

2009 Annual Report
on the Farm Credit System by the
FARM CREDIT ADMINISTRATION
Regulator of the FCS

CONTENTS

Statement of the Chairman and CEO	2
Farm Credit Administration	4
Overview and Mission	4
The Board	4
Farm Credit System—An Overview of Events and Conditions	8
FCS Role and Structure	8
Financial Condition of the FCS	10
Borrowers Served	17
Funding for Other Lenders	20
Market Share of Debt	21
Farmer Mac as a Secondary Market	23
Serving Young, Beginning, and Small Farmers and Ranchers	25
YBS Lending Results	25
Assessment of YBS Results for Individual Associations	28
YBS Borrowing Trends, 2001–2009	28
YBS Programs	31
Regulatory Policy and Approvals	33
Regulatory Activity in 2009	33
Corporate Activity in 2009	35
Funding Activity in 2009	37
Mission-Related Investments	38
Maintaining a Dependable Source of Credit for Farmers and Ranchers	41
Conducting a Risk-Based Examination and Oversight Program	41
Meeting Statutory Examination Requirements	41
Identifying and Responding to Potential Threats to Safety and Soundness	41
Measuring the System’s Safety and Soundness	42
Providing Differential Supervision and Enforcement	44
Working with Financially Stressed Borrowers	45

Condition of Farmer Mac **46**

- Capital 46
- Program Activity 49
- Asset Quality 49
- Earnings 50

Challenges Facing the Agricultural Economy and the Farm Credit System **53**

- Prospects for the General Economy 53
- Economic Setting for Agriculture and Credit 55
- Growing Credit Risk in the System’s Portfolio 58

Appendix **60**

- FCA Offices 60
- Agency Officials 62

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



STATEMENT OF THE CHAIRMAN AND CEO

May 2010

Dear Reader,

On behalf of the Board and the dedicated employees of the Farm Credit Administration, I present the 2009 Annual Report on the Farm Credit System (FCS or System).

I am pleased to report that, despite a very challenging year for the credit markets, the System's overall condition and performance remained sound in 2009. It is well positioned to withstand the continuing challenges posed by the general economy and by stress in some sectors of the agricultural economy.

Access to Funding Improved, Loan Growth Declined in 2009

Early in 2009, the System faced increased funding costs, limited access to term funding, and extreme market turmoil. However, because of the strong condition of the System and its status as a Government-sponsored enterprise (GSE), it was able to continue to issue short-term debt securities. As the year progressed, market access for term financing steadily improved, and, despite relatively wider spreads to Treasury, interest rates were generally low. By the end of the year, the improved economic and financial market conditions afforded the System good access to funding across the yield curve, with narrower spreads than at the beginning of the year. System banks added high-quality liquid assets to their investment portfolios to ensure sufficient liquidity in the event of another market disruption.

Also noteworthy in 2009, we saw several years of double-digit loan growth in the System come to an end. Growth was basically flat for the year. Not only was loan demand down, but System institutions further controlled and managed loan growth by focusing their lending activities in their local service areas and by adjusting loan structure, payment terms, and pricing to better reflect risk and market conditions. Despite the decline in its growth, the System had another year of solid earnings, with a combined net income of \$2.85 billion. That was a significant accomplishment in a challenging environment and reflects the System's effectiveness in managing some difficult credit situations, particularly in the dairy, hog, and ethanol segments of the loan portfolio. The System also maintained appropriate asset/liability management practices while continuing to strengthen its capital position. Its capital as a percentage of assets grew from 12.7 percent at December 31, 2008, to 13.9 percent at the end of 2009.

FCA Increases Supervision and Enforcement Activities

Because of the difficult economic environment, some of the System's key performance measures have weakened. As a result, FCA has increased its supervisory activities and enforcement actions. As of December 31, 2009, we had 10 associations under special supervision, whose assets totaled \$3.6 billion, amounting to less than 2 percent of the System's total assets. During the year, FCA also entered into formal written agreements with two associations, whose assets totaled \$423 million at the end of 2009.

During the past year, FCA conducted special studies on distressed agricultural industries to assess emerging risks that may impact the System. The studies identified concentrations within institutions, trends, and recent structural changes in these industries. The studies also provided an update on each industry's economic conditions, credit situation, and outlook.

With the more difficult economic environment, we also increased our communication to the System on safety and soundness issues during 2009. For example, we issued an Informational Memorandum on confronting the increased risk environment, and we provided other guidance addressing such issues as executive compensation, responding to local financial institution failures, and financing land in transition.

YBS Lending Declines in Step with Overall System Lending

The FCS is required to offer programs to provide credit and related services to young, beginning, and small (YBS) farmers and ranchers. Through these programs, FCS associations may offer lower interest rates and less stringent underwriting standards, such as high loan-to-value ratios or lower debt coverage requirements, to make it easier for potential YBS borrowers to qualify for loans.

While loans outstanding at year end to farmers in the young and beginning categories continued to increase in both dollars and numbers, loans made (both dollars and numbers) in calendar year 2009 to young, beginning, and small farmers declined for the first time in several years. Loan volume outstanding to small farmers edged higher while loan numbers dipped at year end. The System's decreased YBS lending activity (new loans plus loan renewals) during 2009 was in step with declines in its non-YBS lending activity.

Since 2001, trends in the System's YBS lending volume have nearly kept pace with the System's strong loan growth. As a percentage of total loans outstanding, loans outstanding in each of the three categories have dipped just a few points or remained relatively flat. This trend has occurred in spite of the general decline in the number of YBS farm operators in the general farming population, suggesting that the System has continued to serve the needs of YBS farmers.

Borrower Complaints Increased as Economy Deteriorated

Under provisions of the Farm Credit Act, the FCS provides borrowers certain rights when they apply for loans and when they have difficulty repaying loans. FCA enforces borrower rights and examines institutions to make sure they are complying with these provisions. It also receives and reviews complaints from borrowers regarding their rights as borrowers.

When the economy began deteriorating and affecting FCS borrowers, FCA began receiving more borrower complaints. Generally, borrowers who contact FCA with complaints are seeking clarification, additional information, and options to redress their concerns. To the extent there are potential violations of law and regulations, FCA requires corrective actions by the institutions.

FCA Remains Committed to Its Mission

As the regulator of the FCS, FCA will continue working to ensure that the System remains safe and sound by providing appropriate guidance and maintaining strong examination and supervisory programs. We are continuing to focus the resources necessary for adequate oversight, to take proactive measures to safeguard institutions, and to identify emerging risks across institutions. FCA must ensure that FCS institutions have the governance, policies, procedures, and management controls to effectively identify and manage risks.

As agriculture and rural America continue to contend with a challenging economic environment, we are mindful that the System was designed to be a dependable lender to agriculture and rural communities in both good times and bad. FCA remains committed to ensuring that the System can fulfill its mandate to current and future generations of farmers and ranchers and the rural areas in which they live.

Sincerely,

A handwritten signature in black ink, appearing to read "Leland A. Strom". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Leland A. Strom

FARM CREDIT ADMINISTRATION

OVERVIEW AND MISSION

The Farm Credit Administration (FCA or Agency) is an independent agency in the Executive branch of the U.S. Government. FCA is responsible for regulating and supervising the banks, associations, and related entities in the Farm Credit System (FCS or System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). The FCS is a nationwide network of borrower-owned financial institutions that provide credit to farmers, ranchers, residents of rural communities, agricultural and rural utility cooperatives, and other eligible borrowers.

FCA was created by a 1933 Executive order of President Franklin D. Roosevelt; the Agency now derives its powers and authorities from the Farm Credit Act of 1971, as amended (12 U.S.C. 2001-2279cc). The U.S. Senate Committee on Agriculture, Nutrition, and Forestry and the U.S. House of Representatives Committee on Agriculture oversee FCA and the FCS.

FCA is responsible for ensuring that the System remains a dependable source of credit for agriculture and rural America. The Agency does this in two specific ways:

1. It ensures that FCS institutions, including Farmer Mac, operate safely and soundly and comply with applicable laws and regulations. FCA's examinations and

oversight strategies focus on an institution's financial condition and any material existing or potential risk, as well as on the ability of its board of directors and management to direct its operations. The Agency also evaluates each institution's compliance with laws and regulations to serve eligible borrowers, including young, beginning, and small farmers and ranchers. If a System institution violates a law or regulation or operates in an unsafe or unsound manner, FCA uses its supervisory and enforcement authorities to ensure appropriate corrective action.

2. It develops policies and regulations that govern how System institutions conduct their business and interact with customers. FCA's policy and regulation development focuses on protecting System safety and soundness; implementing the Farm Credit Act; providing minimum requirements for lending, related services, investments, capital, and mission; and ensuring adequate financial disclosure and governance. FCA also approves corporate charter changes, System debt issuance, and other financial and operational matters.

The Agency maintains its headquarters and a field office in McLean, Virginia. FCA also has field offices in Bloomington, Minnesota; Dallas, Texas; Denver, Colorado; and Sacramento, California.

FCA does not receive a Federal appropriation. The Agency is funded through assessments paid by System institutions and by reimbursable activities.

THE BOARD

FCA policy, regulatory agenda, and supervisory and examination activities 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. Board members serve a six-year term and may not be reappointed after serving a full term or more than three years of a previous member's term but may remain on the Board until a successor is nominated by the President and confirmed by the Senate. The President designates one member as Chairman of the Board, who serves in that capacity until the end of his or her own term. The Chairman also serves as FCA's Chief Executive Officer (CEO).

FCA Board members also serve as members of the Farm Credit System Insurance Corporation board of directors.

Leland A. “Lee” Strom

Chairman and CEO



Leland A. Strom is Chairman of the Board and CEO of the Farm Credit Administration. Mr. Strom was appointed to a six-year term on the FCA Board by President George W. Bush on December 12, 2006, and was designated Chairman and CEO on May 22, 2008. His term expires on October 13, 2012.

Mr. Strom also serves as a member of the board of directors of the Farm Credit System Insurance Corporation (FCSIC), which is responsible for ensuring the timely payment of principal and interest on obligations issued on behalf of FCS banks. Before being named FCA Chairman and CEO, he had served as chairman of the board of directors of FCSIC since December 2006.

For more than 30 years he has been active in the agriculture industry. He served for more than 25 years on the board of 1st Farm Credit Services, an FCS institution in Illinois, holding various positions, including chairman. During the agriculture crisis of the 1980s, he was selected to sit on the Restructuring Task Force of the Sixth Farm Credit District.

From 2000 to 2006, he was on the Federal Reserve Bank of Chicago Advisory Council on Agriculture, Labor, and Small Business. Part of this time he also served on the Country Mutual Fund Trust Board, an investment fund of the Illinois Farm Bureau and its Country Financial organization.

Other boards Mr. Strom has served on include Northern F.S., Inc., a farm service and supply cooperative serving farmers in Northern Illinois; AgriBank, FCB; and the Farm Credit Council, the national trade organization representing the FCS in Government affairs.

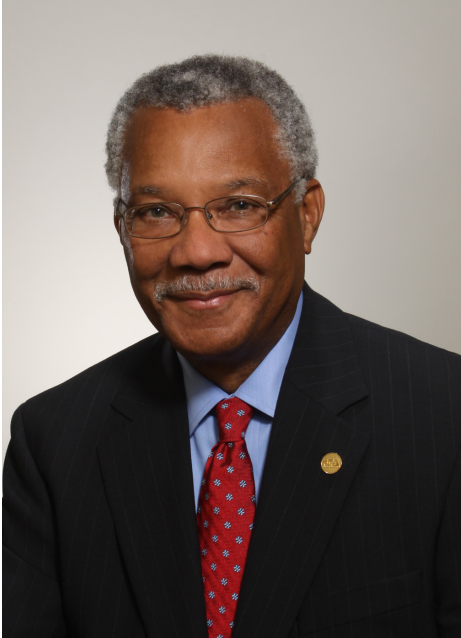
Mr. Strom has served in several capacities with the Illinois Farm Bureau. He also served on his county Farm Bureau board. He was a member of the State Young Farmer Committee from 1981 to 1985. For his overall involvement in agriculture, he received an Outstanding Young Farmer Award.

In his community of Kane County, Illinois, which lies at the edge of suburban Chicago, Mr. Strom helped develop a farmland preservation program. The original Strom Family Farm was the first to be dedicated to permanent agricultural use under the program.

Mr. Strom studied agriculture business at Kishwaukee College and business administration at Northern Illinois University. His community involvement includes having served as vice president of his local K–12 school district, chairman of his church council, 4-H parent leader, and coach of boys’ and girls’ sports teams. Mr. Strom owns a third-generation family farm in Illinois that produces corn and soybeans. He and his wife, Twyla, have two sons, a daughter, and a daughter-in-law.

Kenneth A. Spearman

Board Member



Kenneth A. Spearman was appointed to the FCA Board by President Barack Obama on October 13, 2009. He was appointed for the balance of Dallas Tonsager's term and reappointed for a full six-year term that expires on May 21, 2016.

Mr. Spearman also serves as Chairman of the Board of Directors of the Farm Credit System Insurance Corporation, which is responsible for ensuring the timely payment of principal and interest on obligations issued on behalf of Farm Credit System banks.

Mr. Spearman brings to his position on the FCA Board many years of experience in finance, agriculture, and agricultural cooperatives. He spent 28 years in the citrus industry.

From 1980 to 1991, he was controller of Citrus Central, a \$100 million cooperative in Orlando, Florida, where he was responsible for financial management and reporting and the supervision of staff accountants.

He later served as director of internal audit for Florida's Natural Growers, where he designed and implemented the annual plan for reviewing and appraising the soundness, adequacy, and application of accounting, financial, and other operating internal controls.

From January 2006 until his appointment to the FCA Board, Mr. Spearman served as an appointed outside director on the AgFirst Farm Credit Bank board in Columbia, South Carolina. During his tenure, he served on the board compensation committee and the board governance committee.

Before entering agriculture, Mr. Spearman was involved with development of a public accounting firm in Chicago, Illinois, and worked as an accountant for a major public accounting firm. He served as chair-

man of the board of trustees for the Lake Wales Medical Center. He is a member of the Institute of Internal Auditors, as well as the National Society of Accountants for Cooperatives, where he served at one time as president.

He obtained his master's degree in business administration from Governors State University in University Park, Illinois, and his B.S. in accounting from Indiana University.

Mr. Spearman and his wife Maria of Winter Haven, Florida, have three children—twin daughters, Michelle Springs and Rochelle Puccia, and a son, Dr. Kenneth Spearman.

Jill Long Thompson

Board Member



Jill Long Thompson was appointed to the FCA Board by President Barack Obama on March 27, 2010. Her recess appointment is effective through the end of the 2011 legislative session. She also serves as a member of the Board of Directors of the Farm Credit System Insurance Corporation, which is responsible for ensuring the timely payment of principal and interest on obligations issued on behalf of System banks.

Ms. Long Thompson brings to her position on the FCA Board many years of leadership experience. From 1989 to 1995, she represented northeast Indiana as a Member of the U.S. House of Representatives, serving on the Agriculture Committee and the Committee on Veterans' Affairs. As

congresswoman, she introduced one of the nation's first pieces of legislation banning members of Congress from accepting gifts; this legislation also expanded disclosure requirements for lobbying activities.

From 1995 to 2001, she served as Under Secretary for Rural Development in the U.S. Department of Agriculture, where she oversaw an annual budget of \$10 billion and a staff of 7,000 employees. In this position, she managed programs that provide services to the underserved areas of rural America.

In addition, Ms. Long Thompson served as chief executive officer and senior fellow at the National Center for Food and Agricultural Policy, a nonprofit research and policy organization in Washington, D.C.

The first and only woman to be nominated by a major party to run for Governor of Indiana, Ms. Long Thompson is also the first and only Hoosier woman to be nominated by a major party to run for the U.S. Senate. She was nominated by the President on October 15, 2009, for a term on the Farm Credit Administration Board ending May 21, 2014, and is awaiting confirmation by the United States Senate.

Ms. Long Thompson also has many years of experience as an educator, having taught at Indiana University, Valparaiso University, and Manchester College. She is also a former fellow at the Institute of Politics at Harvard University's John F. Kennedy School of Government. She holds the M.B.A. and Ph.D. in Business from the Kelley School of Business at Indiana University and a B.S. in Business Administration from Valparaiso University.

Ms. Long Thompson grew up on a family farm outside of Larwill, Indiana; today she lives with her husband Don Thompson on a farm near Argos, Indiana.

Note: Ms. Long Thompson's position on the FCA Board was previously held by Nancy C. Pellett, who was appointed to the FCA Board by President George W. Bush on November 26, 2002. From May 2004 to May 2008, Ms. Pellett served as Chairman and CEO of FCA. She continued as a member of the Board until Ms. Long Thompson's appointment in March 2010.

Farm Credit System—An Overview of Events and Conditions

FCS ROLE AND STRUCTURE

The Farm Credit System is a network of borrower-owned cooperative financial institutions and service organizations serving 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).¹

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 for its business activities by selling securities in the national and international money markets; its Systemwide debt funding is subject to FCA approval. The U.S. Government does not guarantee the securities issued by the System.

As of December 31, 2009, the System was composed of 94 banks and associations. Loan funds were provided to 82 Agricultural Credit Association (ACA) parent organizations² and

7 stand-alone Federal Land Credit Associations (FLCAs) by the following five banks:

- CoBank, ACB
- AgriBank, FCB
- U.S. AgBank, FCB
- AgFirst Farm Credit Bank
- Farm Credit Bank of Texas

An ACA can make short-, intermediate-, and long-term loans; an FLCA can make only long-term real estate loans. Under the Farm Credit Act of 1971, the FLCA is exempt from State and Federal income taxes.

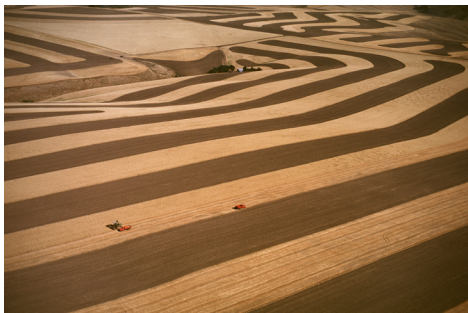
CoBank, one of the five Farm Credit banks, is an Agricultural Credit Bank (ACB), which has a nationwide charter to make loans to agricultural and aquatic cooperatives and rural utilities, as well as to other persons or organizations that have transactions with, or are owned by, these cooperatives. The 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 four affiliated ACAs, which serve New York, New Jersey, Connecticut, Rhode Island, Maine, Massachusetts, New Hampshire, Vermont, Alaska, Oregon, Washington, Montana, and Idaho.

Several structural changes occurred at the association level in early January 2010. A merger of two ACAs took effect on January 1, 2010, reducing the number of ACAs to 81. Most of the remaining changes were related to amendments to the Farm Credit Act contained in the 2008 Farm Bill, which took effect January 1, 2010.

Section 7.7 of the Farm Credit Act now authorizes FCA to convert the charters of certain FLCAs to those of ACAs with subsidiaries, amend the charters of certain ACAs, and thus equalize the loan-making power of associations serving the states of Alabama, Mississippi, and most of Louisiana. FCA's implementation of section 7.7 occurred on January 4, 2010, and, as a consequence, the number of ACAs increased to 85 while the number of FLCAs fell to 3. Overall, the number of banks and associations as of January 4, 2010, was 93.

Each ACA contains two subsidiaries, a Production Credit Association, which can make only short- and intermediate-term loans, and an FLCA. The parent-subsidary structure, with an ACA as parent and its wholly owned PCA and FLCA as subsidiaries, accounted for 92 percent of all associations as of December 31, 2009, and 97 percent of all associations as of January 4, 2010. The ACA

1. The Federal Land Banks were created in 1916, when the System was originally established. Other major parts of the FCS were created in 1923 and 1933.
2. Although legally separated, the ACA, the PCA, and the FLCA operate an integrated lending business, with loans made through the subsidiaries possessing the appropriate authority. 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.



and its two subsidiaries operate with a common board of directors and staff, and each of the three entities is responsible for the debts of the others. For most regulatory and examination purposes, FCA treats the ACA and its subsidiaries as a single entity; however, the Agency has retained discretion to treat the parent and subsidiaries as separate entities if the Agency deems it to be appropriate.

The ACA's parent-subsidiary structure enables the ACA to preserve the tax-exempt status of the FLCA. Its structure offers several other benefits as well. It allows the ACA to build and use capital more efficiently and enables members to be stockholders of one entity—the ACA—and to be borrowers of the ACA or of one or both subsidiaries. This 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. Further, the structure allows an association to provide a broader range of specialized services to its member-borrowers. It enables one-stop borrowing—borrowers can obtain long-, intermediate-, and short-term loans from the same institution.

FCA examines and regulates the Federal Farm Credit Banks Funding Corporation (Funding Corporation), an institution established under the Farm Credit Act. The Funding Corporation issues and markets debt securities on behalf of the Farm

Credit banks to raise loan funds. In addition, FCA examines and regulates the following five service corporations organized under section 4.25 of the Farm Credit Act:³

1. AgVantis, Inc., which provides technology-related and other support services to the associations affiliated with U.S. AgBank, FCB. AgVantis is owned by the bank and 18 of its affiliated associations.
2. Farm Credit Leasing Services Corporation, which provides equipment leasing services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities, and is wholly owned by CoBank, ACB.
3. Farm Credit Financial Partners, Inc. (FPI), which provides support services to CoBank, ACB; CoBank's five affiliated associations; two associations affiliated with U.S. AgBank, FCB; one association affiliated with AgriBank, FCB; and two System-related entities. FPI is owned by CoBank, ACB, and the eight associations to which FPI provides services.
4. The FCS Building Association, which acquires, manages, and maintains facilities to house FCA's headquarters and field office staff. The FCS Building Association is owned by the FCS banks. The FCA Board oversees the Building Association's activities on behalf of its owners.

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

FCA also examines and regulates the Federal Agricultural Mortgage Corporation (Farmer Mac), which provides a secondary market arrangement for agricultural real estate loans, Government-guaranteed portions of certain loans, rural housing mortgage loans, and eligible rural utility cooperative loans. These secondary market activities are intended to provide greater liquidity and lending capacity to agricultural lenders. Farmer Mac is established in the Farm Credit Act as a federally chartered instrumentality and an institution of the FCS. However, it 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

3. 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.



institutions. Nonvoting stock may be owned by any investor. Farmer Mac is regulated and examined by FCA through the Office of Secondary Market Oversight, whose director reports to the FCA Board on matters of policy. For more information about Farmer Mac, see “Condition of Farmer Mac” on page 46.

When Congress established the FCS, its purpose was to provide a permanent, reliable source of constructive 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 also encouraged the participation of farmer- and rancher-borrowers in the management, control, and ownership of these cooperative institutions to help the institutions remain focused on serving their members’ needs.

The System helps to meet 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 homeowners.

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 borrower-stockholders.

The sections in this chapter first assess the System’s financial strength and then its service to rural America. The 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 activities and programs that benefit YBS farmers and ranchers and the use of Government guarantee programs to assist farmers who are unable to meet normal underwriting requirements.

FINANCIAL CONDITION OF THE FCS⁴

The overall condition and performance of the FCS remained safe and sound during 2009. Earnings, assets, and capital levels indicate that the System remains in a solid financial position despite continuing pressures in certain farm sectors and the general economy. See tables 1 and 2 for a breakdown of major financial indicators of the FCS. While the overall FCS remained financially sound, some individual FCS institutions’ condition and performance declined. FCA addressed these declines by

increasing its supervision of these institutions, which resulted in enforcement actions for some entities. More detailed information on the System’s performance and condition may be found in the 2009 Annual Information Statement of the Farm Credit System, located on the website of the Federal Farm Credit Banks Funding Corporation at www.farmcredit-ffcb.com.

The economic environment for the System is expected to improve in 2010 because of stronger global demand for agricultural commodities. Some industries experiencing severe stress in 2009—in particular swine, dairy, poultry, and ethanol—may see better profits in 2010. Nevertheless, after several quarters of losses, many of these producers will remain financially vulnerable, and some crop producers may face lower profit margins in 2010. In addition, sectors such as the forestry and nursery industries were particularly affected by the overall downturn in the general U.S. economy and the housing market. Although farmland prices have weakened somewhat, they have held up well despite the stress experienced in many sectors of the economy. However, they remain vulnerable to further decline depending on the pace of economic growth, agricultural net income, and future interest rates.

The unusual stress in the financial markets in late 2008 began to diminish in 2009, allowing certain segments of the capital markets to begin

4. The information presented in this section pertains to all Farm Credit Banks, the Agricultural Credit Bank, and the affiliated associations of the System banks. The FCS institutions provided the data used in the overall FCS analysis to 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, 2009, and is presented on a combined basis reflecting eliminations of transactions between System entities.

Table 1
Farm Credit System Major Financial Indicators, Annual Comparison
 As of December 31
 Dollars in Thousands

	31-Dec-09	31-Dec-08	31-Dec-07	31-Dec-06	31-Dec-05
FCS Banks¹					
Gross loan volume	152,412,187	149,491,137	131,191,826	112,260,474	94,865,873
Accruing restructured loans ²	4,651	5,125	4,301	5,378	6,131
Accrual loans 90 days or more past due	28,816	21,594	12,917	5,439	1,322
Nonaccrual loans	759,134	582,160	46,069	107,556	152,223
Nonperforming loans/total loans ³	0.52%	0.41%	0.05%	0.11%	0.17%
Cash and marketable investments	39,305,172	41,358,881	34,408,807	31,680,712	27,788,225
Capital/assets ⁴	5.59%	4.89%	5.43%	5.65%	6.20%
Unallocated retained earnings/assets	2.80%	2.50%	2.69%	2.95%	3.28%
Net income	1,442,328	1,231,430	981,688	845,191	740,785
Return on assets ⁵	0.74%	0.65%	0.60%	0.60%	0.61%
Return on equity ⁵	13.13%	12.44%	10.59%	10.24%	9.48%
Net interest margin	1.17%	0.97%	0.83%	0.80%	0.84%
Operating expense rate ⁶	0.33%	0.31%	0.30%	0.33%	0.33%
FCS Associations					
Gross loan volume	118,575,715	114,026,889	105,620,488	93,413,704	83,253,781
Accruing restructured loans ²	58,926	30,381	47,212	51,384	53,885
Accrual loans 90 days or more past due	68,508	68,856	43,840	19,504	13,156
Nonaccrual loans	2,631,604	1,706,613	465,414	425,545	371,703
Nonperforming loans/gross loans ³	2.33%	1.58%	0.53%	0.53%	0.53%
Capital/assets ⁷	15.82%	15.46%	15.57%	16.27%	17.19%
Unallocated retained earnings/assets	14.56%	13.51%	13.58%	13.89%	14.79%
Net income	1,589,151	1,805,929	1,934,968	1,662,255	1,613,346
Return on assets ⁵	1.30%	1.56%	1.74%	1.75%	1.85%
Return on equity ⁵	8.14%	9.83%	10.82%	10.44%	10.55%
Net interest margin	2.64%	2.50%	2.57%	2.64%	2.71%
Operating expense rate ⁶	1.46%	1.45%	1.49%	1.58%	1.53%
Total Farm Credit System⁸					
Gross loan volume	164,830,000	161,423,000	142,906,000	123,436,000	106,272,000
Nonperforming loans	3,535,000	2,416,000	621,000	615,000	600,000
Nonaccrual loans	3,369,000	2,282,000	512,000	533,000	524,000
Nonperforming loans/gross loans ³	2.14%	1.50%	0.43%	0.50%	0.56%
Bonds and notes	178,358,000	179,769,000	155,295,000	134,466,000	113,576,000
Capital/assets ⁹	13.90%	12.70%	14.20%	15.00%	16.30%
Surplus/assets	11.57%	10.80%	11.52%	12.25%	13.30%
Net income	2,850,000	2,916,000	2,703,000	2,379,000	2,096,000
Return on assets ⁵	1.33%	1.44%	1.56%	1.59%	1.61%
Return on equity ⁵	9.92%	10.63%	10.44%	10.06%	9.43%
Net interest margin	2.65%	2.41%	2.43%	2.48%	2.58%

Sources: Farm Credit System Call Report as of December 31, 2009, and the Farm Credit System Annual Information Statement provided by the Federal Farm Credit Banks Funding Corporation.

Note: Changes to previous periods occasionally occur for accounting reasons.

1. Includes Farm Credit Banks and the Agricultural Credit Bank.
2. Excludes loans 90 days or more past due.
3. Nonperforming loans are defined as nonaccrual loans, accruing restructured loans, and accrual loans 90 days or more past due.
4. Capital excludes mandatorily redeemable preferred stock.
5. Income ratios are annualized.
6. Operating expenses divided by average gross loans, annualized.
7. Capital excludes protected borrower capital.
8. Cannot be derived through summation of above categories because of intradistrict and intra-System eliminations used in reports to investors.
9. Capital includes restricted capital (amount in Farm Credit Insurance Fund), excludes mandatorily redeemable preferred stock and protected borrower capital.

Table 2
Farm Credit System Major Financial Indicators, by District^a
 As of December 31, 2009
 Dollars in Thousands

FCS Banks	Total assets	Gross loan volume	Nonaccrual loans	Allowance for loan losses	Cash and marketable investments ^b	Capital stock ^c	Surplus ^d	Total capital ^e
AgFirst	30,867,544	21,327,319	217,307	32,292	9,184,625	838,707	864,827	1,580,330
AgriBank	66,143,331	55,659,788	111,729	23,412	9,659,133	1,702,257	1,723,910	3,266,635
CoBank	58,160,702	44,174,365	307,630	369,817	12,761,000	2,220,054	1,871,986	4,057,629
Texas	13,776,721	11,033,114	111,915	31,602	2,640,111	437,361	373,060	821,292
U.S. AgBank	25,549,449	20,217,601	10,553	5,077	5,060,303	849,053	618,516	1,141,252
Total	194,497,747	152,412,187	759,134	462,200	39,305,172	6,047,432	5,452,299	10,867,138
Associations								
AgFirst	18,324,961	16,795,927	552,345	162,840	627,078	187,434	2,690,574	2,856,090
AgriBank	57,998,957	52,688,530	1,038,583	358,352	2,342,625	220,478	8,925,066	9,145,655
CoBank	13,467,932	12,805,021	330,008	150,627	102,916	26,238	2,075,618	2,049,571
Texas	13,802,889	13,214,598	426,368	114,761	169,403	63,980	1,935,556	2,007,975
U.S. AgBank	24,699,168	23,071,639	284,300	107,165	555,440	506,826	3,731,220	4,242,029
Total	128,293,907	118,575,715	2,631,604	893,745	3,797,462	1,004,956	19,358,034	20,301,320
Total FCS	215,457,000	164,830,000	3,369,000	1,359,000	42,221,000	1,504,000	24,765,000	29,959,000

Sources: Farm Credit System Call Report as of December 31, 2009, and the Farm Credit System Annual Information Statement provided by the Federal Farm Credit Banks Funding Corporation.

1. Aggregations of district data may not equal totals because of eliminations.
2. Includes accrued interest receivable on marketable investments.
3. Includes capital stock and participation certificates, excludes mandatorily redeemable preferred stock and protected borrower capital.
4. Includes allocated and unallocated surplus.
5. Includes capital stock, participation certificates, perpetual preferred stock, surplus, and accumulated other comprehensive income. For the total Farm Credit System amount, total capital also includes \$3.289 billion of restricted capital, which is the amount in the Farm Credit Insurance Fund. Excludes mandatorily redeemable preferred stock and protected borrower capital.



functioning more normally. Generally, the System continued to have ready access to short-term funds. Early in 2009, market demand for medium-term securities remained low, particularly for maturities over five years. However, as the year progressed, access to term securities improved markedly, and the System was able to enhance earnings performance and to maintain its debt maturity profile by calling and re-issuing term debt at lower rates. For 2010, System access to the debt markets may again be challenged based on legislative action related to regulatory financial and GSE reform. Similarly, the interest rate environment may not provide the same opportunity to lower the cost of debt by calling and re-issuing term securities.

These conditions are expected to cause continued challenges for the System in 2010. For a discussion of how these stresses and others are likely to affect the agricultural economy and the System in 2010 and beyond, see “Challenges Facing the Agricultural Economy and the Farm Credit System” on pages 53 to 59.

Earnings

The FCS earned \$2.85 billion in 2009 compared with \$2.92 billion in 2008 (See figure 1). This 2.4 percent decline in net income was largely driven by higher provisions for loan losses. The FCS established a provision for loan losses of \$925 million in 2009 compared with \$408 million

in 2008. The significant increase in the 2009 provision resulted primarily from credit deterioration caused by continued volatility in commodity prices, which adversely affected the swine, dairy, poultry, and ethanol sectors. Another factor causing the increase in the provision for loan losses was the weakness in the overall economy and uncertainty regarding the likely path of the recovery.

Net interest income increased by \$690 million and was attributable to the more favorable net interest spread, which increased by 44 basis points from year-end 2008 to 2.43 percent at year-end 2009. The System’s return on average assets declined to 1.33 percent in 2009 from 1.44 percent the prior year. The return on average capital also declined, dropping to 9.92 percent in 2009 from 10.63 percent in 2008.

As cooperative institutions, the FCS banks and associations pass a portion of their earnings on to their borrower-owners as patronage distributions. During 2009, System institutions declared a total of \$749 million in patronage distributions. Of that amount, \$469 million was paid in cash, \$215 million was issued in the form of allocated retained earnings, and \$65 million was issued as stock. The System also distributed \$70 million in cash from patronage allocations of earlier years. Many System institutions decided to pay out a smaller percentage of net income

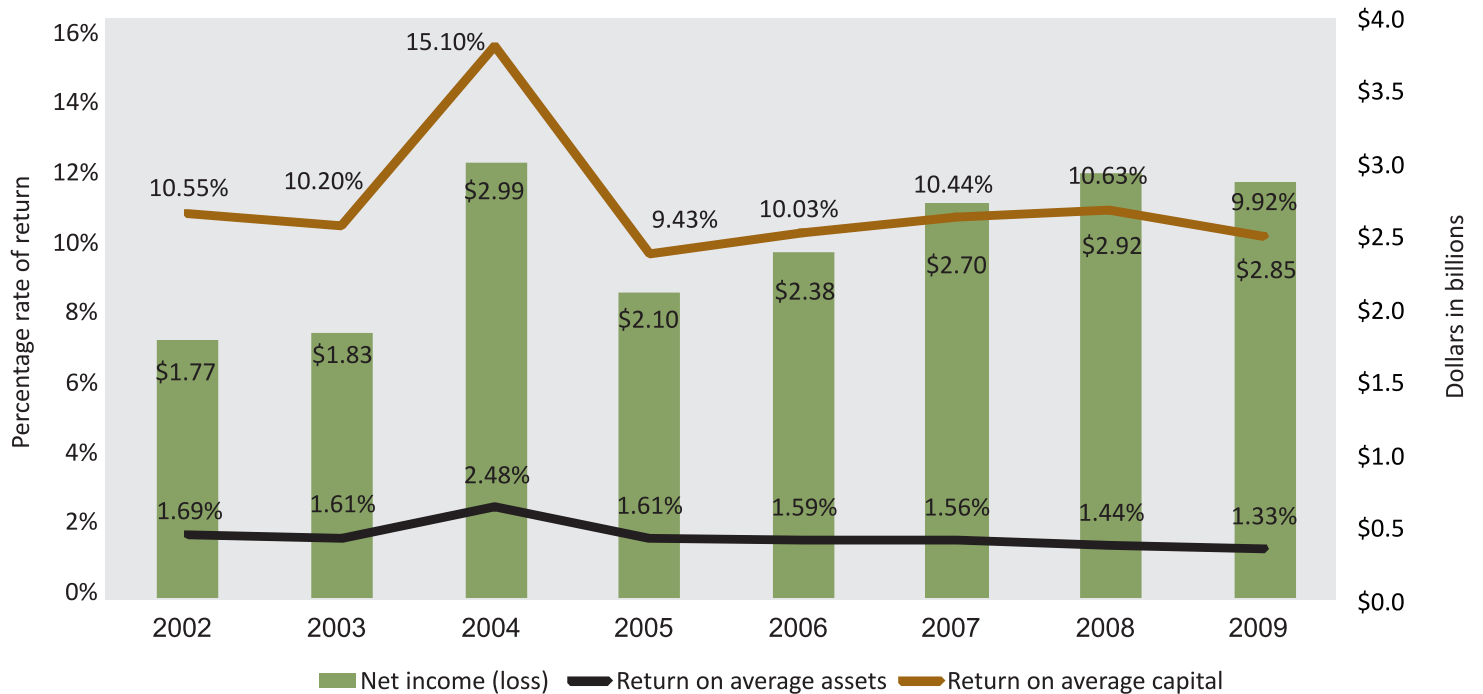
in 2009 (26 percent) compared with 2008 (33 percent) to conserve their capital after experiencing high provisions for loan losses and increased credit risk.

Asset Growth

The System faced a challenging operating environment in 2009. A global recession sapped demand for many agricultural products, unemployment reached high levels in the United States, and there was overcapacity in the swine and dairy sectors. The result was severe stress and record losses for many swine and dairy farmers. Ethanol margins were also under considerable pressure during much of 2009 because of excess capacity in the industry and uncertainties associated with pending government actions. Grain prices declined considerably in 2009 from the extremely high levels reached in mid-2008. Crop sector input prices also declined as grain prices dropped, but not to the same extent as grain prices, leading to reduced profit margins for many grain farmers. The riskier conditions in agriculture led to lower loan demand as well as more stringent underwriting practices at many FCS institutions.

System growth slowed considerably in 2009 as a result of reduced borrower demand and tighter underwriting practices. FCS assets grew to \$215.5 billion, up only \$1.1 billion from 2008. Total System assets increased just 0.5 percent in 2009

Figure 1
FCS Net Income, 2002–2009
 As of December 31



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

Note: The net income for 2004 includes \$1.167 billion in net reversals of the allowance for loan losses.

compared with 15 percent in 2008. Loan growth also declined sharply in 2009; total loans increased by just 2.1 percent after four years of double-digit growth (see figure 2).

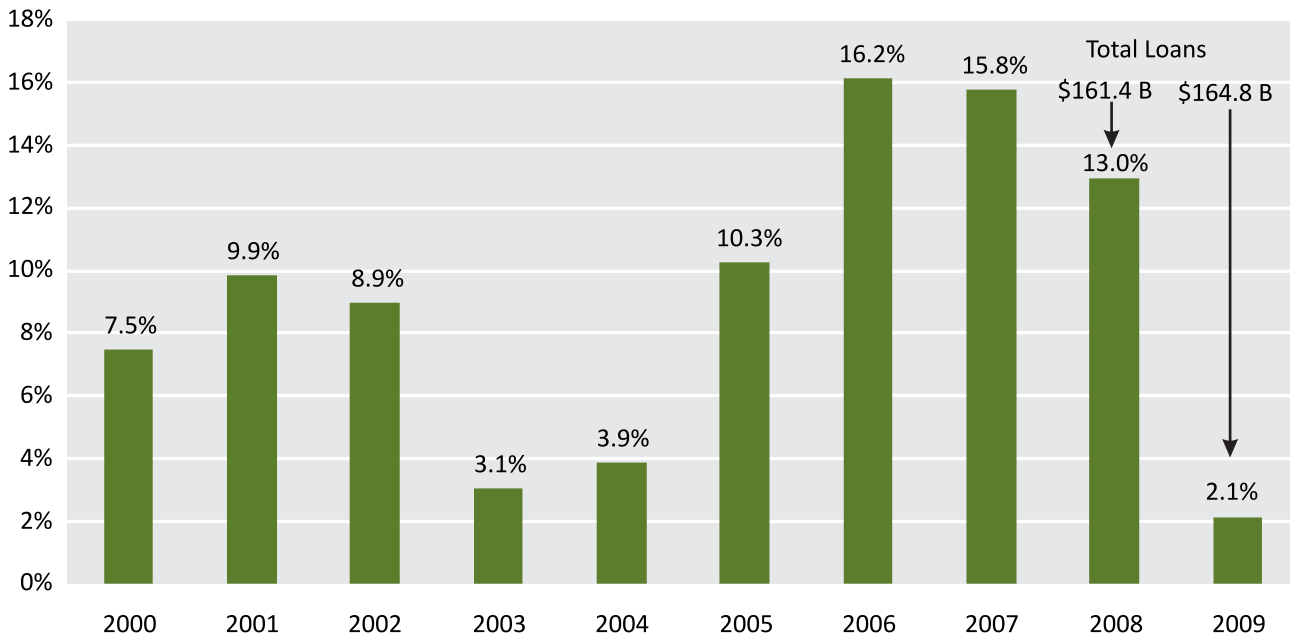
Asset Quality

The quality of the System’s loan portfolio declined in 2009 from 2008 because of the conditions discussed above. Nonperforming loans increased to 2.14 percent of gross loans by year-end 2009 from 1.50 percent at the end of 2008 (see figure 3). Nonaccrual loans increased from \$2.3 billion, or 1.41 percent of

gross loan volume, at year-end 2008 to \$3.4 billion, or 2.04 percent of gross loan volume, at year-end 2009. Loan delinquencies (that is, total accruing loans that are 30 days or more past due) remained the same from year-end 2008 to year-end 2009 at 0.53 percent of all accruing loans. Despite the improvement in the general economy, credit quality may deteriorate further in 2010 because this indicator tends to lag behind the general economy. Nevertheless, the overall level of nonperforming loans was within the System’s risk-bearing capacity.

The allowance for loan losses increased to \$1.4 billion, or 0.82 percent of loans outstanding in 2009, from \$936 million, or 0.58 percent of loans outstanding the year before. The System recognized a provision for loan losses of \$925 million in 2009 compared with \$408 million in 2008. The 2009 provision for loan losses was primarily related to the deterioration in the swine, dairy, and ethanol sectors. Net charge-offs increased in 2009 to \$518 million from \$99 million in 2008. Although the System’s overall asset quality remains strong, the current riskier

Figure 2
Annual Growth Rate of FCS Loans Outstanding, 2000 to 2009



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

lending environment may lead to further deterioration in coming years.

Funding

In 2009, the System's funding composition changed slightly. Short-term debt securities made up 36.8 percent of total Systemwide debt securities at December 31, 2008, and 34.8 percent at December 31, 2009. The debt securities due within a year decreased by 6.0 percent in 2009, and those due after one year increased by 2.6 percent. Although the System continues to have regular and flexible access to the short-term debt markets, issuance

of securities with maturities greater than five years was more challenging in early 2009, and the cost of such term issuances increased as a result. However, the access to term securities improved throughout the year. (See section titled "Funding Activity in 2009" on page 37 for further discussion of how the System's funding environment has changed.)

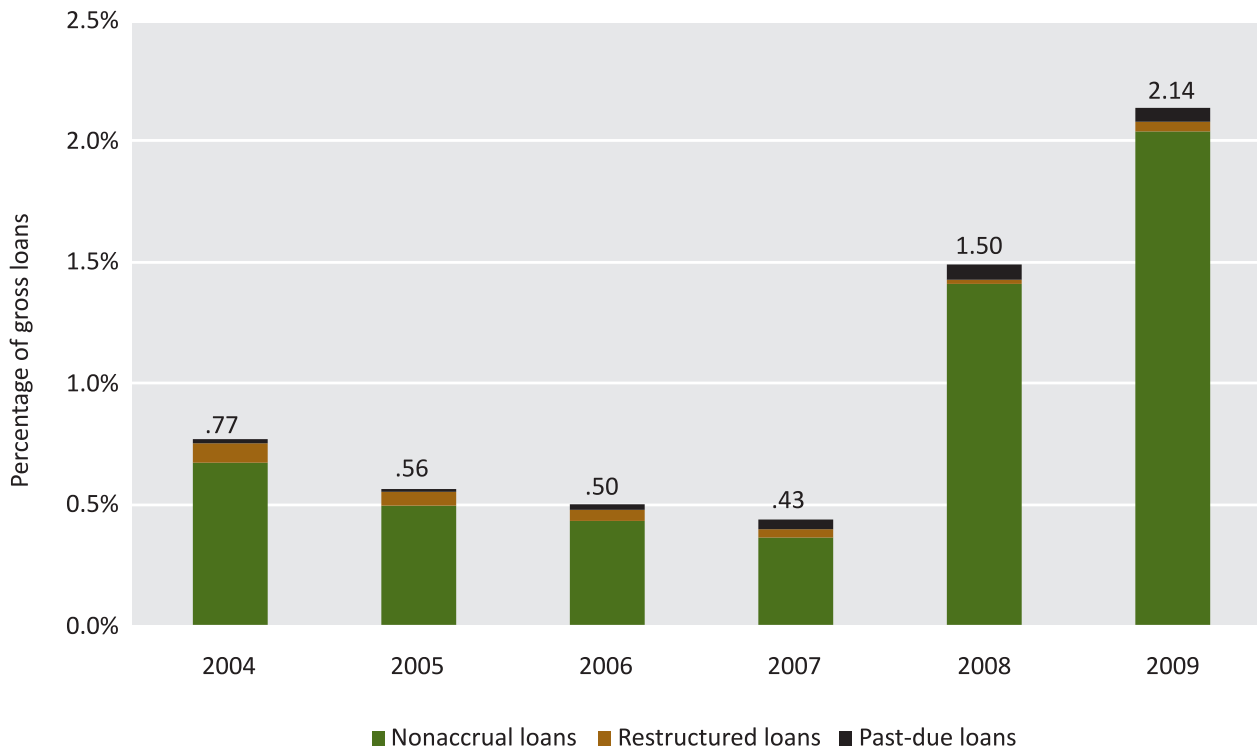
Liquidity

The System's days of liquidity position was 178 days at year-end 2009, up slightly from 177 days at year-end 2008. This level is significantly higher

than the regulatory minimum.⁵ The System banks also improved the quality of their liquidity through purchases of U.S. Treasury securities and corporate securities with explicit U.S. Government guarantees. This liquidity provides each bank with a cushion against significant negative events in the U.S. and global markets and also creates financial flexibility to operate more effectively in a challenging funding environment. Investments available for sale (based on fair value) remained relatively steady at \$34.9 billion in 2009, with a weighted average yield of 1.9 per-

5. The regulatory liquidity standard requires each FCS bank to maintain a minimum of 90 days of liquidity on a continuous basis to guard against a possible interruption in its access to the capital markets. The number of days of liquidity is calculated by comparing maturing Systemwide debt securities and other bonds for which the bank is primarily liable with the total amount of cash, investments, and other liquid assets maintained by that bank. For purposes of calculating liquidity, liquid assets are subject to discounts that reflect potential exposure to adverse market value changes that might be recognized upon liquidation or sale.

Figure 3
FCS Nonperforming Loans, 2004–2009
 As of December 31



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

cent. Investments held to maturity also remained steady at \$3.7 billion, with a weighted average yield of 4.5 percent. The yields on investments declined in 2009 because of the lower interest rate environment.

The quality of some System investments continues to be adversely affected by the historic declines in the Nation's financial markets. By regulation, System banks may acquire certain investments only if they have a triple-A rating from at least one major rating agency. If such an investment loses its triple-A rat-

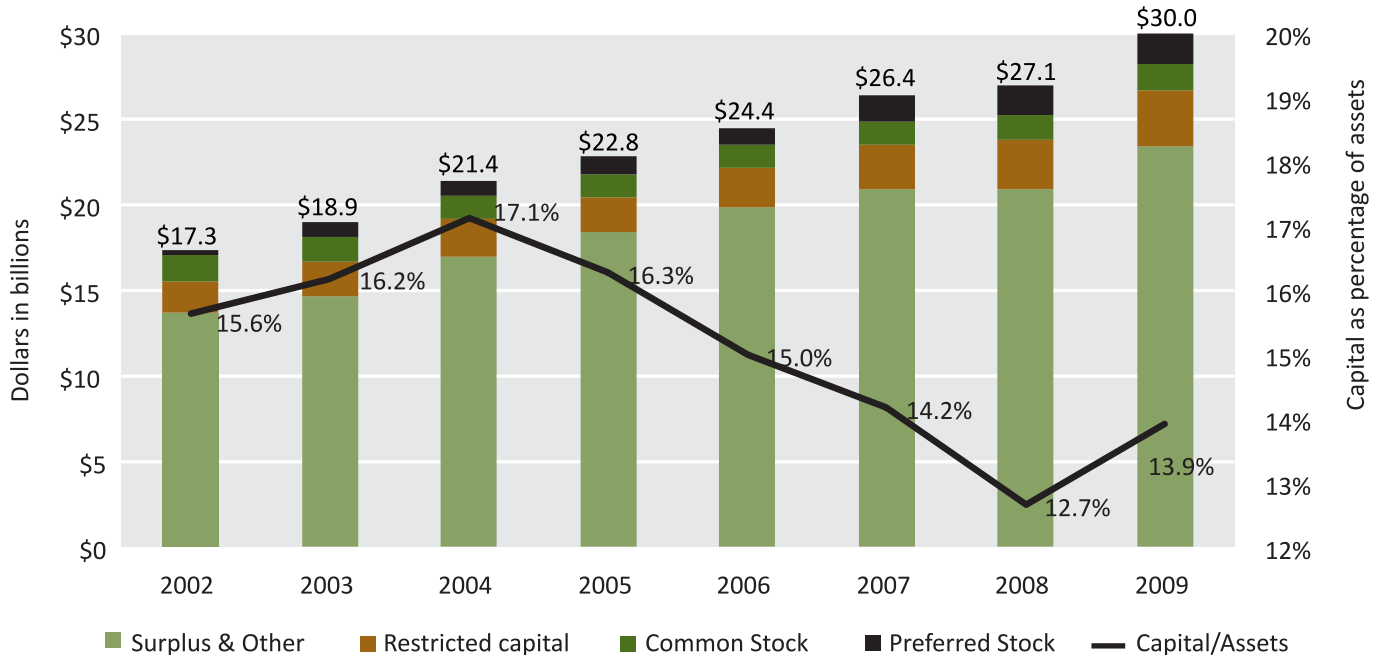
ing, the investing bank must dispose of the investment within six months or receive written approval from FCA to divest the investment over a longer period of time. The FCS had 135 ineligible securities because of a ratings downgrade (3.6 percent of total FCS investments). FCA has approved, or is in the process of approving, divestiture plans to hold these investments longer than six months. The FCS recognized other-than-temporary impairment of \$217 million on securities (recognized through earnings in 2008 and 2009). These impairments represent 0.6

percent of the \$35 billion available-for-sale investment portfolio.

Capital

Capital levels were strong and increased during 2009, going from \$27.1 billion at year-end 2008 to \$29.9 billion at year-end 2009. A number of factors contributed to the increase in System capital, including the accumulation of net income earned and retained, growth in restricted capital (i.e., the Farm Credit Insurance Fund), additional paid-in capital, and a reduction in accumulated other comprehensive loss.

Figure 4
FCS Capital, 2002–2009
 As of December 31



Source: Federal Farm Credit Banks Funding Corporation Annual Information Statements.

As figure 4 shows, surplus accounts for the overwhelming majority of capital. Overall, the System's capital-to-assets ratio rose from 12.7 percent at year-end 2008 to 13.9 percent at year-end 2009, caused principally by a sharp reduction in the growth of System assets. In addition, accumulated other comprehensive losses decreased to \$1.6 billion, which consisted primarily of net unrealized losses and other-than-temporary impairment on investments and pension and other benefit plans.

System banks, both as a whole and as individual institutions, are capitalized in excess of the System's regulatory requirements. The minimum permanent capital ratio requirement is 7.0 percent, and, as of December 31, 2009, the permanent capital ratios ranged between 15.3 percent and 18.4 percent for the System's banks and between 9.1 percent and 27.6 percent for the associations. In addition, at December 31, 2009, the FCS had \$3.3 billion of restricted capital in the Farm Credit Insurance Fund, which exceeded the 2 percent secure base amount.

The System has augmented regulatory capital through third-party capital, including \$2.01 billion in various forms of preferred stock and \$1.55 billion in subordinated debt. See Funding Activity in 2009 for additional information on System third-party capital.

BORROWERS SERVED

The System fulfills its overall mission by lending to agriculture and rural America. Through changes in the law since the first part of the FCS was established in 1916, the System's

lending authorities have evolved to include the following:

- Long-term agricultural real estate loans and 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
- Loans to rural utilities
- Limited portions of loans to entities that qualify under the System's similar-entity authority⁶

Nationwide, the System had \$164.8 billion in gross loans outstanding as of December 31, 2009, (see table 3). Agricultural producers represented by far the largest borrower group, with \$115.0 billion, or 69.7 percent, of the total dollar amount of loans outstanding.⁷ As required by law, borrowers own stock or participation certificates in System institutions. The FCS had more than 850,000 loans and approximately 481,000 stockholders in 2009. Approximately 84.5 percent of the stockholders were farmers

or cooperatives with voting stock. The remaining 15.5 percent were nonvoting stockholders, including rural homeowners and other financing institutions that borrow from the System. Over the past five years, the number of System stockholders has increased gradually, rising more than 4.5 percent since year-end 2004.

The aggregate total of loans outstanding at FCS banks and associations (net of intra-System lending) grew by \$3.4 billion, or 2.1 percent, during the year ended December 31, 2009. Both the dollar volume and the percentage growth in 2009 were significantly less than the gain in the previous year. In 2008, gross loans grew 13.0 percent, which followed growth of 15.8 percent in 2007 and 16.2 percent in 2006. Since year-end 2005, total System loans outstanding increased by \$58.6 billion, or 55.1 percent.

As of December 31, 2009, 45.7 percent of the dollar volume of the System's loans outstanding was in long-term real estate loans, 24.0 percent in short- and intermediate-term loans to agricultural producers, and 14.3 percent in agribusiness loans. Agribusiness loans are broken down further into 6.4 percent for loans to cooperatives, 6.7 percent for processing and marketing enterprises, and 1.3 percent for farm-related businesses. Loans to finance rural utilities represented 8.8 percent of the System's loan volume, while rural residential real estate loans made

up 3.0 percent of the System's total loans. International loans (export financing) represented 2.4 percent of the System's loan portfolio, and lease receivables accounted for 1.3 percent of the overall portfolio. Finally, loans outstanding to OFIs represented a small but important segment of the System's portfolio.

The System's increase in loan volume in 2009 stemmed primarily from its core customer base, the farmers and ranchers of America. Long-term real estate loans increased \$3.5 billion, or 4.8 percent, in 2009, while short- and intermediate-term loans increased \$2.1 billion, or 5.7 percent. Agribusiness loans were down sharply in 2009, decreasing \$3.3 billion, or 12.2 percent, because of lower loan demand as prices for commodities and farm inputs declined. However, rural utility loans (energy, water, waste disposal, and communication loans) increased \$631 million, or 4.5 percent, and rural residential real estate loans increased \$366 million, or 7.9 percent. The other categories posted modest changes for the year, either up or down, including a 3.0 percent drop for international loans.⁸

Several factors caused the slow growth in System lending during 2009. Two factors slowing demand were declining farm income and increased risk in several agricultural sectors (see "Challenges Facing the Agricultural Economy and the Farm Credit System" in this report). On

6. A similar-entity borrower is not eligible to borrow directly from an FCS institution, but because the similar-entity borrower's operation is functionally similar to that of an eligible borrower, the System can participate in these loans (the participation interest must be less than 50 percent).

7. This amount includes real estate mortgage loans and production and intermediate-term loans but excludes leases and loans to "rural homeowners" (as defined in 613.3030 of the FCA regulations).

8. A majority of the System's international loan portfolio is guaranteed by the Commodity Credit Corporation (CCC) through USDA's GSM-102 and GSM-103 export credit programs. Overall, 92 percent of the System's international loans in 2009 carried a CCC guarantee.

Table 3
FCS Gross Loans Outstanding, 2005–2009
 As of December 31
 Dollars in Millions

	2005	2006	2007	2008	2009	Percent change from 2005
Production agriculture						
Long-term real estate mortgage loans	51,690	56,489	63,458	71,892	75,352	45.8
Short- and intermediate- term loans	24,935	28,731	32,267	37,468	39,610	58.9
Agribusiness loans*	14,673	21,141	28,091	26,901	23,626	61.0
Rural utility loans	8,063	9,569	10,846	13,931	14,562	80.6
Rural residential loans	2,950	3,408	3,965	4,611	4,977	68.7
International loans	2,277	2,183	2,135	4,077	3,956	73.7
Lease receivables	1,290	1,489	1,708	1,952	2,160	67.4
Loans to other financing institutions	394	426	436	591	587	50.0
Total	106,272	123,436	142,906	161,423	164,830	55.1

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

* At December 31, 2009, agribusiness loans consisted of loans to cooperatives of \$10.5 billion, processing and marketing loans of \$11.0 billion, and farm-related business loans of \$2.1 billion.



the supply side, growth slowed because most lenders took prudent steps to adjust for rising risks by tightening their credit underwriting practices and increasing interest spreads. As a result of these factors, loan growth is expected to remain low in 2010.

Although net cash farm income experienced a sharp decline in 2009, the final figure of \$70.8 billion was down only \$2.1 billion from its 10-year average of \$72.9 billion. Thus, the core segments of the System's portfolio—farm real estate mortgages and production and intermediate-term loans—continued to grow as farmers demanded more credit to purchase land and other inputs needed to maintain production and to manage through operating losses in stressed agricultural sectors. Nonetheless, the System's growth rates in 2009 were well below the levels of earlier years.

The growth in rural utility loans last year was driven, in part, by a reduction in available credit in the broader debt capital markets, as well as ongoing marketing efforts by the System to attract new customers. Despite considerable turmoil in the capital and credit markets last year, the FCS was able to meet its mission as a reliable source of constructive and reasonably priced credit for U.S. agriculture and rural America.

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 certain non-System lending institutions described as "other financing institutions" (OFIs). OFIs include commercial banks, savings institutions, credit unions, trust companies, agricultural credit corporations, and other specified agricultural lenders that are significantly involved in lending to agricultural and aquatic producers and harvesters. System banks can fund and discount short- and intermediate-term loans for OFIs that demonstrate a need for additional funding to meet the credit needs of borrowers who are eligible to receive loans from the FCS. OFIs benefit by using the System as an additional source of liquidity for their own lending activities and by capitalizing on the System's expertise in agricultural lending.

As of December 31, 2009, the System served 28 OFIs, up from 27 the year before. Outstanding loan volume to OFIs was \$587 million at year-end, down \$4 million from 2008. OFI loan volume continues to be less than one percent of the System's loan portfolio. More than three-fourths of the System's OFI loan volume is in the Midwest.

Decline in Loan Participations and Syndications with Non-FCS Lenders

In addition to the authority to provide funding and discounting services to OFIs, the Farm Credit Act gives System banks and associations the authority to partner with financial institutions outside the System, including commercial banks, in mak-

ing loans to agriculture and rural America. Generally, System institutions partner with these financial institutions through loan participations and syndications.

- A loan participation is a large loan in which two or more lenders share in providing loan funds to a borrower to manage credit risk or to fund a loan that exceeds a lender's legal or internally established lending limit for a single credit. One of the participating lenders originates, services, and documents the loan. Generally, the borrower deals with the institution originating the loan and is not aware of the other participating institutions, each of which has a contractual interest in the loan.
- A loan syndication (or "syndicated bank facility") is a large loan in which a group of financial institutions work together to provide funds for a borrower. Usually one financial institution takes the lead, acting as an agent for all syndicate members and serving as a liaison between them and the borrower. All syndicate members are known at the outset to the borrower, and they each have a contractual interest in the loan.

Financial institutions primarily use loan participations and syndications to reduce credit risk and to comply with lending limits, but they also use them to manage and optimize capital, earnings, and liquidity. For





example, a financial institution with a high concentration of production loans for a single commodity could use participations or syndications to diversify its loan portfolio, or it could use them to sell loans that are beyond its credit limit. As figure 5 shows, activity from loan participations and syndications with non-System lenders has generally grown over the past six years. However, this activity declined in 2009 because of uncertainty in the capital markets, mounting credit quality concerns in agriculture, and lower demand for large loans.

The first group of bars shows gross loan syndication activity by FCS banks and associations.⁹ Gross loan syndications by the System with non-System lenders totaled \$11.3 billion at year-end 2009, down about \$500 million from the 2008 figure but still well above the totals of earlier years. Although syndication volume as a percentage of the System's loan portfolio decreased from 7.3 percent at year-end 2008 to 6.9 percent at year-end 2009, the overall level of activity was still the second highest in the history of the FCS despite the general market conditions noted above. This use of syndications reflects the growing complexity of commercial credits in agriculture. For large loans, lenders are shifting from being single-lender originators who sell loan participations to other institutions to being members of syndicates in which groups of lenders originate loans. This arrangement allows multi-

ple lenders to have direct contractual agreements with customers as a way to manage risk while satisfying the credit needs of their customers.

The other bars in figure 5 show net loan participation activity involving non-System lenders for two lending categories for the past six years.

- The middle group shows net loan participations with institutions that are originating loans with customers who are also eligible to borrow from the FCS. The net total of these participations was \$7.5 billion, down slightly from 2008. Much of the lending activity in this group probably results from gross loan syndications (the first group of bars in this figure) and the subsequent sale of pieces of the loans to other System institutions.
- In addition to participating in loans to eligible borrowers, FCS institutions have authority to work with non-System lenders that originate "similar-entity" loans (third group of bars in figure 5). A similar-entity borrower is not eligible to borrow directly from an FCS institution, but because the borrower's operation is functionally similar to that of an eligible borrower, the System can participate in the borrower's loans (the participation interest must be less than 50 percent). At the end of 2009, the net amount of similar-entity participations in

the System amounted to \$8.6 billion, a decrease of \$1.3 billion, or 15 percent, from 2008.

The net total of all loan participations was \$16.1 billion at year-end 2009, compared with \$17.5 billion the year before. Again, the unsettled credit market situation contributed to the decrease in the System's loan participation activity in 2009. While the results for 2010 may be sluggish, the partnering between System and non-System lenders remains an important component of System lending, and it will continue to expand the availability of credit to rural America.

MARKET SHARE OF DEBT

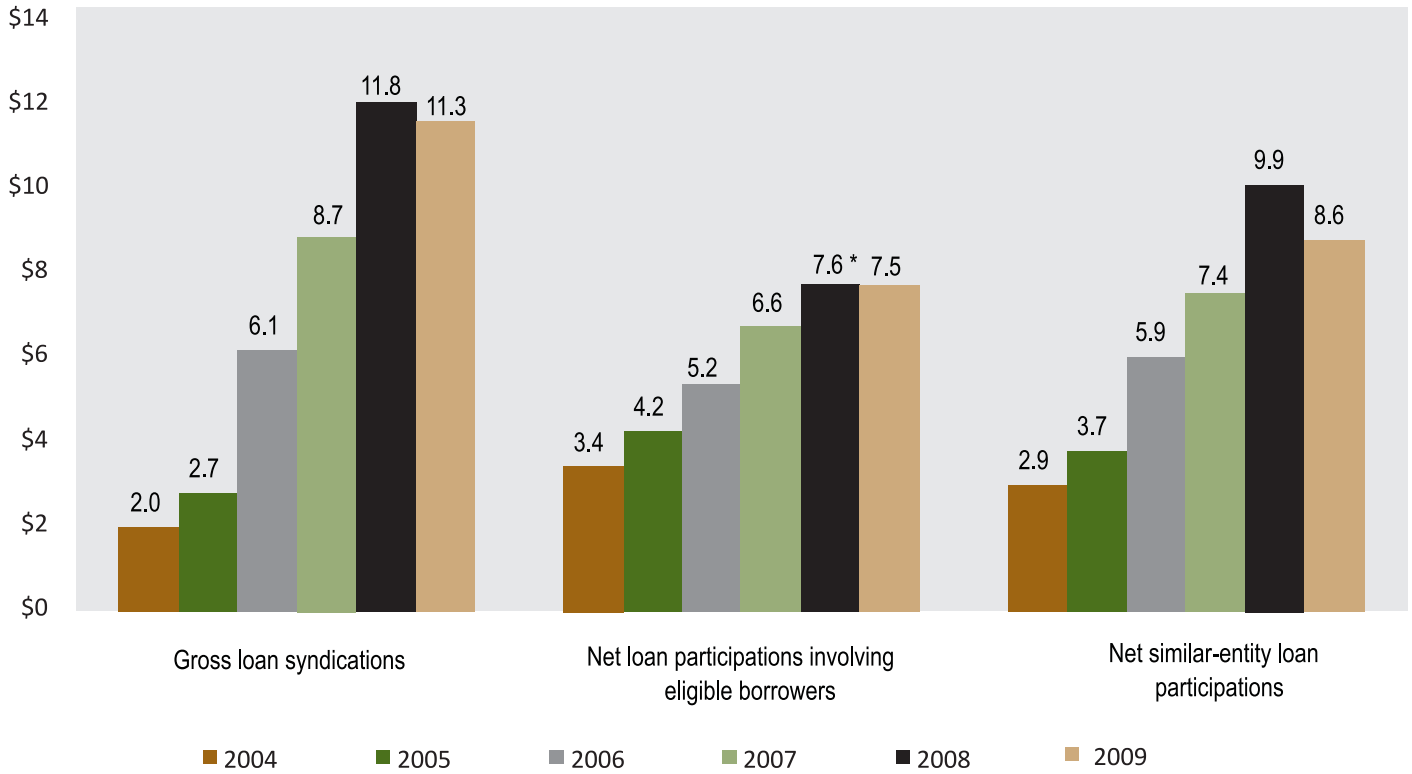
According to USDA preliminary data, total farm business debt for the year ended December 31, 2009, was a record \$249.5 billion (nominal dollar basis), up 4.4 percent from year-end 2008.¹⁰ (After accounting for inflation, farm debt is still well below the peak level of 1980.) Farm debt increased more than 10 percent in 2008, reflecting record-high farm income, strong farm real estate prices, and higher input costs. The lower demand for debt in 2009 was caused by two factors: the sharp drop in farm income and the recession. On the supply side, lenders had adequate funds to lend, but credit underwriting practices were tightened.

USDA expects farm debt to decrease to \$232.5 billion in 2010, down almost 7 percent from year-end 2009,

9. Typically, some of the syndication volume is sold and may be reported by FCS institutions as part of net loan transactions (purchases less sales) with non-FCS lenders (see second group of bars). Net loan transactions include traditional loan participations and assignments or other interest in loans.

10. In 2009, USDA made several revisions in its data series. As a result, adjustments were made to farm debt estimates for prior years.

Figure 5
Syndications and Net Loan Participations Involving Non-System Lenders, 2004–2009
 As of December 31
 Dollars in Billions



Sources: Farm Credit System Call Reports.

* The 2008 FCA Annual Report on the Farm Credit System reported \$9.0 billion in net loan participations involving eligible borrowers in 2008. Subsequently, that figure was revised to \$7.6 billion.

Note: A similar-entity borrower is not eligible to borrow directly from an FCS institution, but because the borrower’s operation is functionally similar to that of an eligible borrower, the System can participate in some of these loans (the participation interest must be less than 50 percent).

because of an increasing softness in the farm real estate market and tighter profit margins in several key enterprises. Farm debt will also be affected by the future direction of the economy and by off-farm income opportunities.

The most current market share information from USDA is for year-end 2008.¹¹ The information for 2009 will not be available until USDA issues its planned update in August 2010. USDA's estimated debt by lenders shows that commercial banks held 44.3 percent of the \$238.9 billion in total farm business debt at the end of 2008. The System's share was 39.0 percent. The System was the only lender group to increase its market share in 2008, posting a gain of 2.4 percentage points. Commercial banks lost about a half point of market share in 2008, and the other lenders, such as life insurance companies, the Farm Service Agency, and merchants and dealers, also had small market share losses. Commercial banks and the FCS now represent more than 80 percent of the total farm business debt market, as compared with about 74 percent in 2000. (Figure 6 shows market share shifts for the major lenders since 1989.)

Except for the unusual period of the 1980s and a brief time in the 1990s, the FCS has typically had the largest market share of farm real estate mortgages. Commercial banks have always dominated non-real estate lending. The System's share of debt secured by farm real estate increased to 43.1 percent at year-end 2008, continuing the steady upward trend of the past 10 years. The System's share of non-real estate farm debt was 34.2 percent at year-end 2008, again continuing a solid upward trend since the late 1990s when it was slightly less than 20 percent. At year-end 2008, commercial banks held 37.5 percent of the farm real estate mortgage debt, up slightly from 2007, and 52.5 percent of the non-real estate debt, which was down almost one percentage point from 2007.

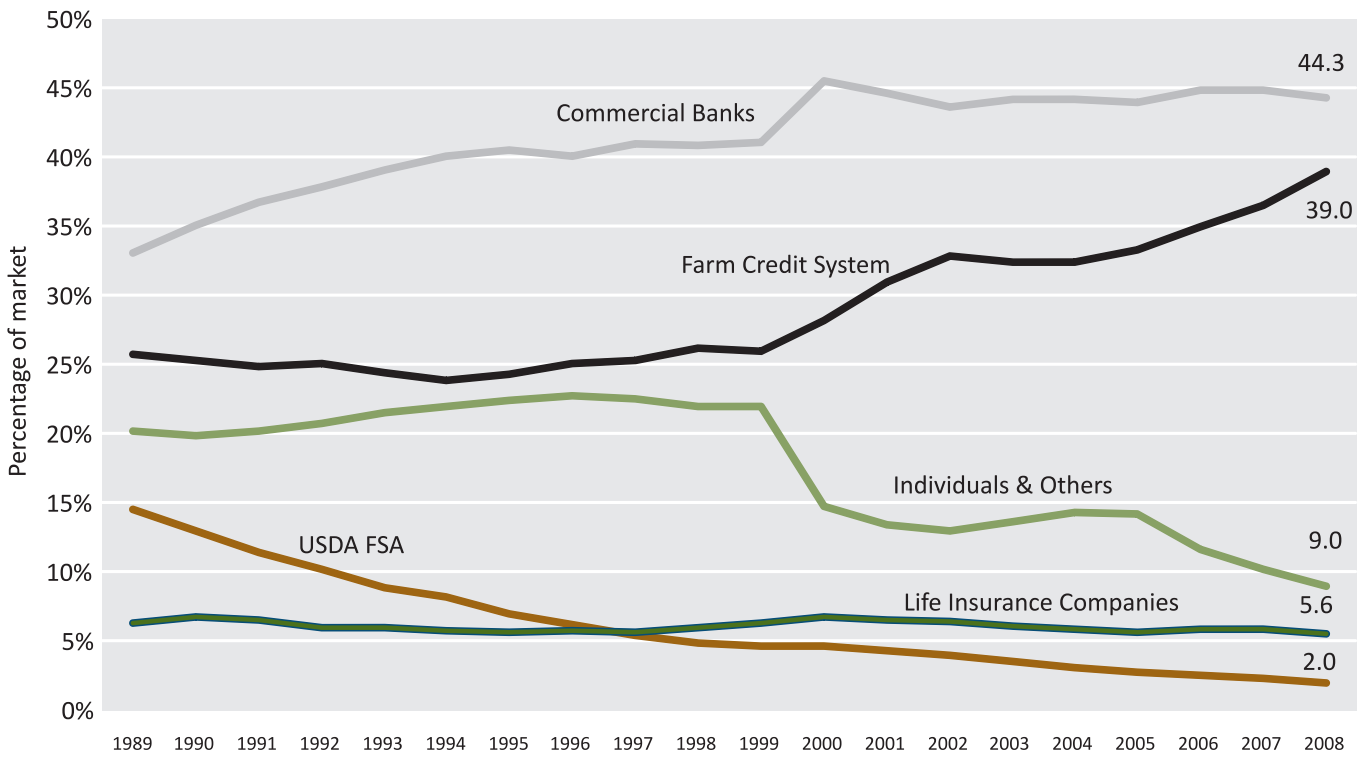
FARMER MAC AS A SECONDARY MARKET

FCA also examines and regulates the Federal Agricultural Mortgage Corporation (Farmer Mac). Farmer Mac provides a secondary market arrangement for agricultural real estate, Government-guaranteed portions of certain loans, rural housing mortgage loans, and rural utility

loans; in doing so, it provides greater liquidity and lending capacity to rural lenders. Under the Farmer Mac I program, Farmer Mac guarantees timely 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, Farmer Mac purchases and securitizes portions of certain loans guaranteed by the U.S. Department of Agriculture, including farm ownership and operating loans and rural business and community development loans. Farmer Mac also guarantees the timely payment of principal and interest on the securities created from these loans. In May 2008, the Food, Conservation, and Energy Act of 2008 expanded Farmer Mac's program authorities by allowing it to purchase and guarantee securities backed by eligible rural utility loans made by cooperative lenders.

11. Market share is calculated by USDA for farm business debt only. Market share information is not available for the other portions of the System's portfolio, such as agribusiness lending, rural utility lending, or rural home lending.

Figure 6
Market Shares of U.S. Farm Business Debt, 1989–2008



Sources: USDA, Economic Research Service.

Note: Year-end 2008 figure is a preliminary estimate.

Serving Young, Beginning, and Small Farmers and Ranchers

Programs to provide financially sound and constructive credit and related services to young, beginning, and small (YBS) farmers and ranchers are a statutory mandate and a high priority for the System. Loans to YBS borrowers help provide a smooth transition of agribusiness to the next generation and maintain a diversified customer base, from very small enterprises to large commercial operations, for the FCS. Through its regulatory agenda, special reports, disclosure requirements, and examination activities, FCA is strongly committed to ensuring that the System fulfills its responsibility to support this important segment of the agricultural industry.

As the percentage of retirement-age farmers continues to rise, the System's potential role becomes more important in helping young and beginning farmers finance the purchase of agricultural assets sold by those who are exiting the business. USDA's 2007 Census of Agriculture found that 29.7 percent of principal operators are 65 years old or older, compared with 21.4 percent in 1987. The census also reported a continuing sharp decline in the percentage of young operators. Principal operators aged 34 or younger declined from 13.3 percent in 1987 to 5.4 percent in 2007.¹² The 2007 results show that almost a third of all farm operators are not principal operators. Moreover, 13.4 percent of the members in this group are young. Therefore, when all are included (principal

operators and other farm operators), young operators represented 8.0 percent of the total number of farm operators in 2007, as compared with 8.6 percent in 2002.

Other USDA surveys and studies show that potential YBS borrowers have a heavy and increasing reliance on off-farm income, as well as a wide range of credit needs beyond their agricultural production activities. Such changing demographics and economic conditions in many areas of rural America pose challenges for System institutions in meeting their YBS program goals.

Each System bank is required 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 Farm Credit Act stipulates that 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 its lending volume, operations, and achievements in its YBS program. (See the YBS Programs section on page 31.)

FCA's oversight and examination activities encourage System institutions to assess their performance and market penetration in the YBS area. This self-assessment increases the mission awareness of System institutions and prompts them to earmark resources to serve this important

market segment. Finally, FCA continues to review and consider various policy options for supporting the System's YBS programs.

YBS LENDING RESULTS

In calendar year 2009, the volume of YBS loans outstanding increased for each of the three borrower categories, as it has for the past nine years. However, loans made in 2009 (including new loans and renewals) for each of the three YBS categories decreased in both number and dollar volume from 2008 levels, reversing the steady increases of earlier years.¹³

These results closely follow declines in the System's overall number of loans made in 2009 (down 2.4 percent from 2008) and the dollar volume of all System loans made (down 15.2 percent from 2008). These declines were driven by both supply and demand factors. The supply of credit declined because System lenders tightened their underwriting standards to protect themselves from credit risks, and the demand for credit was down because of the deep recession in the general economy and the drop in net farm income.

However, the more instructive longer-term perspective shows that overall loans in 2009 were actually up by about 10 percent for both loan numbers and volume over the prior five-year average. Likewise, loan numbers and dollar volume for two of the three YBS categories were

12. The System's definition of a young farmer differs slightly from USDA's definition. See the note below table 4B.

13. System data on service to YBS farmers and ranchers cover the calendar year and are reported at year-end. The statistics show loans made during the year (both number of loans and dollar volume of loans), as well as loans outstanding at year-end (both number of loans and dollar volume of loans). The volume measure includes loan commitments to borrowers, which typically exceed actual loan advances.

higher in 2009 than the prior five-year average.

In the section on YBS borrowing trends (page 28), FCA provides information on the progress in YBS lending activity since 2001, which was the first year institutions reported their results using the current definitions for young, beginning, and small farmers and ranchers. Table 4A contains information on loans outstanding in each category at the end of 2009; table 4B provides information on loans made during the year. Loans to YBS farmers include real estate loans and short- and intermediate-term loans.

Young—The System’s extension of credit to young farmers, those aged 35 or younger, consisted of 157,708 loans totaling \$20.4 billion at the end of 2009 as compared with \$19.5 billion at the end of 2008. During 2009, 50,689 loans totaling \$6.6 billion were made to young borrowers. The 2008 total was \$7.7 billion. The loans made to young borrowers in 2009 represented 16.4 percent of all loans the System made for the year, which totaled 308,279, and 11.3 percent of the dollar volume of loans made, which totaled \$58.5 billion. The average size of loans made to young farmers in 2009 was \$130,915. The number and volume of loans made during the year is a good indicator of current service to YBS borrowers. The number of loans made to young farmers during 2009 was 4.1 percent lower than in 2008, and the volume

of loans made was 13.7 percent lower. However, if you compare 2009 numbers to the prior five-year average, the number of loans made to young farmers was actually up 9.3 percent, and the dollar volume of loans made to young borrowers in 2009 was up by 15 percent.

Beginning—Beginning farmers, defined as those with 10 or fewer years of farming experience, constituted 223,311 of the System’s YBS loans, totaling \$34.1 billion at year-end 2009 as compared with \$33.0 billion at the end of 2008. During 2009, 61,387 loans totaling \$9.5 billion were made to beginning borrowers. The 2008 total was \$12.0 billion. Loans made to beginning farmers in 2009 represented 19.9 percent of all loans made in 2009 and 16.2 percent of the dollar volume of loans made. The average size of loans made in 2009 was \$154,169. The number of loans made during 2009 was 7.8 percent lower than in 2008, and the volume of loans made was 20.9 percent lower than in the previous year. Compared to the prior five-year average, however, the number of loans made was up in 2009 by 4.7 percent, and the volume was up by 1.5 percent.

Small—FCS institutions had 474,762 outstanding loans, totaling \$42.8 billion, to small farmers (those with gross annual sales of less than \$250,000) at the end of 2009. The loan volume was up fractionally from year-end 2008. During 2009, 145,618 loans were made to small borrow-



ers for a total of \$11.9 billion as compared with \$14.2 billion in 2008. Loans made in 2009 to small farmers represented 47.2 percent of all loans made in 2009 and 20.3 percent of the dollar volume of loans made in 2009. The average size of loans made in 2009 was \$81,713. Compared with 2008 year-end numbers, the number of loans made during 2009 was 3.4 percent lower and the volume of loans made was 16.4 percent lower. However, compared with the prior five-year average, 2009 numbers were just slightly lower, by 3.9 percent for number of loans and by 0.1 percent for volume of loans. Over time, many producers graduate from the small farm category by expanding their farm operations or increasing farm revenue through other means, which shrinks the potential number of small customers for YBS programs. Nevertheless, during 2009, almost half of the loans by number were to small farm producers, which is a testament to the importance of small farm lending for the System.

The YBS information is reported separately for each of the three YBS borrower categories because the YBS mission is focused on each borrower group separately. Also, loans cannot be added across categories because some loans belong to more than one category. If, for example, a borrower is less than 35 years old, if he sells less than \$250,000 in agricultural or aquatic products per year, and if he has farmed for less than 10 years, his loan would be included in each

Table 4A
YBS Loans Outstanding
 As of December 31, 2009

	Number of loans	Percentage of total number	Dollar volume of loans in millions*	Percentage of total volume	Average loan size
Young farmers/ranchers	157,708	18.4	\$20,424	11.7	\$129,507
Beginning farmers/ranchers	223,311	26.0	\$34,109	19.5	\$152,743
Small farmers/ranchers	474,762	55.3	42,756	24.4	\$90,057

Table 4B
YBS Loans Made During 2009
 As of December 31

	Number of loans	Percentage of total number	Dollar volume of loans in millions*	Percentage of total volume	Average loan size
Young farmers/ranchers	50,689	16.4	\$6,636	11.3	\$130,915
Beginning farmers/ranchers	61,387	19.9	\$9,464	16.2	\$154,169
Small farmers/ranchers	145,618	47.2	\$11,899	20.3	\$81,713

Sources: Annual Young, Beginning, and Small Farmer Reports submitted by each System lender through the Farm Credit banks.

Note: A "young" farmer/rancher is defined as 35 years old or younger when the loan is made; a "beginning" farmer/rancher has been operating for not more than 10 years; and a "small" farmer/rancher 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 lending.

* The volume figures for loans made and loans outstanding include both advances and commitments.

category. Therefore, adding the categories together would produce a misleading measurement of the System's YBS lending involvement.

ASSESSMENT OF YBS RESULTS FOR INDIVIDUAL ASSOCIATIONS

Individual associations vary significantly in their YBS lending results. Some institutions may have a high number or dollar volume of loans in one category and be low in another, while activity levels for other institutions may be just the opposite. However, every FCS institution reported at least some lending activity in each category in 2009. Beginning with 1999, specific YBS data by institution, by district, and for the System as a whole are available on FCA's Web site at www.fca.gov under Consolidated Reporting System Reports.

The significant diversity in farm types and sizes and farmer demographics across the United States inevitably leads to wide differences among institutions' YBS results. For example, in 2007, the average value of farm production in three States was more than \$250,000 per farm, compared with 21 States whose average production values were less than \$100,000 per farm. Census of Agriculture data also show that the average age of farmers varies by State, ranging from 52.8 years in Pennsylvania to 57.1 years in New Mexico. Such differences make comparisons among individual associations difficult and explain why YBS regulations do not

specify fixed goals but require individual institutions to establish YBS targets appropriate for their lending territories. Other factors—such as the competitiveness of the local lending market, the availability of State and USDA/Farm Service Agency (FSA) guarantees, and local economic conditions—also affect individual association results.

In addition, the number of small farms in an association's territory can affect its YBS lending results. The 2007 Census of Agriculture classified 90.5 percent of all U.S. farms as small, using the same definition for a small farm that the System uses in its YBS reporting. However, less than a third of all small farms show interest paid as a farm business expense, which means that more than two-thirds of all small farms have no farm debt at all. Indeed, according to the census, more than half of all U.S. farms had annual sales of \$10,000 or less in 2007. Instead of being potential YBS borrowers, most of these operators probably rely on off-farm income sources for almost all of their family income and are not likely to be customers for agricultural credit. However, even within this group some farmers are seeking credit for their farming enterprises and will be able to meet the criteria to qualify for a YBS loan.

YBS BORROWING TRENDS, 2001–2009

FCA now has nine 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. The information in figures 7A, 7B, and 7C shows fairly strong upward trends in dollars of loans outstanding for each of the three categories from 2001 to 2009. With the exception of 2009, the same conclusion is valid for the dollars of loans made. (Also, until 2009, the number of loans made in each category has generally increased.)

As a percentage of total loans outstanding in the System, the YBS statistics for all three categories have either dipped a few points or remained relatively flat since 2001. Thus, System YBS lending has nearly kept pace with the System's strong loan growth since 2001 in spite of the general decline in the number of young, beginning, and small farm operators.

Comparisons between the System's YBS lending results and the results reported by other organizations are difficult to make. For example, comparisons are not feasible between FCS institutions and other lenders because other Federal regulators do not require reporting on young and

Figures 7A, 7B, and 7C
Loans Made to, and Loans Outstanding for, YBS Farmers and Ranchers, 2001–2009
As of December 31

Figure 7A
Young Farmers and Ranchers

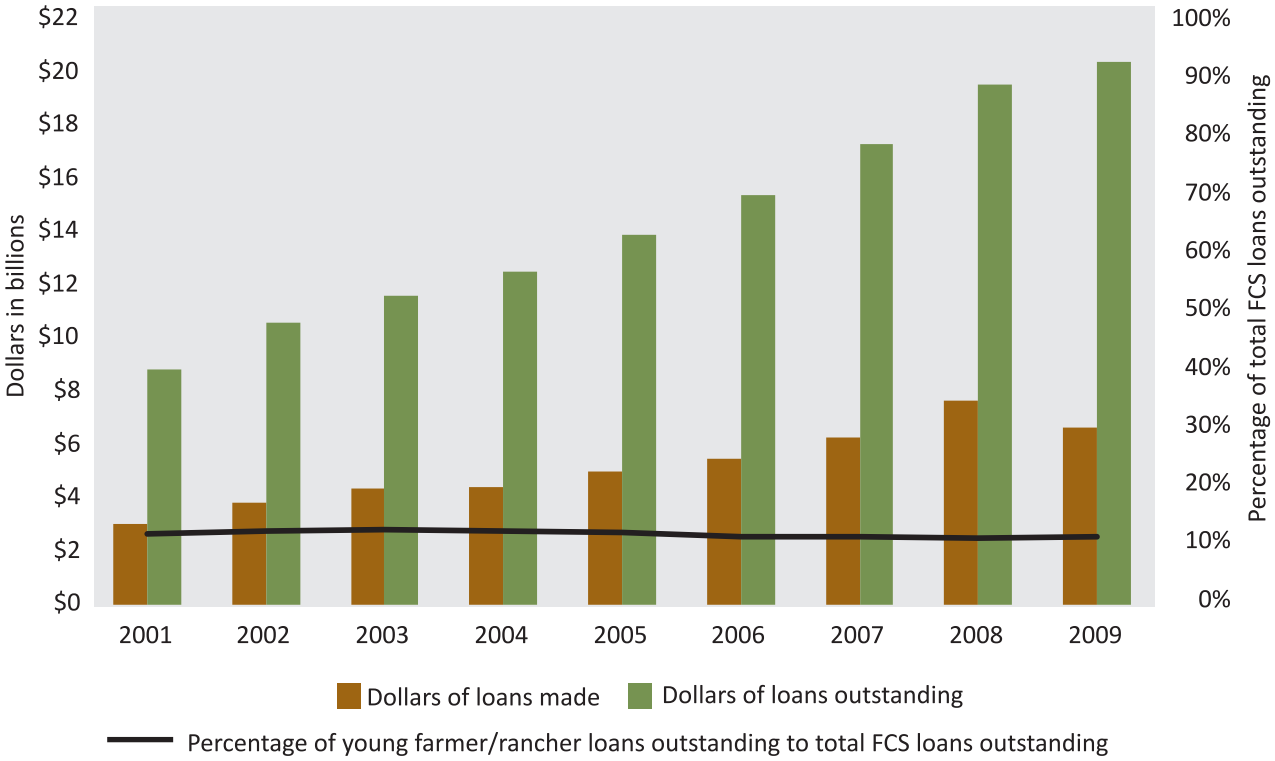


Figure 7B
Beginning Farmers and Ranchers

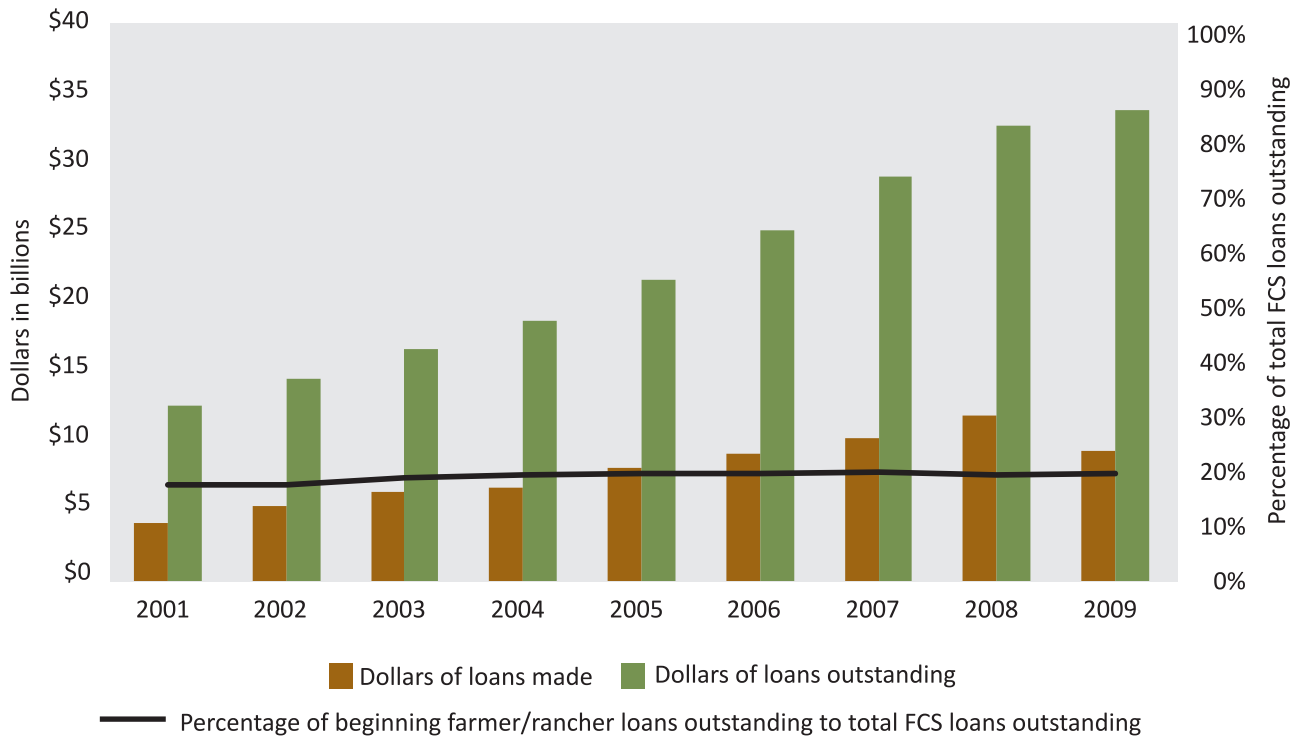
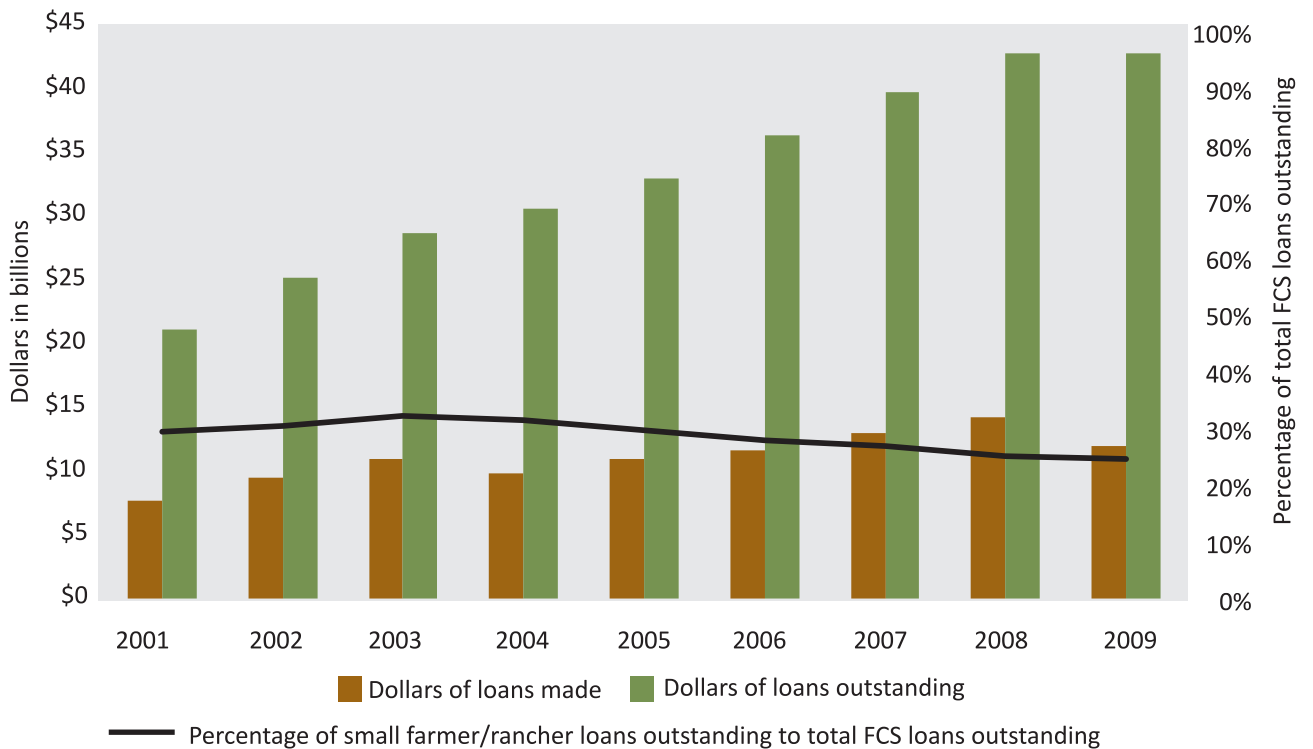


Figure 7C
Small Farmers and Ranchers



Sources: Annual YBS reports submitted by System lenders through the FCS banks.

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 directly comparable with Census of Agriculture data, which are collected only once every five years.

YBS PROGRAMS

Delivering Credit Services

Because of its status as a Government-sponsored enterprise with a statutory YBS mandate, the FCS is in a unique position to assist the next generation of American farmers, and System institutions have developed YBS programs to provide this assistance.

Through these programs, FCS associations may offer lower interest rates and less stringent underwriting standards, such as higher loan-to-value ratios or lower debt coverage requirements, to make it easier for potential YBS borrowers to qualify for loans.

During 2009, System institutions used four types of loan concessions for YBS borrowers.

- Lower loan fees—offered by 27 associations
- Loan covenants designed specifically for YBS borrowers—offered by 12 associations

Most of the loan concessions made by System institutions to YBS borrowers are for the young and the beginning categories. Altogether, 54 of the System's 89 associations provided some form of loan concessions to young borrowers in 2009; 55 of the 89 associations applied one or more of these four concessions to the beginning category; and 51 out of the 89 used one or more of these concessions for small farmers.

As required by the Farm Credit Act, System institutions coordinate their YBS programs with other Government programs whenever possible. Several State and Federal programs provide interest rate reductions or guarantees for YBS borrowers. By partnering with these Government programs, FCS institutions help reduce their risk exposure, enabling them to continue to provide credit to YBS borrowers. Without such concessions and guarantees, credit would not be extended to some YBS borrowers because of excessive repayment or collateral risks.

Almost all YBS programs make some use of Federal or State sources to obtain guarantees on loans to qualifying YBS borrowers. USDA's Farm Service Agency is the primary provider of Government-guaranteed

loans for farmers, although a small portion of guaranteed loans is made through the Small Business Administration (SBA) and various State programs. In 2009, 84 of the 89 FCS associations used FSA guarantees for some of their YBS lending, while 17 associations used SBA guarantees and 13 associations used State and local programs. In addition, 26 associations used Farmer Mac as a vehicle to either guarantee a segment of eligible loans in their portfolios or otherwise shift credit risk to third-party investors.

FCS institutions use FSA's guaranteed lending program for both conventional and YBS lending. Agency surveys indicate that about 36 percent of the System's overall volume of FSA-guaranteed loans outstanding went to young farmers; about 41 percent went to beginning farmers; and about 47 percent went to small farmers (numbers are not additive because categories overlap). At year-end 2009, the guaranteed loan volume figures for young, beginning, and small farmer/rancher loans outstanding were \$1.0 billion, \$1.1 billion, and \$1.3 billion, respectively.

Delivering Insurance, Training, and Other Services

In addition to offering credit, FCS institutions also serve YBS producers by offering insurance services. Almost 80 percent of the associations offered insurance services to YBS farmers in 2009.

The FCS also offers training programs for its borrowers. Strengthening the business and financial management skills of its borrowers is one of the System's key training objectives. In 2009, approximately 70 percent of the associations provided training in this area. FCS associations also offer training opportunities in estate planning, recordkeeping, tax planning and preparation, and farm business consulting. In some cases, they discount or waive the cost of these programs for YBS borrowers.

In addition to the training provided at association locations, System institutions are developing System-wide online training programs for YBS farmers. In 2009, the System implemented a mentored online business plan development training course; recently 30 young and beginning farmers from North Carolina completed business plans through the program. Other System institutions provide an online mentored course to promote sound business practices and sustainable farm operations.

Some outreach activities are offered in partnership 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 and of the National FFA Organization. Several System associations are active supporters of Annie's Project, a farm financial skills training program for farm women. They donate to the

program, grant tuition reimbursement for participants, and provide meeting space for Annie's Project local chapters in the 23 States that now have the program. In some cases, System employees provide training through Annie's Project. One System association spearheaded the effort to bring Annie's Project to Kansas.

The System has developed financial skills training seminars for young and beginning farmers in conjunction with agricultural trade groups. The System created and delivered "Financial Skills for Ag Organization Leaders" and "Leading Off the Farm" to young and beginning producers at Farm Bureau, National Milk Producer Federation, and National Cattlemen's Beef Association meetings.

Many FCS associations also provide financial support for college scholarships and for FFA, 4-H, and other agricultural organizations. One association invested capital to help establish a local farmer's market. Also, in recognition of the growing diversity of farm borrowers in some institution territories, a few associations are now providing foreign language training.

Crafting Policies and Procedures to Support YBS Producers

Farm Credit institutions have been responsive to FCA's encouragement to develop YBS policies and procedures and to enhance their service to YBS producers in their territories. At year-end 2009, 40 associa-



tions reported that they had revised their YBS policies or procedures in response to guidance issued in an August 2007 FCA Bookletter. As a result of these revisions, 13 associations reported that they had made loans to YBS farmers on the same terms as those offered to lower-risk, full-time farmers. Also, 22 associations reported that they had made loans to YBS farmers who had minimal agricultural income or performance history but who possessed the knowledge and ability to farm.

In 2009, the boards of directors of 23 associations indicated that they had received input from advisory committees that helped shape their operations, including, in most cases, the associations' YBS policies. In 2010, 18 associations plan to revise their policies and procedures for their YBS borrowers. FCA's oversight activities are helping institution management and boards stay focused on this important mission area.

Regulatory Policy and Approvals

FCA routinely issues regulations, policy statements, and other documents to ensure that the Farm Credit System complies with the law, operates in a safe and sound manner, and efficiently carries out its statutory mission. The regulatory philosophy of FCA is to establish a flexible regulatory environment that enables the System to safely and soundly offer high-quality, reasonably priced constructive credit and related services to farmers and ranchers, agricultural cooperatives, rural residents, and other entities on which farming operations depend.

The Agency strives to develop balanced, well-reasoned, and flexible regulations whose benefits outweigh their costs. FCA's objectives are (1) to enhance the System's relevance in the marketplace and in rural America while remaining consistent with the law and safety and soundness principles, and (2) to promote participation by member-borrowers in the management, control, and ownership of their System institutions.

REGULATORY ACTIVITY IN 2009

The following paragraphs describe some of FCA's regulatory efforts in 2009, along with several projects that will remain active in 2010.

Effective Interest Rate Disclosure—The FCA Board approved a proposed rule in May 2009 and a final rule in December 2009 that amended the borrower rights regulations govern-

ing what initial and subsequent disclosures a qualified lender must make to a borrower when the borrower's interest rate is directly tied to a widely publicized external index.

Director Elections—The FCA Board approved a proposed rule in March 2009 that would amend FCA regulations to consolidate Farm Credit bank and association director election and voting rules and enhance election reporting and disclosure rules.

Registration of Mortgage Loan Originator—The FCA Board approved a proposed rule to implement the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act). The rule requires System institution employees who act as residential mortgage loan originators to register with the Nationwide Mortgage Licensing System and Registry.

Announcement of Meetings—The FCA Board approved a direct final rule in August 2009 that amended the regulations to provide the Board greater flexibility in scheduling meetings.

Farmer Mac Risk-Based Capital Stress Test Revisions—The FCA Board approved a proposed rule in December 2009 that would modify the Federal Agricultural Mortgage Corporation's Risk-Based Capital Stress Test. The proposed version of the test would include a component to characterize credit losses on rural utility loan volume and would

modify the risk-reducing characteristics of structures such as off-balance-sheet AgVantage.

Questions and Answers Regarding Flood Insurance—The FCA Board approved a notice with request for comment in April 2009 regarding loans in areas having special flood hazards. The notice provides an updated set of interagency questions and answers regarding flood insurance that were proposed in March 2008. The updated questions and answers will help FCS institutions better understand the flood insurance statutes, regulations, and Federal Emergency Management Agency guidance. The notice also solicits comments on new proposed questions and answers that address insurable value and force placement.

Regulatory Burden Notice—The FCA Board in October 2009 approved a notice for publication in the Federal Register to respond publicly to comments FCA received in response to the June 2008 Regulatory Burden Solicitation.

Disclosure and Accounting Requirements—The FCA Board approved a final rule in June 2009 to amend FCA regulations on disclosure to shareholders and accounting and reporting requirements. The final rule will ensure that FCA regulations are consistent with System structural changes and are updated to include changes in accounting, auditing, and reporting standards.

Frequently Asked Questions on Borrower Rights—FCA issued frequently asked questions on borrower rights to provide clear guidance to both System management and borrowers on the application of borrower rights.

Investments in Rural America—FCA continues to evaluate how System partnerships and investments could help increase the availability of funds to agriculture and rural America. FCA is reviewing investments made under pilot projects to determine if these investments assist institutions in fulfilling mission objectives. These projects may be considered in future rulemakings.

Loan Syndications and Assignment Markets Study—FCA continued to study loan syndication and assignment markets to determine whether its regulations should be modified to reflect significant changes in the markets.

Rural Housing Mortgage-Backed Securities—FCA issued a Bookletter in November 2009 allowing System banks to hold rural housing mortgage-backed securities as mission-related investments for the purpose of addressing liquidity needs in the rural housing mortgage market.

Compensation Committees—FCA issued a Bookletter in July 2009 that provides guidance to System institutions' boards of directors and their compensation committees on prudent committee operations and practices.

Eligibility and Scope of Financing for Limited Liability Companies—FCA issued a Bookletter in July 2009 to provide guidance and answers to frequently asked questions about eligibility and scope of financing for limited liability companies.

Financing Agricultural Land in Transition—FCA issued a Bookletter in May 2009 to provide guidance on how System institutions should ensure compliance with the eligibility and scope of financing regulations when loan funds will be used to purchase, or refinance debt on, land that is in the path of development.

Use of State-Chartered Business Entities to Hold Acquired Property—FCA issued a Bookletter in April 2009 to provide guidance to System institutions on the use of limited liability companies or other State-chartered business entities for limited purposes related to holding acquired property.

Financial Institution Rating System—FCA issued an Informational Memorandum in March 2009 describing changes to the FCA Financial Institution Rating System (FIRS). The FIRS is the rating system used by FCA examiners for evaluating and categorizing the safety and soundness of System institutions on an ongoing, uniform, and comprehensive basis.

Revised Guidelines on Submission of Proposals to Merge or Con-

solidate Associations—FCA issued an Informational Memorandum (updated in January 2010) that provided revised guidelines for mergers and consolidations that reflect changes in regulations, Board policy, and generally accepted accounting principles.

Maximum Bank Director Compensation for 2009—FCA issued an Informational Memorandum in March 2010 that communicated the annual adjustment in the maximum annual compensation payable to FCS bank directors to reflect the change in the Consumer Price Index.

National Oversight and Examination Program for 2010—FCA issued an Informational Memorandum in December 2009 that provided a summary of the National Oversight Plan for 2010, which details strategies for addressing critical risks or other areas of focus in the System.

FACT Act Regulations and Resources—FCA issued an Informational Memorandum regarding recently issued regulations and resources relating to the Fair and Accurate Credit Transactions Act of 2003 (FACT Act). The rules will promote the accuracy and integrity of information furnished to credit reporting agencies.

Allowance for Loan Losses (ALL)—FCA issued an Informational Memorandum that introduced FCA's recently revised Examination Manual





section for evaluation of the ALL. FCA's revised examination guidance reinforced the need for FCS management to use prudent judgment supported by a thorough and well-documented analysis of risks facing institutions when determining the appropriate level of the ALL.

Correspondence from the Chairman and Chief Executive Officer—The FCA Chairman and Chief Executive Officer issued several Informational Memorandums to System institutions that communicated his thoughts and concerns on issues such as executive compensation and benefits programs, confronting the increased risk environment, responding to local financial institution failures, and association mergers in economically challenging times.

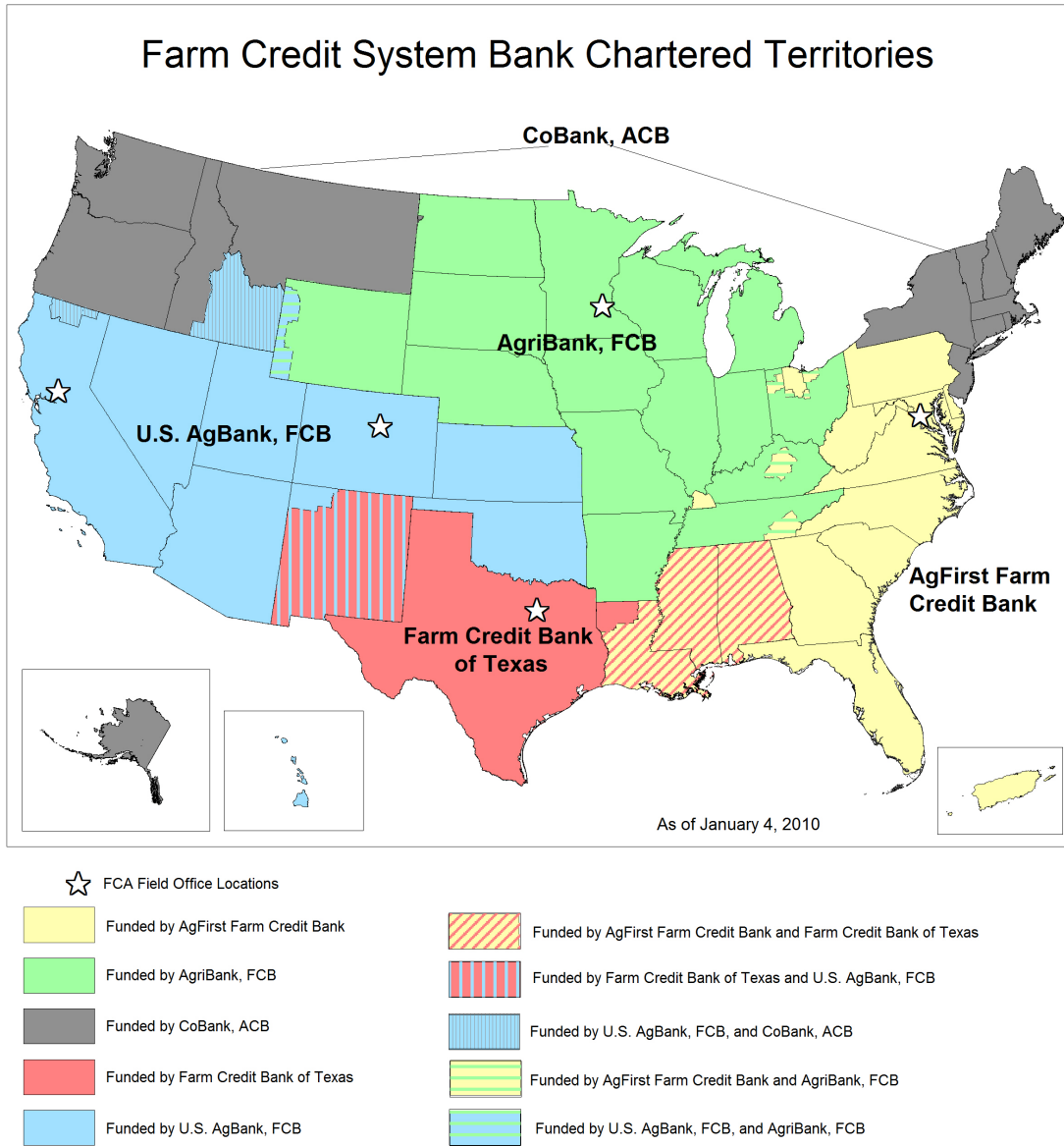
CORPORATE ACTIVITY IN 2009

In 2009 and early 2010, FCA analyzed and approved nine corporate applications, compared with eight applications processed in 2008.

- On January 4, 2010, four stand-alone FLCAs affiliated with the Farm Credit Bank of Texas received FCA final approval to convert their charters to those of ACAs, each with PCA and FLCA subsidiaries. The stockholders of each FLCA approved the conversion to an ACA. By converting from FLCAs to ACAs, these associations, which already had mortgage lending authority, acquired the additional authority to provide production lending in their respective territories. Amendments to the Farm Credit Act that were contained in the 2008 Farm Bill granted FCA the authority to convert these charters. The provisions of section 7.7 of the Farm Credit Act, which took effect January 1, 2010, equalized the loan-making powers among the associations serving the states of Alabama, Mississippi, and most of Louisiana.
- On January 4, 2010, FCA amended the charters of an ACA affiliated with the Farm Credit Bank of Texas and an ACA affiliated with AgFirst Farm Credit Bank. The Texas-affiliated ACA was authorized to provide short- and intermediate-term lending throughout its territory; the AgFirst-affiliated ACA was authorized to provide long-term lending throughout its territory. By amending their charters, FCA extended new lending authorities to these ACAs in accordance with section 7.7 of the Farm Credit Act.
- On January 1, 2010, two ACAs affiliated with CoBank, ACB, merged their operations following stockholder approval of the merger. The PCA and FLCA subsidiaries associated with the ACAs also merged. The continuing ACA and its subsidiaries also changed their names effective on the same date.
- On December 1, 2009, two ACAs affiliated with U.S. AgBank, FCB, merged their operations following stockholder approval of the merger. The PCA and FLCA subsidiaries associated with the ACAs also merged.
- On January 1, 2009, a stand-alone FLCA received FCA approval to convert its charter to that of an ACA with PCA and FLCA subsidiaries. The new ACA and its subsidiaries are affiliated with the Farm Credit Bank of Texas. The voting stockholders of the stand-alone FLCA approved the conversion.

The total number of associations as of December 31, 2009, was 89. Following the early 2010 activity, the total number of associations as of January 1, 2010, was 88. Although FCA's actions to fully implement section 7.7 of the Farm Credit Act on January 4, 2010, did not reduce the number of associations below 88, they did alter the makeup of associations in the FCS. As of January 4, 85 ACAs and 3 FLCAs make up the System's structure of associations. The number of banks remains at five. Figure 8 shows the chartered territory of each FCS bank. Details about specific corporate applications are available on FCA's Web site at www.fca.gov.

Figure 8
Chartered Territories of FCS Banks
 As of January 4, 2010



Note: CoBank funds 4 associations in the indicated areas and serves cooperatives nationwide; U.S. AgBank, FCB, funds 26 associations; Farm Credit Bank of Texas funds 19 associations; AgriBank, FCB, funds 17 associations; and AgFirst Farm Credit Bank funds 22 associations. The FCS contains a total of 93 banks and associations.

FUNDING ACTIVITY IN 2009

During 2009, the System continued to have regular and flexible access to debt markets, though demand for longer-term securities remained moderate. Dissipation of the severe financial market stresses of 2008 allowed key capital market sectors to function more normally. Corporate debt issuance improved, and borrowing rates for shorter-term issuances trended lower as a result of strong investor demand. While investor demand for the System's longer-term maturities, especially over five years, remained moderate, System access to term securities improved throughout the year, resulting in significant opportunities to call debt, lower term funding costs, and improved net interest spreads.

The System's status as a Government-sponsored enterprise (GSE) enabled it to have continual access to debt capital markets. However, with two housing-related GSEs¹⁴ now in conservatorship, investor perceptions of all GSEs have adversely affected the System's ability to issue debt at favorable rates, on favorable terms, and with the flexibility it has historically enjoyed as a GSE.

The System has enhanced its marketing programs, strengthened internal liquidity reserve requirements, and analyzed and implemented methods to improve loan pricing and financial projection models. These efforts should provide additional stability

for funding programs and market access in 2010 as the System continues to respond to stresses in the capital debt markets.

The System continues to issue third-party capital (preferred stock and subordinated debt). However, activity—especially for preferred stock—has been curtailed by the higher costs of these transactions compared to conventional funding costs. The amount of mandatorily redeemable preferred stock outstanding at year-end 2009 was \$225 million, unchanged from December 31, 2008. The System also had perpetual preferred stock that totaled \$1.78 billion at December 31, 2009, up only slightly from year-end 2008. Outstanding subordinated debt totaled \$1.55 billion at December 31, 2009, up from \$1.05 billion at December 31, 2008.

The System funds its loans with a combination of consolidated Systemwide debt and capital. The Federal Farm Credit Banks Funding Corporation, the fiscal agent for the five System banks, sells debt securities such as discount notes, bonds, and designated bonds on behalf of the System.¹⁵ This process facilitates the flow of funds from worldwide capital-market investors to agriculture and rural America, providing rural communities with efficient access to global resources. At year-end 2009, outstanding Systemwide debt was \$177.3 billion, down from \$178.4 bil-

lion a year earlier, representing a 0.6 percent decline.¹⁶

The decline of \$1.1 billion in Systemwide debt was caused by several factors. Although gross loans increased \$3.4 billion in 2009, which typically increases the debt, the System's combined investments, Federal funds, and cash balances decreased \$2.2 billion in 2009 and reduced the amount of debt needed. In addition, the increase in subordinated debt and significant net income in 2009 contributed to the decrease in Systemwide debt.

FCA has various responsibilities pertaining to System funding activities. As required by the Farm Credit Act, the System must obtain FCA approval before distributing or selling debt issuances. FCA has systems and processes that enable it to respond to requests quickly and efficiently. For example, FCA has a program that allows the System to issue discount notes at any time, up to a maximum of \$60 billion, as long as it provides FCA with periodic reports on this activity. In addition, FCA approves the majority of longer-term debt issuances through a monthly "shelf" approval program. For 2009, FCA approved \$179 billion in longer-term debt issuance requests.

To participate in the issuance of an FCS debt security, a System bank must maintain, free from any lien or other pledge, specified eligible assets (available collateral) that are at least

14. The GSEs are the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

15. The primary function of the Funding Corporation, whose headquarters are in Jersey City, New Jersey, 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 responsible for preparing the financial disclosures to investors and for making information concerning the financial condition and performance of the System as a whole publicly available.

16. Payment of principal and interest on Systemwide debt securities is insured by the Farm Credit System Insurance Corporation's Farm Credit Insurance Fund to the extent provided in the Farm Credit Act. Some FCS debt (\$1.1 billion outstanding as of December 31, 2009) was issued by individual banks of the FCS. These individual banks are solely liable for the principal payments on this uninsured debt.

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 that 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, less the amount of affiliated associations' investments in the bank that are counted in the regulatory capital of the associations, divided by liabilities) of not less than 103 percent. In connection with preferred stock and subordinated debt offerings, certain System banks are required by FCA to maintain a minimum net collateral ratio of 104 percent. All System banks have managed their operations to achieve net collateral ratios that are higher than the required minimum, with 104.56 percent being the lowest ratio for any individual bank as of December 31, 2009.

As another safe and sound practice, FCA regulations require the banks to maintain a minimum of 90 days of liquidity to guard against a possible interruption in its access to the capital markets. In 2008, FCA adopted a Market Emergency Standby Resolution that authorizes a waiver of the 90-day liquidity reserve requirement whenever FCA deems that a financial, economic, agricultural, or national defense emergency has occurred. This resolution would go into effect only in the event of

a serious market disruption, and it would temporarily allow banks (for no more than 14 days) to fund their assets with short-term liabilities even if doing so would cause the liquidity reserve of one or more banks to drop below the minimum 90-day requirement.

The Funding Corporation and the System banks have also entered into voluntary agreements to provide for mutual protection in the support of joint and several liability on Systemwide debt obligations. First, the System banks have adopted a common liquidity standard to help ensure their collective ability to meet their obligations under these mutual agreements. Second, the amended and restated Market Access Agreement (MAA) establishes certain financial thresholds that provide the Funding Corporation with operational oversight and control over the System banks' participation in Systemwide debt obligations.¹⁷ Third, the amended and restated Contractual Interbank Performance Agreement (CIPA) is tied to the MAA and establishes certain measures that monitor the financial condition and performance of the institutions in each System bank district. For the third quarter of 2009, one Farm Credit bank's CIPA score fell below a defined MAA threshold, but, effective February 27, 2010, the bank's score returned to compliance and exceeded the MAA financial performance threshold.



Between 2002 and 2005, the volume of new debt issuances declined as System banks extended maturities to comply with the common liquidity standard and to take advantage of historically low interest rates. From 2006 through 2008, debt issuances increased as a result of favorable economic conditions in agriculture and strong loan demand from System borrowers. In 2009, debt issuances increased as the System called debt and reissued it at lower rates. For the 12 months ended December 31, 2009, the System issued \$523 billion in debt securities, compared with \$519 billion for 2008, \$484 billion for 2007, and \$387 billion for 2006.

Investor preference for shorter-term debt instruments made it more difficult for the System to extend its debt maturities in 2009. The System's weighted-average remaining maturity for all outstanding insured debt was 3.1 years as of December 31, 2009, compared with 3.3 years as of December 31, 2008, and 3.6 years as of December 31, 2007. The weighted-average interest rates for the insured debt decreased from 2.8 percent as of December 31, 2008, to 1.8 percent as of December 31, 2009. The decrease is attributable to the low interest rate environment created by U.S. monetary and fiscal policy.

MISSION-RELATED INVESTMENTS

FCA is committed to helping ensure a dependable and affordable flow of funds to agriculture and to rural

17. The System banks and the Funding Corporation first entered into the MAA in 1994, and the agreement is periodically amended (updated) and restated to revise financial targets, economic incentives, and other matters.



areas so that farmers, ranchers, and rural communities can flourish. Agriculture and rural America face new challenges that require innovative solutions. Investments in rural communities can help create infrastructure improvements that promote the economic vitality of these communities for current and future generations of American farmers and rural residents. FCA believes that farming families benefit from investment projects that promote rural development and off-farm income opportunities. 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.

FCA's regulations allow System institutions to make certain mission-related investments. Examples include investments in farmers' notes; certain debt obligations issued or guaranteed by Federal agencies or State or local municipalities for rural utilities and other economic development; and agricultural mortgage-backed securities (AMBS), which Farmer Mac issues or guarantees. As of December 31, 2009, the mission-related investment securities held under these regulatory authorities totaled \$2.56 billion, including \$774.7 million in AMBS as held-to-maturity and \$277.9 million as available-for-sale, \$799.1 million in securities backed by guaranteed portions of USDA loans and agricultural equipment loans, and \$12.6 million in

farmer's notes. In addition, in 2005 FCA approved System institution investments in successor-in-interest contracts created as a result of the Tobacco Transition Payment Program.¹⁸ As of December 31, 2009, investments in successor-in-interest contracts totaled \$695.5 million.

The Agency realizes, however, that these investment vehicles may no longer be sufficient to meet the growing and changing demands of agriculture and of rural communities for dependable, affordable, and flexible financing in the 21st century. In particular, FCA recognizes that rural areas have an essential and growing need for additional sources of capital to support economic growth and infrastructure improvements. In response, FCA has issued guidance giving 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, Investments in Rural America—Pilot Investment Programs, which is available on the FCA Web site at www.fca.gov).

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 to rural communities across the country. The investments made under the pilot programs are expected to support and supplement investments by

Government and community banks for worthwhile community projects. The pilot programs provide FCA with the opportunity to study these investments to determine how the System can use them to help it fulfill its mission and to increase the availability and efficiency of funding to rural areas.

FCA has placed controls on these pilot investment programs to ensure their legal sufficiency, safety and soundness, and consistency with the FCS mission. The restricted authorizing environment includes special examination and reporting for those institutions participating in the pilot programs. The pilot program structure also enables FCA to gain critical insight and understanding of rural financial markets.

Since 2005, FCA has approved a number of pilot programs and specific investments involving the following investment areas and structures.

Rural Housing Mortgage Securities (RHMS)—During 2009, three Farm Credit banks continued to be authorized to purchase and hold RHMS under a pilot program. 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).

18. 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 includes a provision that allows the quota holders to assign to a financial institution the right to receive payments under a contract with the Secretary of Agriculture. 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.

These pilot programs are expected to provide additional liquidity for rural housing loans by providing economic incentives to lenders to create RHMS for sale in the secondary market. In turn, these programs should create more cost-effective credit for rural homeowners. As of December 31, 2009, only one of the Farm Credit banks was participating in this program; it had \$1.24 billion in RHMS classified as held to maturity.

Agriculture and Rural Community Bonds and Securities—During 2009, all FCS institutions continued to be authorized to participate, under specific conditions, in pilot programs 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 these pilot programs is to stimulate FCS partnerships and alliances with other agricultural and rural lenders that will increase the availability of cost-effective funds to agriculture and to rural communities. Many of these projects included collaboration with U.S. Department of Agriculture Rural Development programs, rural community banks, and regional and local economic development authorities. As of December 31, 2009, FCS institutions held \$635.2 million of investments in these programs.

Equity Investments—FCA has approved several mission-related equity investments, including an investment in a starter farmer pro-

gram for beginning farmers and producers, as well as investments in regional venture capital funds focusing on rural areas. In addition, since the Farm Security and Rural Investment Act of 2002 authorized any FCS institution, under limited conditions,¹⁹ to invest in rural business investment companies (RBICs) to promote economic development and job opportunities in rural areas, several FCS institutions have made equity investments in RBICs. As of December 31, 2009, the amount of mission-related equity investments outstanding totaled \$4.7 million for investments in the starter farmer program, venture capital funds, and RBICs.



19. 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.

Maintaining a Dependable Source of Credit for Farmers and Ranchers

As federally chartered agricultural lending cooperatives, the banks and associations of the Farm Credit System are limited-purpose lenders exposed to risk in making loans and investments to benefit their borrower-stockholders and meet their public mission. For FCS institutions to keep providing a dependable source of credit and financially related services for rural America, they must operate with sufficient capital and appropriately manage and control risk. FCA deploys examination and supervisory resources to monitor systemic risks in the FCS as a whole and specific risks in 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 risk in that institution. Examiners also evaluate whether each institution is meeting its public mission. They do so by determining whether each institution is operating in compliance with applicable laws and regulations and if it is responsive to the credit needs of all types of agricultural producers and cooperatives that are eligible for credit, including young, beginning, and small (YBS) farmers and ranchers.

CONDUCTING A RISK-BASED EXAMINATION AND OVERSIGHT PROGRAM

FCA's examination and oversight program is designed to monitor and address FCS risk as effectively and efficiently as possible. Therefore, FCA assigns highest priority to institutions at greatest risk. This approach also relies in part on the ability of FCS institutions to identify and manage both institution-specific and systemic risks. When institutions are either unable or unwilling to address unsafe and unsound practices or to comply with applicable laws and regulations, FCA takes appropriate supervisory action.

Through its oversight practices, the Agency ensures that FCS institutions have the programs, policies, procedures, and controls to effectively identify and manage risks. The oversight programs also ensure compliance with laws and regulations. For example, FCA regulations require FCS institutions to have effective loan underwriting and loan administration processes. FCA also has specific regulations requiring FCS institutions to maintain strong asset-liability management capabilities. For approximately 20 years, FCA has used a comprehensive regulatory and supervisory framework for ensuring System safety and soundness. FCS institutions, on their own and in response to FCA efforts, continue to build the capabilities of their risk management systems.

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 conducts ongoing monitoring and interim examination activities in each institution as risk and circumstances warrant. In addition, FCA takes systemic risks into consideration when it develops its annual National Oversight Plan. This approach provides differential risk-driven examination activities for all institutions.

As of January 1, 2010, FCA was overseeing and examining the following FCS institutions:²⁰

- 88 FCS direct-lender associations
- 4 Farm Credit Banks
- 1 Agricultural Credit Bank
- 5 service corporations and 1 special-purpose entity
- Farmer Mac

IDENTIFYING AND RESPONDING TO POTENTIAL THREATS TO SAFETY AND SOUNDNESS

Because of the dynamics and risks in the agricultural and financial industries, FCA must ensure that FCS institutions have the culture, governance, policies, procedures, and management controls to effectively identify and manage risks. To be fully effective in meeting this challenge, the Agency has various risk

20. On a reimbursable basis, FCA performs examinations of certain entities that are not part of the Farm Credit System. As mandated by 12 U.S.C. 3025, FCA examines the National Consumer Cooperative Bank, which specializes in non-agriculture cooperative loans. In 2009, FCA also performed contract work for the U.S. Department of Agriculture (USDA). However, the safety and soundness of the FCS remains FCA's principal focus and responsibility.

supervision processes for evaluating systemic risks emerging in agriculture and the financial services industry that can affect an institution, a group of institutions, and the System as a whole, and we respond to ensure that these risks are safely and soundly managed by the System. These risk supervision processes emphasize taking a proactive, nationally focused approach to addressing material risks and emerging issues. Also, as part of its examination approach, FCA uses a combination of methods to communicate with regulated institutions.

FCA is addressing numerous risks and emerging issues, and it is placing particular emphasis on the following:

- **Loan Portfolio Management.** Our examiners review systems and processes used by the board of directors and management to plan, direct, control, and monitor the institution's lending operations.
- **Large, Complex, and Shared Assets.** We provide guidance to institutions in evaluating portfolio risks; enhancing processes, risk management systems, and controls; and establishing audit and review plans to address risks.
- **Collateral Risk Management.** We will evaluate how collateral risk is being routinely monitored

and assessed and if operational adjustments are made to manage increased collateral risk.

- **Compensation Programs and Corporate Governance.** We have increased our scrutiny of the quality of board operations and directorates—especially in a risky lending environment.

MEASURING THE SYSTEM'S SAFETY AND SOUNDNESS

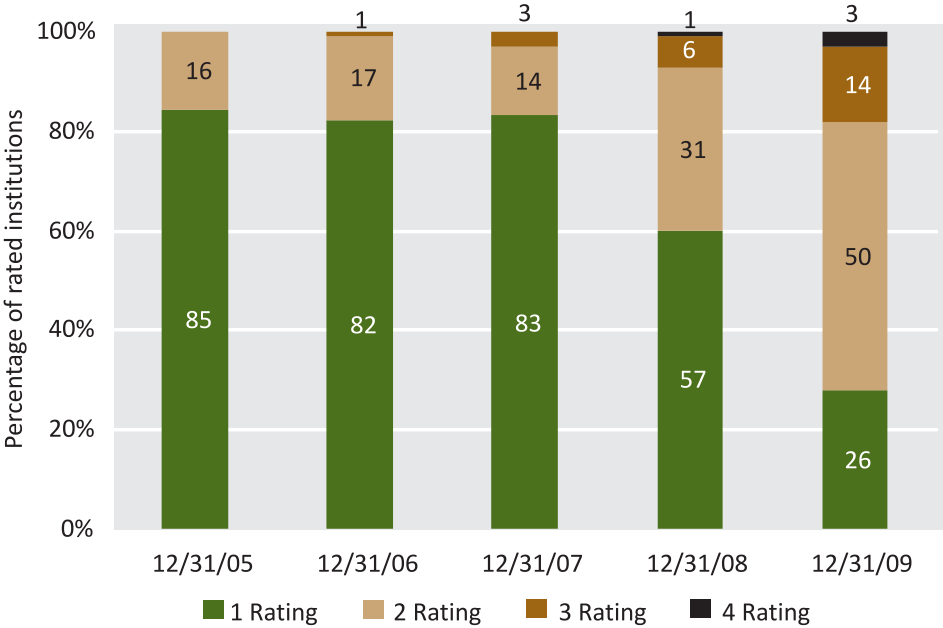
The Financial Institution Rating System (FIRS) is a key risk-rating methodology used by FCA to indicate the safety and soundness threats in each institution. Similar to the systems used by other Federal financial regulators, it is a "CAMELS-based" system, with component ratings for capital, assets, management, 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.²¹

Through its ongoing monitoring and oversight programs, FCA examiners continually evaluate institutional risk and regularly review and update FIRS ratings to reflect current risks and conditions. 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 and CEO to provide perspective on relative safety and soundness. These ratings are also disclosed to the institution's funding bank to ensure that it takes any actions necessary to safely and soundly oversee its direct loan with the institution. Examination reports and other communications 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 for 2009 show that the financial condition and performance of the FCS remained relatively strong throughout the year; however, risk did increase from the low risk levels of previous years. As shown in figure 9, FIRS ratings continued to decline in 2009 as stresses from the general economy, the credit crisis, and volatility in commodity prices surfaced and impacted some institutions. At December 31, 2009, 26 FCS institutions were rated 1 (28 percent), 50 were rated 2 (54 percent), 14 were rated 3 (15 percent), and 3

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

Figure 9
Financial Institution Rating System (FIRS)
Composite Ratings for the FCS, 2005–2009



Source: FCA’s FIRS Ratings Database.

Note: Figure 9 reflects ratings for only the System’s banks and direct-lending associations; it does not include ratings for the System’s service corporations, Farmer Mac, or the Federal Farm Credit Banks Funding Corporation. Also, the numbers shown on the bars reflect the total number of institutions with a given rating; please refer to the y-axis to determine the percentage of institutions receiving a given rating.



were rated 4 (3 percent). There were no institutions with a rating of 5. (FCA applies FIRS ratings only to the banks and associations of the FCS, not to the System's service corporations. It also applies a FIRS rating to Farmer Mac, but Farmer Mac is not counted in figure 9.) Although there has been some decline, the ratings still reflect a financially safe and sound FCS. Stresses in the swine, dairy, nursery, timber, and ethanol industries largely drove the decline in the number of institutions with a rating of 1. The overall financial strength maintained by the System reduces the risk to investors in FCS debt, to the Farm Credit System Insurance Corporation (FCSIC), and to FCS institution stockholders.

In addition to the FIRS process, FCA examiners use another tool to assess prospective risk. This tool considers six risk criteria: credit, interest rate, liquidity, operational, compliance, strategic, and reputation. It measures quantity of risk, quality of risk management, and direction of risk (that is, whether risk is increasing or declining). This tool is used, along with FIRS ratings and other information, to assist the Office of Examination in allocating resources to where the risks are highest.

PROVIDING 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 unacceptable risks, it takes action to ensure that the identified risks are appropriately mitigated. Corrective actions include reducing risk exposures; increasing capital and enhancing earnings, which improves an institution's ability to bear risk; and strengthening risk management.

The Agency uses a three-tiered supervision program: normal supervision, special supervision, and enforcement actions. 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, FCA shifts from normal to special supervision, and its examination oversight increases accordingly. Under special supervision, an institution is given clear and firm regulatory guidance to address identified

weaknesses, and the institution is allowed time to correct the problems. As of December 31, 2009, FCA had 10 associations under special supervision whose assets totaled \$3.6 billion, amounting to less than 2 percent of the System's total assets.

If informal 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 and sound and are in compliance with laws and regulations. FCA may take an enforcement action for a number of reasons:

- A situation threatens an institution's financial stability.
- An institution has a safety and soundness problem or has violated a law or regulation.
- An institution's board is unable or unwilling to correct problems FCA has identified.

FCA's enforcement authorities include the following powers:

- To enter into formal agreements
- To issue cease and desist orders
- To levy civil money penalties
- To suspend or remove officers, directors, and other persons

If an enforcement action is taken, the FCS institution must operate under the Agency's enforcement program and report back to FCA. FCA's examiners oversee the institution's performance to ensure compliance

with the enforcement action. During 2009, FCA entered into formal written agreements with two associations whose assets totaled \$423 million at December 31, 2009. The written agreements require the associations to take corrective actions with respect to certain areas of their operations, including financial condition and performance, portfolio management, and asset quality.

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.

The significant risks in agriculture can sometimes make it difficult for borrowers to repay loans. The Farm Credit act provides System borrowers certain rights when they apply for loans and when they have difficulty repaying loans. For example, the act requires FCS institutions to consider restructuring an agricultural loan before initiating foreclosure. It also provides borrowers an opportunity to seek review of certain credit and restructuring decisions. If a loan is foreclosed on, 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 and examines institutions to make

sure that they are complying with these provisions. It also receives and reviews complaints from borrowers regarding their rights as borrowers. Through these efforts, FCA ensures compliance with the law and helps FCS institutions continue to provide sound and constructive credit and related services to eligible farmers and ranchers. As the economy has deteriorated and affected FCS borrowers, FCA has received an increase in the number of borrower complaints. Generally, borrowers who contact FCA with complaints are seeking clarification, additional information, and options to redress their concerns. To the extent there are potential violations of law and regulations, FCA requires corrective actions by the institutions.



Condition of Farmer Mac

Farmer Mac is a stockholder-owned, federally chartered instrumentality of the United States and an institution of the System. It was created in 1988 to establish a secondary market for a variety of loans to borrowers in rural areas. This secondary market is designed to increase the availability of long-term credit at stable interest rates to America's rural communities and to provide those borrowers with the benefits of capital markets pricing and product innovation.

Farmer Mac conducts activities through three programs, Farmer Mac I, Farmer Mac II, and its Rural Utilities program. Loans eligible for the Farmer Mac secondary market include the following:

- Farmer Mac I: mortgage loans secured by first liens on agricultural real estate and rural housing
- Farmer Mac II: certain agricultural and rural loans guaranteed by the U.S. Department of Agriculture, including farm ownership loans, operating loans, and rural business and community development loans
- Rural Utilities program: loans to finance electrification and telecommunications systems in rural areas

Farmer Mac's secondary market activities include purchasing eligible loans directly from lenders; providing advances against eligible loans by purchasing obligations secured by those loans; securitizing assets and

guaranteeing the resulting securities that represent interests in, or obligations secured by, pools of eligible loans; and issuing long-term standby purchase commitments (LTSPCs) for eligible loans. Securities guaranteed by Farmer Mac may be retained by the originator of the underlying assets, retained by Farmer Mac, or sold to third-party investors.

In May 2008, the Food, Conservation, and Energy Act of 2008 expanded Farmer Mac's program authorities by allowing it to purchase, and to guarantee securities backed by, eligible rural utility loans made by cooperative lenders.

Farmer Mac is regulated by FCA through the Office of Secondary Market Oversight (OSMO), which was established by the Food, Agriculture, Conservation, and Trade Act Amendments of 1991. 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 OSMO 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 supervising the banks and associations of the FCS.

Through this office, the Agency performs the following functions:

- Examines Farmer Mac at least annually for capital adequacy, asset quality, management per-

formance, earnings, liquidity, and interest rate sensitivity

- Supervises Farmer Mac's operations
- Evaluates Farmer Mac's safety and soundness and mission achievement

OSMO reviews Farmer Mac's compliance with FCA's risk-based capital regulations and supervises its operations and condition throughout the year. Table 5 summarizes Farmer Mac's condensed balance sheets at the end of each year from 2004 to 2009. Please note that certain prior-year amounts will differ from amounts published in some of the earlier annual reports because in late 2006 Farmer Mac provided a financial restatement for several reporting periods. The restatement was required as a result of Farmer Mac's determination that it was not applying hedge accounting in accordance with Statement of Financial Accounting Standard 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). Farmer Mac completed the financial restatements during the fourth quarter of 2006 and eliminated the use of hedge accounting.

CAPITAL

By statute, Farmer Mac is permitted to operate with lower statutory capital margins than are primary market lenders. Accordingly, monitoring the capital levels of Farmer Mac is a central component of FCA's oversight programs.

Table 5
Farmer Mac Condensed Balance Sheets, 2004–2009
 As of December 31
 Dollars in Millions

	2004 Restated	2005 Restated	2006	2007	2008	2009	Percentage growth rate 2008–2009
Total assets	3,847.4	4,341.4	4,953.7	4,977.6	5,107.3	6,138.8	20.2
Total liabilities	3,612.2	4,095.4	4,705.2	4,754.0	4,947.7	5,798.4	17.2
Net worth or equity capital	235.2	246.0	248.5	223.6	15.3	196.2	1,182.3

Sources: Farmer Mac's Securities and Exchange Commission Form 10-Ks.

On December 31, 2009, Farmer Mac's net worth (that is, equity capital determined using generally accepted accounting principles [GAAP]) was \$196.2 million, compared with \$15.3 million a year earlier. Net worth was 3.2 percent of on-balance-sheet assets as of December 31, 2009, compared with 0.3 percent at the end of 2008. The increase resulted primarily from \$80.3 million of retained earnings, \$50.7 million of other comprehensive income from unrealized gains on investment securities and Farmer Mac Guaranteed Securities classified as available-for-sale, and the issuance of \$48.4 million of Farmer Mac's Series C Preferred Stock during 2009. When Farmer Mac's off-balance-sheet program assets (that is, its guarantee obligations) are added to total on-balance-sheet assets, capital coverage is 1.5 percent. In March 2009, Farmer Mac reduced its common stock dividend in response to investment

losses experienced in 2008, which also added to its capital position.

As of December 31, 2009, Farmer Mac continued to be in compliance with all statutory and regulatory minimum capital requirements. In addition, in the first quarter of 2010, Farmer Mac issued \$250 million of Farm Asset Linked Credit Notes (FALConS). This hybrid equity was issued by Farmer Mac II, LLC, a newly created subsidiary of Farmer Mac that now houses all Farmer Mac II program business. Farmer Mac used part of the proceeds from the sale of the FALConS to repurchase and retire all \$150 million of the outstanding Series B Preferred Stock.

At year-end 2009, 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 as determined by the Risk-Based Capital Stress Test (RBC Model).²² Farmer Mac's core capital as of December 31, 2009, totaled \$337.2 million, exceeding the statutory minimum capital requirement²³ of \$217 million by \$120.2 million. Farmer Mac's regulatory capital totaled \$351.3 million as of December 31, 2009, exceeding the regulatory risk-based capital requirement of \$35.9 million by \$315.4 million. Regulatory capital was 4.8 percent of total Farmer Mac I program volume (including both on- and off-balance-sheet program volume). Table 6 offers a historical perspective on capital and capital requirements for 2005 through 2009.

22. See the FCA Web site at www.fca.gov for more information about the RBC Model.

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

Table 6
Farmer Mac Capital Positions, 2005–2009

As of December 31

Dollars in Millions

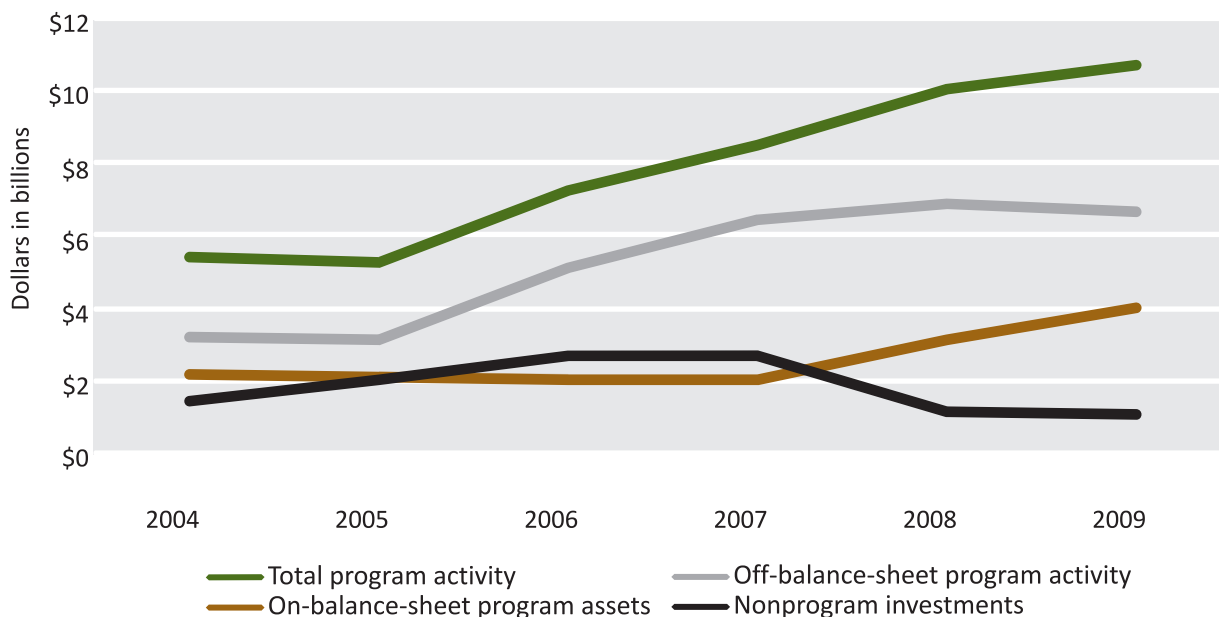
	2005 Restated	2006	2007	2008	2009
GAAP equity	\$246.0	\$248.5	\$223.6	\$15.3	\$196.2
Core capital	\$230.8	\$243.5	\$226.4	\$207.0	\$337.2
Regulatory capital	\$239.4	\$248.1	\$230.3	\$223.4	\$351.3
Statutory requirement	\$142.5	\$174.5	\$186.0	\$193.5	\$217.0
Regulatory requirement	\$29.5	\$42.9	\$42.8	\$57.3	\$35.9
Excess over statutory or regulatory requirement*	\$88.3	\$69.0	\$40.4	\$13.5	\$120.2
Capital margin excess > minimum	62.0%	39.6%	21.7%	7.0%	55.4%

Sources: Farmer Mac's Securities and Exchange Commission Form 10-Ks.

* Farmer Mac is required to hold capital at the higher of the statutory minimum capital requirement or the amount required by FCA regulations as determined by the Risk-Based Capital Stress Test.

Figure 10
Farmer Mac Program Activity and Nonprogram Investment Trends

As of December 31



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

In 2009, FCA published a final rule revising the risk-based capital regulations. The revisions updated the RBC 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 in financial modeling. During 2009, FCA issued a proposed rule revising the risk-based capital regulations to address new program authorities for rural utility financing.

In addition to supporting program assets, Farmer Mac's capital supports nonprogram investments. 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 consist of 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'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. During 2010, FCA issued an

advance notice of proposed rulemaking to solicit public comments on potential amendments to the current nonprogram investment and liquidity regulations.

PROGRAM ACTIVITY

Farmer Mac's total program activity increased to \$10.7 billion on December 31, 2009, from \$10.1 billion a year earlier (see figure 10). The net increase was largely attributable to new on-balance-sheet rural utility cooperative business completed through the Farmer Mac AgVantage program. AgVantage transactions are general obligations of the issuing financial institution that are guaranteed by Farmer Mac. In addition to the general obligation of the financial institution, each AgVantage security is secured by eligible loans under one of Farmer Mac's programs in an amount at least equal to the outstanding principal amount of the security.

Farmer Mac's Long-Term Standby Purchase Commitment (LTSPC, Standby) product also generates 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. Lenders may also elect to exchange Standby commitments for securities guaranteed by Farmer Mac. Farmer Mac recently announced an agreement with an investment banking partner to market Farmer Mac investment products—primarily the LTSPC—to commercial banking clients that hold agricultural mortgage loans in their portfolios.

Off-balance-sheet program activity consists of Standbys, certain AgVantage securities, and agricultural mortgage-backed securities (AMBS) sold to investors. At the end of December 2009, 62 percent of program activity consisted of off-balance-sheet obligations²⁴ (see figure 11).

ASSET QUALITY

On December 31, 2009, the portion of the Farmer Mac I program portfolio that was nonperforming was \$62.0 million, or 1.41 percent of the principal balance of all loans purchased, guaranteed, or committed to be purchased.²⁵ This compares with \$80.0 million, or 1.61 percent, on December 31, 2008. Assets are considered to be nonperforming when they are 90 days or more past due,

24. Because of on-balance-sheet AgVantage activity, this percentage does not correspond to the total of percentages shown in figure 11 for AMBS, Standbys, and AgVantage program activity.

25. Farmer Mac assumes 100 percent of the credit risk on loans made after enactment of the Farm Credit System Reform Act of 1996, whereas loans made prior to enactment of the act are supported by mandatory 10 percent subordinated interests, which mitigate Farmer Mac's exposure. For that reason, loans made before enactment of the 1996 act are excluded from analysis for comparison purposes. These amounts also exclude loans underlying AgVantage guaranteed securities, whose risk is significantly mitigated by the general obligation of the issuer.

in foreclosure, or in bankruptcy; real estate properties acquired by Farmer Mac through foreclosure are also reported as nonperforming assets. As of December 31, 2009, Farmer Mac's 90-day delinquencies were \$49.5 million, or 1.13 percent, compared with \$67.1 million, or 1.35 percent, as of December 31, 2008. Real estate owned as of December 31, 2009, was \$739,000, up from \$606,000 a year earlier. Thirty-nine percent of the 90-day delinquencies in Farmer Mac's loan portfolio were on ethanol loans. Delinquencies on non-ethanol loans remain low and reflect the strength of the rest of the agricultural economy. Farmer Mac reported no delinquencies or nonperforming loans in its pools of rural utility cooperative loans.

On December 31, 2009, Farmer Mac's allowance for losses totaled \$14.2 million, compared with \$16.4 million on December 31, 2008. Farmer Mac attributed the change in the allowance for losses primarily to a \$5.2 million provision for loan losses; charge-offs of \$8.5 million recognized during the year, which were largely driven by defaults in the ethanol loan portfolio; and \$1 million in recoveries. Figure 12 shows the levels of Farmer Mac's nonperforming assets and its 90-day delinquencies relative to outstanding program volume, excluding volume prior to passage of the Farm Credit System Reform Act of 1996.

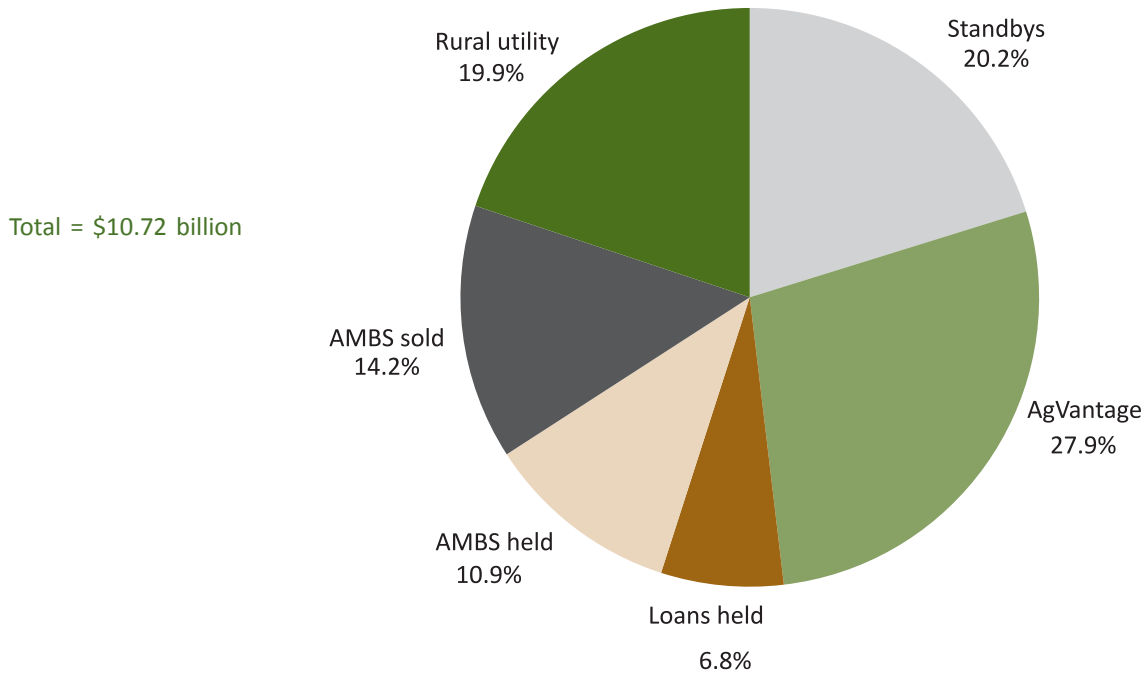
EARNINGS

Farmer Mac reported net income available to common stockholders of \$82.3 million (in accordance with GAAP) for the year ended December 31, 2009, up significantly from the \$154.1 million loss reported at year-end 2008. The significant loss in 2008 was attributable primarily to losses on investments in Lehman Brothers and Fannie Mae and to significant unrealized losses resulting from the mark-to-market impact on derivatives and trading assets. Core earnings for 2009 were \$16.1 million, compared with a loss of \$81.5 million on a core earnings basis in 2008.²⁶ Net interest income, which excludes guarantee fee income, was \$85.9 million in 2009, down slightly from what it was in 2008. Guarantee fee income, at \$31.8 million, was 12.1 percent higher in 2009 than in 2008. Nonprogram investments accounted for an estimated 16 percent of interest income for 2009, down from 44.5 percent for 2008.²⁷ Table 7 shows a six-year trend for the basic components of income.

26. 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 Farmer Mac's discretion. In the 2008 FCA Annual Report, 2008 core earnings were reported as a positive \$24.7 million. That figure excludes impairment losses on investments, but a more meaningful amount to report includes such losses, which were \$106.2 million.

27. Because of a transposition error, nonprogram investments were incorrectly reported in the 2008 annual report as 52.3 percent of interest income.

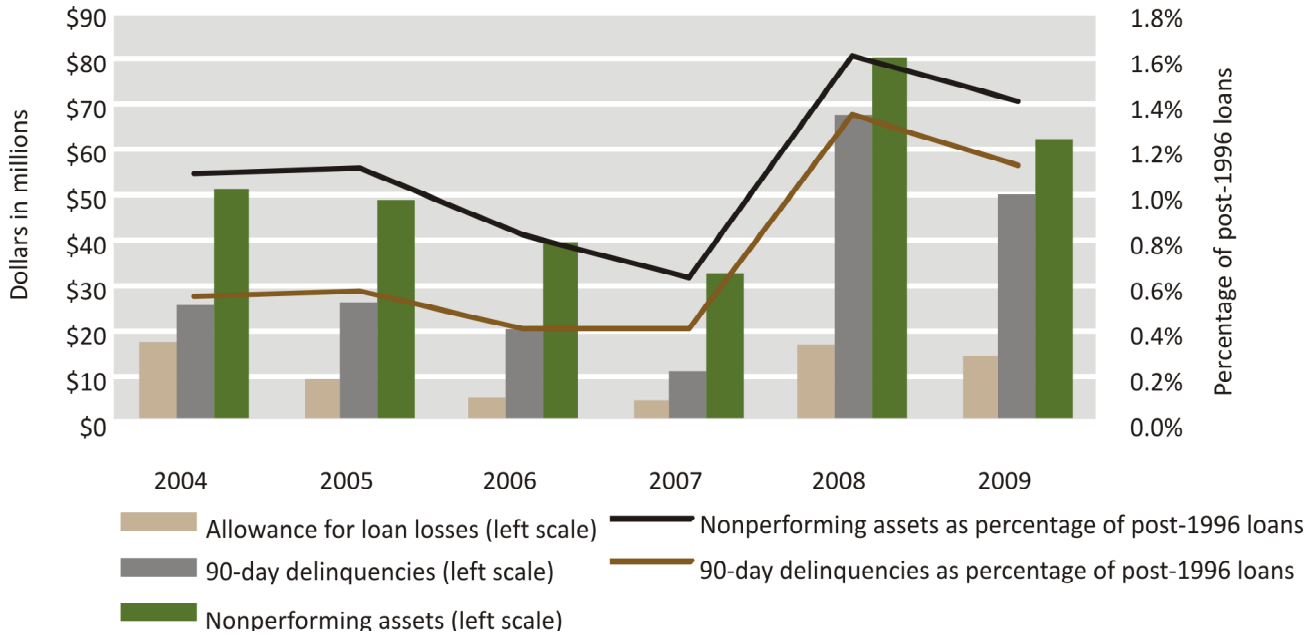
Figure 11
Farmer Mac Total Program Activity
As of December 31, 2009



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

AMBS = agricultural mortgage-backed securities

Figure 12
Allowance, Nonperforming Asset, and Delinquency Trends, 2004–2009
 As of December 31



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

Table 7
Farmer Mac Condensed Statements of Operations, 2004–2009

As of December 31

Dollars in Millions

	2004 Restated	2005 Restated	2006	2007	2008	2009
Total revenues	\$77.3	\$83.9	\$67.8	\$31.5	(\$140.6)	\$181.8
Total expenses	\$38.3	\$36.8	\$38.0	\$27.1	\$13.5	\$99.5
Net income available to shareholders	\$39.0	\$47.0	\$29.8	\$4.4	(\$154.1)	\$82.3
Core earnings	\$27.4	\$28.7	\$25.9	\$29.9	(\$81.5)	\$16.1

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

Challenges Facing the Agricultural Economy and the Farm Credit System

During 2009, the Farm Credit System operated in an environment of economic uncertainty and financial volatility. The United States and most of the world were mired in one of the worst economic downturns since the Great Depression. The situation was characterized by plummeting residential real estate values, tightening credit markets, sharp cutbacks in consumer purchases, and double-digit unemployment rates in many countries. Consequently, both domestic and foreign demand for agricultural products declined sharply last year, particularly for higher-end items like meats and dairy products, and resulted in reduced prices and incomes for farmers and a number of agribusiness bankruptcies. Dairy, cattle, and hog producers had a particularly challenging year as prices for their products fell faster than the drop in feed costs, resulting in low to negative returns. They responded, though somewhat slowly, by cutting back herd sizes. As a result, by the end of 2009 and early 2010, producer prices had seen some improvement. Record crops, both at home and abroad, further weakened crop prices and returns in 2009. The economic downturn and oversupply also affected the ethanol industry, which struggled throughout 2009 with low to negative margins. Sectors tied to the housing sector also suffered financially, including timber, nursery, and sod.

Economic conditions in the United States and throughout the world are expected to improve in 2010 and 2011, with economic growth expected to be slower in industrialized countries than in developing countries. Consumers are returning to the marketplace, exports are beginning to grow again, and business spending is finally picking up after a long period of decline. The USDA forecasts an improvement in net farm income for 2010, with almost all of the gains occurring in the livestock sector. Although crop sales may decrease in 2010, a likely drop in fertilizer costs and other production expenses will help support net income for crop producers. A moderate level of direct Government payments for program crops will also aid many producers in 2010.

The FCS experienced a relatively good year in 2009, achieving relatively low loan growth and another round of solid earnings despite the difficult environment. However, the System's financial performance was negatively affected by the global recession: credit quality declined and the number of nonperforming loans rose. Increases in nonaccrual loans were especially evident in the dairy, hog, and ethanol segments of the System's loan portfolio. Furthermore, the collapse of the housing market had an adverse effect on the System's forestry and nursery products portfolio as well.

Several challenges, both domestic and foreign, could affect the System's long-term ability to profitably finance the agricultural industry. In the following paragraphs, FCA identifies some of these challenges, including uncertain conditions in the macro-economy, margin pressures for producers, financial stress in the System's loan portfolio, and other longer-term challenges that will influence the financial performance of agriculture and the FCS in the coming years. Through its regulatory and examination activities, FCA will continue to closely monitor and address these challenges.

PROSPECTS FOR THE GENERAL ECONOMY

Key economic indicators released in April 2010 offer hope for a speedier recovery of the U.S. economy yet the continued economic and sovereign debt stress in Europe creates uncertainty. Buoyed by an uptick in consumer confidence and durable goods orders, payroll employment registered a gain of 162,000 jobs in March, the largest increase in more than two years, following a year that saw a loss of 4.1 million jobs. While the jobs market turned a corner in March, hiring remained sluggish compared with hiring in previous recoveries, and the unemployment rate remained stuck at 9.7 percent for the third month in a row. In all likelihood, the unemployment rate will stay above 9.0 percent this year and will continue to be high until

the economy sees more strength from consumer and business spending. While many of the problems that precipitated the recession have now been addressed, a few still remain and will likely slow the pace of the recovery.

One of those problems is the housing sector. In a typical recovery, housing often spurs economic activity at an early stage as confident buyers begin to purchase homes, new furniture, and other home improvements. This time, however, housing may be slow to contribute to the turnaround, acting as a drag on overall GDP growth. While the housing market began to show some improvement early in 2010, with existing home sales up slightly from a year ago, new home sales remained stagnant. Many regional housing markets continue to be depressed by a lack of jobs, as well as prospects for more home foreclosures in 2010.

On balance, the economic outlook for 2010 suggests that consumer demand will be sufficient to promote a continuation of the recovery that began in the second half of last year. Most forecasters expect to see moderate GDP growth of about 3.2 percent this year, up considerably from the 2.4 percent contraction in the economy in 2009. Consumer spending will be a key factor in the economy's performance. A gradual improvement in employment earnings, some recovery in household wealth, and more credit availability will promote consumer

spending. The export sector is also expanding with the improving economy, but so too are imports. These offsetting developments will leave the net trade balance in a negative position for 2010, although the trade balance for agriculture will remain positive. As noted earlier, while the employment picture for 2010 may see some gradual improvement as the year progresses, meaningful reductions in the unemployment rate will face stubborn resistance.

An issue raising concerns among policymakers is the size of the Federal budget deficit and its potential effect on inflation. The projected deficit for this fiscal year is on track to nearly match the \$1.4 trillion gap recorded in fiscal year 2009. Ongoing deficits of this magnitude could lead to structural imbalances in the capital and credit markets that would threaten the confidence of market participants—both domestic and foreign—and spark inflationary fears and a rise in interest rates. While the current deficits have been necessary to address the economic recession, focus is now shifting to greater fiscal discipline. For example, in February 2010 President Obama established the National Commission on Fiscal Responsibility and Reform. As a result of this shift in focus, policymakers will likely move to set the budget on a path toward fiscal balance. Such a move would help calm investor fears, yield lower long-term interest rates, and enhance consumer and business confidence.



With respect to inflation, most of the current data point to a modest rate of increase in consumer prices despite a sharp jump in energy prices. Core inflation, which excludes food and energy, was less than 1 percent (annual rate) in the first quarter. Most observers believe it will remain in check for the rest of this year and 2011, reflecting household and business uncertainty, sluggish labor markets, slack manufacturing capacity, and a slow increase of credit availability. The longer-term picture for inflation also appears relatively stable, with most forecasts pointing to only modest gains in consumer prices over the next decade.

Other factors affecting the outlook for the FCS are funding costs and the future direction of borrower interest rates. As noted on page XX, the System maintained regular and flexible access to the debt markets in 2009, although demand for longer-term securities remained moderate and pricing was volatile, as spreads over Treasury securities show. Because of the Federal Reserve's low interest rate policies, rates paid by System borrowers have been near historic lows. The outlook for Treasuries is for an increase of about 25 basis points in both short- and long-term rates by the end of 2010. Over the longer term, larger rate increases seem possible, though future interest rate movements are highly unpredictable and events could occur that prolong the current low rate environment in the United States. How-



ever, because of the safety of System securities, investors are expected to continue purchasing them in 2010 at favorable spreads over U.S. Treasury securities. Higher volatility in the financial markets could lead to new marketing challenges in issuing System securities in the period ahead. Another factor that could affect the System's funding costs and its ability to meet its funding needs is Government policy change. For example, actions associated with financial regulatory reform or policy actions affecting the role of the housing GSEs could have an impact on the System.

ECONOMIC SETTING FOR AGRICULTURE AND CREDIT

From a big-picture perspective, the agricultural sector appears to be relatively healthy. Net farm income is expected to be on the mend in 2010. And while land values are projected to dip again this year, the sector's aggregate balance sheet continues to be strong. However, behind what are relatively favorable sector-wide measures, the financial condition of commercial farmers has diverged greatly over the past several years. In general, producers of the major field crops have enjoyed record incomes and substantial gains in accumulated wealth. Meanwhile, those producers with incomes dependent on the sale of livestock and livestock products have had extremely poor earnings (particularly if they had to rely on purchased feed grain items), and

many have had their equity positions severely eroded. Similarly, producers of housing-related products, such as nursery plants and timber, have had depressed earnings. Naturally, considerable regional differences exist, reflecting enterprise mixes and local economic conditions.

USDA has forecast that net farm income will increase nearly 12 percent to \$63 billion in 2010 (forecast of February 11, 2010). If achieved, this level would be the fifth largest on record and slightly below the prior 10-year average, an average made higher by four record years. Net farm income topped \$87 billion in 2008, nearly matching the 2004 record high, and it was over \$70 billion in both 2005 and 2007. Still, in constant dollars, 2010 net income would be off about 13 percent from the prior 10-year average. Also, given a higher cost structure, the potential rebuilding of grain stocks, much uncertainty over the demand prospects for livestock products, and the link to ethanol policy and volatile oil prices, this year's net income forecast is by no means certain. Included in net farm income are direct Government payments, which are projected to dip \$0.5 billion to \$12.4 billion in 2010, or about 19.7 percent of net farm income, a level lower than the average of the past 10 years.

Farm programs and foreign trade agreements are two important policy forces that help shape farm income results and thus their effect on bor-

rower repayment risk. The flow of Government payments serves as a safety net offering protection to producers against ruinous price declines, yield disasters, or other market disruptions. Over the years, these programs have generally supported farm income, mostly for crop producers, and helped stabilize prices, but sometimes at a heavy cost to taxpayers. Government farm program payments under the five-year 2002 farm act averaged \$16 billion per year.

A key concern for many agricultural lenders has been the potential for significant change to the Government payment mechanism. In the 2008 farm bill, vigorous debates occurred over reducing, or at least redistributing, direct payments to producers, but in the end the 2008 act retained many of the basic features of earlier laws with respect to acreage bases, yield histories, loan rates, and target prices for program crops. Still, Congress successfully shifted the overall spending priorities toward nutrition, renewable fuels, conservation, and rural development in an effort to benefit a broader base of participants. Congress also emphasized revenue protection under redesigned crop insurance programs to provide financial assistance in low-income years, with the aim of eliminating the need for costly ad hoc disaster assistance programs.

Short of a significant market disruption in agriculture, most policymakers likely will remain focused on

employment issues and the future direction of the economy until the current farm bill legislation expires and a new farm bill is introduced (scheduled in 2012). As that date draws near, worries will once again surface that Congress will try to reduce Government payments to farmers in its continuing efforts to reduce deficits in the Federal budget. Agricultural lenders cannot assume that the Federal safety net for agriculture will automatically keep pace with structural changes in the industry and the rise in production costs. In fact, the safety net is likely to play a lesser role in off-setting farmer repayment risk in the future.

Exports are a critical part of the farm income picture because our domestic markets cannot absorb all that is produced each year. About a fourth of all farm production is shipped abroad, resulting in a substantial net trade surplus for the farm sector. Trade is governed by the World Trade Organization (WTO), which is a voluntary association of countries that periodically meets to set international trade rules and adjudicate disputes among its members. The Doha Round of multilateral negotiations, which was launched in 2001, has faced strong headwinds from the outset, resulting in very little progress toward a new agreement on tariffs and trade. The world recession and other economic priorities continue to distract the negotiations, and it seems unlikely that anything meaningful will be accomplished

by the WTO this year. Fortunately, bilateral agreements with various countries and a return to growth for the world's economies should lead to farm export growth. In fact, USDA's February forecast for 2010 shows agricultural exports increasing \$3.4 billion above the previous year's level to \$100 billion, which would be the second highest on record.

As previously noted, agriculture's balance sheet remains strong. According to USDA, the sector's debt-to-asset ratio was down to about 10 percent at year-end 2007 and is projected to be 12.4 percent at the end of 2010. This ratio is still among the lowest in history and sharply below the crisis years of the 1980s when it topped 20 percent. However, for individual farm lenders, this often-quoted national average leverage ratio is not particularly relevant, in part because it includes the roughly two-thirds of farms that have no debt. Portfolio risk is determined by the distribution of widely varying debt-to-asset ratios for individual farm loans across the portfolio.

With about 85 percent of the farm sector balance sheet made up of farmland assets, land value trends are tracked closely by System lenders. According to USDA projections, by December 2010 land values will have declined by 10 percent in the past three years. This decline has for the most part been driven by nonagricultural influences on farmland and, to a lesser degree, by poor returns to

livestock producers. Quarterly surveys conducted by Federal Reserve district banks reported mixed results for changes in cropland and ranchland values in 2009. Pasture and ranchland values generally decreased in most regions, and all land classes have been affected by the general economic recession and high unemployment rates. The lack of economic opportunity in some regions has hurt farm households that rely on off-farm sources of income to sustain their farming operations, leading to a weaker farm real estate market. Note that agricultural land values for prime land have stayed about flat in the major field crop States, even as crop earnings prospects have weakened. One factor currently supporting land values, especially for prime farmland, is the limited amount of land being placed on the market.

In 2009, net farm income dropped much more sharply than previously projected to an estimated \$56.4 billion as a result of relatively weak export and domestic demand. Early farm income prospects were worrisome for both the crop and livestock sectors. For livestock and dairy, product prices declined faster than feed costs, which squeezed profit margins. Crop producers were concerned about the ethanol industry and a weaker outlook for renewable fuels, plus planting delays and rising input prices. As the year progressed, however, concerns on the crop side lessened as inputs became readily available at lower prices and as





favorable growing conditions led to high yields in many areas. However, concerns on the livestock side materialized, especially among milk and pork producers, where losses either wiped out or greatly reduced the equity accumulations from earlier years.

Through herd downsizing and some increase in expected demand, the excess capacity problem in the livestock industry is expected to ease as 2010 progresses. Adjustments in agricultural production capacity are expected to firm up market prices and improve the margins of livestock producers—broiler producers mostly self-corrected in 2009. In fact, USDA expects the average net cash income for commercial and intermediate-sized farms in each of the major livestock enterprises to improve in 2010.

One caveat is the dairy industry. Even as late as April 2010, the imbalance of supply and demand in the dairy industry was still a problem because milk production had not decreased as expected. On the other hand, pork margins were doing better than anticipated by spring 2010; thus the average earnings for commercial hog operations may come in higher than projected. These developments show how difficult estimating farm income can be.

In contrast to the livestock outlook, USDA projects that receipts and net cash earnings for commercial and intermediate-sized operations in each

of the major crop enterprises will be down in 2010. However, the earnings estimates are only marginally lower than those of a year ago, and they follow a string of years with record earnings. Also, some of the declines in cash receipts from crops will be offset by further reductions in input costs. Fertilizer expenses are forecast to decline by almost 8 percent in 2010, after a 26 percent decline in 2009.

There are some concerns that demand for crops will falter, causing crop prices to collapse and placing many producers in a greater cost squeeze. However, demand will be less likely to weaken for the crop sector if the Environmental Protection Agency decides to increase the ethanol blend mix above 10 percent. Of course, this may not be good news for livestock producers because it may increase their input costs. The fact that such a policy decision can be a boon for one agricultural sector and a disadvantage for another reflects the diversity of the agricultural industry.

The massive fiscal stimulus programs of 2009 should benefit agriculture in 2010, both directly and indirectly: directly, by providing tax credits and new spending on alternative fuels and infrastructure projects and, indirectly, by generating jobs and new off-farm income opportunities. However, financial outcomes will vary widely by region and by enterprise type and size as produc-

ers continue to wrestle with volatile output and input prices and with labor and water shortages. New Government policies may also affect outcomes. There is considerable support for new regulations aimed at reducing green house gas emissions in the production of energy. These may raise costs and narrow margins, especially for the livestock sector.

Another factor affecting farmers, ranchers, and their lenders is the rise in credit risk. Driving this increase in risk is the increase in price volatility, which affects not only the prices farmers receive for their products but also the prices they pay for their inputs. Farmers have always had years of profit and years of loss, but the swings have been wider in recent years. Also, to reduce their own risks, traditional agricultural intermediaries, such as grain elevators, are having to push risk down the production chain to the producer. Government programs, which have traditionally helped farmers—especially crop producers—to manage risk, may not provide enough protection in this increased risk environment.

Concerned that large price swings may be characteristic of the future, many lenders, including System institutions, are becoming more cautious and looking more closely at the risk management practices of credit applicants. More and more lenders are likely to expect potential borrowers to use risk management tools such as forward contracting, futures, options,



USDA revenue insurance, and the new USDA ACRE program. In addition, lenders are better aligning their pricing structures to charge for risk, which results in higher rates for borrowers who have the greatest risk.

Not only does high volatility in profits or margins increase the need for risk management, it also increases the need for working capital and increases the risk of leverage (use of debt relative to capital). As a result, many lenders today expect potential borrowers to have more collateral and greater cash flow relative to debt. Furthermore, the low cost of agricultural credit, which has been a big benefit for System borrowers,²⁸ is expected to rise, along with the cost of credit in the non-farm economy.

GROWING CREDIT RISK IN THE SYSTEM'S PORTFOLIO

Declines in 2009 commodity prices and farm income, coupled with decreases in farm real estate values on marginal or transitional land, increased the stress on agricultural

credit last year, especially in the dairy, hog, and biofuels sectors. In some cases losses were greater because producers did not have sufficient risk management experience to adjust for the greater volatility in both output and input prices. Furthermore, stress in the forestry sector rose as demand for housing declined and the general economy weakened. In total, nonaccrual loans to these four sectors accounted for \$1.8 billion, or 53 percent, of the \$3.4 billion in total nonaccrual loans in the System at the end of 2009. Also, \$267 million in loan charge-offs, representing about half of the System's total charge-offs, was associated with loans to these four agricultural sectors. In comparison, these four sectors represented about \$31 billion, or 19 percent, of the System's total loan portfolio. The individual sectors are discussed more fully in the following paragraphs.

Dairy

The System's loans outstanding to the dairy sector totaled \$13.4 billion at the end of 2009, up about

14 percent from year-end 2008. The increase, which resulted from a combination of rising feed costs and declining milk prices, reflects the distressed conditions in the industry. The sharp decline in milk prices stemmed from an oversupply of milk caused by the reduced demand for exports and other dairy products. As a result, producers borrowed more money to finance their operating losses and to refinance operating losses using equity in their real estate or other assets where possible. While most producers reported profits during 2008, substantial losses during 2009 wiped out the financial progress many producers had made over the past few years. System dairy loans not accruing interest rose to \$640 million at year-end 2009 as compared with a negligible amount at the end of 2008. Charge-offs amounted to \$73 million. Loans to this sector were about 8 percent of the System's total loan portfolio and 45 percent of its capital at the end of the year.

28. The average rate charged by FCS institutions for farm real estate and production loans was only 5 percent in 2009.



Hogs

The System's loans outstanding to the hog industry totaled almost \$4.7 billion at year-end 2009, an increase of \$0.2 billion from a year earlier. Like dairy producers, hog producers borrowed money to finance their operating loans and to refinance operating losses using equity in their real estate where possible. Reduced export demand and insufficient herd downsizing decisions led to an oversupply of pork and significantly lower hog prices, causing many producers to suffer losses during most of the last two years. System loans not accruing interest were \$398 million at year end compared with a negligible amount at the end of 2008. Charge-offs totaled \$15 million in 2009. Loans to this sector represented about 3 percent of the System's total loan portfolio and 16 percent of its capital.

Biofuels

At the end of 2009, the System's loan commitments to the biofuel industry (primarily ethanol) totaled \$3.6 billion, down about 20 percent from a year earlier. Of the total com-

mitments, System institutions had funded \$2.5 billion at year end. The decline in loan activity reflected the distressed conditions in the industry. As firms in the industry filed for bankruptcy or idled their plants during the year, the System's non-performing loans to this sector rose significantly before declining in the latter half of 2009. System loans not accruing interest totaled \$370 million at year end, while charge-offs totaled \$142 million for the year, which was 4.8 percent of the loans outstanding to the biofuel industry at the start of 2009. Biofuel loans outstanding at year end 2009 were less than 9 percent of capital and less than 2 percent of total loan volume, both relatively small numbers when compared to the System's exposure to other industries or commodities. Furthermore, both losses and nonaccrual assets were concentrated in a few firms. A key risk for the FCS is the dependency of the biofuels industry on Government policy and support, including tax credits, protection from imports, loan guarantees, and Government grants. To reduce

its risk exposure, the System has originated and participated out a significant amount of debt to non-System lenders.

Forestry

The System's loans outstanding to the forestry sector totaled \$10.3 billion at year-end 2009, down about 6 percent from a year earlier. The decline was an outgrowth of conditions in the general economy, which witnessed a huge shift downward in housing demand and, as a result, a significant decrease in the demand for lumber. As new loan demand fell in 2009, many producers also reduced their debt. Despite the reduction in outstanding forestry loans, forestry nonaccruals rose to \$392 million at year-end 2009, and charge-offs for the year were \$37 million. Loans to this sector represented about 6 percent of the System's total loan portfolio and 34 percent of its capital.

APPENDIX

FARM CREDIT ADMINISTRATION OFFICES

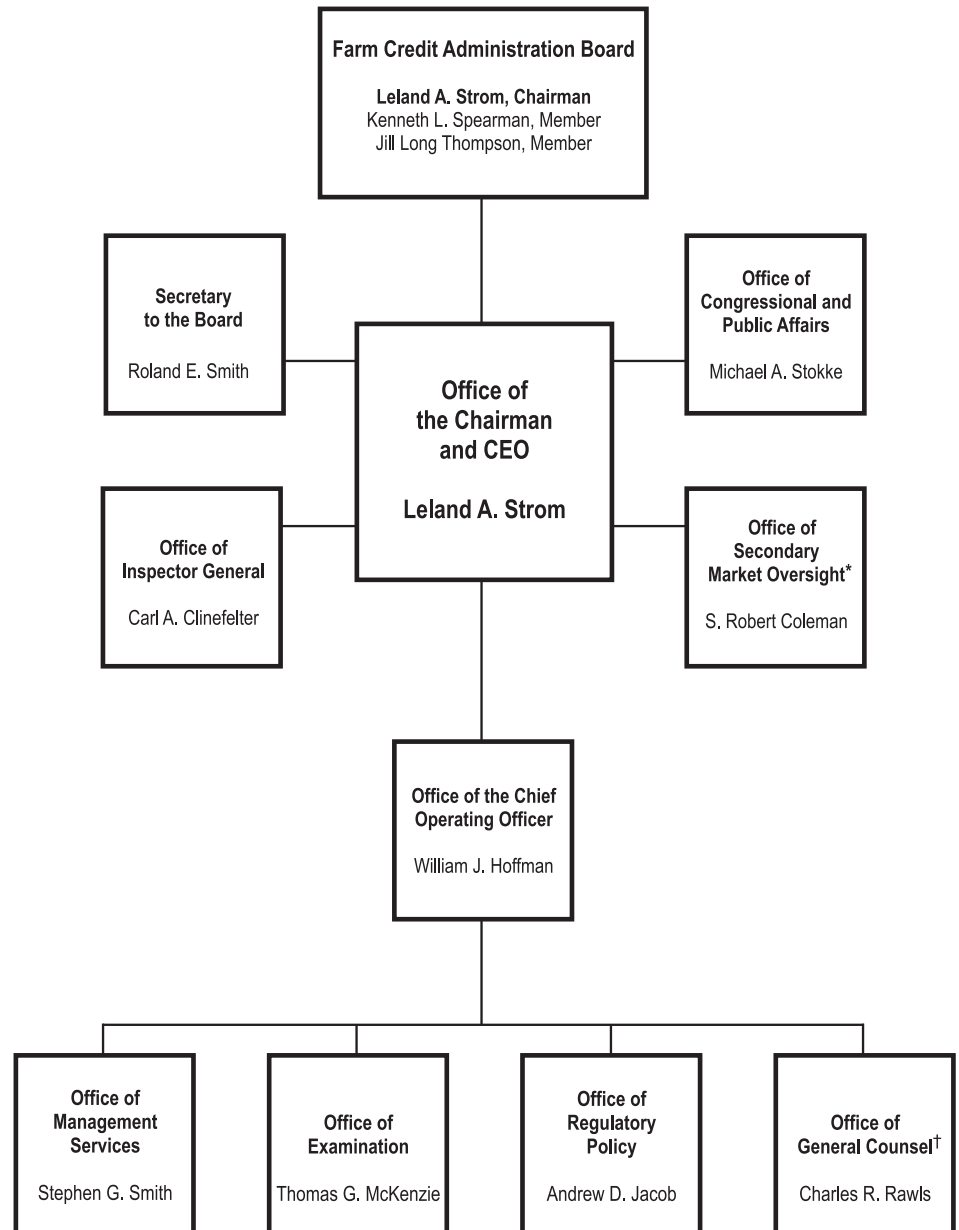
The 266 full- and part-time employees of FCA work together to ensure that the FCS remains a dependable source of credit for agriculture and rural America. The following paragraphs explain the functions of each of the Agency's offices.

The **FCA Board** manages, administers, and establishes policies for FCA. The Board approves the policies, regulations, charters, and examination 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** serves as the Parliamentarian for the Board and keeps permanent and complete records of the acts and proceedings of the Board. He or she ensures that the Board complies with statutory, regulatory, and internal operation reporting requirements. The Secretary to the Board also serves as Secretary to the Farm Credit System Insurance Corporation Board. In addition, he or she serves as the Sunshine Act Official for the FCA Board.

The **Chairman of the FCA Board** serves as the chief executive officer (CEO). The CEO enforces the rules, regulations, and orders of the FCA Board. He or she directs the implementation of policies and regulations

Figure 13
FCA Organizational Structure
As of April 2010



*Reports to the Board for policy and to the CEO for administration.

†Maintains a confidential advisory relationship with each of the Board members.

adopted by the FCA Board. The Office of the Chief Executive Officer plans, organizes, directs, coordinates, and controls FCA's day-to-day 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 also provides information to external audiences through news releases, fact sheets, reports, and other publications. It manages media relations regarding Agency activities and is responsible for the content of the FCA Web site. OCPA also coordinates special meetings, briefings for international visitors, and field hearings.

The **Office of Examination** is responsible for examining and supervising each FCS institution in accordance with the Farm Credit Act and applicable regulations. The office develops oversight plans; conducts examinations; monitors the System's condition and current and emerging risks to the System; and develops supervisory strategies to ensure that the FCS operates in a safe and sound manner, complies with the law and regula-

tions, and fulfills its public policy purpose. For more information about the role of the Office of Examination, go to www.fca.gov/law/guidance.html and click View Board Policy Statements to read "Examination Policy" (FCA-PS-53).

The **Office of General Counsel** (OGC) provides the FCA Board and staff with legal counsel as well as guidance on general corporate, personnel, ethics, and administrative matters. OGC 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 Registrar and maintains the Agency's public rulemaking files. OGC also handles Freedom of Information Act requests and matters pertaining to the Privacy Act.

The **Office of 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, abuse, and mismanagement in the Agency's programs and operations.

The **Office of Regulatory Policy** (ORP) manages policy and regulation development activities that ensure the safety and soundness of the FCS

and support the System's mission. Policy and regulation development activities include the analysis of policy and strategic risks to the System on the basis of economic trends and other risk factors. ORP also evaluates all regulatory and statutory prior approvals for System institutions on behalf of the FCA Board, including chartering and other corporate approvals as well as funding approvals.

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

AGENCY OFFICIALS



Carl A. Clinefelter is the Inspector General of FCA. Before assuming this position in July 2005, he concurrently served as Acting Director of the Office of

Communications and Public Affairs and the Office of Congressional and Legislative Affairs. Prior to this, Mr. Clinefelter served as Director of the Office of the Ombudsman, Director of the Office of Secondary Market Oversight, Executive Assistant to FCA Board Member Doyle Cook, 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 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.



William J. Hoffman is Chief Operating Officer, responsible for planning, organizing, and directing a range of Agency functions. Before assuming this

position in July 2008, Mr. Hoffman was Executive Assistant to Board Member and former Chairman and CEO Nancy C. Pellett. Prior to this, he served as the Associate Director for Examination and Supervision in the Office of Secondary Market Oversight, which oversees the Federal Agricultural Mortgage Corporation. He began his career as a credit representative in the Louisville Farm Credit District. Mr. Hoffman first joined FCA in 1976 as a credit and operations officer and went on to work in various divisions of the Office of Supervision. In 1980 he became director of the Eastern Division, Office of Supervision, where he served for four years before being named Associate Deputy Governor for the Office of Examination and Supervision. In 1986 he joined the St. Louis Farm Credit Bank as vice president of risk assets. He later was the CEO of PennWest Farm Credit, ACA, which served western Pennsylvania. Before rejoining FCA in 2004, he was involved in agricultural finance in the private sector and several international projects.



Andrew D. Jacob, CFA, 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 Sec-

ondary Market Oversight, a position he assumed in 2004. 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, as an information systems examiner, and as a capital markets specialist 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. Mr. Jacob holds the Chartered Financial Analyst (CFA) designation, which the CFA Institute awarded him in 2000.



Mark McBeth is the Executive Assistant to Leland A. Strom, Chairman and CEO of FCA. His duties include advising the Chairman on policy, admin-

istrative, and management issues affecting FCA, the FCS, and the Farm Credit System Insurance Corporation. Mr. McBeth began his career with the former Farm Credit Banks of Omaha where he was director of public relations from 1973 to 1980. In 1980 he joined FCA, and his experience includes serving as a commissioned examiner in the Enforcement Division. Other positions Mr. McBeth held within the Agency include Assistant Director of the Office of Congressional and Public Affairs and Executive Assistant to FCA Board Member Douglas L. Flory. Mr. McBeth also served as Executive Assistant to Leland Strom prior to Mr. Strom's appointment as Chairman and CEO.



Thomas G. McKenzie is Chief Examiner and Director of the Office of Examination. Before his current position, he 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. As a Regional Director he oversaw field office operations in Albany, Atlanta, Dallas, Denver, and Sacramento. Before joining FCA in 1979, 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.



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 to 2001, he was General Counsel for the USDA, and from 1993 to 1998 he was Chief of Staff to the Deputy Secretary of Agriculture. 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 to 1985.



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 associa-

tion 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 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 is the Chief Financial Officer and Director of the Office of Management Services. Before accepting this position, he served

as the Agency's Inspector General. He joined FCA in 1981 as a technical specialist, 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 New York field office and then served as Senior Staff Director for the Chief Examiner before being 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.



Michael Stokke is Director of the Office of Congressional and Public Affairs. Prior to joining FCA, Mr. Stokke was founder and president of Prairie Strategies,

a consulting firm based in Illinois, where he advised corporations and nonprofit organizations. He served as Deputy Chief of Staff to former Speaker of the House Dennis Hastert from February 1998 to October 2007. Prior to this, Mr. Stokke served as Chief of Staff for the Office of the Speaker in the Illinois House of Representatives from 1995 to 1998. He served as Chief of Staff for Representative Thomas W. Ewing of Illinois from 1991 through 1994. From 1984 to 1991, he was Assistant Director of Personnel for the Office of the Governor of Illinois. He also served as Assistant to the Secretary of the Illinois Department of Transportation from 1985 to 1987.

GLOSSARY

A

Agricultural Credit Association—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—An ACB results from the merger of a Farm Credit Bank 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—A BC provided lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems. It was 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—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. Currently there are 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 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. The chairman of the FCSIC board of directors must be an FCA Board member other than the current Chairman of the FCA Board.

Federal Agricultural Mortgage Corporation—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—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 autho-



rized 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 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. The associations 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—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.

Financial Institution Rating System—The FIRS is similar to the Uniform Financial Institutions Rating System used by other Federal banking regulators. However, unlike the Uniform Financial Institutions Rating System, the FIRS was designed 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. These institutions give no cause for regulatory concern.
- **Rating 2**—Institutions in this group are fundamentally sound but may reflect modest weaknesses correctable in the normal course of business. Since the nature and severity of deficiencies are not material, 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 sever-

ity 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.

G

Government-sponsored enterprise—A GSE is typically 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. 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. The FCS is the oldest financial GSE.

P

Participation—A loan participation is usually a large loan in which two or more lenders share in providing loan funds to a borrower to manage credit risk or overcome a legal lending limit for a single credit. One of the participating lenders originates, services, and documents the loan. Generally, the borrower deals with the institution originating the loan and is not aware of the other participating institutions.

Production Credit Association—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.

S

Syndication—A loan syndication (or “syndicated bank facility”) is a large loan in which a group of banks work together to provide funds for a borrower. Usually one bank takes the lead, acting as an agent for all syndicate members and serving as the focal point between them and the borrower. All syndicate members are known at the outset to the borrower and they each have a contractual interest in the loan.

ACRONYMS AND ABBREVIATIONS

- ACA**—Agricultural Credit Association
- ACB**—Agricultural Credit Bank
- AMBS**—agricultural mortgage-backed securities
- CAMELS**—capital, assets, management, earnings, liquidity, and sensitivity
- CEO**—chief executive officer
- Farm Credit Act, the Act**—Farm Credit Act of 1971, as amended
- Farmer Mac**—Federal Agricultural Mortgage Corporation
- FCA**—Farm Credit Administration
- FCB**—Farm Credit Bank
- FCS**—Farm Credit System
- FCSIC**—Farm Credit System Insurance Corporation
- FIRS**—Financial Institution Rating System
- FLCA**—Federal Land Credit Association
- FSA**—Farm Service Agency
- GAAP**—generally accepted accounting principles
- GSE**—Government-sponsored enterprise
- OFIs**—other financing institutions
- PCA**—Production Credit Association
- RBC**—Risk-Based Capital (Model)
- RBIC**—rural business investment company
- SBA**—Small Business Administration
- USDA**—U.S. Department of Agriculture
- WTO**—World Trade Organization
- YBS**—young, beginning, and small (farmers and ranchers)





ADDITIONAL INFORMATION

The Farm Credit Administration 2009 Annual Report on the Farm Credit System 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 be obtained from

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

Farm Credit System Insurance Corporation
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