2010 *Annual* Report

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

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STATEMENT OF THE CHAIRMAN AND CEO

June 2011

Dear Reader,

On behalf of the Board and the dedicated employees of the Farm Credit Administration, I present the 2010 Annual Report on the Farm Credit System (FCS or System).

I am pleased to report that, despite volatile commodity prices and stress to some individual institutions, the System's overall condition and performance remained sound in 2010. It is well positioned to withstand the continuing challenges posed by the general economy and by stress in some sectors of the agricultural economy.

Financial Indicators Are Strong
Both earnings and asset growth increased in 2010 from 2009. Driven largely by higher net interest income and lower provisions for loan losses, System earnings were $3.495 billion in 2010, up 22.6 percent from 2009. System assets grew to $230.0 billion, up $14.5 billion or 6.7 percent from 2009.

Asset quality also improved despite lingering stress to the dairy, livestock, forestry, and nursery industries. As of December 31, 2010, nonperforming loans amounted to $3.4 billion or 1.93 percent of gross loans, down from $3.5 billion or 2.14 percent at year-end 2009. Loan delinquencies (that is, accruing loans that are 30 days or more past due) declined to 0.33 percent of total accruing loans from 0.53 percent at year-end 2009.

In 2010, the System had largely overcome the funding challenges it experienced in 2008 and 2009 as a result of the credit crisis. The System had reliable access to the capital markets, and investor demand for System debt was favorable across all maturities in 2010. The System's liquidity position declined slightly in 2010. It had 173 days of liquidity at year-end 2010, compared with 178 days at year-end 2009, but this level is still well above the regulatory liquidity standard of 90 days.

In addition, the System's total capital remains strong. Capital increased to $33.3 billion at year-end 2010 from $30.0 billion at year-end 2009.

Lending to YBS Farmers Increases in 2010
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.

Loans made in calendar year 2010 (including new loans and renewals) for YBS farmers rose in both number and dollar volume, reversing the decline in new lending activity that occurred in 2009. The volume of loans made was up by 10.3 percent to young farmers, 10.0 percent to small farmers, and 8.6 percent to beginning farmers.

In 2010, the lending to the three YBS categories was consistent with trends in overall System lending to farmers. Therefore, the share of total System farm lending going to the YBS categories did not change significantly from that of 2009.

FCA Monitors Increases in Farmland Values
Because farmland accounts for about 84 percent of all farm assets, farmland values strongly affect the ability of farmers and ranchers to borrow money, and inflated, unsustainable land values pose a real risk both to agricultural producers and lenders.

In the past six years farmland prices have doubled in some Midwest States like Iowa, raising concerns that current values may be unsustainable. Therefore, FCA is closely monitoring farmland values across the country and especially in the Midwest.

In addition, the Agency has issued guidance on collateral risks to System lenders through a series of Informational Memorandums. Links to this and other guidance are provided on the Agency's Farmland Collateral Risk Web page at www.fca.gov/info/farmlandcollateralrisk. In February 2011, FCA also hosted a Regulators Roundtable to lead a discussion among financial regulators about agricultural land values, risks to loan collateral, and how regulators should address these risks.

The System is also taking action. Many System institutions are improving underwriting standards and appraisal guidelines on farmland collateral. Some institutions are also conducting land value studies and stress testing their lending portfolios for changes in land values.

FCA Increases Supervision and Enforcement Activities
Because of persistent stress in certain agricultural industries, the condition of certain individual System institutions deteriorated in 2010. As of December 31, 2010, FCA had 11 associations under special supervision. The assets of these associations represented 5 percent of the System's total assets. In comparison, at year-end 2009, the Agency had 10 associations under special supervision, whose assets represented less than 2 percent of the System's assets.

As a result of FCA enforcement actions, the Agency had formal written agreements with five System associations as of December 31, 2010, representing $1.5 billion in assets. At year-end 2009, FCA had formal written agreements with two associations, representing $423 million.

In addition to providing additional supervision and oversight of troubled institutions, FCA has provided guidance in recent months to help all System institutions better manage risks associated with volatile economic conditions.

- In March 2011, FCA issued an Informational Memorandum to convey the Agency's expectations regarding the collection of borrower financial information and the impact that this information should have on loan underwriting standards.
- In December 2010, FCA issued a Bookletter on the Agency's expectations for System institutions to use prudent investment asset management to ensure that they maintain a pool of highly liquid assets.
- In July 2010, the FCA Board approved a proposed rule to ensure appropriate safety and soundness guidance is in place to limit Systemwide credit exposure to a single borrower/entity.
- In June 2010, FCA issued an Informational Memorandum to encourage System boards and senior management to improve collateral risk management practices.
- In May 2010, FCA issued a Bookletter to provide guidance for the pricing and structure of loans to ensure appropriate earnings performance.
- In March 2010, FCA issued an Informational Memorandum describing the Agency's expectations for portfolio stress testing at System institutions.

FCA Addresses Borrower Complaints
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.

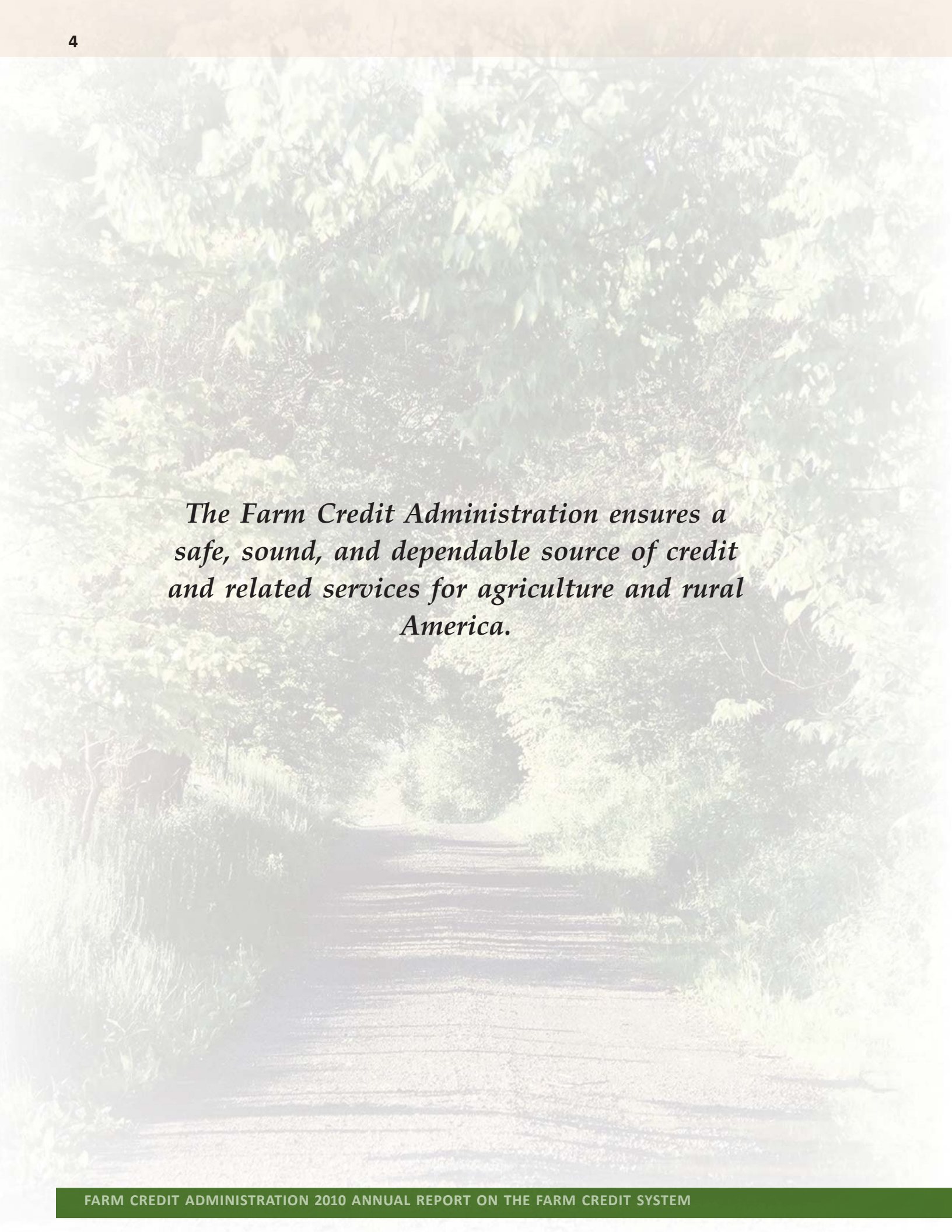
In 2010, when some FCS borrowers were under stress from the weakened economy, FCA received an increase in the number of borrower complaints. Generally, borrowers who contact FCA with complaints are seeking clarification, additional information, and options to redress their concerns. If FCA finds violations of law or regulations, the Agency has several enforcement options to bring about corrective action.

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 identifying risks to the System, providing guidance to mitigate risks, and strong examination and supervisory programs. 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,

Leland A. Strom



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

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 in Northern Illinois; AgriBank, FCB; and the Farm Credit Council, the national trade organization representing FCS in Government affairs.

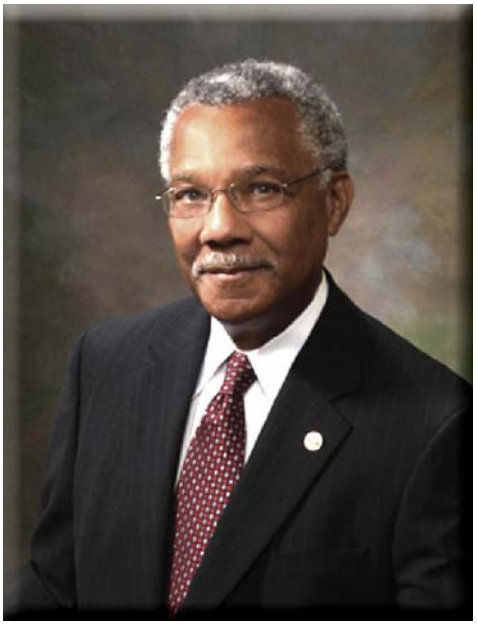
Mr. Strom has served in several capacities with the Illinois Farm Bureau and was a member of the Illinois Ag Leadership Program Class of 1988.

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. He also attended the Harvard Kennedy School Executive Education program. In 2011 he received an Honorary Doctorate of Humane Letters from 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, a daughter-in-law, and a son-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 chairman 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 in March 2010. Her term continues to May 2014. 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 Farm Credit 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 Committee on Agriculture, the Committee on Veterans' Affairs, and the Select Committee on Hunger. 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.

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.

Farm Credit System—An Overview of Events and Conditions

FCS ROLE

The Farm Credit System (FCS or 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 agricultural and aquatic cooperatives. They also make credit available for agricultural processing and marketing activities, rural housing, certain farm-related businesses, 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.

When Congress established the FCS, its purpose was to provide a permanent, reliable source of credit and related services to agriculture and aquatic producers, farmer-owned cooperatives, and farm-related businesses in rural America. Congress intended the FCS to improve the income and well-being of American farmers and ranchers. It formed the FCS as a system of farmer-owned cooperatives to ensure the participation of farmer- and rancher-borrowers in the management, control, and ownership of these cooperative institutions. The participation of member-borrowers helps keep the institutions 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.

FCS STRUCTURE

The Lending Institutions

As of January 1, 2011, the System was composed of 89 banks and associations. Loan funds were provided to 81 Agricultural Credit Association (ACA) parent organizations and 3 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, as amended, 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.

Each ACA contains two subsidiaries, a Production Credit Association (PCA), which can make only short- and intermediate-term loans, and an FLCA.[2] The parent-subsidiary structure, with an ACA as parent and its wholly owned PCA and FLCA as subsidiaries, accounted for 96 percent of all associations as of January 1, 2011. The ACA 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

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.

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.

Special-Purpose Entity and Service Corporations

In addition to the banks and lending associations, the System also contains a special-purpose entity known as the Federal Farm Credit Banks Funding Corporation (Funding Corporation). 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.

The System also contains 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 four 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 seven associations to which FPI provides services.
4. The FCS Building Association, which acquires, manages, and maintains facilities to house the Farm Credit Administration's (FCA's) headquarters and field office staff. The FCS Building Association is owned by the FCS banks, but the FCA Board oversees the Building Association's activities.
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.

Farmer Mac

Also part of the FCS is 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 institutions. Nonvoting stock may

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.

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.

THE SAFETY AND SOUNDNESS OF THE FCS

The Farm Credit Administration, which produces this report, regulates the FCS—its lending institutions, the Funding Corporation, the service corporations, and Farmer Mac. 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. For an overview of FCA, see page 5 or visit the FCA website at www.fca.gov.

Also serving to protect the safety and soundness of the FCS is the Farm Credit System Insurance Corporation (FCSIC). FCSIC was established by the Agricultural Credit Act of 1987 in the wake of the agricultural credit crisis of the 1980s, when the FCS, like most lenders heavily concentrated in agriculture, experienced severe financial difficulties. The purpose of FCSIC is to protect the FCS against future crises by ensuring the timely payment of principal and interest on insured notes, bonds, and other obligations issued on behalf of FCS banks. It ensures timely payment by maintaining the Farm Credit Insurance Fund, a reserve that represents the equity of FCSIC. The balance in the Insurance Fund at December 31, 2010, was $3.23 billion. For more information about FCSIC, go to www.fcsic.gov. Also see FCSIC's 2010 annual report.

Investors in Systemwide debt securities are further protected by the joint and several liability provision of the Farm Credit Act, which applies to all FCS banks. The banks are jointly and severally liable for the principal and interest on all Systemwide debt securities. Therefore, if a bank is unable to pay the principal or interest on a Systemwide debt security and if the Farm Credit Insurance Fund has been exhausted, then FCA must call all nondefaulting banks to satisfy the security.

FINANCIAL CONDITION OF THE FCS[4]

The overall condition and performance of the FCS remained safe and sound during 2010. Earnings, assets, and capital levels indicate that the System remains in a solid financial position despite the high level of volatility in commodity prices. See tables 1 and 2 for a breakdown of major financial indicators of the FCS. While the overall FCS remained financially sound, the condition and performance of some individual System institutions declined. FCA addressed these declines by increasing its supervision of these institutions, which resulted in enforcement actions for some entities. For more information on measures FCA took to address weaknesses at individual institutions, see "Maintaining a Dependable Source of Credit for Farmers and Ranchers" on pages 41 to 45 of this report. More detailed information on the System's performance and condition may be found in the 2010 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 System faced a generally favorable but volatile operating environment in 2010. Grain prices moved up sharply in the second half of the year in response to strong demand and tight global supplies. Supported by a weaker dollar and stronger global economic growth, agricultural exports were up in 2010 and are projected to reach record levels in 2011. Volatile commodity prices challenged livestock and dairy producers, who came under increasing stress in 2010 because of soaring feed costs. Farmland values continue to escalate, particularly in regions where cash grains are grown.

The System continues to have reliable access to capital markets to support its mission. Financial markets contin-

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, 2010, 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-10	31-Dec-09	31-Dec-08	31-Dec-07	31-Dec-06
FCS Banks[1]					
Gross loan volume	161,069,141	152,412,187	149,491,137	131,191,826	112,260,474
Accruing restructured loans[2]	48,457	4,651	5,125	4,301	5,378
Accrual loans 90 or more days past due	8,695	28,816	21,594	12,917	5,439
Nonaccrual loans	477,341	759,134	582,160	46,069	107,556
Nonperforming loans/total loans[3]	0.33%	0.52%	0.41%	0.05%	0.11%
Capital/assets[4]	6.00%	5.59%	4.89%	5.43%	5.65%
Unallocated retained earnings/assets	3.03%	2.80%	2.50%	2.69%	2.95%
Net income	1,917,143	1,442,328	1,231,430	981,688	845,191
Return on assets	0.95%	0.74%	0.65%	0.60%	0.60%
Return on equity	15.00%	13.13%	12.44%	10.59%	10.24%
Net interest margin	1.22%	1.17%	0.97%	0.83%	0.80%
Operating expense rate[5]	0.30%	0.33%	0.31%	0.30%	0.33%
Associations					
Gross loan volume	124,148,362	118,575,715	114,026,889	105,620,488	93,413,704
Accruing restructured loans[2]	65,385	58,926	30,381	47,212	51,384
Accrual loans 90 or more days past due	34,029	68,508	65,703	43,840	19,504
Nonaccrual loans	2,751,042	2,634,046	1,706,613	465,414	425,545
Nonperforming loans/gross loans[3]	2.30%	2.33%	1.58%	0.53%	0.53%
Capital/assets[7]	16.54%	15.82%	15.46%	15.57%	16.27%
Unallocated retained earnings/assets	15.07%	14.56%	13.51%	13.58%	13.89%
Net income	2,416,816	1,585,984	1,805,929	1,934,968	1,662,255
Return on assets	1.85%	1.29%	1.57%	1.74%	1.75%
Return on equity	10.91%	8.13%	9.84%	10.82%	10.44%
Net interest margin	2.79%	2.64%	2.50%	2.57%	2.64%
Operating expense rate[5]	1.38%	1.49%	1.45%	1.49%	1.58%
Total Farm Credit System[7]					
Gross loan volume	175,351,000	164,830,000	161,423,000	142,906,000	123,436,000
Nonperforming loans	3,386,000	3,535,000	2,416,000	621,000	615,000
Nonaccrual loans	3,229,000	3,369,000	2,282,000	512,000	533,000
Nonperforming loans/gross loans[3]	1.93%	2.14%	1.50%	0.43%	0.50%
Bonds and notes	189,575,000	178,358,000	179,769,000	155,295,000	134,466,000
Capital/assets[8]	14.46%	13.90%	12.65%	14.17%	15.00%
Surplus/assets	11.80%	11.48%	10.80%	11.52%	12.25%
Net income	3,495,000	2,850,000	2,916,000	2,703,000	2,379,000
Return on assets	1.60%	1.32%	1.41%	1.53%	1.56%
Return on equity	10.90%	9.86%	10.70%	10.38%	9.99%
Net interest margin	2.82%	2.65%	2.41%	2.43%	2.48%

Sources: Farm Credit System Call Report as of December 31, 2010, 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. Operating expenses divided by average gross loans.
6. Capital excludes protected borrower capital.
7. Cannot be derived through summation of above categories because of intradistrict and intra-System eliminations used in reports to investors.
8. 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, 2010

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	30,781,566	20,905,165	115,720	14,873	9,522,281	817,333	1,053,119	1,902,781
AgriBank	70,996,366	59,517,358	73,575	12,956	10,715,270	1,727,643	1,953,894	3,595,144
CoBank	65,825,890	49,992,338	166,973	400,744	14,563,830	2,268,989	2,137,394	4,406,197
Texas	14,108,416	10,464,033	120,199	28,678	3,540,894	710,399	418,965	1,150,858
U.S. AgBank	25,386,018	20,190,247	874	2,504	4,946,873	856,379	717,942	1,366,700
Total	207,098,256	161,069,141	477,341	459,755	43,289,148	6,380,743	6,281,314	12,421,680
Associations								
AgFirst	18,404,354	16,935,253	679,355	167,456	527,034	197,537	2,870,453	3,044,185
AgriBank	63,735,262	58,204,674	886,244	393,389	2,413,909	226,538	10,005,959	10,232,570
CoBank	13,772,699	13,148,173	334,646	175,721	68,829	191,160	2,078,898	2,224,452
Texas	13,155,037	12,467,288	562,643	134,467	300,910	82,643	2,015,092	2,099,576
U.S. AgBank	24,991,698	23,392,974	288,154	116,053	493,331	563,334	4,010,324	4,578,660
Total	134,059,050	124,148,362	2,751,042	987,086	3,804,013	1,261,212	20,980,726	22,179,443
Total Farm Credit System	229,973,000	175,351,000	3,229,000	1,447,000	46,282,000	1,542,000	27,136,000	33,251,000

Sources: Farm Credit System Call Report as of December 31, 2010, 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 $3.226 billion of restricted capital, which is the amount in the Farm Credit Insurance Fund. Excludes mandatorily redeemable preferred stock and protected borrower capital.

ued to improve in 2010, and investor demand for Systemwide securities has been favorable. The current low interest rate environment has enabled System banks to lower their cost of funds by refinancing callable bonds. Depending on the rules that will be issued to implement the Dodd-Frank Act, System banks may have to adjust their risk management strategies involving the use of derivatives if their use becomes too costly.

These conditions are expected to continue to challenge the System in 2011. For a discussion of how this environment is likely to affect the agricultural economy and the System in 2011 and beyond, see "Challenges Facing the Agricultural Economy and the Farm Credit System" on pages 51 to 57.

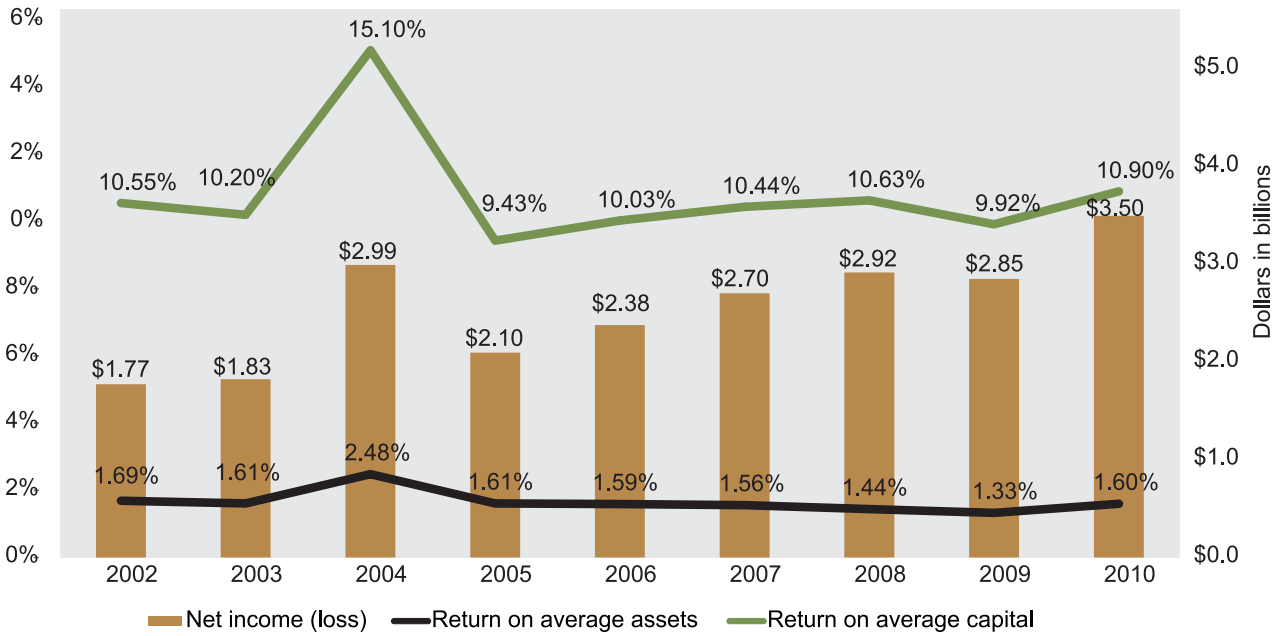
Earnings

System earnings were up 22.6 percent in 2010, increasing to $3.495 billion compared with $2.850 billion in 2009 (See figure 1). This increase in earnings was largely driven by higher net interest income and lower provisions for loan losses. Net interest income increased by $498 million as net interest spread improved by 18 basis points from year-end 2009 to 2.61 percent at year-end 2010. The System's return on average assets increased to 1.60 percent in 2010 from 1.33 percent the prior year. The return on average capital was also higher, increasing to 10.90 percent in 2010 from 9.92 percent in 2009.

Provisions for loan losses dropped to $667 million in 2010 from $925 million in 2009, in part because of improved operating margins in the swine and ethanol sectors. Certain agricultural sectors did experience increased credit stress as higher commodity and other input prices adversely affected some System borrowers, particularly dairy and livestock producers. In addition, System borrowers in other agricultural sectors, such as forestry, continue to feel the impact of the downturn in the U.S. economy and the general weakness in the housing market.

As cooperative institutions, the FCS banks and associations pass a portion of their earnings on to their borrower-owners as patronage distributions. For 2010, System institutions declared a total of $1.016 billion in patronage distributions. Of that amount, $648 million was paid in

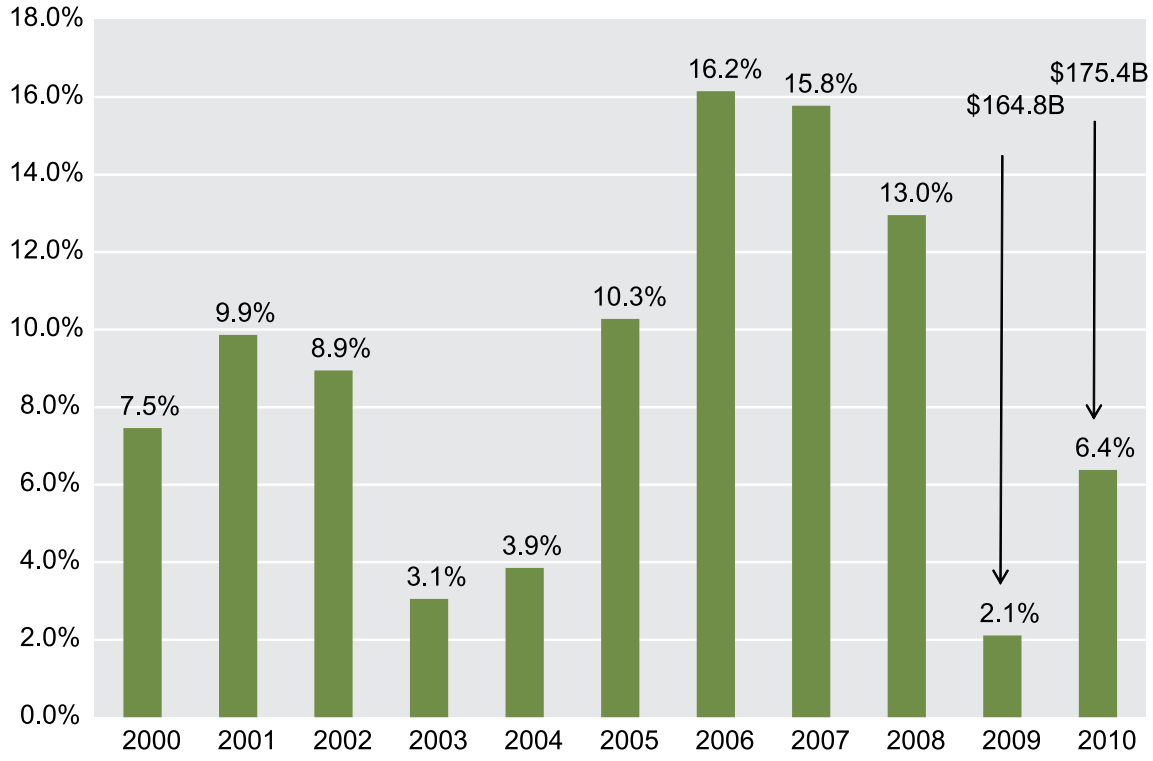
Figure 1
FCS Net Income, 2002–2010
As of December 31



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.

Figure 2
Annual Growth Rate of FCS Loans Outstanding, 2000 to 2010



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

cash, $300 million was issued in the form of allocated retained earnings, and $68 million was issued as stock. The System also distributed $83 million in cash from patronage allocations of earlier years. Strong earnings performance in 2010 allowed System institutions to pay out, in total, a larger percentage of net income in 2010 (29 percent) compared with 2009 (26 percent).

Asset Growth

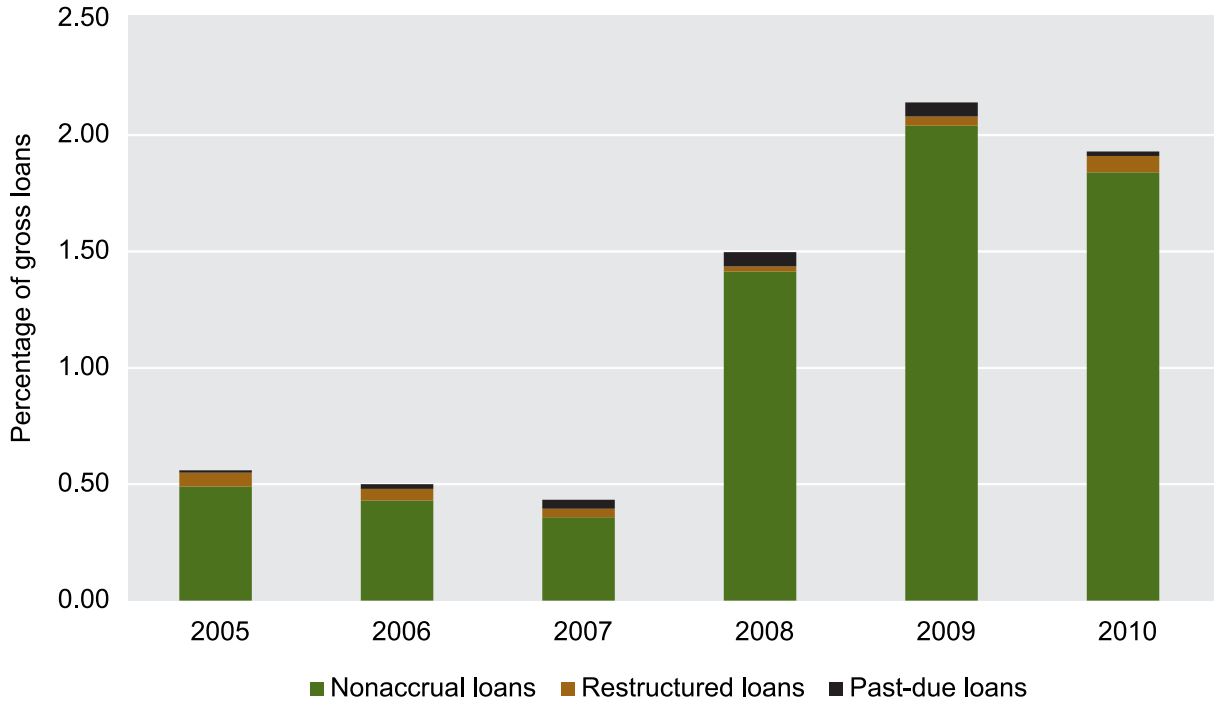
Overall, the System experienced moderate growth in 2010, principally in the second half of the year as sharply rising commodity prices led to increased loan volume, particularly in agribusiness loans to finance grain inventories and real estate mortgage loans. In total, System assets grew to $230.0 billion, up $14.5 billion or 6.7 percent from 2009. Loan growth accounted for the majority of asset growth in 2010 as the System's portfolio of loans outstanding increased by 6.4 percent compared with 2.1 percent in 2009 (see figure 2).

Asset Quality

While credit quality in the System's loan portfolio is generally favorable, certain System borrowers, particularly those in the dairy and livestock sectors are under increasing stress. In addition, certain sectors such as the forestry and nursery industries continue to be affected by general economic conditions and the state of the housing market. As of December 31, 2010, nonperforming loans equaled $3.4 billion or 1.93 percent of gross loans, down from $3.5 billion or 2.14 percent at year-end 2009 (see figure 3). Loan delinquencies (that is, accruing loans that are 30 days or more past due) declined to 0.33 percent of total accruing loans from 0.53 percent at year-end 2009.

The allowance for loan losses remained essentially unchanged at $1.45 billion, or 0.83 percent of loans outstanding at year-end 2010, compared with $1.36 billion, or 0.82 percent of loans outstanding at year-end 2009. As previously indicated,

Figure 3
FCS Nonperforming Loans, 2005–2010
As of December 31



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

provisions for loan losses were down in 2010, dropping to $667 million in 2010 from $925 million in 2009. Net charge-offs were up in 2010, increasing to $596 million from $518 million in 2009.

While the outlook remains favorable for agriculture in 2011, conditions in both the general and agricultural economies remain volatile. Some additional deterioration in asset quality is possible as certain agricultural sectors continue to be adversely affected by high commodity prices. Nevertheless, the overall level of nonperforming loans continues to be well within the System's risk-bearing capacity.

Funding

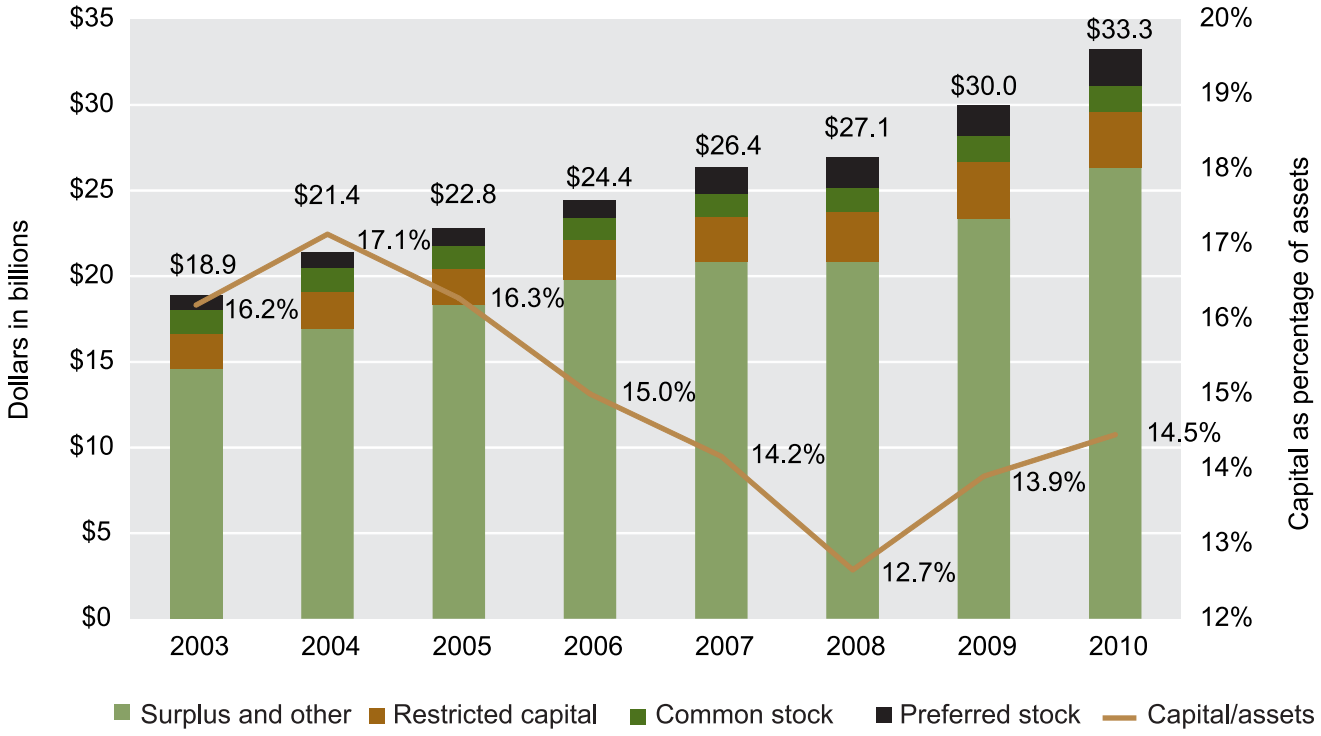
The System continues to have reliable access to the capital markets, and investor demand for System debt was favorable across all maturities in 2010. The System's funding composition shifted in 2010 as short-term debt made up 36.1 percent of total Systemwide debt securities at December 31, 2010, compared with 34.8 percent at December 31, 2009. Total Systemwide debt increased 6.5 percent in 2010, with securities due within a year increasing by 10.2 percent and securities due after one year increasing by 4.5 percent. (See section titled "Funding Activity in 2010" on page 37 for further discussion on the System's funding environment.)

Liquidity

As of December 31, 2010, the System's liquidity position equaled 173 days, down slightly from 178 days at year-end 2009, but still significantly above the 90-day regulatory minimum.[5] The System banks continued to improve the quality of their liquidity reserves in 2010. 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

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 4
FCS Capital, 2003–2010
As of December 31



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

in a challenging funding environment. Investments available for sale (based on fair value) increased 7.8 percent to $37.6 billion in 2010, and had a weighted average yield of 1.9 percent. Investments held to maturity remained steady at $3.7 billion, with a weighted average yield of 3.9 percent.

By regulation, System banks may acquire and hold certain investments provided they have a triple-A rating from at least one major rating agency. If the investment no longer meets the credit rating criteria, the investment becomes ineligible, and 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. As of December 31, 2010, the FCS had 148 ineligible securities because of rating downgrades, which, at fair value, represented 3.9 percent of Federal funds and available-for-sale securities. FCA has approved, or is reviewing requests for approval for, divestiture plans to hold these investments longer than six months. For 2010, the System recognized $90 million of other-than-temporarily impaired losses on securities.

Capital

The System's capital position remained strong as total capital increased to $33.3 billion at year-end 2010 compared with $30.0 billion at year-end 2009. The most significant factors contributing to the increase in System capital were net income earned and retained, the issuance of $300 million in preferred stock by one System bank, and a reduction in accumulated other comprehensive loss. With the increase in total capital, the System's capital-to-assets ratio at year-end improved from 13.9 percent in 2009 to 14.5 percent in 2010. As figure 4 shows, surplus accounts for the overwhelming majority of capital.

Table 3
FCS Gross Loans Outstanding, 2006–2010
As of December 31
Dollars in Millions

	2006	2007	2008	2009	2010	Percent change from 2006
Production agriculture						
Long-term real estate mortgage loans	56,489	63,458	71,892	75,352	78,021	38.1
Short- and intermediate-term loans	28,731	32,267	37,468	39,610	40,584	41.3
Agribusiness loans*	21,141	28,091	26,901	23,626	29,581	39.9
Rural utility loans	9,569	10,846	13,931	14,562	15,091	57.7
Rural residential loans	3,408	3,965	4,611	4,977	5,475	60.7
International loans	2,183	2,135	4,077	3,956	4,036	84.9
Lease receivables	1,489	1,708	1,952	2,160	2,021	35.7
Loans to other financing institutions	426	436	591	587	542	27.2
Total	**123,436**	**142,906**	**161,423**	**164,830**	**175,351**	**42.1**

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

* At December 31, 2010, agribusiness loans consisted of loans to cooperatives of $16.2 billion, processing and marketing loans of $11.1 billion, and farm-related business loans of $2.3 billion.

FCA regulations establish minimum capital requirements that each System bank and association must achieve and maintain. As of December 31, 2010, the permanent capital ratios for all System banks and associations were above the regulatory minimum of 7.0 percent and ranged between 14.3 percent and 22.0 percent for System banks and between 11.3 percent and 28.4 percent for System associations. At year-end, two associations did not meet the minimum regulatory requirement of 3.5 percent for the core surplus ratio. One association had a core surplus ratio of 3.1 percent and assets of less than $450 million; the other association had a core surplus ratio of 2.9 percent and assets of less than $300 million. Both associations have corrective action plans in place. All other associations had a core surplus ratio in excess of 10.0 percent.

The System has augmented regulatory capital through third-party capital, including $2.35 billion in various forms of preferred stock and $1.65 billion in subordinated debt. See "Funding Activity in 2010" on page 37 for additional information on System third-party capital. In addition, at December 31, 2010, the FCS had $3.2 billion of restricted capital in the Farm Credit Insurance Fund.

BORROWERS SERVED

The System fulfills its overall mission by lending to agriculture and rural America. Its lending authorities 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 authority[6]

Nationwide, the System had $175.4 billion in gross loans outstanding as of December 31, 2010 (see table 3). Agricultural producers represented by far the largest borrower group, with $118.6 billion, or 67.6 percent, of the total dollar amount of loans outstanding.[7] As of December 31, 2010, 44.5 percent of the dollar volume of

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).

the System's loans outstanding was in long-term real estate loans, 23.1 percent in short- and intermediate-term loans to agricultural producers, and 16.9 percent in agribusiness loans. Agribusiness loans are broken down further into 9.2 percent for loans to cooperatives, 6.4 percent for processing and marketing enterprises, and 1.3 percent for farm-related businesses. Loans to finance rural utilities represented 8.6 percent of the System's loan volume, while rural residential real estate loans made up 3.1 percent of the System's total loans. International loans (export financing) represented 2.3 percent of the System's loan portfolio, and lease receivables accounted for 1.2 percent of the overall portfolio. Finally, loans outstanding to "other financing institutions" represented a small but important segment of the System's portfolio (see "System Funding for Other Lenders" below).

As required by law, borrowers own stock or participation certificates in System institutions. The FCS had nearly 880,000 loans and approximately 488,000 stockholders in 2010. Approximately 85.0 percent of the stockholders were farmers or cooperatives with voting stock. The remaining 15.0 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 6.2 percent since year-end 2005.

According to the U.S. Department of Agriculture (USDA), net cash farm income in the United States experienced a sharp increase in 2010 to $91.3 billion, up $22.2 billion from 2009 and up $19.5 billion from its 10-year average of $71.8 billion. Thus, the core segments of the System's portfolio—farm real estate mortgages and production and intermediate-term loans—grew 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 (see "Challenges Facing the Agricultural Economy and the Farm Credit System" on pages 51 to 57 for a discussion of stressed sectors).

The aggregate total of loans outstanding at FCS banks and associations (net of intra-System lending) grew by $10.5 billion, or 6.4 percent, during the year ended December 31, 2010. Both the dollar volume and the percentage growth in 2010 were significantly more than the gain in the previous year. In 2009, gross loans grew 2.1 percent, which followed growth of 13.0 percent in 2008 and 15.8 percent in 2007. Since year-end 2006, total System loans outstanding increased by $51.9 billion, or 42.1 percent.

The System's increase in loan volume in 2010 stemmed primarily from its core customer base—farmers and their cooperatives. Long-term real estate loans increased $2.7 billion, or 3.5 percent, because of rising land values, while short- and intermediate-term loans increased $974 million, or 2.5 percent, because of rising costs for production inputs. Agribusiness loans grew sharply in 2010, increasing $6.0 billion, or 25.2 percent. This increase was driven primarily by the 53.7 percent increase in loans to cooperatives, which amounted to $16.2 billion. Agricultural cooperatives, which keep large inventories of grain commodities, were affected by the sharp price increases in corn, soybeans, and wheat. They had to borrow more to finance the increased cost of their inventories. In addition, largely because many electric distribution cooperatives were refinancing loans from other lenders and making capital expenditures, rural utility loans (energy, water, waste disposal, and communication loans) increased $529 million, or 3.6 percent. Rural residential real estate loans increased $498 million, or 10.0 percent. The other categories posted modest changes for the year, either up or down, including a 2.0 percent increase for international loans.[8]

SYSTEM 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

8. A majority of the System's international loan portfolio is guaranteed by the Commodity Credit Corporation (CCC) through the U.S. Department of Agriculture's GSM-102 and GSM-103 export credit programs. Overall, 85 percent of the System's international loans in 2010 carried a CCC guarantee.

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, 2010, the System served 28 OFIs, the same as in 2009, and 27 in 2008. Outstanding loan volume to OFIs was $542 million at year-end, down $45 million from 2009. 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.

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 making 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 grew four of the last six years. This activity began to decline in 2009 and continued to decline in 2010 because of reduced need for bank credit by some large agribusinesses, credit quality concerns in some agricultural sectors, and more conservative standards in the capital markets.

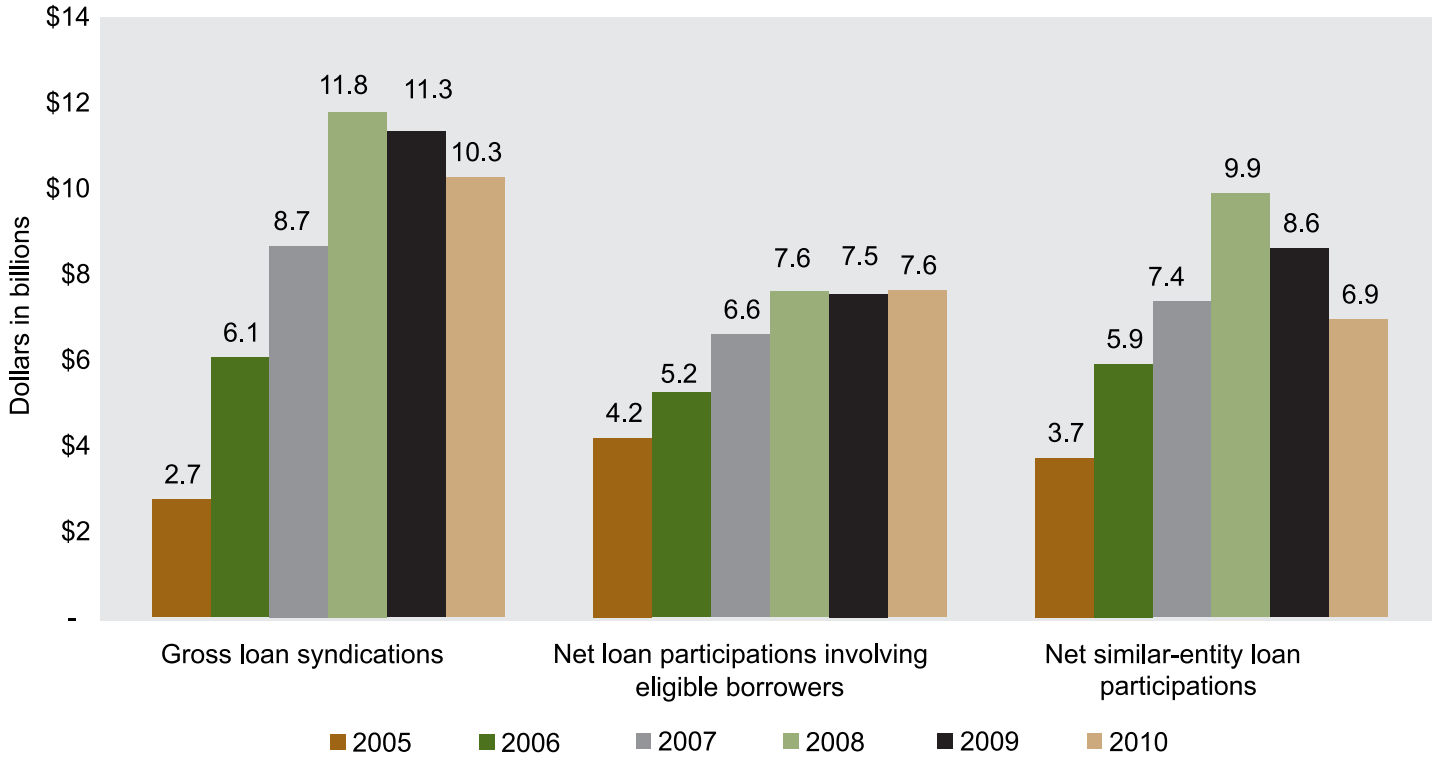
The first group of bars shows gross loan syndications outstanding by FCS banks and associations.[9] Gross loan syndications by the System with non-System lenders totaled $10.3 billion at year-end 2010, down more than $1.0 billion from the 2009 figure but still well above the totals of earlier years. Although syndication volume as a percentage of the System's loan portfolio decreased from 6.9 percent at year-end 2009 to 5.9 percent at year-end 2010, the overall level of activity was still the third 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 multiple 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

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.

Figure 5
Syndications and Net Loan Participations Involving Non-System Lenders, 2005–2010
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).

with customers who are also eligible to borrow from the FCS. The net total of these participations was $7.6 billion, a slight increase above 2009. 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 participations in these loan syndications 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 2010, the net amount of similar-entity participations in the System amounted to $6.9 billion, a decrease of $1.7 billion, or 19.7 percent, from 2009.

The net total of all loan participations involving non-System lenders was $14.6 billion at year-end 2010, compared with $16.1 billion the year before. Not only did the recession reduce the demand for participations, but System institutions also tightened standards on participation lending.

FARM DEBT AND MARKET SHARES

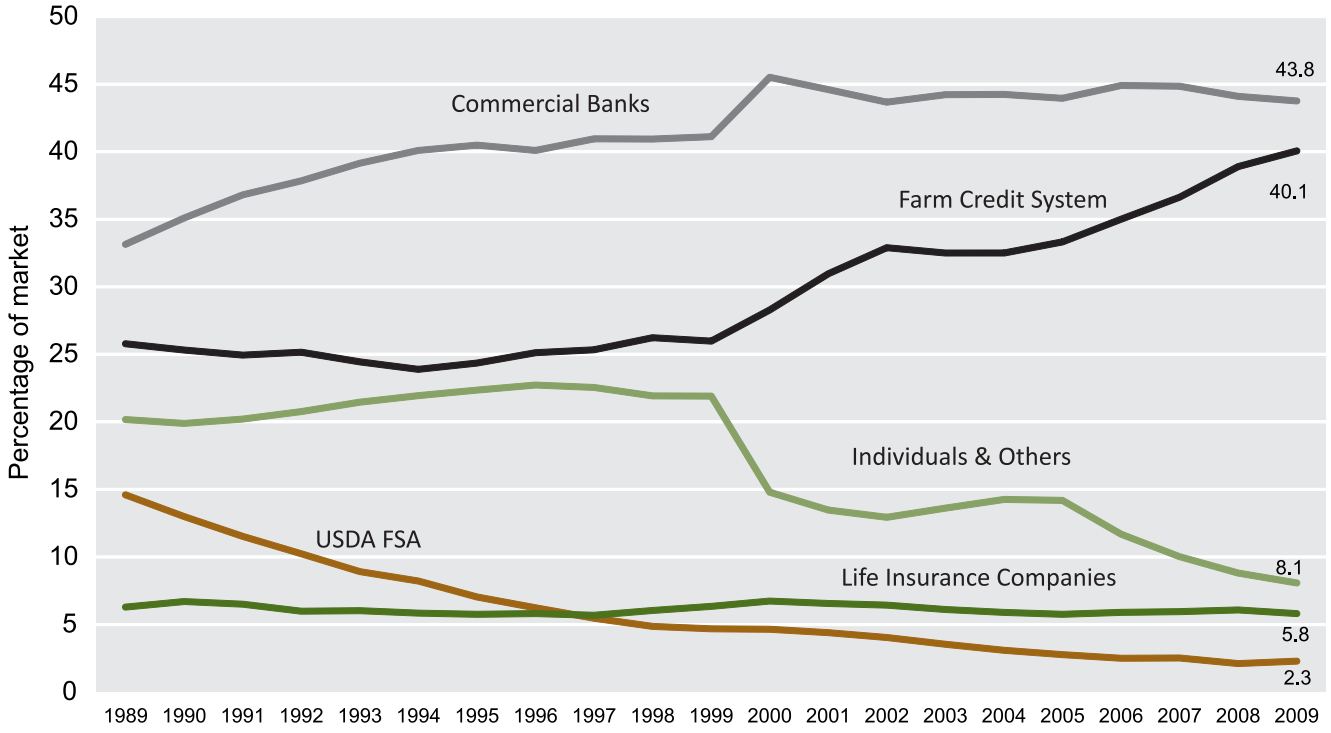
USDA's forecasted estimate of total farm business debt for the year ended December 31, 2010, was $240 billion, down 2.1 percent from its estimate for year-end 2009 of $245 billion. This estimate could increase after USDA releases its next estimate, as the outstanding farm debt reported by most major classes of lenders rose in 2010. Data for the FCS and commercial banks show that their farm loan portfolios grew 3.2 percent and 2.1 percent, respectively. The rise in outstanding farm debt reported by lenders reflected record-high farm income, rising farm real estate prices, and the higher input costs in 2010. On the supply side, lenders had adequate funds to lend, but credit underwriting practices remained relatively stringent in the past year. According to the USDA forecast for 2011, farm debt will change little in 2011, rising less than 1 percent over 2010. The forecast includes a 2 percent increase in non-real estate farm debt but a 0.6 percent decline in farm real estate farm debt in 2011. Strong farm incomes, increasing real estate values, greater capital investments, and improving off-farm income opportunities in 2011 are supportive of debt accumulation and could alter USDA's next forecast update.

The most current market share information from USDA is for year-end 2009.[10] USDA's estimate of debt by lender shows that commercial banks held 43.8 percent of the $245 billion in total farm business debt at the end of 2009. The System's market share rose to 40.1 percent from a 38.9 percent share the previous year. Except for the USDA Farm Service Agency, all other lender groups, including banks, life insurance companies, and merchants and dealers had small market share losses. Commercial banks and the FCS now represent 84 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 brief periods, the FCS has typically had the largest market share of farm real estate mortgages. The System's share of debt secured by farm real estate increased to 43.4 percent at year-end 2009, con-tinuing the upward trend of the past 10 years. At year-end 2009, commercial banks held 37.4 percent of the farm real estate mortgage debt, up slightly from 2008. Commercial banks have historically dominated non-real estate farm lending, but that dominance has been eroding, falling one percentage point to 51.4 percent at the end of 2009. The System's share of non-real estate farm debt was 36.0 percent at year-end 2009, continuing an upward trend since the late-1990s when it was slightly less than 20 percent.

10. Market share is calculated by USDA for farm business debt only. The information for 2010 will not be available until USDA issues its planned update in August 2010. 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, 1989–2009



Sources: USDA, Economic Research Service, as of February 14, 2011.

Note: Year-end 2009 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 thus are a priority for the Farm Credit System. Loans to YBS borrowers help to provide a smooth transition of farm businesses to the next generation and to maintain a diversified customer base, from very small enterprises to large commercial operations, for the FCS. Through its regulatory agenda, data collection and reporting, disclosure requirements, and examination activities, FCA is strongly committed to ensuring that the System fulfills its responsibility to support these important segments of the agricultural industry.

Young farmers are the smallest segment of the farming population that the YBS mandate targets. The number of young farm operators in the United States has been trending down for decades, reflecting years of farm consolidations, integrations, and older retirement ages for current farm operators. According to USDA's Agricultural Resource Management Survey (ARMS), only 4 percent of all primary family farm operators were 34 years or younger in 2009, which compares with 5.5 percent 10 years earlier.[11] These farmers overwhelmingly operate smaller farms, with only 14 percent having production valued at more than $250,000 in 2009. Many farmers that belong in the young category also belong in the beginning category—more than three-quarters of all young operators have farmed for 10 years or less, and nearly half of them consider farming to be their primary occupation.

For 2009, the ARMS shows that approximately 20 percent of all family farms had operators who would be considered beginning farmers—having farmed for no more than 10 years. Although beginning farmers are generally believed to be young, only 14 percent of these principal operators were under 35 years of age, and 10 percent of them were of retirement age (65 or older). Within this group, only 25 percent of these principal operators considered farming to be their primary occupation. Beginning farmers can also be part of established farms with multiple operators; 10 percent of all beginning operators were associated with farms that had primary operators with more than 10 years of experience.

Small farms, which represented 90 percent of all U.S. farms in the 2009 ARMS, are difficult to characterize because of their diversity. Like other YBS borrowers, small farmers typically rely heavily on off-farm incomes and hence their credit needs are more consumer based. Within this large segment are farming operations that are growing in size or producing higher-margin agricultural products for local markets, often on a seasonal basis. The segment also includes farmers who are in the process of retiring. The majority of small farms do not use agricultural credit within a given year and hence would not be potential YBS borrowers.

In a very general sense, the relative shares of Systemwide total farm lending going to the three separate YBS categories has been consistent with the share of these farmer segments in the total farmer population, with the smallest share of total System farm lending going to the young farmer segment and the largest share going to the small farm segment. The range of YBS demographics and the changing economic conditions in rural America, as well as the wide range of credit needs of YBS farmers beyond their agricultural production activities, can 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 29.)

11. The System's definition of a young farmer differs slightly from USDA's definition. See the note below table 4B. A family farm is one for which the majority of the farm business is owned by individuals related by blood, marriage, or adoption. In 2009, more than 97 percent of all farms were considered to be family farms according to ARMS.

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. In addition, FCA continues to review and consider various policy options for supporting the System's YBS programs.

YBS LENDING RESULTS

The number and volume of loans made during the year is a good indicator of current service to YBS borrowers. Loans made in calendar year 2010 (including new loans and renewals) for each of the three YBS categories rose in both number and dollar volume from 2009, reversing the decline in new lending activity that had occurred in that year.[12] This increase in credit demand reflected improvement in both the general economy and the farm economy, and an increase in capital purchases among farmers in 2010. All three YBS categories experienced similar increases in new lending activity during 2010, with the volume of loans made during the year up 10.3 percent to young farmers, 10.0 percent to small farmers, and 8.6 percent to beginning farmers. The percentage increases in the numbers of loans made (5.5 to 7 percent) were not as great as the increase in volume, reflecting a significant increase in the average size of loans made in 2010.

In 2010, the volume of YBS loans outstanding also increased for each of the three borrower categories, as it has for the previous nine years. The volume of outstanding loans increased by 3.1 percent to young farmers, by 2.2 percent to small farmers, and by 0.6 percent to beginning farmers.

In 2010, the lending to the three YBS categories was consistent with trends in overall System lending to farmers. Therefore, the share of total System farm loans going to the YBS categories did not change significantly from that of 2009. In 2010, the volume of all System farm loans made (including commitments) during the year ($64.1 billion) was up 9.5 percent over that of 2009, whereas the volume of outstanding farm loans (including commitments) at year-end ($179.6 billion) was up 2.4 percent from the amount at the end of 2009. The total number of farm loans made in 2010 (330,693) was 7.3 percent higher than the number made in 2009, while the number of outstanding loans (889,780) at the end of 2010 was 3.7 percent higher than at the end of 2009.

In the section on YBS borrowing trends (page 29), 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 2010; table 4B provides information on loans made during the year.

Loans and commitments to YBS farmers include real estate loans, and short- and intermediate-term loans, but do not include rural home loans. In the percentages below, young, beginning, and small farmer lending is compared with all System lending and commitments to farmers.

Young—The System's extension of credit to young farmers, those aged 35 or younger, consisted of 53,470 loans totaling $7.3 billion in 2010. During 2009, 50,689 loans totaling $6.6 billion were made to young borrowers. The loans made to young borrowers in 2010 represented 16.2 percent of all farm loans the System made during the year and 11.4 percent of the dollar volume of loans made. The average size of loans made to young farmers in 2010 was $136,917, up 4.6 percent from the $130,915 average for 2009. At the end of 2010, there was $21.1 billion in outstanding loans as compared with $20.4 billion at the end of 2009.

Beginning—Defined as those borrowers with 10 or fewer years of farming experience, these borrowers received 65,653 loans totaling $10.3 billion in 2010. During 2009, 61,387 loans totaling $9.5 billion were made to beginning borrowers. The loans made to beginning farmers in 2010 represented 19.9 percent of all farm loans made during the year and 16 percent

12. 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. Borrowers may have more than one loan and thus the loan numbers reported here do not directly measure the number of borrowers.

Table 4A
YBS Loans Outstanding
As of December 31, 2010

	Number of loans	Percentage of total number[a]	Dollar volume of loans in millions[b]	Percentage of total volume[a]	Average loan size
Young farmers/ranchers	162,982	18.3	$21,066	11.7	$129,255
Beginning farmers/ranchers	231,975	26.1	$34,326	19.1	$147,973
Small farmers/ranchers	485,148	54.5	$43,717	24.4	$90,110

Table 4B
YBS Loans Made During 2010
As of December 31

	Number of loans	Percentage of total number[a]	Dollar volume of loans in millions[b]	Percentage of total volume[a]	Average loan size
Young farmers/ranchers	53,470	16.2	$7,321	11.4	$136,917
Beginning farmers/ranchers	65,653	19.9	$10,278	16.0	$156,557
Small farmers/ranchers	155,371	47.0	$13,089	20.4	$84,243

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.

a. Totals include loans, advancements, and commitments made to farmers, ranchers, and aquatic producers by the associations, and excludes such activity from rural home, Title III, and the Leasing Corporation.
b. The volume figures for loans made and loans outstanding include both advances and commitments.

of the dollar volume of loans made. The average size of loans made was $156,557 in 2010, up 1.5 percent from the $154,169 average for 2009. At the end of 2010, there was $34.3 billion in outstanding loans to beginning farmers as compared with $34.1 billion at the end of 2009.

Small—FCS institutions made 155,371 loans, totaling $13.1 billion to small farms (those with gross annual sales of less than $250,000) in 2010. This compares with 145,618 loans totaling $11.9 billion that were made to small farms in 2009. The loans made in 2010 to small farms represented 47.0 percent of all farm loans made during the year and 20.4 percent of the dollar volume of loans made. The average size of loans made was $84,243 in 2010, which was up 3.1 percent from the $81,713 average for 2009. At the end of 2010, there was $43.7 billion in outstanding loans to small farms as compared with $42.8 billion at the end of 2009.

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 every 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

The diversity in farm types and sizes and farmer demographics across the United States inevitably leads to wide differences among institutions' YBS results. 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 guarantees, and local economic conditions—also affect individual association results. Beginning with 1999, specific YBS data by institution, by district, and for the System as a whole are available on FCA's website at www.fca.gov under Consolidated Reporting System Reports.

As a result of diversity and other factors, there was considerable range in the total share of lending made to YBS borrowers across FCS associations again during 2010. While the share of total new System farm loans made to young farmers was 16.2 percent, this share ranged from as little as 1.9 percent at one association to as high as 31.6 percent at another. Larger ranges were evident in the share of total new loans made to the beginning and small farm categories by associations. Whereas 19.9 percent of the System's total farm loans went to beginning farmers in 2010, this share ranged from as little as 5.8 percent to as much as 62.4 percent at one association. And for small farms, the 47 percent share was bounded by a range from 11.2 percent to 92.9 percent at the associations.

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 depending on the demographics and agriculture of their service territory. While new volume was up in each of the YBS categories during 2010 for the System as a whole, 47 percent of the associations had declines in new lending volume to both beginning and small farmers, and 42 percent had declines to young farmers. Likewise, outstanding loan volumes rose for each YBS category in 2010 for the System as a whole, but at the association level the number expe-

riencing an increase in volume for each category was about the same as the number of associations seeing a decline in outstanding loan volume. Small associations can experience significant variability in their lending shares because of their small lending base.

YBS BORROWING TRENDS, 2001–2010

FCA now has 10 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 shows fairly strong upward trends in dollars of loans outstanding and new lending activity for each of the three categories from 2001 through 2008, but there is some divergence in these trends over the past two years. The dollar value of new lending activity fell significantly for all three groups in 2009, as the recession and a slower farm economy reduced demand for credit in general, but then rebounded in 2010 with a stronger farm and nonfarm economy. This same trend occurred in the number of loans made, with the number of loans made for each YBS categories rebounding in 2010 after falling in 2009. While outstanding loan volume flattened for beginning and small farmer categories in 2009 and 2010, outstanding loan volume increased for young farmers over the entire 10 years.

Over time, the inflation of farm assets, such as farmland, increases loan volume growth and makes evaluating long-term trends more problematic. Therefore, measuring the share of the System's total new farm lending to YBS borrowers can more accurately show changes in performance over longer periods. Figures 7A, 7B, and 7C show that the percentage of new farm loan volume going to the three YBS borrower categories has been relatively constant over the past 10 years. Over this period there was more of a downward trend in the share of new farm loan volume made to small farms, whereas the share made to young farmers was more constant. In the last five years the share going to beginning farmers has trended down slightly, from 18.3 percent in 2005 to 16.0 percent in 2010.

Comparisons between the System's YBS lending results and the results reported by other organizations are difficult to make. One reason these comparisons are not feasible is that other Federal regulators do not require reporting on young and beginning farmer loans. Although 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 2010, System institutions used four types of loan concessions for YBS borrowers.

- Interest rate concessions—offered by 40 percent of associations, down slightly from 43 percent in 2009
- Exceptions to underwriting standards—offered by 53 percent of associations, compared with 52 percent in 2009
- Lower loan fees—offered by 26 percent of associations, down slightly from 30 percent in 2009

Figures 7A, 7B, and 7C

Loans Made to, and Loans Outstanding for, YBS Farmers and Ranchers, 2001–2010

As of December 31

Figure 7A

Young Farmers and Ranchers

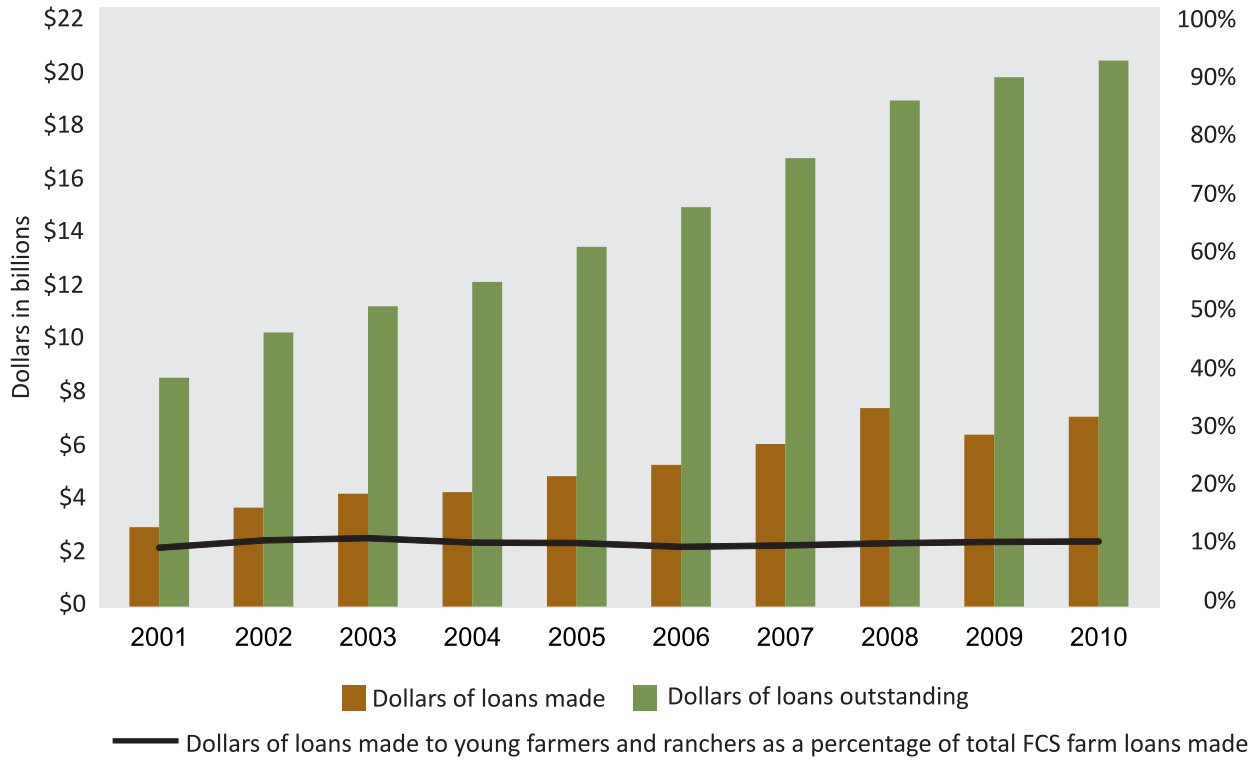


Figure 7B

Beginning Farmers and Ranchers

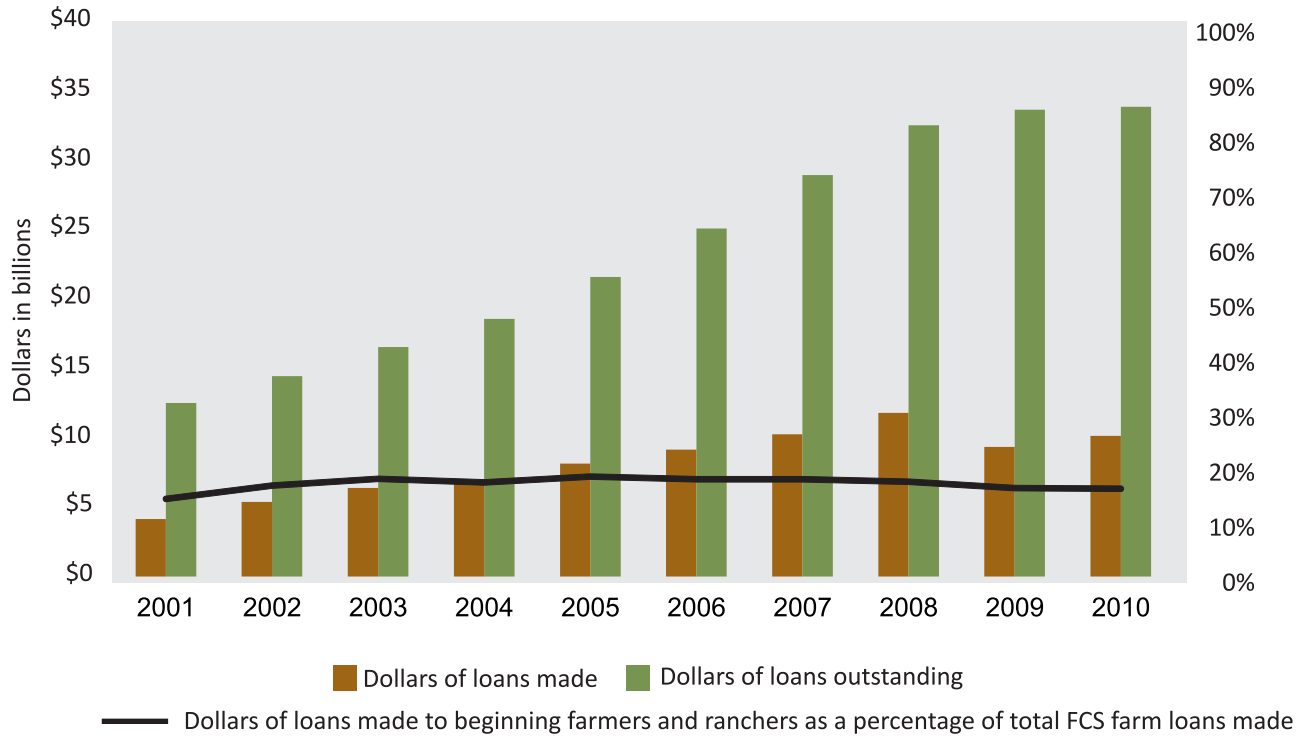
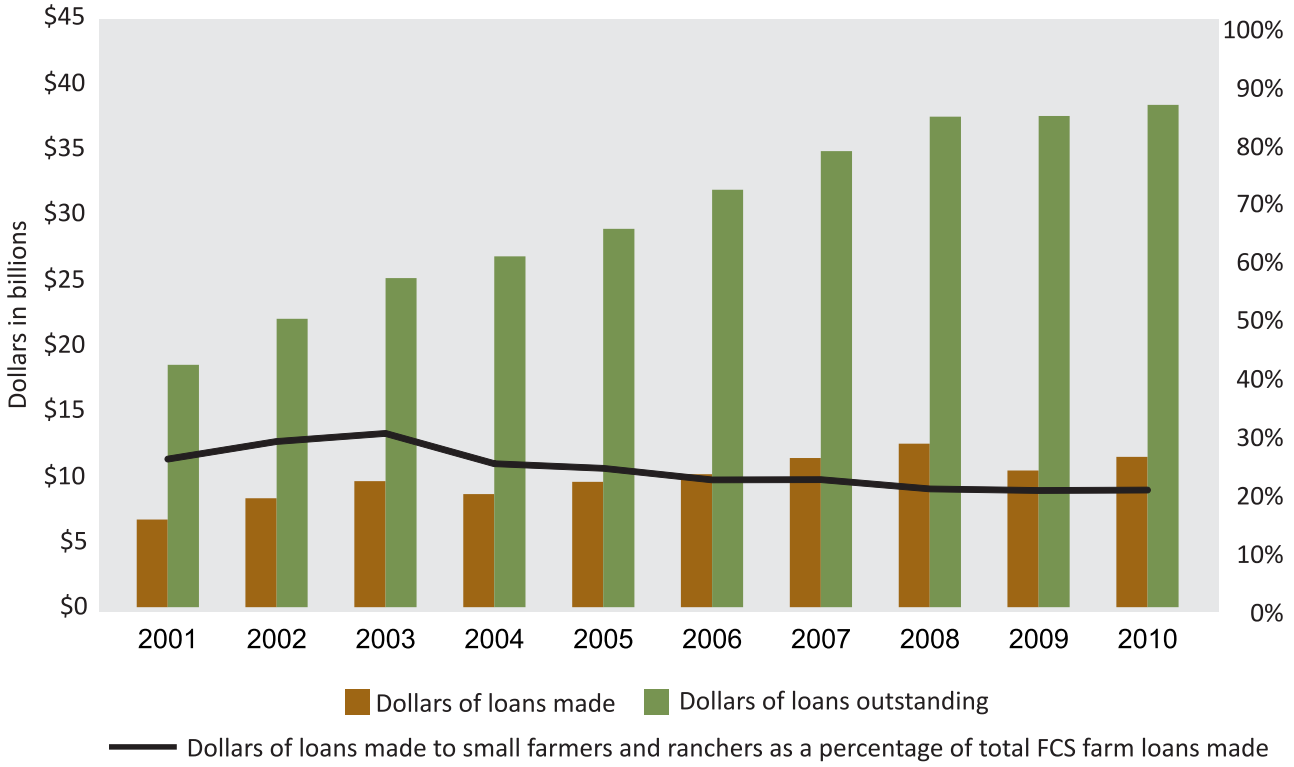


Figure 7C

Small Farmers and Ranchers



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

Note: In past reports these charts have shown the percentage of young, beginning, or small loans *outstanding* to total FCS loans *outstanding*. This year, FCA concluded that showing the percentage of young, beginning, or small loans *made* in a given year to the total FCS loans *made* in that year would be a better measure for comparing lending performance from year to year.

- Loan covenants designed specifically for YBS borrowers—offered by 8 percent of associations, down from 12 percent in 2009

Most of the loan concessions made by System institutions to YBS borrowers are for the young and the beginning categories. Altogether, 60 percent of the System's 86 associations provided some form of loan concessions to the young or beginning borrower category in 2010; and 56 percent used one or more of these concessions for small farmers. Results for 2010 were comparable with 2009.

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 might not be extended to some YBS borrowers because of excessive repayment or collateral risks.

In 2010, 97 percent of the 86 FCS associations used USDA Farm Service Agency loan guarantees for some of their YBS lending, while 17 percent used Small Business Administration loan guarantees and 15 percent of the associations used State and local programs.

FCS institutions use guaranteed lending programs from Federal, State, and local sources for both conventional and YBS lending. About 25 percent of the System's overall loans with guarantees went to young farmers; about 26 percent went to beginning farmers; and about 41 percent went to small farmers (numbers are not additive because categories overlap). At year-end 2010, the loans with guarantees for young, beginning, and small farmer/rancher loans outstanding were 10,700, 11,300, and 18,000, respectively. System associations obtained guarantees on more loans in 2010 than in 2009, an increase of about 2,000 loans to young farmers, 1,000 loans to beginning farmers, and 1,000 loans to small farmers. However, the percentage of loans receiving guarantees was slightly down, by about 1 percent per category.

Delivering Insurance, Training, and Other Services

In addition to offering credit, FCS institutions also serve YBS producers by offering insurance services, business training, and other services. Almost 71 percent of the associations offered insurance services to YBS farmers in 2010, and a similar percentage of associations provided training services to these borrowers. FCS associations offer training opportunities in estate planning, recordkeeping, tax planning and preparation, and farm business consulting. Strengthening the business and financial management skills of its borrowers is one of the System's key training objectives. In some cases, they discount or waive the cost of these programs for YBS borrowers.

System institutions offer numerous opportunities to educate existing and potential YBS borrowers. System associations offer Systemwide online training programs for YBS farmers, which in some cases include a mentoring component. Associations coordinate with State and national agricultural organizations and educational centers to offer educational training and in some cases to provide funding to allow YBS farmers to attend training. Examples of training opportunities include the Ag Leadership Institute, Ag Biz Planner, and a course titled "Succeeding through Knowledge," which is offered in conjunction with the Farm Bureau.

System associations are actively involved in marketing to potential YBS borrowers. Some associations attend and help sponsor local trade shows, fairs, and training workshops specifically targeting young farmers. Some also conduct outreach and marketing activities in partnership with 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. In addition, many FCS associations provide financial support for college scholarships and for FFA, 4-H, and other agricultural organizations.

Regulatory Policy and Approvals

FCA routinely issues regulations, as well as policy statements and other guidance 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 provide a flexible regulatory environment that enables the System to safely and soundly offer high-quality, reasonably priced 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 ensuring that it remains 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 2010

The following paragraphs describe some of FCA's regulatory efforts in 2010, along with several projects that will remain active in 2011. Full text for the items below is available on the FCA website. To access Board Policy Statements, FCA Bookletters, and Informational Memorandums, go to www.fca.gov/law/guidance.html.

To access proposed and final rules, go to www.fca.gov/law/pending.html and select "FCA Pending Regulations and Notices database."

Governance

Serving the Members of Farm Credit System Institutions—The FCA Board adopted Policy Statement FCA-PS-80, "Cooperative Operating Philosophy—Serving the Members of Farm Credit System Institutions," in November 2010, which reaffirmed FCA's commitment to FCS members' participation in their institutions and emphasized that operating in a cooperative manner requires the boards of directors and management to engage, communicate with, and provide value-added benefits to members.

Disclosure to Shareholders and Investors on Senior Officer Compensation—The FCA Board approved an advance notice of proposed rulemaking in November 2010 requesting public comments on ways to clarify and enhance FCA rules related to the disclosures of senior officer compensation and the responsibilities and authorities of FCS institution compensation and audit committees.

Nominating Committee Brochure—FCA issued an Informational Memorandum in November 2010 to remind FCS institutions of the importance of nominating committees in election of boards of directors.

Director Elections—The FCA Board approved a final rule in March 2010 that amended FCA regulations to consolidate Farm Credit bank and association director election and voting rules and to enhance election reporting and disclosure rules. Maximum Bank Director

Compensation for 2011—FCA issued an Informational Memorandum in February 2011 that communicated the annual adjustment in the maximum annual compensation payable to FCS bank directors. The adjustment reflects the change in the Consumer Price Index.

Mergers

Farm Credit System Bank Merger Applications—FCA issued a Bookletter in July 2010 to communicate FCA's expectations for the submission of proposals to merge FCS banks.

Guidelines on Submission of Proposals to Merge Banks—FCA issued an Informational Memorandum in August 2010 distributing guidelines for the submission of proposals to merge banks.

Lending

Lending and Leasing Limits and Risk Management—The FCA Board approved a proposed rule in July 2010 and a final rule in May 2011 that would amend FCA regulations to ensure appropriate safety and soundness requirements are in place to limit Systemwide credit exposure to a single borrower/entity. In addition, the rule would consider policy

requirements to limit exposure to loan portfolio concentrations by industry segment, repayment source, etc.

Loan Purchases from the Federal Deposit Insurance Corporation—The FCA Board approved a proposed rule in April 2010 and a final rule in May 2011 to amend FCA regulations to permit FCS institutions with direct-lending authority to purchase agricultural and cooperative loans from the FDIC that meet the System's eligibility and scope of financing requirements.

Registration of Mortgage Loan Originators—The FCA Board approved a final 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.

Loan Underwriting Standards – Borrower Financial Information—FCA issued an Informational Memorandum in March 2011 to convey FCA's expectations regarding the collection of borrower financial information and the impact of this information on loan underwriting standards.

Collateral Risk Management in Farm Credit System Institutions—FCA issued an Informational Memorandum in June 2010 to encourage boards and senior management to improve collateral risk management practices in FCS real estate lending activities.

Evaluating Strategies and Risks for Loan Pricing and Structure—FCA issued a Bookletter in May 2010 to provide guidance for the pricing and structure of loans to ensure appropriate earnings performance.

Accounting and Disclosure of Troubled Debt Restructurings—FCA issued an Informational Memorandum in March 2011 to provide guidance to FCS institutions on complying with Financial Accounting Standards Board requirements for troubled debt restructurings and on making related disclosures in reports to shareholders.

FACT Act Regulations – Risk-Based Pricing Notices—FCA issued an Informational Memorandum in January 2010 to inform System institutions about the recently published final rules that implement the risk-based pricing provisions of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), which amends the Fair Credit Reporting Act.

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.

Capital and Investments

Capital Adequacy—The FCA Board approved an advance notice of proposed rulemaking in June 2010 that solicited public input on amending FCA's regulations to replace the current core and total surplus capital standards with a "Tier 1/Tier 2" capital framework that is more consistent with the Basel Accord and more closely aligned with that of other Federal financial regulatory authorities.

Farm Credit System Investment Asset Management—FCA issued a Bookletter in December 2010 that provided clarification and guidance regarding FCA's regulations and expectations with respect to the key elements of a robust investment asset management framework that each institution should establish to prudently manage its investments in changing markets.

USDA Guaranteed Investments—FCA issued an Informational Memorandum in March 2011 to reiterate and clarify that FCS institutions have broad authority to invest in obligations (including loans and bonds) that are fully insured or guaranteed by the U.S. Department of Agriculture and its agencies.

Investments in Rural America—FCA continued 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.

Amendment to Conditions of Approval for Rural America Bond (RAB) and Agriculture and Rural Community (ARC) Pilot Investment Programs—In September 2010, the FCA Board amended the "definition of rural area" condition of approval for the RAB and ARC bonds and securities pilot investment programs.

Farmer Mac

Farmer Mac Nonprogram Investments and Liquidity—The FCA Board approved an advance notice of proposed rulemaking in May 2010 that solicited public input to questions related to regulations governing Farmer Mac's liquidity and investment management.

Farmer Mac Risk-Based Capital Stress Test Revisions—The FCA Board approved a proposed rule in December 2009 and a final rule in April 2011 that would modify Farmer Mac's Risk-Based Capital Stress Test. The revised version of the test incorporated the addition of rural utility program business authority into the stress test and revised the existing treatment of risk mitigations of general obligations for the AgVantage Plus program and related structures.

Other

Joint and Several Liability Reallocation Agreement—The FCA Board approved a notice and request for public comments in August 2010 and a notice of approval in October 2010 of the "Joint and Several Liability Reallocation Agreement" among the five FCS banks and the Federal Farm Credit Banks Funding Corporation. FCA's Stress Testing Expectations for All FCS Institutions—FCA issued an Informational Memorandum in March 2010 that communicated its expectations of an institution's board and management in the stress testing process.

Technical Changes—The FCA Board approved a direct final rule in June 2010 that amended FCA's regulations to eliminate unnecessary, redundant, or outdated regulations, to correct cross-reference errors, and to clarify the intent of a regulatory provision.

National Oversight and Examination Program for 2011—FCA issued an Informational Memorandum in December 2010 that provided a summary of the National Oversight Plan for 2011, which details strategies for addressing critical risks or other areas of focus in the System.

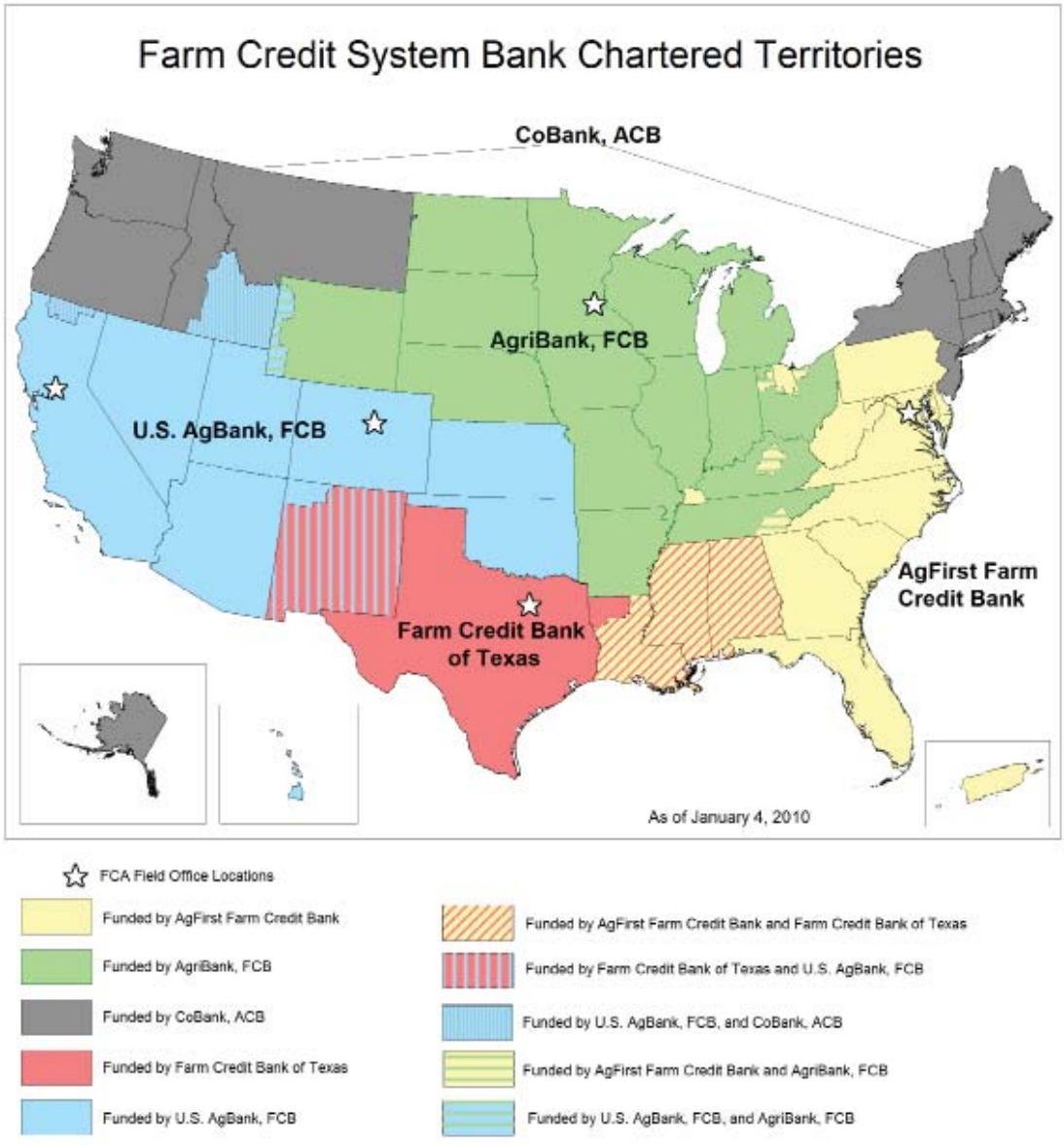
CORPORATE ACTIVITY IN 2010

In 2010 and early 2011, FCA analyzed and approved four corporate applications, compared with nine applications processed in 2009.

- On July 1, 2010, two ACAs affiliated with the Farm Credit Bank of Texas merged their operations following stockholder approval of the merger. The PCA and FLCA subsidiaries associated with the ACAs also merged.
- On November 1, 2010, FCA amended the charters of an ACA and its subsidiaries affiliated with the Farm Credit Bank of Texas to reflect a new headquarters location. No stockholder vote was required to relocate the association's headquarters.
- On December 1, 2010, two ACAs affiliated with the Farm Credit Bank of Texas merged their operations following stockholder approval of the merger. The PCA and FLCA subsidiaries associated with the ACAs also merged.
- On January 1, 2011, three ACAs affiliated with the AgFirst Farm Credit Bank merged their operations following stockholder approval of the merger. The PCA and FLCA subsidiaries associated with the ACAs also merged. A name change for the continuing ACA and its subsidiaries also took effect on the same date.

The total number of associations as of January 1, 2011, was 84, compared with 88 associations at January 1, 2010. As of January 1, 2011, 81 ACAs and 3 FLCAs made up the System's structure of associations. The number of banks remains at five. On December 15, 2010, two of the banks signed a letter of intent to merge. Figure 8 shows the chartered territory of each FCS bank. Details about specific corporate applications are available on FCA's website at www.fca.gov/info/mergers.html.

Figure 8
Chartered Territories of FCS Banks
As of January 1, 2011



Note: As of January 1, 2011, CoBank was funding 4 associations in the indicated areas and serving cooperatives nationwide; U.S. AgBank, FCB, was funding 26 associations; Farm Credit Bank of Texas was funding 17 associations; AgriBank, FCB, was funding 17 associations; and AgFirst Farm Credit Bank was funding 20 associations. The FCS contains a total of 89 banks and associations.

FUNDING ACTIVITY IN 2010

During 2010, the System experienced a return to normal market conditions. The System had regular and flexible access to debt markets over the full maturity spectrum although demand by certain prior large investors remained weak. As the severe financial market stresses of 2008 continued to dissipate, corporate debt issuance increased and borrowing rates improved. The System's funding costs declined markedly both in terms of the overall pricing of securities as well as their corresponding spreads to U.S. Treasuries. The System's status as a Government-sponsored enterprise (GSE), as well as its financial strength, enabled it to have continual access to debt capital markets. Despite the placement of two housing-related GSEs[13] in conservatorship, investor perceptions of the System have become favorable again. As a result, the System is now able to issue debt at very competitive rates.

The System continued to enhance its marketing programs and strengthened its internal liquidity reserve requirements. The System also continued to issue third-party capital (preferred stock and subordinated debt); however, overall activity has been curtailed by the high costs of these transactions relative to conventional funding costs. The amount of mandatorily redeemable preferred stock outstanding at year-end 2010 was $225 million, unchanged from December 31, 2009. The System also had perpetual preferred stock that totaled $2.12 billion at December 31, 2010, up from the $1.78 billion for the preceding year-end. Outstanding subordinated debt totaled $1.65 billion at December 31, 2010, up slightly from $1.55 billion at December 31, 2009.

The System funds its loans with a combination of consolidated Systemwide debt and capital. The 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.[14] This process allows funds to flow from worldwide capital-market investors to agriculture and rural America, providing rural communities with highly efficient access to global resources. At year-end 2010, outstanding Systemwide debt was $188.8 billion, up from $177.3 billion a year earlier, representing a 6.5 percent increase.[15]

The sizable increase of $11.5 billion in Systemwide debt was an outgrowth of several factors. Gross loans increased $10.5 billion in 2010, prompting the majority of this increase. The System's combined investments, Federal funds, and cash balances also contributed to the increase in debt as these amounts increased by $4.1 billion in 2010. Record net income in 2010 and increased third-party capital provided the additional funding necessary.

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 2010, FCA approved $119 billion in longer-term debt issuances.

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 equal in value to the total amount of its outstanding debt securities.

13. The GSEs are the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).
14. 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 financial disclosure and the release of public information concerning the financial condition and performance of the System as a whole.
15. 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. Investors in Systemwide debt securities are also protected by a joint and several liability provision that applies to all System banks. If a bank is unable to pay the principal or interest on a Systemwide debt security and if the Farm Credit Insurance Fund has been exhausted, then FCA must call all nondefaulting banks to satisfy the security. However, an FCS bank may issue debt individually, as well. Debt issued by an individual bank is uninsured, and the issuing bank is solely liable for the principal payments.

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 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 105.6 percent being the lowest for any single bank as of December 31, 2010.

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 a financial, economic, agricultural, or national defense emergency is deemed to exist. 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. In 2010, the System banks agreed to improve the quality of liquidity by establishing a framework under which each bank at all times met stringent requirements for debt maturing in the next 15 days, as well as the subsequent 30 days.

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.[16] 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 all of 2010, all Farm Credit banks maintained scores in excess of the established CIPA benchmarks.

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 capitalize on 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 and 2010, debt issuances increased further as the System called debt (multiple times in some cases) and reissued it at lower rates. For the 12 months ended December 31, 2010, the System issued $534 billion in debt securities, compared with $523 billion for 2009, $519 billion for 2008, $484 billion for 2007, and $387 billion for 2006.

Previous investor preference for shorter-term debt instruments dissipated in 2010, thereby allowing the System to extend its debt maturities in 2010. The System's weighted-average remaining maturity for all outstanding insured debt was 3.5 years as of December 31, 2010, compared with 3.1 years as of December 31, 2009, and 3.3 years as of December 31, 2008. The weighted-average interest rates for the insured debt decreased from 1.8 percent as of December 31, 2009, to 1.5 percent as of December 31, 2010.

MISSION-RELATED INVESTMENTS

FCA is committed to helping ensure a dependable and affordable flow of funds to agriculture and to rural areas so that farmers, ranchers, and rural communities can flourish. Agri-

16. The amended and restated Market Access Agreement began in the late 1990s and is periodically amended (updated) to adjust financial targets, economic incentives, and other matters.

culture 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, 2010, the mission-related investment securities held under these regulatory authorities totaled $3.07 billion, including $820.3 million in AMBS as held-to-maturity and $564.9 million as available-for-sale, $1.09 billion in securities backed by guaranteed portions of USDA loans and agricultural equipment loans, and $10.2 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.[17] As of December 31, 2010, investments in successor-in-interest contracts totaled $580.2 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 given System institutions a provisional opportunity to make addi-tional 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 website 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. The pilot program structure also enables FCA to gain critical insight and understanding of rural financial markets.

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.

Since 2005, FCA has approved a number of pilot programs and specific investments involving the fol-lowing 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). These pilot programs are expected to provide additional liquidity for rural

17. 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.

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, 2010, only one of the Farm Credit banks was participating in this program; it had $906.4 million in RHMS classified as held to maturity.

Agriculture and Rural Community Bonds and Securities—During 2010, 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 sustain 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, 2010, FCS institutions held $679.7 million of investments in these programs.

Equity Investments—FCA has approved several mission-related equity investments, including an investment in a starter farmer program 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,[18] 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, 2010, the amount of mission-related equity investments outstanding totaled $5.8 million for investments in the starter farmer program, venture capital funds, and RBICs.

18. The Farm Security and Rural Investment Act of 2002 authorizes FCS institutions to establish or 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 25 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 whether 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, FCA ensures that FCS institutions have the programs, policies, procedures, and controls to effectively identify and manage risks. The oversight program also ensures 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's efforts, continue to build the capabilities of their risk management systems.

MEETING STATUTORY EXAMINATION REQUIREMENTS

In accordance with the Farm Credit Act, FCA examines each FCS institution at least once every 18 months. The Agency also conducts 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, 2011, FCA was overseeing and examining the following FCS institutions:[19]

- 84 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 employs various risk supervision processes for

19. 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 2010, FCA also performed contract work for the U.S. Department of Agriculture. However, the safety and soundness of the FCS remains FCA's principal focus and responsibil¬ity.

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. These risk supervision processes address material risks and emerging issues in a proactive, nationally focused way.

Also, as part of its examination approach, FCA uses the following methods to communicate with regulated institutions about systemic issues:

- FCA Board Policy Statements
- Informational Memorandums
- Bookletters
- Examination Bulletins

In addition to e-mailing the communiqués to each institution as they are issued, the Agency keeps an online inventory of each form of communication. For Board Policy Statements, Informational Memorandums, and Bookletters, go to www.fca.gov/law/guidance.html. For Examination Bulletins, go to ÏÛÛ×ôŸŸÞ Þ Ł õÍÊÈõÎÖÝŸÙÌÈËÐÕÎÙÔŸ ÌßÈÔÔÈÕÜÈôõ .

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

- Loan Portfolio Management. FCA 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. FCA provides 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. FCA evaluates how collateral risk is being routinely monitored and assessed and whether operational adjustments are being made to manage increased collateral risk.
- Compensation Programs and Corporate Governance. The Agency has increased its 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.[20]

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 2010 show that the financial condition and performance of the FCS remained relatively strong and stable throughout the year. However, in 2009, risk did increase from

the low risk levels of previous years. As shown in figure 9, FIRS ratings declined in 2009 when stresses from the general economy, the credit crisis, and volatility in commodity prices surfaced and affected some institutions. At December 31, 2010, 29 FCS institutions were rated 1 (33 percent), 46 were rated 2 (52 percent), 12 were rated 3 (13 percent), and 2 were rated 4 (2 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 dairy, livestock, 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, 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—in this case, 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, 2010, FCA had 11 associations under special supervision, whose assets totaled $10.9 billion, amounting to 5 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:

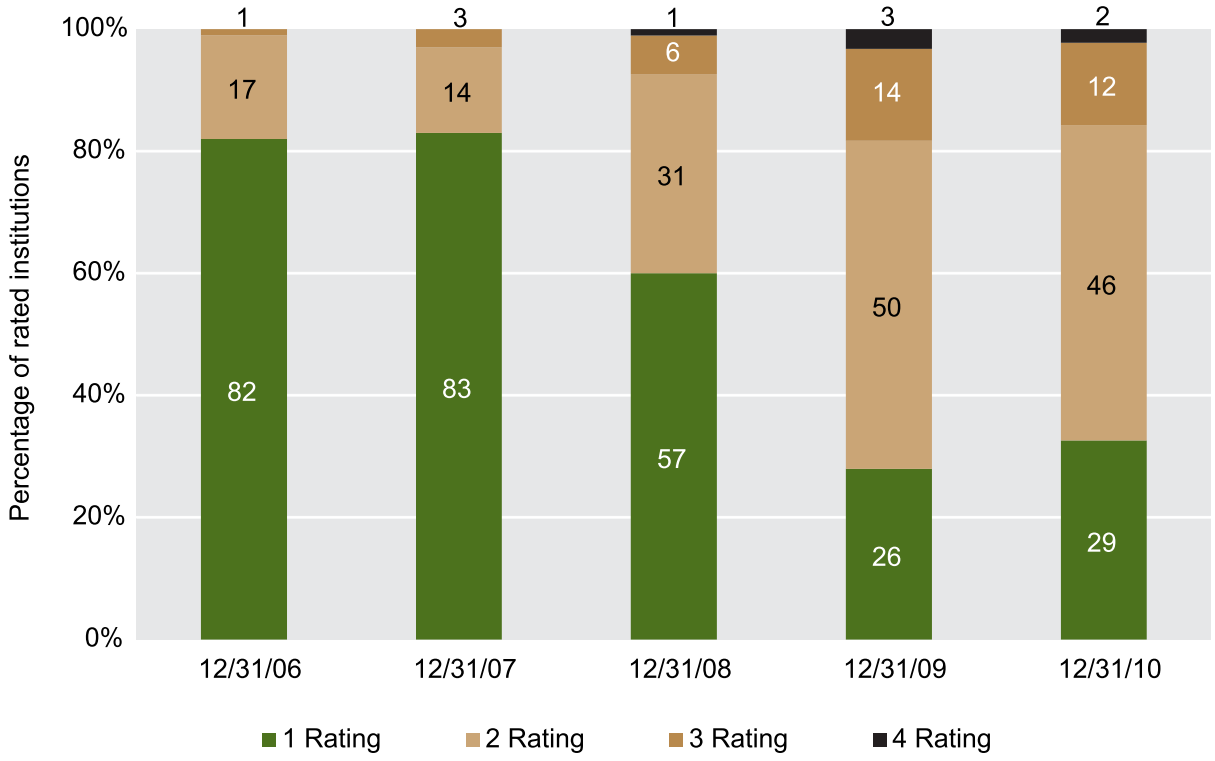
- A situation threatens an institution's financial stability.
- An institution has a safety and soundness problem or has violated a law or regulation.
- An institution's board is unable or unwilling to correct problems FCA has identified.

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

Figure 9
Financial Institution Rating System (FIRS) Composite Ratings for the FCS, 2006–2010



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.

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. As of December 31, 2010, FCA had entered into formal written agreements with five associations, whose assets totaled $1.6 billion. 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 and agricultural real estate is acquired by the FCS, 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. In 2010, when some FCS borrowers were under stress from the weakened economy, FCA 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. If FCA finds violations of law or regulations, FCA has several enforcement options to bring about corrective action.

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 agricultural real estate mortgage loans, rural housing loans, and rural utility cooperative loans. 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, which accepts mortgage loans secured by first liens on agricultural real estate and rural housing
- Farmer Mac II, which accepts 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, which accepts 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, FCA performs the following functions:

- Examines Farmer Mac at least annually for capital adequacy, asset quality, management performance, earnings, liquidity, and interest rate sensitivity
- Supervises and issues regulations governing Farmer Mac's operations
- Oversees and 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 2005 to 2010.

Table 5
Farmer Mac Condensed Balance Sheets, 2005–2010
As of December 31
Dollars in Millions

	2005 Restated	2006	2007	2008	2009	2010	Percentage growth rate 2009–2010
Total assets	4,341.4	4,953.7	4,977.6	5,107.3	6,138.8	9,479.9	54.4
Total liabilities	4,095.4	4,705.2	4,754.0	4,947.7	5,798.4	9,001.0	55.2
Net worth or equity capital	246.0	248.5	223.6	15.3	196.2	478.9	144.1

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

CAPITAL

On December 31, 2010, Farmer Mac's net worth (that is, equity capital determined using generally accepted accounting principles [GAAP]) was $478.9 million, compared with $196.2 million a year earlier. Net worth was 5.1 percent of on-balance-sheet assets as of December 31, 2010, compared with 3.2 percent at the end of 2009. The increase resulted primarily from the issuance of $250 million in 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 virtually 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 its Series B Preferred Stock. 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 3.2 percent. As of December 31, 2010, Farmer Mac continued to be in compliance with all statutory and regulatory minimum capital requirements.

At year-end 2010, 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).[21] Farmer Mac's core capital as of December 31, 2010, totaled $460.6 million, exceeding the statutory minimum capital requirement[22] of $301 million by $159.6 million. Farmer Mac's regulatory capital totaled $480.7 million as of December 31, 2010, exceeding the regulatory risk-based capital requirement of $42.1 million by $438.6 million. Regulatory capital was 4.4 percent of total Farmer Mac I and rural utility program volume (including both on- and off-balance-sheet agricultural and utility program volume but excluding Farmer Mac II). Risk exposure on Farmer Mac II loans is extremely low as they are guaranteed by the U.S. Department of Agriculture. Table 6 offers a historical perspective on capital and capital requirements for 2005 through 2010.

FCA published a proposed rule in December 2009 and a final rule in April 2011 to revise the risk-based capital regulations. The revisions address new program authorities for rural utility financing and update 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.

In addition to supporting program assets, Farmer Mac's capital supports nonprogram investments. Nonprogram investments provide

Table 6
Farmer Mac Capital Positions, 2005–2010
As of December 31
Dollars in Millions

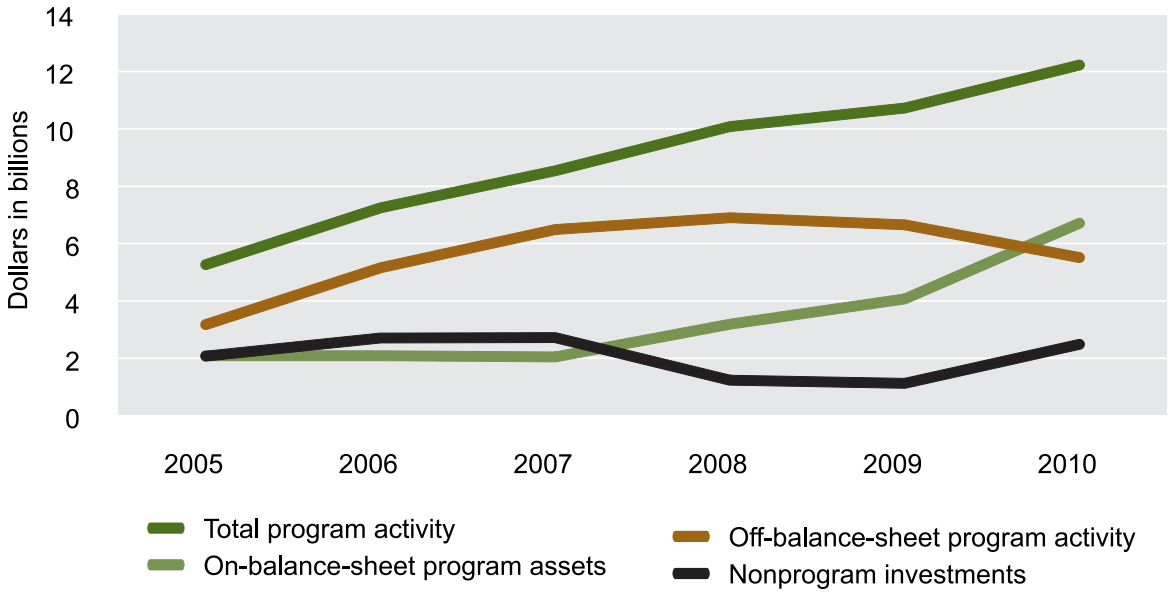
	2005 Restated	2006	2007	2008	2009	2010
GAAP equity	$246.0	$248.5	$223.6	$15.3	$196.2	$478.9
Core capital	$230.8	$243.5	$226.4	$207.0	$337.2	$460.6
Regulatory capital	$239.4	$248.1	$230.3	$223.4	$351.3	$480.7
Statutory requirement	$142.5	$174.5	$186.0	$193.5	$217.0	$301.0
Regulatory requirement	$29.5	$42.9	$42.8	$57.3	$35.9	$42.1
Excess over statutory or regulatory requirement*	$88.3	$69.0	$40.4	$13.5	$120.2	$159.6
Capital margin excess > minimum	62.0%	39.6%	21.7%	7.0%	55.4%	53.0%

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

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

21. See the FCA Website at www.fca.gov for more information about the RBC Model.
22. The statute requires minimum capital coverage of 2.75 percent for on-balance-sheet assets and 0.75 percent for off-balance-sheet obligations.

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.

liquidity in the event of a short-term disruption in the capital markets that would prevent 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. FCA expects to issue a proposed rule on this topic in 2011 that would, among other things, address certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA).

PROGRAM ACTIVITY

Farmer Mac's total program activity increased to $12.2 billion on December 31, 2010, from $10.7 billion a year earlier (see figure 10). The net increase was largely attributable to new on-balance-sheet business (both agricultural and 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 the 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. As shown in figure 11, standbys represented 14.4 percent of Farmer Mac's total program activity in 2010.

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 2010, 45 percent of program activity consisted of off-balance-sheet obligations.

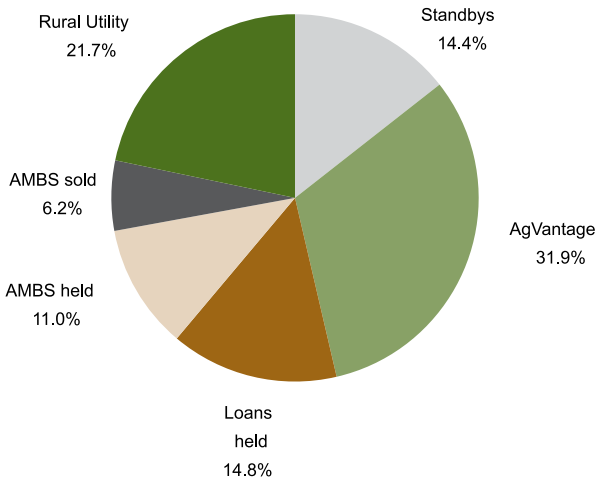
ASSET QUALITY

On December 31, 2010, the portion of the Farmer Mac I program portfolio that was nonperforming was $81.8 million, or 1.9 percent of the principal balance of all loans purchased, guaranteed, or committed to be purchased.[23] This compares with $62.0 million, or 1.41 percent, on

23. Farmer Mac assumes 100 percent of the credit risk on loans purchased (and on most loans underlying Standby commitments) after enactment of the Farm Credit System Reform Act of 1996, whereas the loans purchased prior to enactment of the act are supported by mandatory 10 percent subordinated interests, which mitigate Farmer Mac's exposure. For that reason, loans purchased 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.

Figure 11
Farmer Mac Total Program Activity
As of December 31, 2010

Total = $12.17 billion



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

AMBS = agricultural mortgage-backed securities

December 31, 2009. Assets are considered to be nonperforming when they are 90 days or more past due, in foreclosure, or in bankruptcy; real estate properties acquired by Farmer Mac through foreclosure are also reported as nonperforming assets. As of December 31, 2010, Farmer Mac's 90-day delinquencies were $70.2 million, or 1.63 percent, compared with $49.5 million, or 1.13 percent, as of December 31, 2009. Real estate owned as of December 31, 2010, was $2 million, up from $739,000 a year earlier. Of the 90-day delinquencies in Farmer Mac's loan portfolio, 16 percent were on ethanol loans. Delinquencies on non-ethanol loans increased primarily because of loans on crops (largely corn) and permanent plantings. Farmer Mac reported no delinquencies or nonperforming loans in its pools of rural utility cooperative loans.

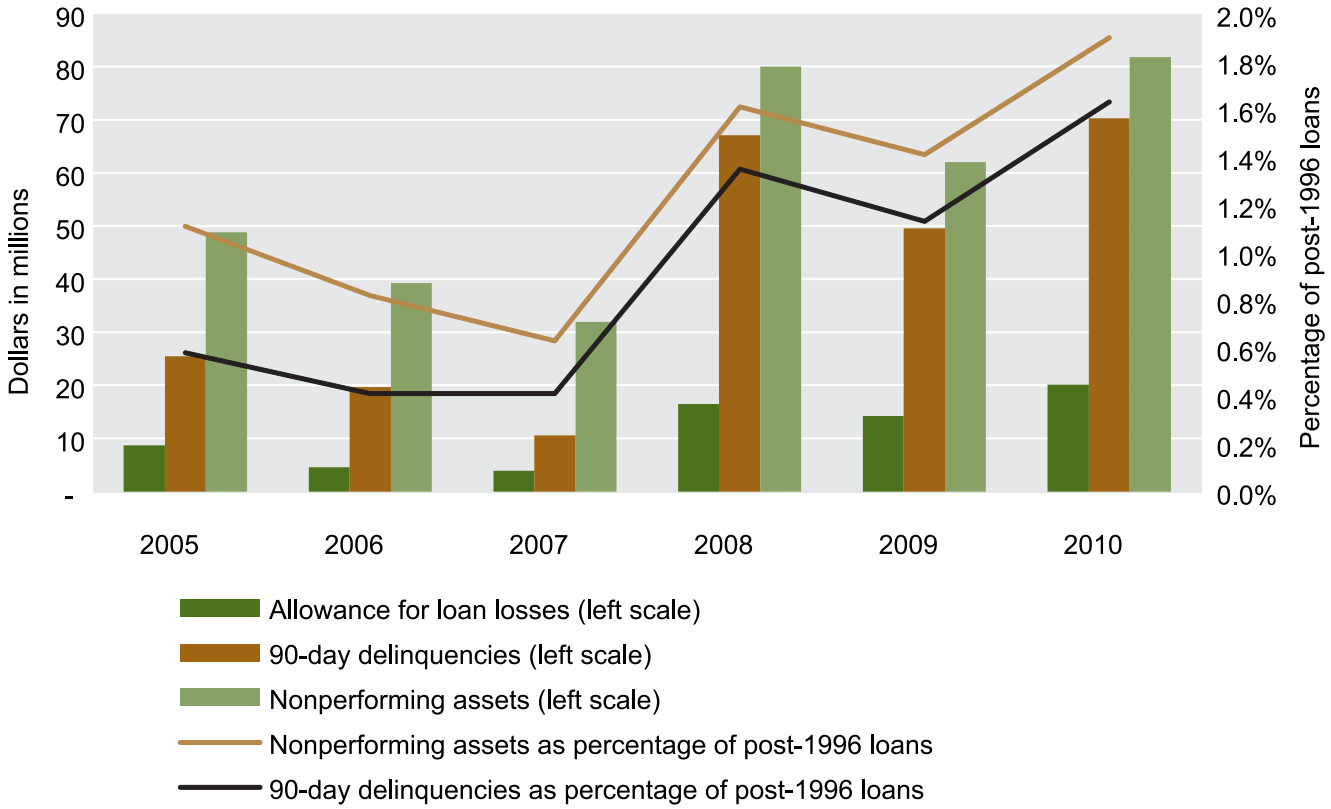
On December 31, 2010, Farmer Mac's allowance for losses totaled $20.1 million, compared with $14.2 million on December 31, 2009. Farmer Mac attributed the change in the allowance for losses primarily to a $4.3 million provision for loan losses, charge-offs of $0.6 million recognized during the year, and $2.2 million in recoveries on a loan secured by an ethanol plant. 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 $22.1 million (in accordance with GAAP) for the year ended December 31, 2010, down from the $82.3 million loss reported at year-end 2009. Core earnings for 2010 were $25.4 million, compared with a loss of $16.1 million on a core earnings basis in 2009.[24] Net interest income, which excludes guarantee fee income, was $96.0 million in 2010, up from $85.9 in 2009. Guarantee fee income, at $24.1 million, was 24.3 percent lower in 2010 than in 2009. This reduction was due in part to the reclassification of $4.6 million in guarantee fees to net interest income to comply with new GAAP accounting guidance requiring securities previously reported as off balance sheet to be reported as on balance sheet. Nonprogram investments accounted for an estimated 12 percent of interest income for 2010, down from 16 percent for 2009. Table 7 shows a five-year trend for the basic components of income.

24. 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 reports core earnings to present an alternative measure of earnings performance. The components included in core earnings calculations are at Farmer Mac's discretion.

Figure 12
Allowance, Nonperforming Asset, and Delinquency Trends, 2005–2010
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, 2005–2010
As of December 31
Dollars in Millions

	2005 Restated	2006	2007	2008	2009	2010	Growth Rate 2009–2010
Total revenues	$83.9	$67.8	$31.5	($140.6)	$181.8	$99.1	(45%)
Total expenses	$36.8	$38.0	$27.1	$13.5	$99.5	$77.0	(23%)
Net income available to shareholders	$47.0	$29.8	$4.4	($154.1)	$82.3	$22.1	(73%)
Core earnings	$28.7	$25.9	$29.9	($81.5)	$16.1	$25.4	57%

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 2010, the Farm Credit System operated in an improving farm and rural economy. The United States and most of the world continued to recover from one of the worst economic downturns since the Great Depression. Consequently, both domestic and foreign demand for agricultural products improved, particularly for higher-end items like meats and dairy products, which had been particularly affected by slumping demand. Dairy, cattle, and hog producers experienced a rebound in profit margins by the end of 2010 as price increases generally outpaced higher input costs, particularly for feed. Rising demand for commodities from emerging markets and poor harvests in key production regions led to much higher prices for major grains, oilseeds, and fibers, particularly in the second half of the year. This boosted farm incomes significantly compared with 2009, with the USDA forecasting that net farm income rose 27 percent over that of 2009. The ethanol industry, which struggled throughout 2009, also rebounded in 2010 as gasoline demand picked up and oil prices rose. Industries tied to the housing sector, such as timber, nursery, and sod, remained weak in 2010 as building starts failed to recover from 2009 lows.

Economic conditions in the United States and throughout the world are expected to improve in 2011 and 2012, with economic growth strongest in developing countries. Modest GDP growth is most likely for the United States in 2011 according to consensus forecasts. In general, rural economies fared somewhat better than metro areas in the past recession and are expected to continue to improve in 2011. For the farm economy, the U.S. Department of Agriculture forecasts that net farm income for 2011 will rise by 20 percent over that of 2010. If the forecast proves correct, net farm income, when adjusted for inflation, will be the second highest in the past 35 years.

With the recovering general economy and strong farm economy in 2010, the FCS experienced growth in loan volume and in earnings. However, the System's financial performance was still negatively affected by continued weakness in loan performance in some of its business segments, such as dairy and cattle. Furthermore, the sluggish housing market continues to adversely affect the System's forestry and nursery portfolio.

A number of factors, both domestic and foreign, could affect the System's long-term ability to profitably finance agricultural enterprises. In the following paragraphs, FCA identifies some of these risks, including conditions in the macro-economy and the farm economy, government policies, foreign trade, and other longer-term challenges. Through its regulatory and examination activities, FCA will continue to closely monitor and address these risks.

PROSPECTS FOR THE GENERAL ECONOMY

Key economic indicators in the first half of 2010 suggest that economic growth will continue into 2012, thus providing a firmer financial footing for businesses and consumers alike. Indicators of business spending and confidence in the manufacturing and the service sectors continued to show strength in the first half of 2011, suggesting that employment growth will likely continue in the second half. While payroll growth in early 2011 was sluggish relative to past recoveries, it is nonetheless bolstering consumer confidence and spending ability. Even so, in all likelihood, the unemployment rate for the year will remain above 8.0 percent as structural changes in the labor market slow the pace to full employment.

On balance, the economic outlook for 2011 suggests that consumer demand will be sufficient to promote sustainable moderate growth, with many forecasters expecting moderate real GDP growth of 3.0 to 3.5 percent this year, up from 2.9 percent for 2010. Consumer spending will be a key factor in the economy's performance, as it represents 70 percent of the U.S. economy. The gradual improvement in employment earnings, some recovery in household wealth, and more credit availability should promote further strength in consumer spending.

While some of the problems that precipitated the recession have now been addressed, a few still continue to be a drag on economic activity. One of those areas is the servicing of household debts that accumulated in the last decade. Total household debt receded below $14 trillion in 2010 from the $14.5 trillion peak before the recession, but relative to disposable incomes it remains historically high. However, low interest rates are aiding consumer spending by lowering the cost of servicing outstanding debts. In the fourth quarter of 2010, the percentage of disposable personal income going toward household financial obligations fell to 16.6 percent from the 18.8 percent peak prior to the recession.

Another one of these problems is the housing sector, which was at the epicenter of the financial crisis. In a typical recovery, housing spurs economic activity as confident buyers begin to purchase homes, new furniture, and other home improvements. This time, however, the housing sector continues to face an imbalance of supply and demand as foreclosure activity remains high in many major housing markets, and consumer ability to qualify or secure credit is less than in the past. As a result, housing prices continued to decline in many areas in the first part of 2011. Although housing accounts for about 6 percent of the economy, housing values impact consumer confidence, consumer credit, and spending, and hence have an outsized impact on the overall economy. New home sales have remained stagnant in the first half of 2011, while housing starts and building permits hovered near the lows of the recession. New home sales have a large impact on the forestry, sod, and nursery industries.

The U.S. export sector is also expanding with the improving world economy, but so too are imports. While the net trade balance will remain in a negative position for 2011, the trade balance for agriculture should remain positive. Trade disruptions caused by the economic consequences of the Japanese earthquake and tsunami, while believed to be temporary, could disrupt agricultural and forestry trade for an extended period. Sovereign debt problems have rattled financial markets over the past year, and these problems represent a drag on growth in Europe going forward.

An issue of rising concern is the size of the Federal budget deficit and its potential effect on inflation. The deficit for fiscal year 2011 is projected to exceed the $1.3 trillion gap recorded in fiscal year 2010. Outstanding public federal debt in the past two fiscal years rose from $5.8 trillion to $9.0 trillion and is forecast to surpass $10 trillion by the end of fiscal 2011 according to the Congressional Budget Office. Ongo-ing 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 budget deficits had been viewed as necessary to address the economic recession, the focus is now shifting to greater fiscal discipline. Such a move, while enhancing consumer and business confidence, also means cuts to spending programs such as farm programs.

With respect to inflation, most of the current data point to low rates of increase in core consumer prices despite sharp jumps in energy, food, and some commodities in late 2010 and early 2011. For the first quarter of 2011, the seasonally adjusted annual consumer inflation rate was 6.1 percent; when food and energy are excluded, the annualized rate was just 2 percent. Most observers believe inflation will remain in check for the rest of this year, reflecting household and business economic uncertainty, slack labor markets and manufacturing capacity. However, over the longer term, inflation may rise further. Agriculture feels the impact of inflation in the rising costs of inputs, as well as in the potential reduction in demand for high-value consumer items such as meats.

Other factors affecting the outlook for the FCS are funding costs and the future direction of borrower interest rates. As noted on page 37, the System maintained regular and flexible access to the debt markets in 2010 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. It is uncertain how markets will react this summer, when the Federal Reserve's latest round of quantitative easing comes to an end. Over the longer term, rate increases are likely although future interest rate movements are highly unpredictable and events could occur that prolong the current low rate environment in the United States. However, because of the safety of System securities, investors are expected to continue purchasing them in 2011 at favorable spreads over U.S. Treasury securities.

ECONOMIC SETTING FOR AGRICULTURE AND CREDIT

Overall, the agricultural sector entered 2011 on a firm footing. Net farm income for 2010 was estimated by USDA to have rebounded to $79 billion from the $62 billion recorded in 2009. Net cash farm income (reflecting cash transactions during the year) rebounded even more strongly, surging 32 percent and surpassing the $90 billion recorded in 2008. The overall strength of the U.S. farm economy is evidenced by the fact that the top five years of earnings of the past three decades have occurred since 2004.

USDA's forecast for 2011 suggests that the farm economy will build on the gains made in 2010, with net farm income forecast to rise nearly 20 percent to $95 billion (forecasts as of February 14, 2011). If achieved, this level would be the second highest inflation-adjusted net farm income recorded in the past 35 years. Historically, extended periods of U.S. farm prosperity such as this are relatively infrequent and have been associated with war-time supply disruptions. As a testimony to the breadth of farm earnings, direct government farm program payments are forecast to total just $10.6 billion in 2011, down from $12.2 billion estimated for 2010. If so, these payments would represent just 11 percent of net farm income, the lowest share in three decades, and well below the 10-year average of 20 percent.

The balance sheet of the farm sector improved in 2010 and is forecast to strengthen further in 2011. Total farm assets are forecast to rise 6 percent and, if realized, total farm equity would surpass $2 trillion. The sector's debt-to-asset ratio would fall below 11 percent at year-end 2011. This ratio would be 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 carry little or no debt from one year to the next.

Behind the favorable sector-wide picture, some commercial farms remain weak financially. While producers of the major field crops have enjoyed record incomes and hefty gains in wealth, producers with incomes dependent on the sale of livestock and livestock products in 2010 were recovering from poor earnings and an erosion of their equity positions (particularly if they had to rely on purchased feed grain items). Similarly, the financial circumstances for producers of housing-related products, such as nursery plants and timber, have also been slow to mend. Naturally, considerable regional differences exist, reflecting enterprise mixes and local economic conditions.

With about 84 percent of the farm sector balance sheet made up of farmland assets, land values have an outsized influence on the strength of farm balance sheets and farmer creditworthiness. Surveys conducted by appraisers, universities, and by Federal Reserve district banks all suggest that farmland prices rose significantly in 2010 and that the upward trend continued into the first quarter of 2011. The strongest reported gains were for cropland in the Midwest, particularly high-quality land in major corn- and soybean-producing regions. These surveys indicated that Statewide average farmland values for 2010 increased by more than 10 percent, and for some States, average price increases exceeded 15 percent.

The volume of farmland sales was low in 2010 as potential sellers held on to land and thus limited the

available supply. When sales did occur, farmers remained the primary purchasers of farmland. Pasture and ranchland values, as well as the value of farmland in transition—that is, farmland located near metro regions, did not change as significantly in 2010, reflecting a less robust livestock sector and weak housing construction. While outstanding farmland debt rose 3.5 percent at System associations, farm leverage is generally viewed as modest, and anecdotal reports of cash purchases of farmland or use of large cash down payments have been frequent.

Land value surveys show that, in some Midwest States like Iowa, farmland prices have doubled in the past six years, raising concerns that current values may be unsustainable and that a destabilizing correction similar to that which occurred in the 1980s is looming. The higher cropland values reported in 2010 were supported by a surge in the crop prices for major acreage crops—corn, oilseeds, wheat, and cotton—in the latter half of the year. Because production costs, including land rental costs, did not rise as much as crop prices, crop producers enjoyed favorable net returns and future profit expectations. Valuation models generally agree that the higher 2010 average cropland values reported were not significantly out of line with these higher expected profit margins, especially in this historically low interest rate environment.

To address the rising risks associated with farmland values, FCA has issued guidance on collateral risks to System lenders through a series of Informational Memorandums. Many System institutions are improving underwriting standards and appraisal guidelines on farmland collateral, as well as improving efforts to identify portfolio risk through land value studies and stress testing of land value changes. To improve the monitoring of these risks and to form the appropriate future regulator response to them, FCA organized a meeting in early 2011 with the other Federal financial regulators regarding agricultural land values and associated risks to loan collateral.

Farm prices for a range of farm products rose significantly during 2010, continuing a pattern of more volatility in farm prices that presents decision-making challenges for producers and lenders alike. Prices received by farmers in January 2011 were at least 30 percent higher than a year earlier for feed grains, food grains, oilseeds, and upland cotton. Positive price gains were recorded for the livestock sector, with broilers and eggs being the only major livestock enterprises experiencing weaker pricing at the start of 2011 than the start of 2010.

Through herd downsizing and higher demand, the excess capacity problem in the livestock industry eased in 2010. But the recovery of the livestock sector has been hampered by the rise in feed prices since mid-2010, once again hurting profit margins despite a more favorable, but also volatile, pricing environment for livestock products. The impact of high feed ration costs is not always uniform in livestock. For example, negative margins are expected for broilers in 2011, whereas margins in turkey production are expected to stay positive. Margins for cow-calf production look favorable for 2011, and dairy, which has been slow to heal from 2009 losses, is likely to stay positive for the year. Because of the large amount of feed that must be purchased, margins for farrow-to-finish hog operations and cattle feedlots are especially affected by rising grain prices. The generally weak margins reduce the incentives for capital investments in production expansion. Other rising input costs, such as fertilizers and fuel, represented a challenge to crop producers. There are concerns that, if crop prices were to collapse, some producers will be caught in a cost squeeze because input costs decline more slowly. Of course, this would be good news for livestock producers because it would decrease their input costs.

Higher prices for major farm commodities are being driven by U.S. biofuels demand, strong emerging market demand for basic foodstuffs and protein, and tighter world stocks brought on by a series of poor crops in major producing regions around the world. A reversal in the direction of any one or all of these factors

could alter the current pricing picture for a particular commodity and quickly erode profit margins. 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 and are looking more closely at the risk management practices of credit applicants, including the use of risk management tools such as forward contracting, futures, options, and USDA revenue insurances.

Rapidly rising U.S. ethanol production in recent years has pushed up corn demand, but that ramp-up in corn demand may have largely ended. U.S. ethanol production grew 238 percent in the past five years, reaching 13.2 billion gallons in 2010 and is expected to grow further this year. In the process, the industry is expected to utilize 5 billion bushels or about 40 percent of the 2010 U.S. crop. Policy changes with respect to blender tax credits and permitted blending levels of ethanol in gasoline present risks to future demand. Also, under current legislation, a maximum of 15 billion gallons of the annual renewable fuel standard mandate is to be derived from conventional biofuels by 2015, suggesting that future growth could be limited in the absence of changes in policies. The conventional mandate for 2011 is 12.6 billion gallons.

Farm program and foreign trade agreements are two important policy forces that help shape farm income and thus affect borrower repayment risk. The flow of Government payments has generally supported farm income, mostly for crop producers, and helped stabilize prices, but sometimes at a heavy cost to taxpayers. More recent policies have shifted more of this responsibility to Government-supported revenue insurance policies. This year's higher crop prices gave producers the opportunity to purchase various revenue insurance products at affordable prices that protected their profit margins and thus their ability to meet debt payments if prices or yields decline significantly this year.

A key concern for agricultural lenders will be the outcome of the 2012 Farm Bill debate. As the 2012 legislative debate approaches, the current budgetary environment suggests that farm program costs will be scrutinized closely as part of the 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 offsetting farmer repayment risk in the near future.

U.S. agricultural exports have been an important driver of past farm income growth, and future directions in trade will continue to shape the farm economy. In the past five years, the value of U.S. farm exports has nearly doubled, reaching $115 billion in 2010. The relatively weak value of the dollar compared with the currency value of our trading partners has likely contributed to recent growth. While trade growth has occurred in a range of agricultural products with a range of countries, the most notable growth in agricultural trade occurred with China, which has become the second largest world economy. China has become a major purchaser of the United States's second largest crop, soybeans, accounting for approximately one-quarter of last year's production volume. Changes in economic growth or trade policies of a handful of major trading partners can alter the economic landscape for U.S. producers quickly.

Increasing future trade opportunities hinges on trade negotiations. While the Doha Round of multilateral negotiations under the World Trade Organization (WTO) remains stalled, progress was made last year on bilateral agreements that could boost future agricultural exports. Perhaps most notable was the finalization of U.S.–Korea trade agreement, known as the KORUS agreement. If approved by Congress, the trade pact would improve the access of

U.S. farm products to South Korea's $1 trillion economy and its 49 million consumers. Already, Korea is the fifth largest export market for U.S. farm products. In addition, progress was made on other trade pacts with important agricultural markets, notably the 2006 U.S.–Colombia Trade Promotion Agreement and the Trans-Pacific Partnership Agreement.

CREDIT RISK IN THE SYSTEM'S PORTFOLIO[25]

The System's loan portfolio resumed its growth in 2010 although some sectors remained exposed to elevated stress levels. Increased farm income and agricultural real estate values in many parts of the United States mitigated the credit stress on the System's overall portfolio. Loan growth largely came in areas where cash grain is produced, as higher commodity prices caused loan demand for production inputs, inventories, and real estate to increase. However, some sectors and regions continued to experience significant credit distress in 2010, particularly the dairy, forestry, livestock, and biofuel sectors, and the southeastern portion of the United States. In some cases such as dairy, operating margins were tight because of the increase in price of production inputs; as a result, producers were unable to reduce their debt levels. In other cases, such as the forestry sector, it was the reduced demand for housing and weaknesses in the general economy that kept producers from reducing their debt. Nonaccrual loans to dairy, forestry, livestock, and biofuel sectors accounted for $1.6 billion of the $3.2 billion in System nonaccrual loans at year-end. The remaining nonaccruals were scattered across the other business segments of the portfolio but were more concentrated in loans for real estate. Also, charge-offs of $354 million, representing about 60 percent of all FCS charge-offs, were realized in loans to these agricultural sectors. These four sectors totaled about $46.7 billion, or 27 percent of System loans, and are discussed in more detail below.

Dairy

System loans outstanding to the dairy sector totaled $14.1 billion at December 31, 2010, up about 5 percent from the figure a year earlier. Many producers continued to face stressful conditions as high feed costs eroded profits from increased milk prices and caused many of those producers with high debt levels to continue to rely on forbearance from their lenders. Most producers who had seen debt levels escalate in 2008 and 2009 were unable to make much progress in reducing their debt and remain vulnerable to factors such as reduced milk prices, higher feed costs, and interest rate increases. System loans not accruing interest rose slightly to $656 million at year-end 2010, and $153 million in charge-offs were realized. Loans to this sector amounted to about 8 percent of total loans and 42 percent of total System capital.

25. See page 11 for an overview of the System's financial condition.

Livestock (Cattle, Hogs)

The System's loans outstanding to the cattle and hog industry totaled $20.3 billion at year-end, down slightly from the past year-end. Cattle loans were up modestly; however, hog loans declined to $4.1 billion at year-end, reflecting a decrease of $0.6 billion during 2010 as producers repaid operating loans or, in some cases, raised capital from investors. Most producers returned to profitability because cattle and pork prices rose more than feed costs during the year. Prices rose in response to a return of strong export demand. System livestock loans not accruing interest fell dramatically to $376 million at year-end from almost $680 million at the end of 2009, and $70 million in charge-offs were realized. Loans to livestock operations amounted to less than 12 percent of total loans and 61 percent of total System capital.

Biofuels

At the end of 2010, loans outstanding to the biofuels (primarily ethanol) industry totaled $2.4 billion, down about 8 percent from a year earlier. Loans declined as firms paid down debt with revenue from improved operating margins and some renewed ability to raise capital. Some of the firms that had filed bankruptcy or had idled their plants during 2009 were able to restructure debt and restart plants, while FCS institutions were able to sell some plants acquired from loan collection actions. System loans not accruing interest totaled $175 million at year-end, and charge-offs totaled $29 million. Biofuel loans outstanding represented 7 percent of capital and less than 2 percent of total loan volume. Both losses and nonaccrual assets are concentrated in a few firms. In addition to its loan holdings in the biofuels industry, the System also originates and participates out a significant amount of debt to non-System lenders.

Forestry

System loans outstanding to the forestry sector totaled $10.0 billion, down about 3 percent from a year earlier. Forestry loans declined because demand for housing and lumber products remained soft, particularly in the Southeast. Many producers reduced debt as a result of scheduled loan pay downs, as well as the liquidation of properties to ease cash flow difficulties. System loans not accruing interest rose to $422 million at year-end, and $102 million in charge-offs were realized. Loans to this sector amounted to about 6 percent of total loans and 30 percent of total System capital.

APPENDIX

FARM CREDIT ADMINISTRATION OFFICES

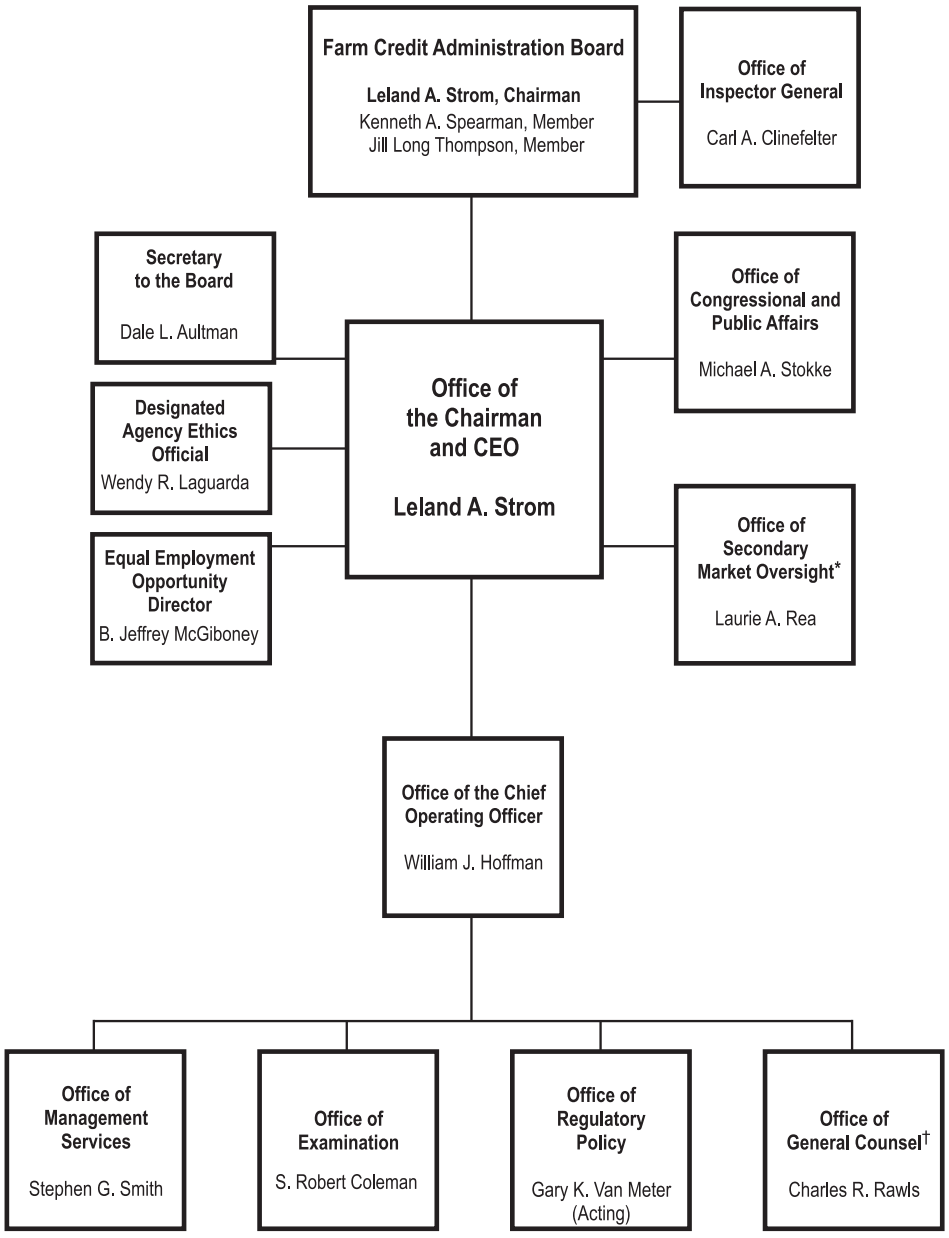
As of December 31, 2010, FCA had 291 full- and part-time employees. These employees are divided among the following offices, with the majority serving in the Office of Examination.

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 adopted by the FCA Board. The

Figure 13
FCA Organizational Structure
As of January 2011



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

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, facilitates intergovernmental relations, and prepares testimony for the Chairman and other Board members. The office also provides information to external audiences through news releases, fact sheets, reports, and other publications. It cultivates relationships with media representatives who report on matters related to agriculture and rural credit, and it manages the content of the FCA website. OCPA also organizes 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 regulations, 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

William J. Hoffman is Chief Operating Officer. Before accepting 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. In 1984 he was 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.

Carl A. Clinefelter is the FCA Inspector General. Before becoming Inspector General in July 2005, Mr. Clinefelter headed several offices at FCA over a number of years. Primarily, his background with the Agency is in financial institution examination, supervision, and regulation. Before joining the Agency in 1980, Mr. Clinefelter was an assistant vice president in the Federal Intermediate Credit Bank of New Orleans, which was regulated by FCA. He received an M.B.A. from Auburn University in 1975 and served as an officer in the U.S. Navy from 1968 to 1971. In addition to being the Agency's Inspector General, Mr. Clinefelter has served since January 2009 as the Vice Chairperson of the Council of the Inspectors General on Integrity and Efficiency, which is composed of Inspectors General from 73 Federal departments and agencies.

Samuel Robert Coleman is Director of the Office of Examination.[1] Before being named to this position in October 2010, he was Director of the Agency's Office of Secondary Market Oversight for five years. Mr. Coleman joined FCA in 1986 as an examiner in the Office of Examination. He held various positions in that office, providing technical support to FCA field offices and to the Policy Development and Planning Division. During this period, Mr. Coleman completed the commissioning program and became a commissioned examiner in 1990. In 1994, he transferred to the Office of Policy and Analysis, where he served as a policy analyst specializing in regulation development, and then as a senior policy analyst. Mr. Coleman was named Director of the Regulation and Policy Division in June 2003. He holds the Chartered Financial Analyst designation, which the CFA Institute awarded him in 2000.

1. Mr. Coleman became Director of the Office of Examination in October 2010, replacing Thomas G. McKenzie, who served in this position from late 2004 through September 2010.

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.

Laurie A. Rea[2] is Director of the Office of Secondary Market Oversight (OSMO). She was named to this position in January 2011. Ms. Rea joined FCA in 1986 after graduating from San Diego State University. She has held several positions with the agency, beginning with the Office of Examination where she became a commissioned FCA examiner in 1989. In 1992, she joined the Office of Policy and Analysis (now the Office of Regulatory Policy), where she gained experience in policy and regulation development. Since 2005, Ms. Rea has served as associate director and finance and capital markets team leader in the Office of Regulatory Policy, where she managed the approval of Systemwide debt securities and led the agency's regulatory capital and investment policy development. Ms. Rea is a Chartered Financial Analyst from the CFA Institute and a Certified Risk Professional.

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.

2. Ms. Rea replaced Daniel Fennewald, who served as Acting Director of OSMO after Samuel Robert Coleman became Director of the Office of Examination in October 2010.

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 1987 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.

Gary K. Van Meter is Acting Director of the Office of Regulatory Policy (ORP).[3] He was named to this position in November 2010 after having served as the Deputy Director of ORP for five years. Prior to this, he served in the Office of General Counsel (OGC) for 17 years. In OGC, he served first as a senior attorney and later as senior counsel before joining ORP. Mr. Van Meter holds a J.D. from West Virginia University College of Law and a master of law in taxation from Georgetown University Law Center. He is also a certified public accountant. From 1972 to 1974, Mr. Van Meter was an enlisted member of the U.S. Marine Corps, and he was an officer in the U.S. Navy Judge Advocate General's (JAG) Corps from 1981 to 1986.

Mark McBeth is the Executive Assistant to Leland A. Strom, Chairman and CEO of FCA.[4] His duties include advising the Chairman on policy, administrative, 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.

3. In June 2011, Mr. Van Meter became Director of the Office of Regulatory Policy.

4. Mr. McBeth retired at the end of May 2011, and Michael Stokke, who also serves as the Director of the Office of Congressional and Public Affairs, became the Acting Executive Assistant to the Chairman.

Dale L. Aultman became Secretary to the FCA Board in January 2011.[5] He began working at FCA in 1988. For the first 10 years, he worked in the Office of Examination, where he became a commissioned examiner. Then for 12 years, he was a policy analyst in the Office of Regulatory Policy. Mr. Aultman is a member of the National Association of Parliamentarians. In 2010, he became Virginia's eighth electronic notary. In 2007, he completed FCA's Supervisory Development Program. Mr. Aultman graduated with distinction from Southwestern Graduate School of Banking at the Southern Methodist University and holds a finance degree from the University of Oklahoma.

5. Mr. Aultman replaced Roland E. Smith, who served as Secretary to the Board from January 2006 until January 2011.

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 severity of weaknesses or unsafe and unsound conditions are so critical as to require urgent external financial assistance. Risk management practices are inadequate for the size, complexity, and risk profile of each institution in this group. In the absence of decisive corrective measures, these institutions will likely require liquidation or some form of emergency assistance, merger, or acquisition.

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 2010 Annual Report on the Farm Credit System is available on FCA's website 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 website at www.farmcredit-ffcb.com. Copies can be obtained from

Federal Farm Credit Banks Funding Corporation
10 Exchange Place, Suite 1401
Jersey City, NJ 07302
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The Farm Credit System Insurance Corporation's annual report is available on its website at www.fcsic.gov. Copies of this report can be obtained from

Farm Credit System Insurance Corporation
1501 Farm Credit Drive
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