and later to rural home buyers. All Federal Land Banks and FICBs have merged to become FCBs or part of the ACB. Thus, no Federal Land Banks remain.

Federal Land Bank Association—These associations were lending agents for FCBs. Federal Land Bank Associations made and serviced long-term mortgage loans to farmers, ranchers, and rural residents for housing. They did not own loan assets but made loans only on behalf of the FCB with which they were affiliated. As of October 1, 2000, there were no remaining Federal Land Bank Associations serving as lending agents for FCBs.

Federal Land Credit Association (FLCA)—An FLCA is a Federal Land Bank Association that owns its loan assets. An FLCA borrows funds from an FCB to make and service long-term loans to farmers, ranchers, and producers and harvesters of aquatic products. It also makes and services housing loans for rural residents.

G

Government-sponsored enterprise (GSE)—A GSE is a federally chartered corporation that is privately owned, designed to provide a source of credit nationwide, and limited to servicing one economic sector. Each GSE has a public or social purpose: to improve the availability of credit to agriculture, education, or housing. GSEs are usually created because the private markets did not satisfy a purpose that Congress deems worthy—either to fill a credit gap or to enhance competitive behavior in the loan market. Each is given certain features or benefits (called GSE attributes) to allow it to overcome the barriers that prevented purely private markets from developing. In some cases, the GSE receives public assistance only to get started; in other cases, the assistance is ongoing.

P

Production Credit Association (PCA)—PCAs are FCS entities that deliver only short- and intermediate-term loans to farmers and ranchers. A PCA borrows money from its FCB to lend to farmers. PCAs also own their loan assets. As of January 1, 2003, all PCAs were eliminated as independent, stand-alone, direct-lender associations. All PCAs are now subsidiaries of ACAs.

List of Acronyms Appearing in Report

1. ACA—Agricultural Credit Association
2. ACB—Agricultural Credit Bank
3. ALL—allowance for loan losses
4. BSE—bovine spongiform encephalopathy
5. CEO—chief executive officer
6. EEO—equal employment opportunity
7. Farmer Mac—Federal Agricultural Mortgage Corporation
8. FCA—Farm Credit Administration
9. FCB—Farm Credit Bank
10. FCS—Farm Credit System
11. FCSIC—Farm Credit System Insurance Corporation
12. FIRS—Financial Institution Rating System
13. FLCAs—Federal Land Credit Associations
14. FSA—Farm Service Agency
15. GAAP—generally accepted accounting principles
16. GDP—gross domestic product
17. GSE—Government-sponsored enterprise
18. ISU—Iowa State University
19. OFIs—other financing institutions
20. PCA—Production Credit Association
21. RBICs—rural business investment companies
22. SBA—Small Business Administration
23. USDA—U.S. Department of Agriculture
24. WTO—World Trade Organization
25. YBS—young, beginning, and small (farmers and ranchers)

Additional Information

The *Farm Credit Administration 2005 Annual Report* is available on FCA's Web site at www.fca.gov. For questions about this publication, contact

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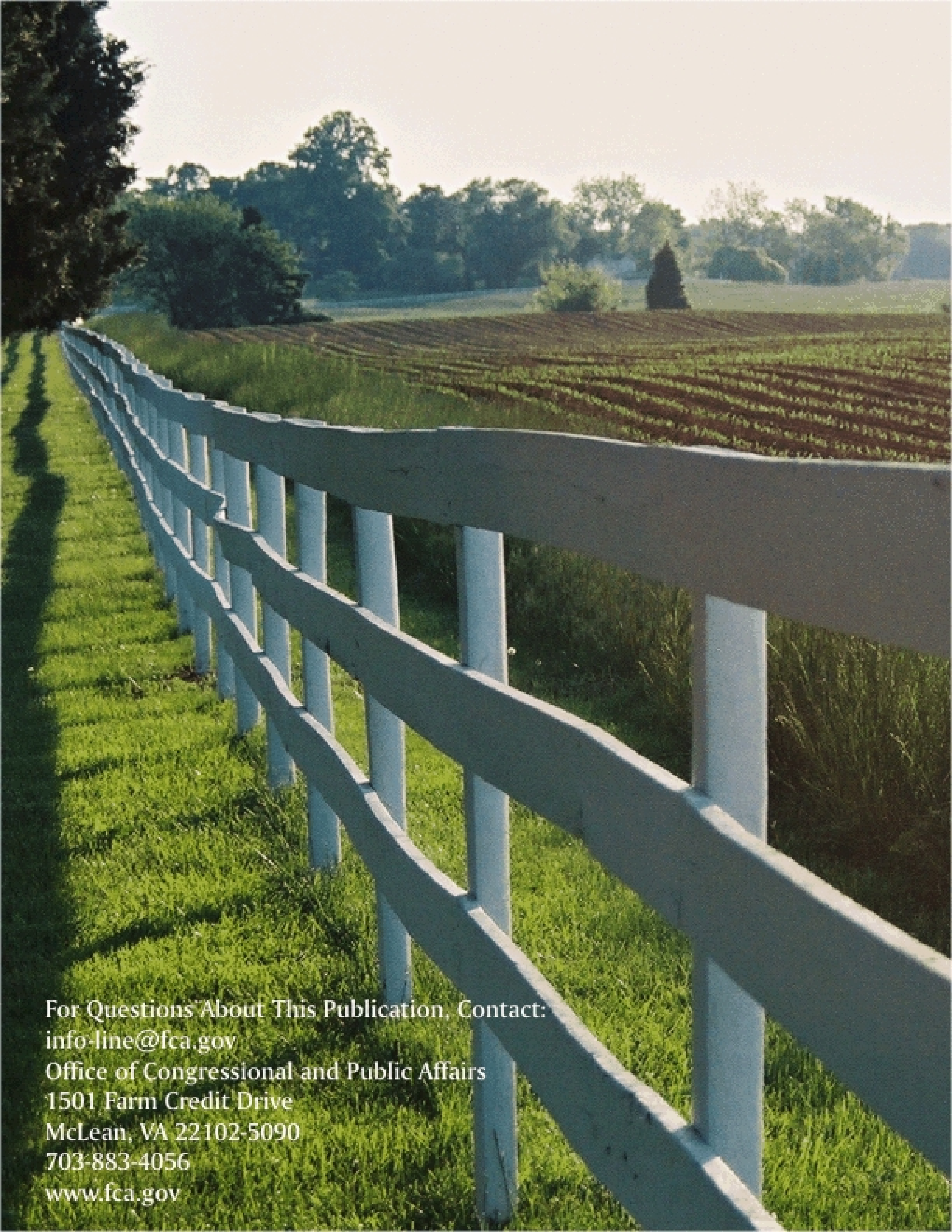
The Federal Farm Credit Banks Funding Corporation prepares the financial press releases, the System's Annual and Quarterly Information Statements, and the System's combined financial statements contained therein, with the support of the System banks. These documents are available on the Funding Corporation's Web site at www.farmcredit-ffcb.com. Copies can also be obtained from

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

The Farm Credit System Insurance Corporation's annual report is available on its Web site at www.fcsic.gov. Copies of this report can also be obtained from

Farm Credit System Insurance Corporation
1501 Farm Credit Drive
McLean, VA 22102
Telephone: 703-883-4380

In addition, FCS banks and associations are required by regulation to prepare annual and quarterly financial reports. Copies of these documents are available for public inspection at FCA headquarters in McLean, Virginia.



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