# 2011 *Annual* Report

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

# Contents



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# Statement of the Chairman and CEO

June 2012

Dear Reader,

On behalf of the Board and the dedicated employees of the Farm Credit Administration, I present the 2011 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 2011. It is well positioned to withstand the continuing challenges posed by the general economy and by stress in some sectors of the agricultural economy.

### Condition of the Farm Economy

The rural economy fared somewhat better in 2011 than the general economy. Many rural areas benefitted significantly from booms in agriculture and the extraction of minerals and energy. As a result, regions dependent on commodity production and mineral/energy extraction have added more jobs.

Many producers enjoyed strong profits in 2011 because prices were high for large-acreage crops like corn and soybeans, and because production costs, including land rental costs, did not rise as much as crop prices. Cropland rental rates are expected to rise significantly in 2012, particularly in the Midwest. Higher rental rates and other production expenses are reducing profit margins and increasing the financial risk of buying land.

### Financial Condition of the FCS

The overall condition and performance of the FCS remained safe and sound during 2011. Earnings, assets, and capital levels are all strong. System earnings were up 12.70 percent in 2011, increasing to a record $3.94 billion compared with $3.50 billion in 2010. The System's increase in earnings continues to be driven largely by higher net interest income and lower provisions for loan losses.

While credit quality in the System's loan portfolio is generally favorable, certain System borrowers remain under stress. In addition, the weakness in the general economy and the housing market continues to affect certain sectors such as forestry and horticulture.

As of December 31, 2011, nonperforming loans accounted for 1.72 percent of gross loans, down from 1.93 percent at year-end 2010. Loan delinquencies (that is, accruing loans that are 30 days or more past due) remained a low 0.38 percent of total accruing loans, compared with 0.33 percent at year-end 2010.

The System's total capital was $35.9 billion at year-end 2011, compared with $33.3 billion at year-end 2010. The most significant factor contributing to the increase in System capital was net income earned and retained. With the increase in total capital, the System's capital-to-assets ratio at year-end improved from 14.5 percent in 2010 to 15.6 percent in 2011. Surplus accounts for the overwhelming majority of capital.

System loan volume did not change from 2010 to 2011, and some sectors continued to face high stress levels. An increase in farm income and the value of farmland, particularly in the middle part of the United States, offset the impact of credit stress created from other regions and sectors on the System's overall portfolio. Lending to finance production inputs, inventories, machinery, and real estate increased in many areas where cash grain is produced.

Some sectors, such as dairy, hogs, cattle, and biofuels, became profitable again in 2011 after enduring significant credit stress in 2010; as a result, the quality of loans to these sectors improved. However, other sectors, such as poultry, horticulture, and forestry, saw continued distress in 2011. Continued weak demand for housing and tepid growth in the general economy did not provide enough revenue to cover operating costs and to reduce debt, and in some areas, real estate values continued to decline.

### Young, Beginning and Small (YBS) Farmer Lending

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 to allow potential YBS borrowers to qualify for loans. Associations also offer training through their YBS programs to help these borrowers be successful.

In 2011, the share of total System farm loans going to young, beginning, and small farmers declined from that of 2010. However, many associations experienced gains in the share of their total lending to these groups. For example, the share of total new farm loan volume going to young farmers rose in 41 percent of the associations, and the share going to beginning farmers rose in 28 percent of the associations.

### FCA's Supervision and Oversight of the System

As the regulator of the System, we employ various processes for evaluating systemic risks in both agriculture and the financial services industry that can affect an institution, a group of institutions, and the System as a whole. Currently, we are emphasizing the following areas:

- **Loan Portfolio Management.** Our examiners review the systems and processes that institution boards of directors and management use to plan, direct, control, and monitor lending operations.
- **Collateral Risk Management.** We evaluate how institutions routinely monitor collateral risk, and we assess whether they are adjusting their operations to manage the risk.
- **Profitability and Repayment Capacity.** Our examiners evaluate systemic and prospective risks that may affect borrowers' profits and their ability to repay loans.
- **Public Mission.** We assess whether FCS institutions are fulfilling their chartered mission to provide credit and related services to all eligible, creditworthy customers.

### Borrower Rights

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 notify borrowers of the right to seek restructuring of an agricultural loan before beginning foreclosure. It also provides borrowers an opportunity to seek review of certain credit and restructuring decisions.

FCA enforces the borrower rights provisions of the Farm Credit Act and examines institutions to make sure that they are complying with these provisions. We also receive and review complaints from borrowers who believe their rights have been denied.

In 2011, we received more than 40 borrower complaints. The number of complaints has increased in recent years as financial stress on System borrowers has increased. Generally, borrowers who contact us with complaints are seeking clarification, additional information, and options to redress their concerns. If we find violations of law or regulations, we have several enforcement options to bring about corrective action.

### FCA's Commitment

FCA will continue working to ensure the safety and soundness of the System. We are mindful that the System was designed to be a dependable lender to agriculture and rural communities in both good times and bad. And we remain 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 System 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.

The Agency 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 System 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. FCA examines 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 bring about appropriate corrective action.

2. It issues policies and regulations governing how System institutions conduct their business and interact with customers. These policies and regulations focus 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 primarily funded through assessments paid by System institutions.

## 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 remain on the Board until a successor is appointed. 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 the board of directors for the Farm Credit System Insurance Corporation.

# 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.

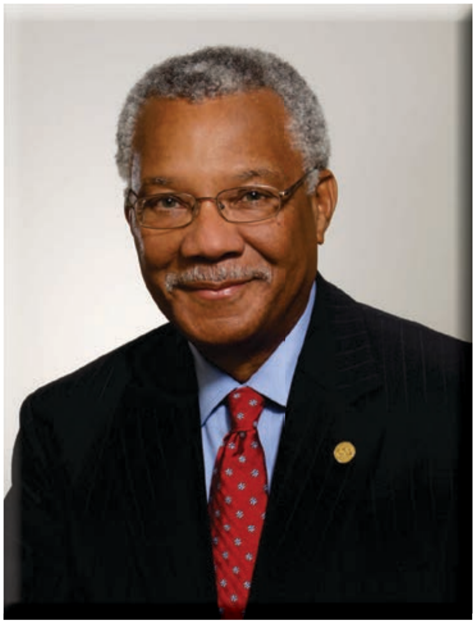
Other boards Mr. Strom has served on include Northern F.S., Inc., a farm service and supply cooperative in Northern Illinois; AgriBank, FCB; and the Farm Credit Council, the national trade organization representing FCS in Government affairs.

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 three children and one grandchild.

## 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 served in the U.S. Army in Vietnam. Later, he 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 has 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. She also served as Chair of the Rural Caucus. While in Congress, 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 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 an 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 our 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 that farmer- and rancher-borrowers participate in the management, control, and ownership of their 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, 2012, the System was composed of 87 banks and associations. The following four banks provide loans to 80 Agricultural Credit Association (ACA) parent organizations and 3 stand-alone Federal Land Credit Associations (FLCAs):

- CoBank, ACB
- AgriBank, 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 four 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 29 affiliated ACAs and FLCAs.

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, 2012. 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, we treat the ACA and its subsidiaries as a single entity; however, when appropriate, we may choose to treat the parent and subsidiaries as separate entities.

The ACA's parent-subsidiary structure enables the ACA to preserve the tax-exempt status of the FLCA. Its structure offers several other benefits

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.

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 six service corporations. These corporations exist under the authority of section 4.25 of the Farm Credit Act:[3]

1. AgVantis, Inc., provides technology-related and other support services to the associations affiliated with CoBank, ACB. AgVantis is owned by the bank and 18 of its affiliated associations.
2. Farm Credit Leasing Services Corporation provides equipment leasing services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities. It is wholly owned by CoBank, ACB.
3. Farm Credit Financial Partners, Inc., provides support services to CoBank, ACB; six associations affiliated with CoBank; one association affiliated with AgriBank, FCB; and two System-related entities. It is owned by CoBank, ACB, and the seven associations to which the corporation provides services.
4. The FCS Building Association acquires, manages, and maintains facilities to house our 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 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, its sole owner, AgFirst Farm Credit Bank, suspended the corporation's operations as of December 31, 2005. The service corporation remains inactive, although the charter is still outstanding.
6. Farm Credit Foundations provides human resource services to its employer-owners, including payroll processing, benefits administration, centralized vendor management, workforce management and operations, corporate tax and financial reporting services, and retirement workshops. It is owned by AgriBank, FCB; each of AgriBank's affiliated associations; 26 associations affiliated with CoBank, ACB; and AgVantis.

### 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. The purpose of Farmer Mac's activities is to provide greater liquidity and lending capacity to agricultural lenders. The Farm Credit Act established Farmer Mac 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 owned by its investors—it is not a member-owned cooperative. Investors in voting stock may include commercial banks, insurance companies, other financial organizations, and FCS institutions. Any investor may own nonvoting stock.

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.

We regulate and examine Farmer Mac through our 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 45.

## THE SAFETY AND SOUNDNESS OF THE FCS

The Farm Credit Administration regulates the FCS—its lending institutions, the Funding Corporation, the service corporations, and Farmer Mac. Our regulations, policy statements, examinations, chartering activities, and other regulatory activities (discussed in later chapters of this report) support 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 our agency, see page 5 or visit our 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 investors in Systemwide debt securities 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, 2011, was $3.4 billion. For more information about FCSIC, go to www.fcsic.gov. Also see FCSIC's 2011 annual report.

Investors in Systemwide debt securities are further protected by the Farm Credit Act's joint and several liability provision, 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 we 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 2011. Despite volatile commodity prices, the System's financial position is solid. Its earnings, assets, and capital levels are all strong. See tables 1 and 2 for a breakdown of the System's major financial indicators.

While the overall FCS remained financially sound, the condition and performance of some individual System institutions declined. As the System's regulator, we addressed these declines by increasing our supervision of these institutions, which resulted in some enforcement actions. For more information on measures we took to address weaknesses at individual institutions, see "Maintaining a Dependable Source of Credit for Farmers and Ranchers" on pages 41 to 44 of this report. For more information on the condition of the System, see the 2011 Annual Information Statement of the Farm Credit System on the website of the Federal Farm Credit Banks Funding Corporation at www.farmcreditfunding.com.

The System faced a generally favorable but volatile operating environment in 2011. Grain prices moved up steadily throughout the year before reaching a peak at mid-year for some commodities and in late summer or early fall for others. Grain prices generally moderated later in the year when USDA revised its estimates of supplies higher. Supported by a relatively weak dollar and continued global economic growth, agricultural exports were at record levels in 2011. USDA expects 2012 exports to be the second highest on record.

High feed costs challenged livestock and dairy producers. However, strong hog, cattle, and milk prices offset these higher feed costs and enabled producers to experience a profitable year. Broiler producers,

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 analyses to FCA or to the Federal Farm Credit Banks Funding Corporation. The analyses in this report are based on publicly available information and, except where noted, are based on the 12-month period ended December 31, 2011. The analyses are based on a combination of bank and association data; these data exclude transactions between System entities.

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

| | 31-Dec-11 | 31-Dec-10 | 31-Dec-09 | 31-Dec-08 | 31-Dec-07 |
|---|---|---|---|---|---|
| **Farm Credit System Banks[a]** | | | | | |
| Gross loan volume | 158,420,741 | 161,069,141 | 152,412,187 | 149,491,137 | 131,191,826 |
| Accruing restructured loans[b] | 43,252 | 48,457 | 4,651 | 5,125 | 4,301 |
| Accrual loans 90 or more days past due | 6,895 | 8,695 | 28,816 | 21,594 | 12,917 |
| Nonaccrual loans | 384,795 | 477,341 | 759,134 | 582,160 | 46,069 |
| Net income | 1,860,347 | 1,917,143 | 1,442,328 | 1,231,430 | 981,688 |
| Nonperforming loans/total loans[c] | 0.27% | 0.33% | 0.52% | 0.41% | 0.05% |
| Capital/assets[d] | 6.49% | 6.00% | 5.59% | 4.89% | 5.43% |
| Unallocated retained earnings/assets | 3.25% | 3.03% | 2.80% | 2.50% | 2.69% |
| Return on assets | 0.92% | 0.95% | 0.74% | 0.65% | 0.60% |
| Return on equity | 13.68% | 15.00% | 13.13% | 12.44% | 10.59% |
| Net interest margin | 1.28% | 1.22% | 1.17% | 0.97% | 0.83% |
| Efficiency ratio[e] | 20.14% | 18.24% | 20.49% | 25.40% | 25.73% |
| Payout ratio[f] | 53.76% | 50.43% | 56.31% | 62.26% | 67.65% |
| **Associations** | | | | | |
| Gross loan volume | 126,189,161 | 124,140,035 | 118,575,715 | 114,026,889 | 105,620,488 |
| Accruing restructured loans[b] | 170,966 | 65,385 | 58,926 | 30,381 | 47,212 |
| Accrual loans 90 or more days past due | 37,988 | 33,182 | 68,508 | 65,703 | 43,840 |
| Nonaccrual loans | 2,354,714 | 2,744,528 | 2,634,046 | 1,706,613 | 465,414 |
| Net income | 3,007,154 | 2,408,449 | 1,585,984 | 1,805,929 | 1,934,968 |
| Nonperforming loans/gross loans[c] | 2.03% | 2.29% | 2.33% | 1.58% | 0.53% |
| Capital/assets[f] | 17.84% | 16.54% | 15.82% | 15.46% | 15.57% |
| Unallocated retained earnings/assets | 16.78% | 15.07% | 14.56% | 13.51% | 13.58% |
| Return on assets | 2.24% | 1.84% | 1.29% | 1.57% | 1.74% |
| Return on equity | 12.42% | 10.88% | 8.13% | 9.84% | 10.82% |
| Net interest margin | 2.94% | 2.79% | 2.64% | 2.50% | 2.57% |
| Efficiency ratio[e] | 31.27% | 35.12% | 39.05% | 44.44% | 42.23% |
| Payout ratio[f] | 22.57% | 22.83% | 22.51% | 23.69% | 25.07% |
| **Total Farm Credit System[g]** | | | | | |
| Gross loan volume | 174,664,000 | 175,351,000 | 164,830,000 | 161,423,000 | 142,906,000 |
| Bonds and notes | 186,889,000 | 189,575,000 | 178,358,000 | 179,769,000 | 155,295,000 |
| Nonperforming loans | 2,997,000 | 3,386,000 | 3,535,000 | 2,416,000 | 621,000 |
| Nonaccrual loans | 2,738,000 | 3,229,000 | 3,369,000 | 2,282,000 | 512,000 |
| Net income | 3,940,000 | 3,495,000 | 2,850,000 | 2,916,000 | 2,703,000 |
| Nonperforming loans/gross loans[c] | 1.72% | 1.93% | 2.14% | 1.50% | 0.43% |
| Capital/assets[h] | 15.60% | 14.46% | 13.90% | 12.65% | 14.17% |
| Surplus/assets | 12.90% | 11.80% | 11.48% | 10.80% | 11.52% |
| Return on assets | 1.71% | 1.59% | 1.32% | 1.41% | 1.53% |
| Return on equity | 11.17% | 10.85% | 9.86% | 10.70% | 10.38% |
| Net interest margin | 2.86% | 2.82% | 2.65% | 2.41% | 2.43% |

Sources: Farm Credit System Call Report as of December 31, 2011, and the Farm Credit System Annual Information Statement provided by the Federal Farm Credit Banks Funding Corporation.

a. Includes Farm Credit Banks and the Agricultural Credit Bank.
b. Excludes loans 90 or more days past due.
c. Nonperforming loans are defined as nonaccural loans, accruing restructured loans, and accrual loans 90 or more days past due.
d. Capital excludes mandatorily redeemable preferred stock.
e. Noninterest expenses as a percentage of net interest income and noninterest income.
f. Capital excludes protected borrower capital.
g. Cannot be derived by adding categories above because of intradistrict and intra-System eliminations used in Reports to Investors.
h. 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, 2011

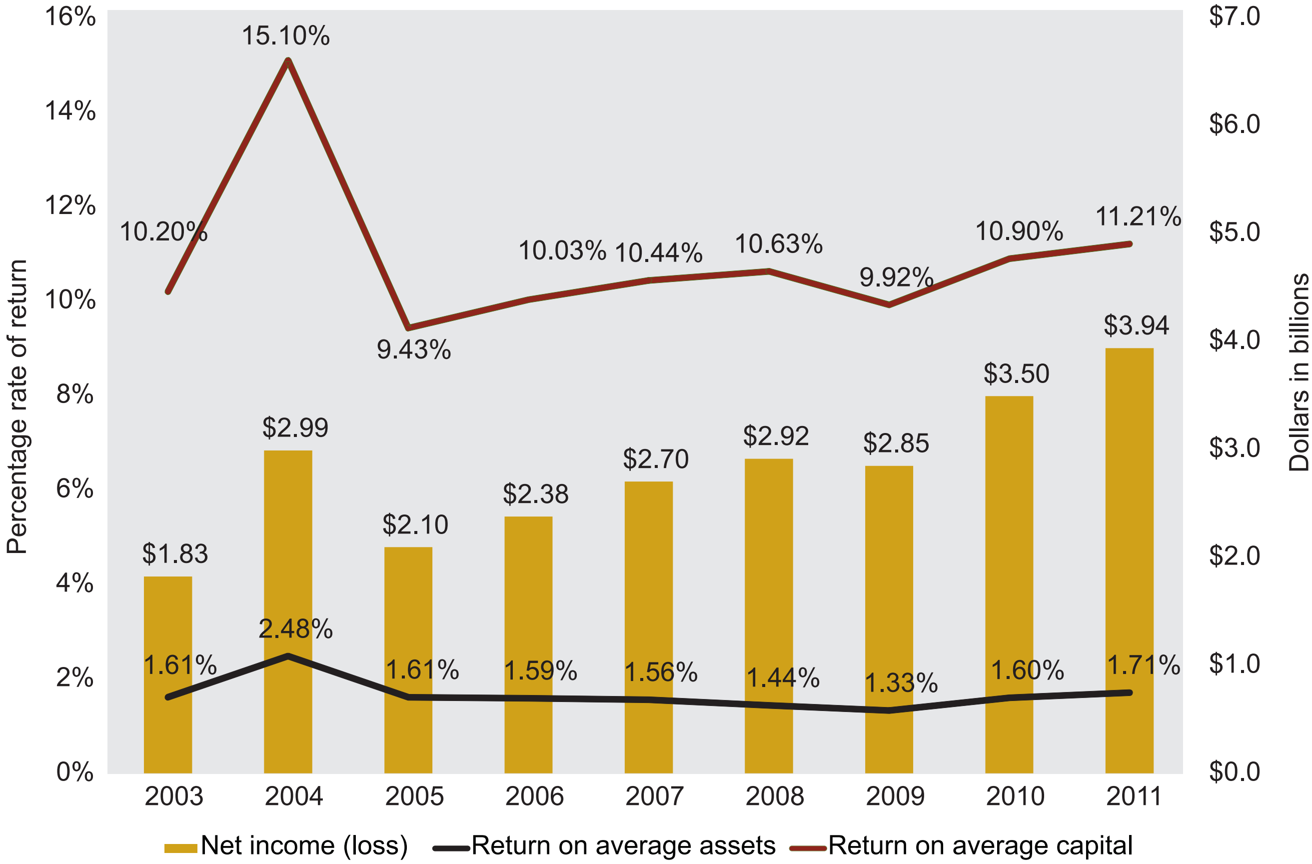
Dollars in Thousands

| 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 | 29,577,506 | 20,152,065 | 85,222 | 27,714 | 9,099,562 | 805,767 | 1,219,506 | 2,149,271 |
| AgriBank | 73,110,012 | 62,043,002 | 62,017 | 9,208 | 10,428,685 | 1,825,177 | 2,129,036 | 3,806,187 |
| CoBank | 63,290,215 | 46,285,142 | 134,862 | 388,056 | 15,795,069 | 2,354,314 | 2,439,531 | 4,895,533 |
| Texas | 14,049,234 | 10,287,377 | 102,694 | 15,659 | 3,612,134 | 698,839 | 486,371 | 1,210,356 |
| U.S. AgBank | 25,060,961 | 19,653,155 | - | 1,504 | 5,111,957 | 1,110,815 | 407,057 | 1,258,623 |
| Total | 205,087,928 | 158,420,741 | 384,795 | 442,141 | 44,047,407 | 6,794,912 | 6,681,501 | 13,319,970 |
| **Associations** | | | | | | | | |
| AgFirst | 17,848,573 | 16,454,868 | 581,488 | 147,261 | 454,333 | 213,406 | 2,970,336 | 3,157,328 |
| AgriBank | 66,773,742 | 60,784,014 | 822,924 | 291,299 | 2,648,356 | 230,664 | 11,183,869 | 11,414,345 |
| CoBank | 13,855,837 | 13,243,073 | 297,701 | 200,823 | 85,154 | 191,481 | 2,254,215 | 2,380,515 |
| Texas | 2,735,232 | 12,071,647 | 354,609 | 98,458 | 272,498 | 81,309 | 2,122,244 | 2,203,416 |
| U.S. AgBank | 25,505,719 | 23,635,559 | 297,992 | 109,935 | 459,922 | 563,773 | 4,663,473 | 5,229,191 |
| Total | 136,719,103 | 126,189,161 | 2,354,714 | 847,776 | 3,920,263 | 1,280,633 | 23,194,137 | 24,384,795 |
| Total Farm Credit System | 230,411,000 | 174,664,000 | 2,738,000 | 1,290,000 | 47,281,000 | 1,618,000 | 29,733,000 | 35,940,000 |

Sources: Farm Credit System Call Report as of December 31, 2011, and the Farm Credit System Annual Information Statement provided by the Federal Farm Credit Banks Funding Corporation.

a. Aggregations of district data may not equal totals because of eliminations.
b. Includes accrued interest receivable on marketable investments.
c. Includes capital stock and participation certificates, excludes mandatorily redeemable preferred stock and protected borrower capital.
d. Includes allocated and unallocated surplus.
e. 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 $3.392 billion of restricted capital, which is the amount in the Farm Credit Insurance Fund. Excludes mandatorily redeemable preferred stock and protected borrower capital.

Figure 1
**FCS Net Income, 2003–2011**
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.

on the other hand, endured a very difficult year because of low broiler prices and high feed costs. In late 2011 and early 2012, the broiler industry appears to have brought its production under control; as a result, broiler producers may receive higher prices and stronger profits in the coming year. Farmland values continue to escalate, particularly in regions where cash grains are grown.

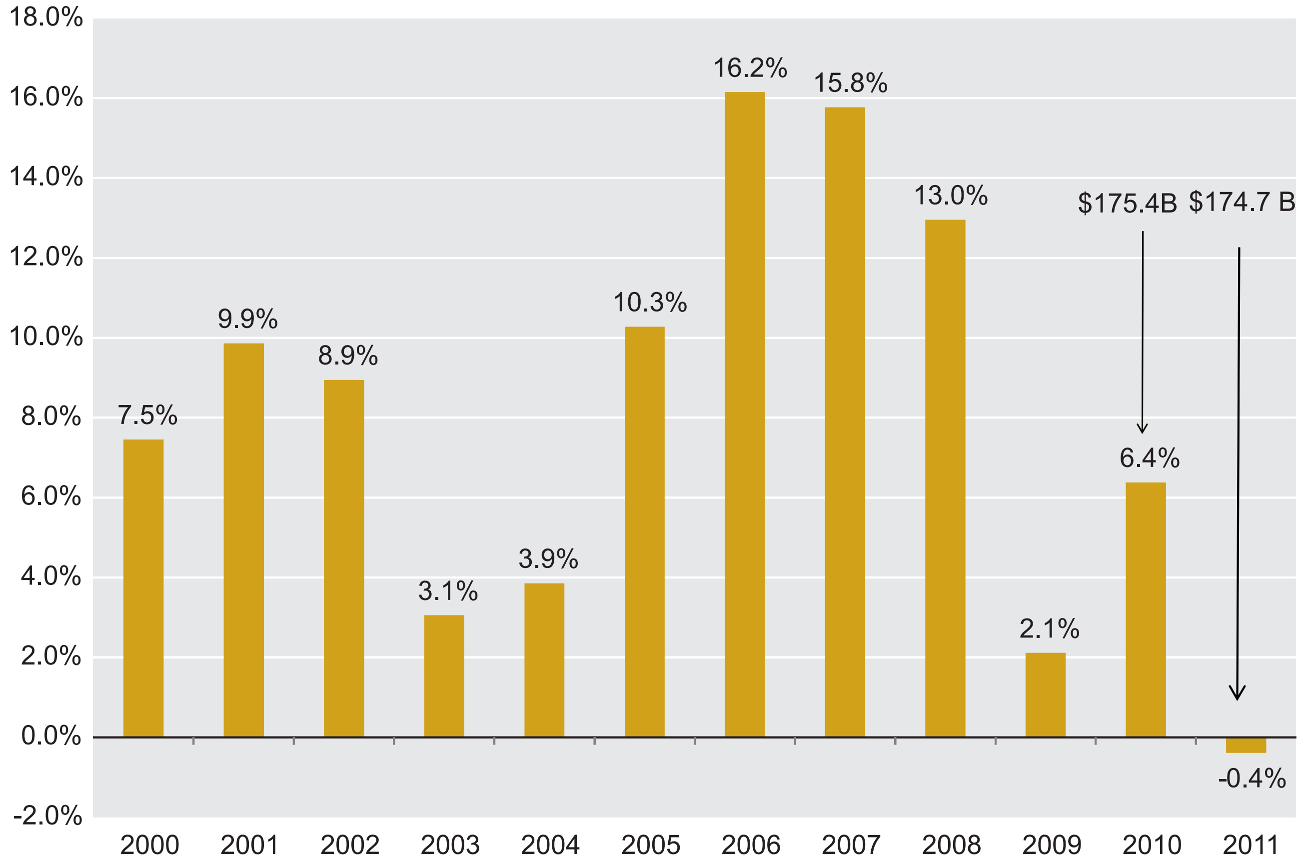
The System continues to have reliable access to capital markets to support its mission. Investor demand for Systemwide securities has been favorable. The current low interest rate environment has enabled System banks to lower their cost of funds by refinancing callable bonds. If the use of derivatives becomes too expensive, System banks may have to adjust the strategies they use to manage risk associated with derivatives. The adjustments they make will depend on the rules that will be issued to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act.

We expect continued commodity price volatility and global economic uncertainty to challenge the System in 2012. For a discussion of how this environment is likely to affect the agricultural economy and the System in 2012 and beyond, see "Challenges Facing the Agricultural Economy and the Farm Credit System" on pages 51 to 57.

### Earnings

System earnings were up 12.70 percent in 2011, increasing to a record $3.94 billion compared with $3.50 billion in 2010 (See figure 1). The System's increase in earnings continues to be driven largely by higher net interest income and lower provisions for loan losses. Net interest income increased by $369 million because the net interest spread improved by 7 basis points from year-end 2010 to 2.68 percent at year-end 2011. The System's return on average assets increased to 1.71 percent in 2011 from 1.60 percent the prior year. The return on average capital was also higher, increasing to 11.21 percent in 2011 from 10.90 percent in 2010.

Figure 2
**Annual Growth Rate of FCS Loans Outstanding, 2000 to 2011**




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

Provisions for loan losses dropped to $430 million in 2011 from $667 million in 2010, in part because conditions improved in the swine and dairy sectors. Credit stress did increase in certain agricultural sectors. For example, higher commodity and other input prices adversely affected poultry producers. In addition, System borrowers in agricultural sectors like forestry continue to feel the impact of the recent economic downturn, the sluggishness in the U.S. economy, and the 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 2011, System institutions declared a total of $1.146 billion in patronage distributions—$763 million in cash, $295 million in the form of allocated retained earnings, and $88 million in stock. This represents 29 percent of the System's net income for 2011; the percentage was the same in 2010. Also in 2011, the System distributed $140 million in cash from patronage allocations of earlier years.

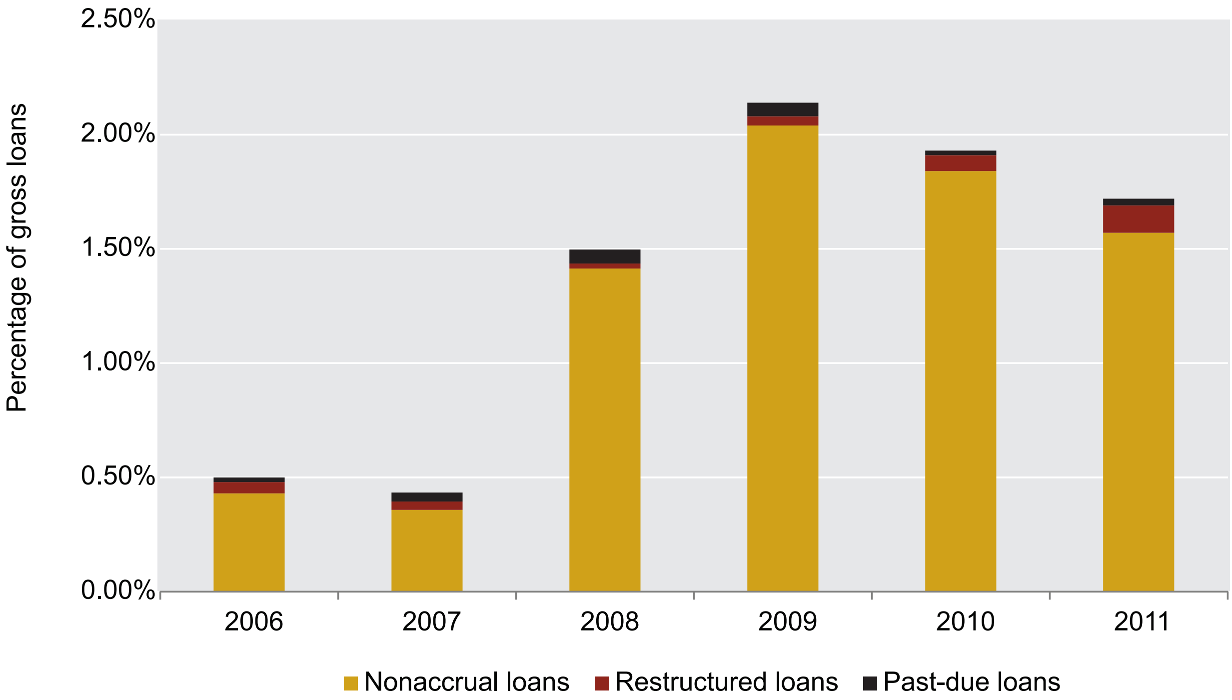
## Asset Growth

Overall, the System experienced no loan growth in 2011, with total loans declining 0.4 percent (see figure 2). Real estate mortgage loans and production and intermediate loans increased by 3.4 percent and 1.7 percent, respectively. However, agribusiness loans declined 16.4 percent because of a drop in seasonal financing demand; lower grain prices at the year-end prompted many farmers to postpone marketing their products to cooperative grain elevators. In total, System assets grew slightly to $230.4 billion, up $438 million or just 0.2 percent from 2010.

## 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, remain under stress. In addition, the weakness in the general economy and the housing market continues to affect certain sectors

Figure 3
**FCS Nonperforming Loans, 2006–2011**
As of December 31




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

such as the forestry and nursery industries. As of December 31, 2011, nonperforming loans equaled $3.0 billion, or 1.72 percent of gross loans, down from $3.4 billion, or 1.93 percent, at year-end 2010 (see figure 3). Loan delinquencies (that is, accruing loans that are 30 days or more past due) remained a low 0.38 percent of total accruing loans, compared with 0.33 percent at year-end 2010.

The allowance for loan losses declined to $1.29 billion, or 0.74 percent of loans outstanding, at year-end 2011, compared with $1.45 billion, or 0.83 percent of loans outstanding, at year-end 2010. Provisions for loan losses were down in 2011, dropping to $430 million in 2011 from $667 million in 2010. Net charge-offs were also down in 2011, declining to $500 million from $596 million in 2010.

Although the outlook remains favorable for agriculture in 2012, conditions in both the general and agricultural economies remain volatile. Additional deterioration in asset quality is possible because of the effect of high commodity prices on certain agricultural sectors. Nevertheless, the overall level of nonperforming loans continues to be well within the System's risk-bearing capacity.

### Funding

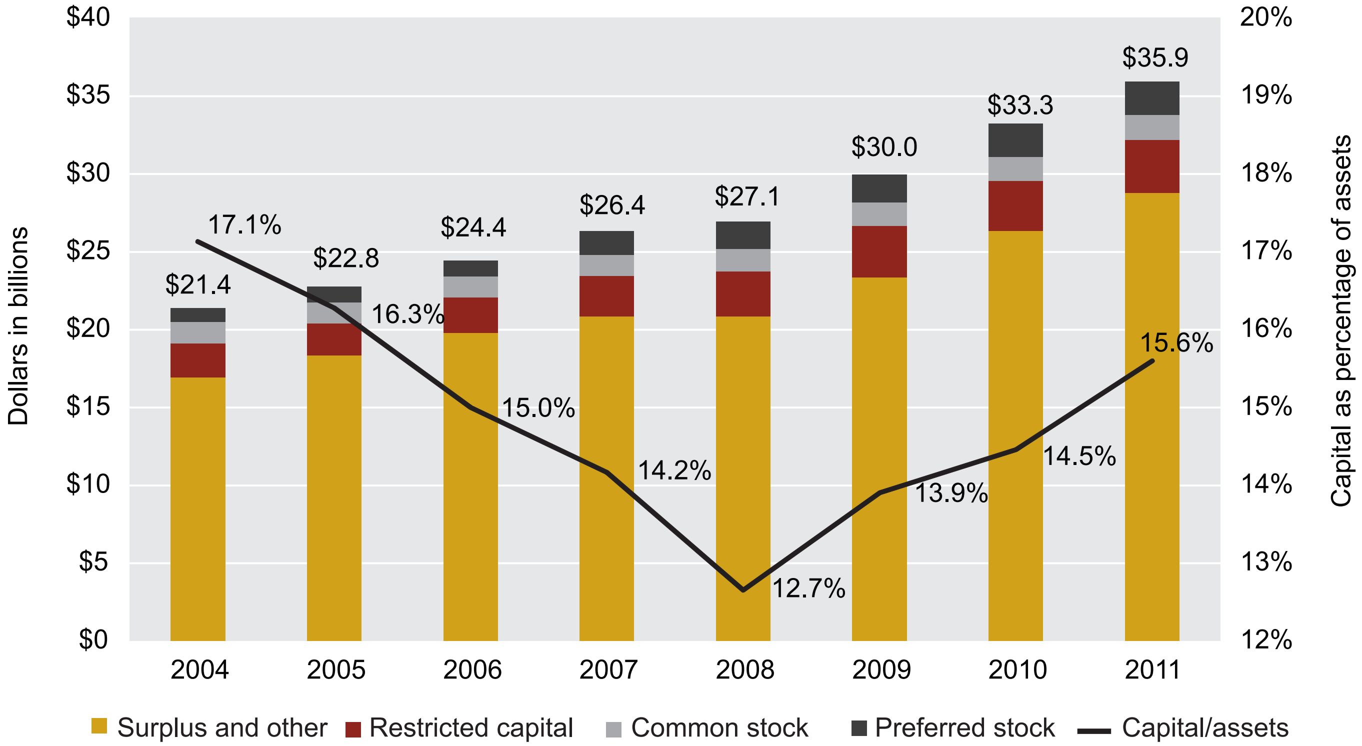
The System continues to have reliable access to the capital markets, and investor demand for System debt was favorable across all maturities in 2011. The System's funding composition changed slightly in 2011; short-term debt made up 35.0 percent of total Systemwide debt securities at December 31, 2011, compared with 36.1 percent at December 31, 2010.

Total Systemwide debt declined 2.1 percent in 2011. Securities due within a year declined by 4.9 percent, and securities due after one year declined by 0.5 percent. (See section titled "Funding Activity in 2011" on page 36 for further discussion of the System's funding environment.)

### Liquidity

As of December 31, 2011, the System's liquidity position equaled 194 days, an improvement from 173 days at year-end 2010. The liquidity position is significantly above the 90-day regulatory minimum.[5] The percentage of highly liquid securities held by System banks decreased from 20 percent of the eligible investment portfolio as of December 31, 2010, to 18 percent a year later. This liquidity provides each bank

Figure 4
**FCS Capital, 2004–2011**
As of December 31




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

with a cushion against negative events in the U.S. and global markets and provides financial flexibility when the bank has fewer funding options. Investments available for sale (based on fair value) increased 0.5 percent to $37.8 billion in 2011, with a weighted average yield of 1.6 percent. Investments held to maturity remained steady at $3.7 billion, with a weighted average yield of 3.0 percent.

By regulation, System banks may acquire and hold certain investments as long as 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, 2011, the FCS had 166 ineligible securities because of rating downgrades, which, at fair value, represented 4.0 percent of total investments. FCA has approved divestiture plans to hold these investments longer than six months. For 2011, the System recognized $69 million of net other-than-temporarily impaired losses on securities.

### Capital

The System's capital position remained strong. Total capital was $35.9 billion at year-end 2011, compared with $33.3 billion at year-end 2010. The most significant factor contributing to the increase in System capital was net income earned and retained. With the increase in total capital, the System's capital-to-assets ratio at year-end improved from 14.5 percent in 2010 to 15.6 percent in 2011. As figure 4 shows, surplus accounts for the overwhelming majority of capital. FCA regulations establish the minimum capital requirements that each System bank and association must achieve and maintain.

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.

As of December 31, 2011, the permanent capital ratios for all System banks and associations were above the regulatory minimum of 7.0 percent. The ratios ranged between 16.4 percent and 24.3 percent for System banks and between 11.7 percent and 31.1 percent for System associations. In addition, at December 31, 2011, the FCS had $3.4 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 $174.7 billion in gross loans outstanding as of December 31, 2011 (see table 3). Agricultural producers represented by far the largest borrower group, with $121.9 billion, or 69.8 percent, of the total dollar amount of loans outstanding.[7] As of December 31, 2011, 46.2 percent of the dollar volume of the System's loans outstanding was in long-term real estate loans, 23.7 percent in short- and intermediate-term loans to agricultural producers, and 14.1 percent in agribusiness loans. Agribusiness loans are broken down further into 6.8 percent for loans to cooperatives, 5.9 percent for processing and marketing enterprises, and 1.4 percent for farm-related businesses.

Loans to finance rural utilities represented 8.9 percent of the System's loan volume, while rural residential loans made up 3.4 percent of the System's total loans. Agricultural export finance loans represented 2.2 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 896,000 loans and approximately 489,000 stockholders in 2011. Approximately 86.0 percent of the stockholders were farmers or cooperatives with voting stock. The remaining 14.0 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 5.4 percent since year-end 2007.

The U.S. Department of Agriculture has forecast $108.7 billion in net cash farm income in the United States for 2011, up $16.4 billion from 2010 and up $28.4 billion from its 10-year average of $80.3 billion. However, loan volume declined slightly in 2011 from 2010 by 0.4 percent. The drop in overall volume was caused by a drop in agribusiness loan volume; in late 2011, prices for certain commodities fell, causing a drop in demand for seasonal financing. In addition, grain producers delayed delivery to cooperatives, which reduced financing requirements from cooperative customers. Another factor contributing to the drop in loan volume was the strong financial positions of certain agricultural producers who have benefitted from favorable agricultural conditions over the past several years.

The aggregate total of loans outstanding at FCS banks and associations (net of intra-System lending) declined by $687 million, or 0.4 percent, during the year ended December 31, 2011, compared with increases of 6.4 percent in 2010,

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 borrow, 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).

Table 3
**FCS Gross Loans Outstanding, 2007–2011**
As of December 31
Dollars in Millions

| | 2007 | 2008 | 2009 | 2010 | 2011 | Percent change from 2007 |
|---|---|---|---|---|---|---|
| Long-term real estate mortgage loans | 63,458 | 71,892 | 75,352 | 78,021 | 80,658 | 27.1 |
| Short- and intermediate-term loans | 32,267 | 37,468 | 39,610 | 40,584 | 41,276 | 27.9 |
| Agribusiness loans* | 28,091 | 26,901 | 23,626 | 29,581 | 24,734 | -12.0 |
| Rural utility loans | 10,846 | 13,931 | 14,562 | 15,091 | 15,606 | 43.9 |
| Rural residential loans | 3,965 | 4,611 | 4,977 | 5,475 | 5,832 | 47.1 |
| International loans | 2,135 | 4,077 | 3,956 | 4,036 | 3,834 | 79.6 |
| Lease receivables | 1,708 | 1,952 | 2,160 | 2,021 | 2,139 | 25.2 |
| Loans to other financing institutions | 436 | 591 | 587 | 542 | 585 | 34.2 |
| **Total** | **142,906** | **161,423** | **164,830** | **175,351** | **174,664** | **22.2** |

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

* At December 31, 2011, agribusiness loans consisted of loans to cooperatives of $11.9 billion, processing and marketing loans of $10.3 billion, and farm-related business loans of $2.5 billion.

2.1 percent in 2009, and 13.0 percent in 2008. However, since year-end 2007, total System loans outstanding have increased by $31.8 billion, or 22.2 percent.

As mentioned above, the decline in the System's loan volume in 2011 stemmed primarily from a decrease in agribusiness loans. Agribusiness loans declined by $4.8 billion, or 16.4 percent. Long-term real estate loans increased $2.6 billion, or 3.4 percent, primarily because of successful marketing efforts and competitive interest rates, particularly in the Midwest. Short- and intermediate-term production loans increased $692 million, or 1.7 percent, because of advance purchases of 2012 inputs, such as fertilizer, seed, and fuel. Rural utility loans increased by $515 million, or 3.4 percent. Rural residential loans increased $357 million, or 6.5 percent. The other categories posted modest changes for the year, either up or down, including a 5.0 percent decrease in agricultural export finance 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 in our regulations as "other financing institutions" (OFIs). OFIs include commercial banks, savings institutions, credit unions, trust companies, agricultural credit corporations, and other specified agricultural lenders that are significantly involved in lending to agricultural and aquatic producers and harvesters. System banks can fund and discount short- and intermediate-term loans for OFIs that demonstrate a need for additional funding to meet the credit needs of borrowers who are eligible to receive loans from the

8. A majority of the System's agricultural export finance 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, 74 percent of the System's agricultural export portfolio in 2011 carried a CCC guarantee.

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, 2011, the System served 26 OFIs, down from 28 in 2010 and 2009, and 27 in 2008. Outstanding loan volume to OFIs was $585 million at year-end, up $43 million from 2010. 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 loan that is co-owned by two or more lenders. Loan participations help lenders manage their credit risk. They also provide another advantage. When a borrower seeks a loan that exceeds a lender's legal or internally established lending limit, the lender may use a loan participation to provide funding for part of the loan. The participating lenders decide who will originate, service, and document 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 an 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 lending limit. As figure 5 shows, activity from net similar-entity loan participations and syndications with non-System lenders grew from 2006 to 2008 and declined through 2010, but rose at year-end 2011. Loan participations involving eligible borrowers rose from 2006 to 2008 and has remained relatively flat since 2008, averaging $7.6 billion.

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 $11.3 billion at year-end 2011, up slightly more than $1 billion from the 2010 figure. The increased 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.

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 involving institutions that are originating with customers who are also eligible to borrow from the FCS. The net total of these participations was $7.7 billion, a slight increase above 2010. 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

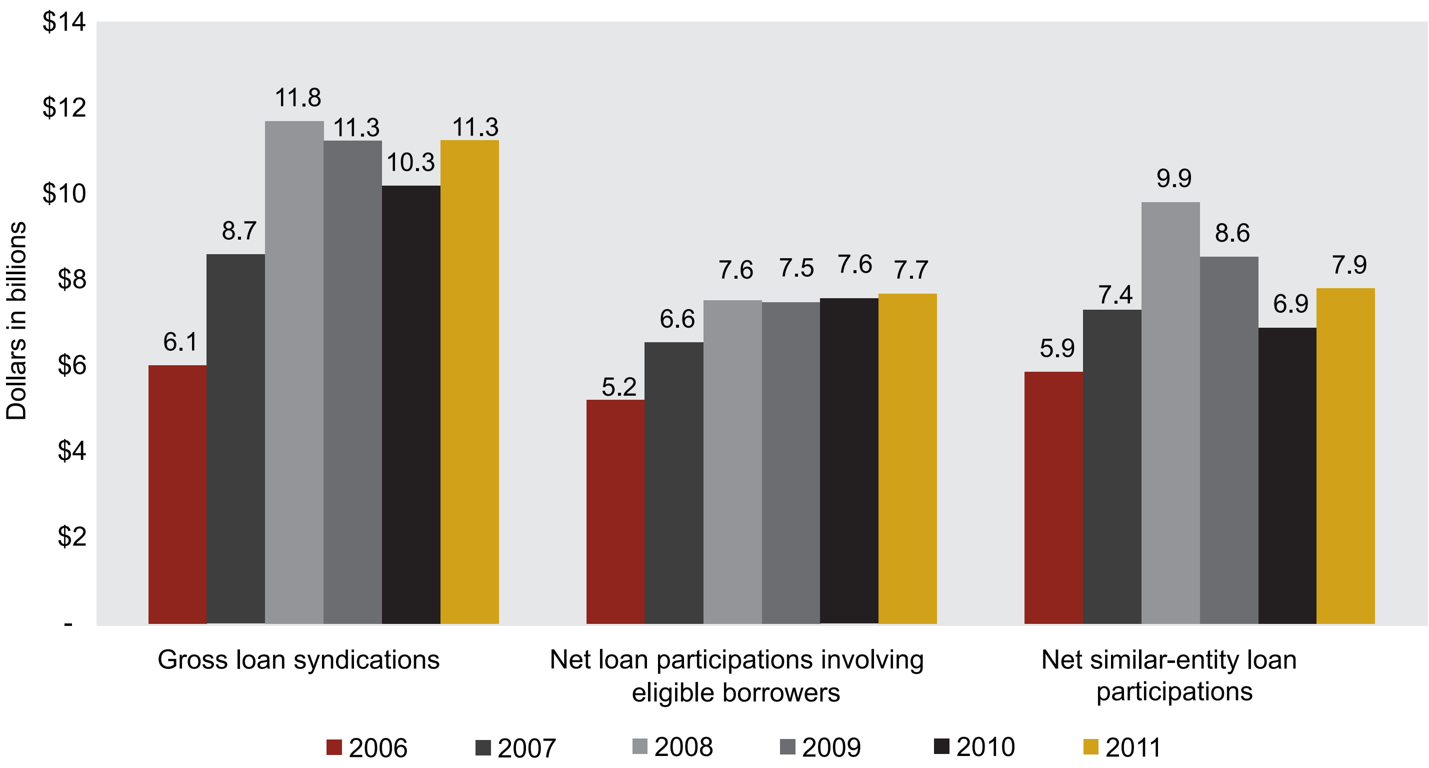
9. Typically, some of the syndication volume is sold and may be reported by FCS institutions as part of net loan transactions (purchases less sales) with non-FCS lenders (see second group of bars). Net loan transactions include traditional loan participations and assignments or other interest in loans.

Figure 5

**Syndications and Net Loan Participations Involving Non-System Lenders, 2006–2011**

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).

these loan syndications to other System institutions.

- In addition to participating in loans to eligible borrowers, FCS institutions have the 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 2011, the net amount of similar-entity participations in the System amounted to $7.9 billion, an increase of less than $1 billion, or 12.6 percent above 2010 volume. The net total of all loan participations involving non-System lenders was $15.6 billion at year-end 2011 compared with $14.6 billion the year before.

### AgDirect, LLP

AgDirect is a point-of-sale agricultural equipment financing program developed by Farm Credit Services of America, ACA. AgDirect facilitates the financing of equipment for farmers and ranchers through participations in retail installment sales contracts made by equipment dealerships. The program enhances financial options for customers and institutions, and provides a diversified revenue stream to AgriBank and the System association owners of AgDirect. AgDirect financing is now available in 14 states with nine System institutions participating through AgDirect, LLP. As of December 31, 2011, the total outstanding participation interests in loans purchased was $1.3 billion.

## FARM DEBT AND MARKET SHARES

The U.S. Department of Agriculture's estimate of total farm business debt for the year ended December 31, 2011, was $247 billion, up from its $242 billion estimate for year-end 2010. USDA's estimate for 2011 farm debt will not be final until later in 2012, but farm loan data reported by Farm Credit System and commercial banks show that their total farm loan portfolios grew during 2011 by 3 percent and 2 percent, respectively.

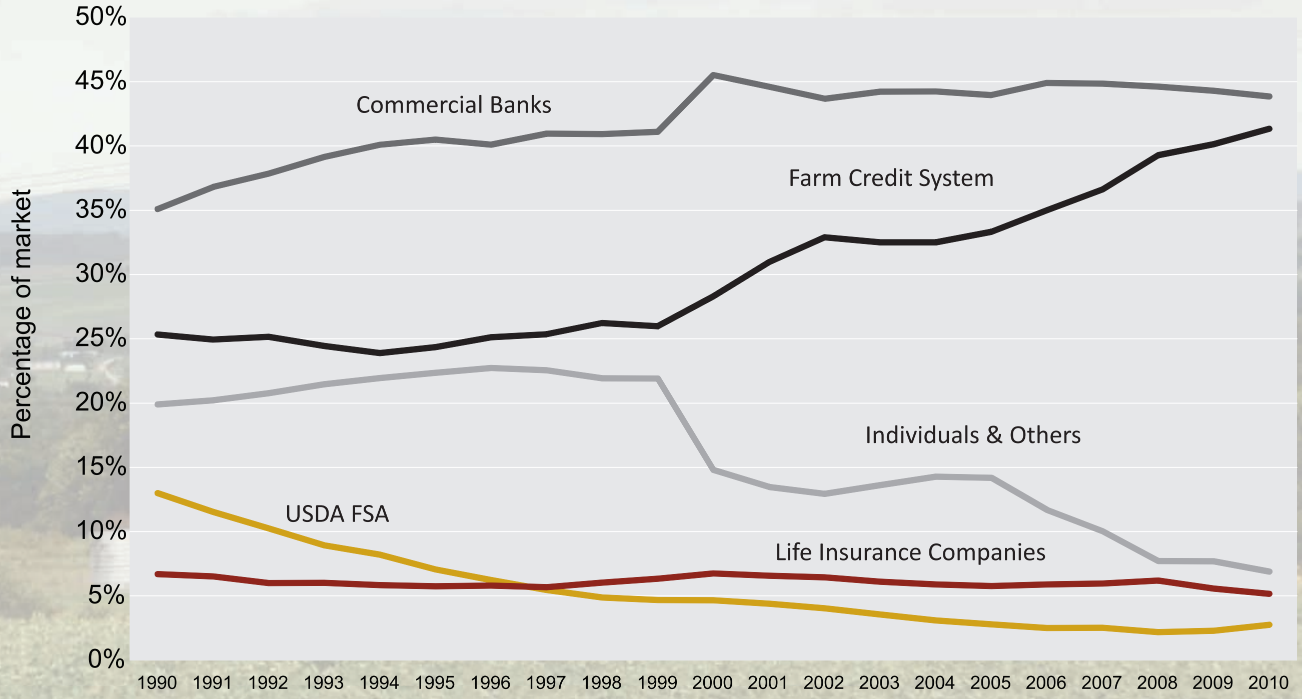
Lender-reported data also show that the demand for farm credit grew more robustly in certain regions—especially the Midwest. In 2011, farmers in the Midwest took advantage of record-high farm incomes and low interest rates to invest in machinery, farm structures, and farmland. On the supply side, lenders had ample funds to lend in 2011 as demand for credit remained below the capacity to lend. Credit underwriting practices remained relatively stringent in a competitive lending environment. Strong farm incomes, high real estate values, low interest rates, and an increase in off-farm income opportunities should be supportive of only modest credit demand once again in 2012.

The most current market share information from USDA is for year-end 2010.[10] USDA's estimate of debt by lender shows that commercial banks held 44 percent of total farm business debt at the end of 2010. The System's market share rose to 41 percent from a 40 percent share the previous year. FCS market share of total farm business debt has been rising steadily over the past decade, whereas commercial bank share of farm debt has been flat over this period. The share of total farm business debt owed to the USDA and to life insurance companies has been relatively stable recently, whereas debt owed to individuals, merchants, and other lender types continue to decline. (Figure 6 shows market shares for the major lenders since 1990.)

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 45 percent at year-end 2010, continuing a 10-year upward trend. At year-end 2010, commercial banks held almost the same share of the farm real estate debt market as they did at year-end 2009—38 percent. Commercial banks have historically dominated non-real estate farm lending, but that dominance has been eroding—commercial banks had a 51 percent market share at the end of 2010. The System's share of non-real estate farm debt grew slightly to 37 percent at year-end 2010, continuing an upward trend since the late-1990s when it was slightly less than 20 percent.

10. USDA calculates market share for farm business debt only. The information for 2011 will not be available until USDA issues its planned update in August 2011. 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, 1990–2010**




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

Note: Year-end 2010 figure is a preliminary estimate.

# Serving Young, Beginning, and Small Farmers and Ranchers

The Farm Credit Act requires Farm Credit System institutions to have programs to provide financially sound and constructive credit and related services to young, beginning, and small (YBS) farmers and ranchers. Loans to YBS borrowers help to provide a smooth transition of farm businesses to the next generation. They also allow System institutions to serve a more diversified customer base—from very small enterprises to large commercial operations. At FCA, we are strongly committed to ensuring that the System fulfills its responsibility to serve YBS producers. We support the YBS mission through our regulatory activities, data collection and reporting, disclosure requirements, and examination activities.

## CHARACTERISTICS OF YBS BORROWERS

Before we discuss the System's lending to YBS producers, let's look at the characteristics of producers who would qualify for a YBS loan with the System.

### Young

Across the United States, there are far fewer young farmers than there are small and beginning farmers, and this number has been shrinking for decades. At FCA, we define young farmers as those who are 35 years of age or younger. The decline in young farmers reflects years of farm consolidations and integrations and increasing retirement ages for farmers. According to USDA's Agricultural Resource Management Survey (ARMS), only 4 percent of all principal family farm operators were under 35 years of age in 2010. This percentage has remained relatively constant in recent years.[11]

Many young farmers are also small and beginning farmers. Young farmers are somewhat less likely than older farmers to operate small farms—that is, farms with less than $250,000 in gross sales. Still, 85 percent of young farmers operated small farms in 2010. In addition, more than three-quarters of all young farmers are also beginning farmers—that is, they have farmed for 10 years or less.

### Beginning

For 2010, the ARMS shows that approximately 21 percent of all family farms had principal operators who are beginning farmers. Although beginning farmers are generally believed to be young, only 16 percent of these principal operators were under 35 years of age, and one-third were 55 years or older. The vast majority of beginning farmers—95 percent—operated small farms in 2010. Only one-quarter of beginning farmers consider farming to be their primary occupation; most of their income comes from off-farm sources.

### Small

Small farms, which represent 88 percent of all U.S. farms in the 2010 ARMS, are difficult to characterize. Two-thirds of the 1.9 million small farms have less than $10,000 in gross farm sales. Those who operate small farms generally seek credit for consumer, rather than farm, products. A higher percentage of very small farms are located in the East, particularly in southern states. 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.

Young operators make up just 4 percent of small farmers, the same percentage that they make up of all U.S. farmers. Beginning farmers make up 22 percent of farmers in the small category. Since nearly a third of all small farmers are 65 years or older, many of them will retire soon. Because many small farms do not use agricultural credit, many small farmers are not potential YBS borrowers.

## FCS LENDING TO YBS PRODUCERS

Generally, the shares of Systemwide total farm lending going to the three separate YBS categories have been consistent with the shares of these farmer segments in the total farmer population. The smallest share of total System farm lending goes to the young farmer segment, and the largest share goes to the small farm segment.

The range of YBS demographics and the changing economic conditions in rural America can pose challenges for

11. FCA'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.

System institutions in meeting their YBS program goals. Another challenge for System lenders is meeting the wide range of nonagricultural credit needs of YBS farmers.

Each System bank must have 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 must report yearly on its lending volume, operations, and achievements in its YBS program. (See the YBS Programs section on page 32.)

Our oversight and examination activities encourage System institutions to assess their performance and market penetration in the YBS area. This self-assessment increases each institution's awareness of its mission and prompts it to earmark resources to serve the YBS market segment. In addition, we continue to review and consider various policy options for supporting the System's YBS programs.

### Comparing the System's YBS Lending in 2011 with Its YBS Lending in 2010

The number and volume of loans (including new loans and renewals) made during the year is an indicator of the extent to which System institutions are serving YBS producers. In general, during calendar year 2011, new lending activity declined across the System for each of the three YBS categories.[12] Lending to YBS borrowers has been slowly trending downward in recent years. The decline in YBS activity in 2011 was consistent with recent trends for all three YBS categories.

Lending to small farmers declined the most during 2011, with an 8.4 percent decline in the number of loans made and a 10.4 percent decline in the dollar volume of new loans made. The increase in gross farm incomes in 2010 probably accounted for much of the percentage decrease in lending to the small farmer category. Remember: to be considered a small farmer, a producer's annual gross farm income must be less than $250,000. Many producers who would have qualified as small farmers in 2010 may not have qualified in 2011.

The decline was less in lending activity to beginning farmers. The number of new loans made to beginning farmers fell 5.8 percent from 2010, and new loan dollar volume fell 5.1 percent. Young farmer lending was relatively stable in 2011. The number of new loans made to young farmers edged down 1.4 percent from 2010, but new loan dollar volume increased 4.9 percent.

In 2011, the dollar volume of loans outstanding increased in all three YBS categories. It increased by 4.0 percent to young farmers, but the increases were much smaller to the other categories. The dollar volume of loans outstanding increased by 0.2 percent to small farmers and by 0.5 percent to beginning farmers.

### Comparing the System's YBS Lending with Its Overall Lending

In 2011, lending to the three YBS categories did not keep pace with the trends in overall System lending to farmers. Therefore, the share of total System farm loans going to the YBS categories fell from that of 2010. In 2011, the volume of all System farm loans made (including commitments) during the year was $71.3 billion, up 11.6 percent over that of 2010, and the volume of outstanding farm loans (including commitments) at year-end was $189.6 billion, up 5.2 percent from that of 2010. The total number of farm loans made in 2011 (333,932) was up less than 1.0 percent from 2010, while the number of outstanding loans (917,640) at the end of 2011 was 2.8 percent higher than at the end of 2010.

In the section on YBS borrowing trends (page 28), we provide 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 2011; table 4B provides information on loans made during the year.

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, 2011

| | 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** | 165,605 | 18.1 | $21,290 | 11.2 | $128,559 |
| **Beginning farmers/ranchers** | 236,033 | 25.7 | $34,113 | 18.0 | $144,525 |
| **Small farmers/ranchers** | 475,310 | 51.8 | $42,850 | 22.6 | $90,152 |

Table 4B

## YBS Loans Made During 2011

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** | 52,800 | 15.8 | $7,464 | 10.5 | $141,360 |
| **Beginning farmers/ranchers** | 61,995 | 18.6 | $9,634 | 13.5 | $155,406 |
| **Small farmers/ranchers** | 137,529 | 41.2 | $11,197 | 15.7 | $81,413 |

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 lending, Title III lending, and the Leasing Corporation.

b. The volume figures for loans made and loans outstanding include both advances and commitments. New loans in 2011 totaled 333,932 in number and $71.3 billion in value; outstanding loans totaled 917, 640 in number and $189.6 billion in value.

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—**In 2011, the System made 52,800 loans to young farmers—that is, to those who are 35 years old or younger. The volume of total new loans to young farmers amounted to $7.5 billion. During 2010, the System made 53,546 loans to young borrowers, totaling $7.1 billion. The loans made to young borrowers in 2011 represented 15.8 percent of all farm loans the System made during the year and 10.5 percent of the dollar volume of loans made. The average size of loans made to young farmers in 2011 increased to $141,360. At the end of 2011, the System had $21.3 billion in outstanding loans to young farmers as compared with $20.5 billion at the end of 2010.

**Beginning—**The System made 61,995 loans to beginning farmers—that is, to those who have been farming for 10 years or less. The volume of total new loans to beginning farmers amounted to $9.6 billion in 2011. During 2010, the System made 65,792 loans, totaling $10.2 billion, to beginning borrowers. The loans made to beginning farmers in 2011 represented 18.6 percent of all farm loans made during the year and 13.5 percent of the dollar volume of loans made. The average size of loans made increased to $155,406 in 2011. At the end of 2011, the System had $34.1 billion in outstanding loans to beginning farmers as compared with $34.0 billion at the end of 2010.

**Small—**FCS institutions made 137,529 loans, totaling $11.2 billion, to small farms (those with gross annual sales of less than $250,000) in 2011. By comparison, the System made 150,140 loans, totaling $12.5 billion, to small farmers in 2010. The loans made in 2011 to farmers in this category represented 41.2 percent of all farm loans made during the year and 15.7 percent of the dollar volume of loans made. The average size of loans made declined to $81,413 in 2011. At the end of 2011, the System had $42.9 billion in outstanding loans to small farmers as compared with $42.6 billion at the end of 2010.

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 in more than one category. If, for example, a borrower is less than 35 years old, sells less than $250,000 in farm products per year, and has farmed for less than 10 years, the borrower's loan would be included in every category. Therefore, adding the categories together would produce a misleading measurement of the System's YBS lending involvement.

## YBS BORROWING TRENDS, 2001–2011

Under the definitions and reporting requirements that became mandatory in 2001, the System's lending to YBS producers increased steadily until 2008. Since then, however, the trends have changed. The number and dollar value of new lending activity fell for all three groups in 2009, as the recession and a slower farm economy reduced demand for credit in general.

Then, in 2010, YBS lending rebounded when the farm and nonfarm economy improved. In 2011, new lending activity once again fell for the beginning and small categories but held relatively steady for the young category. While outstanding loan volume flattened out for beginning and small categories beginning in 2008 or 2009, outstanding loan volume to young farmers continued to grow because of the increase in new loan volume to young farmers.

Figures 7A, 7B, and 7C show that the percentage of new farm loan volume going to the small and beginning farmer categories has been declining somewhat since the early- to mid-2000s, but it fell more sharply in 2011. Despite an uptick from 2010 in new dollar volume to young farmers, the percentage share of loan volume going to young farmers also fell in 2011. In the past five years the share of total farm lending going to beginning farmers fell to 13.5 percent from

17.8 percent, the share to small farmers fell to 15.7 percent from 22.2 percent, and the share to young farmers was unchanged at 10.5 percent.

One explanation for the decline in the share of total loan volume going to any of the YBS categories in 2011 was that the average size of new loans to YBS borrowers fell relative to the size of new loans to other borrowers. We can probably attribute the decrease in the YBS share of new loan volume in 2011 to the larger loans that more established, larger farms took out to cover higher prices for production expenses, farmland, and other capital assets.

One of the main reasons for the decline in the small farmers' share of the System's total lending volume is the growth in farm incomes since the mid-2000s. From 2005 to 2010, cash farm sales rose from $241 billion to $314 billion, a 30 percent increase. As a result, the number of farms with sales above $250,000 rose by one-third from 2005 to 2010, while farms with sales from $100,000 to $250,000 dropped by almost 12 percent. Total U.S. farm sales for 2011 are estimated to have increased another 15 percent over 2010, suggesting that even fewer farms will be defined as small in 2012.

Comparing the System's YBS lending results with results reported by other organizations is difficult. Other Federal regulators do not require reporting on young and beginning farmer loans. Although large banks are required to report on small farm loans, they define small farm lending by loan size and not by the borrower's annual sales (a loan of less than $500,000 is considered a small farm loan). 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.

## ASSESSING YBS RESULTS FOR INDIVIDUAL ASSOCIATIONS

### Factors Affecting Results from One Institution to the Next

The results for individual associations reflect farmer demographics in each institution's territory and the strength of each institution's YBS program. Differences between farmer demographics make comparisons among individual associations difficult. For example, one institution's territory may have a larger population of beginning farmers than another institution's territory. That is why YBS regulations do not specify fixed goals but, instead, require individual institutions to set YBS targets that are appropriate for their lending territories. Other factors—such as the competitiveness of the local lending market and local economic conditions—can also affect YBS results for individual associations.

### Individual YBS Results Versus the System's Average YBS Results

As a result of the factors described above, YBS lending varies considerably across FCS associations.[13] 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. While the share of total new System farm loans made to young farmers was 15.8 percent, this share ranged from as little as 2.4 percent at one association to as high as 26 percent at another. In 2011, the percentage of new farm loans made to young farmers exceeded the Systemwide average in 39 percent of the associations.

The ranges in the share of total new loans made to beginning farmers were even greater. Whereas 18.6 percent of the System's total farm loans went to beginning farmers in 2011, this share ranged from as little as 3.4 percent at one association to as much as 64.5 percent at another. For this YBS category, just over half of all associations had lending shares that exceeded the Systemwide average.

The ranges for the small farm category were the greatest of all. In 2011, 41.2 percent of the System's total farm loans went to small farmers, but the percentage ranged from 4.3 percent at one institution to 86 percent at another. Approximately half of all institutions exceeded the System average in the percentage of small farmers they served, and about half fell below the System average.

13. 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 the Consolidated Reporting System Reports.

Figures 7A, 7B, and 7C

**Loans Made to, and Loans Outstanding for, YBS Farmers and Ranchers, 2001–2011**

As of December 31

Figure 7A

**Young Farmers and Ranchers**

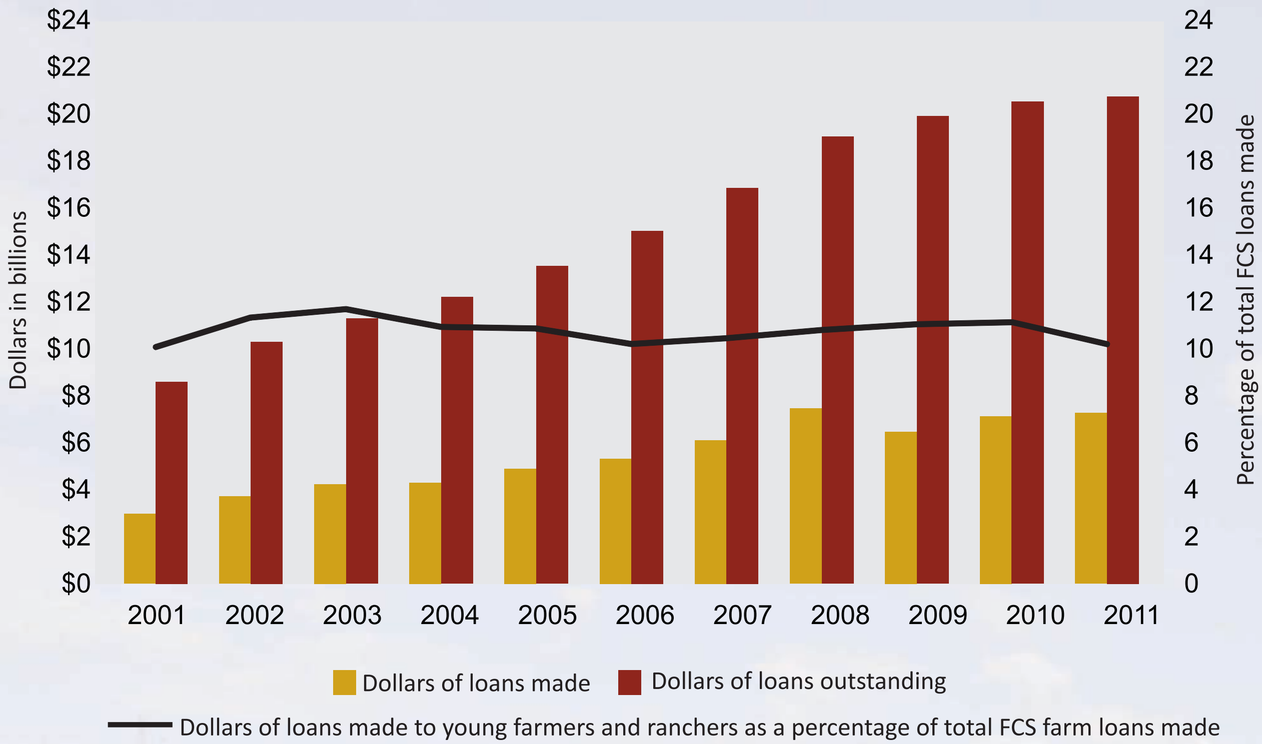


Figure 7B
## Beginning Farmers and Ranchers

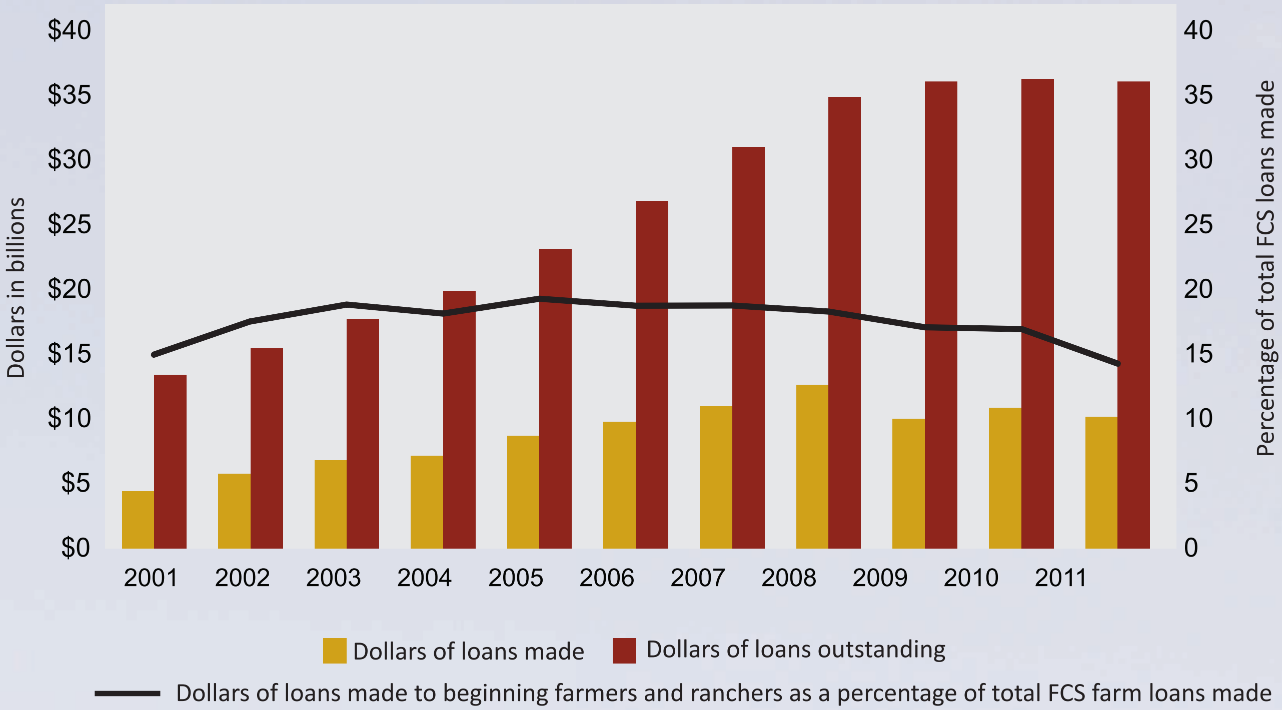
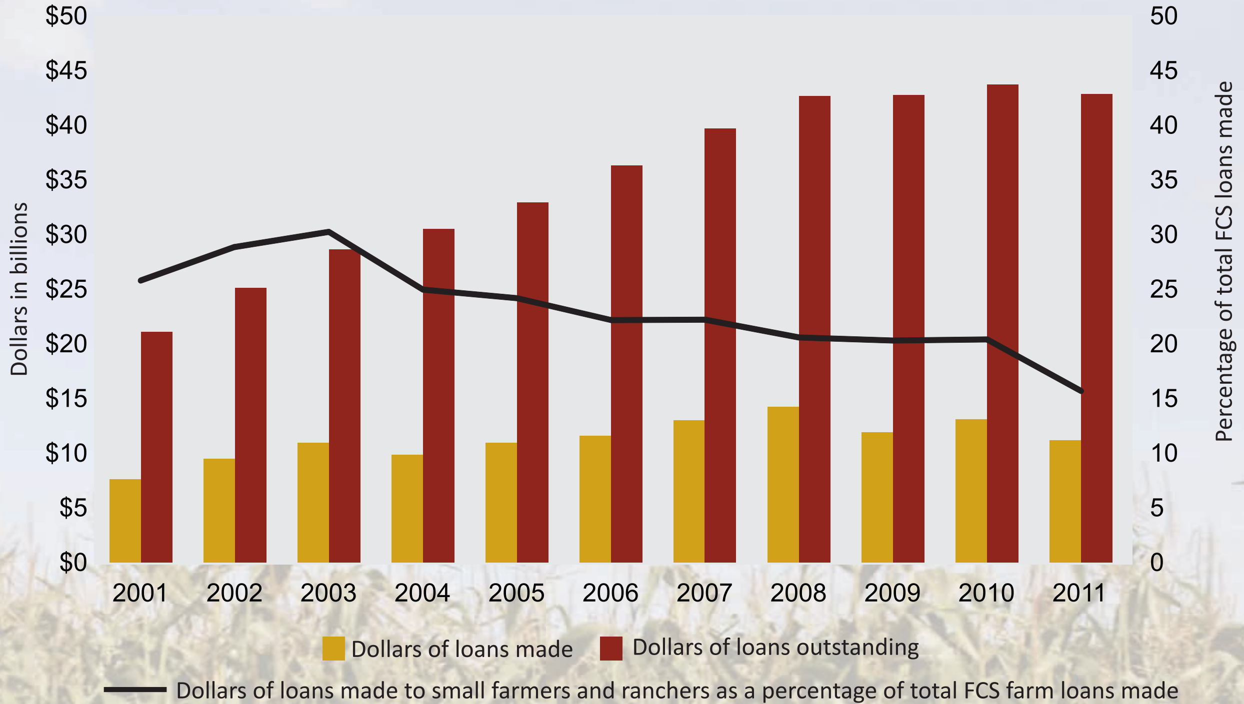



Figure 7C
## Small Farmers and Ranchers



While the share of total farm loan numbers and loan volume that went to beginning and small farmers fell during 2011 for the System as a whole, many associations experienced gains in the share of their total lending to YBS groups. For example, the share of total new farm loan volume going to young farmers rose in 41 percent of the associations, and the share going to beginning farmers rose in 28 percent of the associations. Lending shares for each category are more likely to vary significantly at small associations because of their small lending bases.

## 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 allow potential YBS borrowers to qualify for loans. Associations also offer training through their YBS programs to help these borrowers be successful.

System institutions employ methods to ensure that credit is made to YBS farmers and ranchers in a safe and sound manner. The following are examples of the types of methods used during 2011.

- Interest rate concessions—offered by 41 percent of associations
- Exceptions to underwriting standards—offered by 52 percent of associations
- Lower loan fees—offered by 24 percent of associations
- Loan covenants designed specifically for YBS borrowers—offered by 16 percent of associations

The percentage of associations using the first three types of loan concessions remained about the same in 2011 as in 2010. However, the percentage of associations offering loan covenants specifically for YBS borrowers doubled in 2011 from 2010.

As a whole, the System offered slightly more loan concessions to young and beginning farmers than it did to small farmers. In 2011, 63 percent of the System's 83 associations provided some form of loan concessions to young borrowers, 65 percent provided concessions to beginning borrowers, and 59 percent provided concessions to small farmers. Results for 2011 were similar to results for 2010.

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 are able to reduce the credit risk to these

borrowers. In 2011, all but one association used USDA Farm Service Agency loan guarantees for some of their YBS lending, while 17 percent used Small Business Administration loan guarantees and 41 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 30 percent of the System's overall loans made in 2011 with guarantees went to young farmers; about 30 percent went to beginning farmers; and about 40 percent went to small farmers (although they do this year, numbers do not necessarily add up to 100 percent because categories overlap). Loans made in 2011 with guarantees for young, beginning, and small farmer/rancher loans outstanding were 1,600, 1,600, and 2,200, respectively. System associations obtained guarantees on fewer loans in 2011 than in 2010, a decrease of about 760 loans to young farmers, 800 loans to beginning farmers, and 2,100 loans to small farmers. However, the percentage decline in loan guarantees to YBS loans is not as large as the percentage decline in loan guarantees to all System loans.

#### Training and Other Services

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, GroundBreakers Education Conference, Emerging Entrepreneurs' Conference, and the Young Farmer and Rancher Executive Institute.

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

As the regulator of the Farm Credit System, we issue regulations, as well as policy statements and other guidance, to ensure that the System complies with the law, operates in a safe and sound manner, and efficiently carries out its statutory mission. Our regulatory philosophy is to provide a 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 depends.

We strive to develop balanced, well-reasoned regulations whose benefits outweigh their costs. Our 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 2011

The following paragraphs describe some of FCA's regulatory efforts in 2011, along with several projects that will remain active in 2012. 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

**System Audit Committee—**The FCA Board approved a proposed rule in January 2012 to expand the authorities of the System Audit Committee.

**Senior Officer Compensation Disclosures—**The FCA Board approved a proposed rule in December 2011 that would amend our regulations related to disclosures made by System banks and associations to their stockholders and investors. The purpose of the rule is to provide full, transparent, and consistent disclosures on issues related to senior officer compensation.

**Compensation for 2012—**We issued an Informational Memorandum in February 2012 to communicate the annual adjustment in the maximum annual compensation payable to FCS bank directors. The adjustment reflects the change in the Consumer Price Index.

### Lending

**Operating and Strategic Business Planning—**The FCA Board approved a proposed rule in April 2011 and a final rule in April 2012 to require that FCS institutions' operational and strategic business plans contain human capital plans and marketing plans that include, among other things, outreach toward diversity and inclusion.

**Amendments to Regulations Implementing the RESPA, the FACT Act, and the ECOA—**We issued an Informational Memorandum in October 2011 to inform System institutions about amendments to regulations implementing the Real Estate Settlement Procedures Act, the Fair and Accurate Credit Transactions Act of 2003, and the Equal Credit Opportunity Act, all of which apply to FCS institutions in certain credit transactions.

**Lending and Leasing Limits and Risk Management—**The FCA Board approved a final rule in May 2011 to lower the current limit on the amount of credit that an institution may extend to a single borrower. The rule also requires FCS institutions to adopt written policies to measure, limit, and monitor exposures to concentration risks.

**Loan Purchases from the Federal Deposit Insurance Corporation—**The FCA Board approved a final rule in May 2011 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—**We issued an Informational Memorandum in April 2011 to explain the process for System institutions to register their employees who serve as residential mortgage loan originators.

**Loan Underwriting Standards – Borrower Financial Information—**We issued an Informational Memorandum in March 2011 to explain our expectations of System institutions regarding the collection and use of borrower financial information to measure and manage risks.

**Accounting and Disclosure of Troubled Debt Restructurings—**We 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. The Informational Memorandum also provides guidance on how institutions should disclose debt restructuring information in reports to shareholders.

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

### Capital and Investments

**Liquidity and Funding—**The FCA Board approved a proposed rule in November 2011 to ensure that FCS funding and liquidity requirements are safe, sound, and appropriate. The rule also invited comment on the best way to measure the creditworthiness of liquid investments purchased by System banks. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires agencies to adopt regulations that use standards of creditworthiness other than credit ratings issued by Nationally Recognized Statistical Rating Organizations.

**Capital Adequacy – Risk-Weighting Revisions: Alternatives to Credit Ratings—**The FCA Board approved an advance notice of proposed rulemaking in August 2011 to solicit public input on amending our capital regulations to comply with a provision of the Dodd-Frank Act that requires agencies to replace the references to credit ratings with references to other appropriate standards of creditworthiness.

**Investment Management—**The FCA Board approved a proposed rule in July 2011 to strengthen our investment management regulations. In addition, the proposed rule solicited public input on ways other than credit ratings to determine creditworthiness for eligible investments purchased by System institutions.

**USDA Guaranteed Investments—**We issued an Informational Memorandum in June 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—**We continued to evaluate how System partnerships and investments could help increase the availability of funds to agriculture and rural America. We are reviewing investments made under pilot projects to determine whether these investments help institutions fulfill their mission. These projects may be considered in future rulemakings.

### Farmer Mac

**Farmer Mac Nonprogram Investments and Liquidity—**The FCA Board approved a proposed rule in October 2011 to revise regulations governing Farmer Mac's liquidity and investment management. The rule also addressed the Dodd-Frank Act provision requiring agencies to replace references to credit ratings with other appropriate standards for measuring creditworthiness. The rule solicited public input on how best to replace these references in regulations pertaining to Farmer Mac.

**Farmer Mac Risk-Based Capital Stress Test Revisions—**The FCA Board approved a final rule in April 2011 to modify Farmer Mac's Risk-Based Capital Stress Test to accommodate rural utility program business. It also revised the treatment of risk mitigations of general obligations for the AgVantage Plus program and related structures. Then, in June 2011, the FCA Board approved an advance notice of proposed rulemaking to solicit public comments on alternatives to using credit ratings in regulations governing the Risk-Based Capital Stress Test for Farmer Mac.

The advance notice also sought input on how to revise the test to incorporate counterparty risk to Farmer Mac's portfolio of derivatives. In addition, the notice solicited input on how to require Farmer Mac to place greater emphasis on diversity and inclusion in its human capital and marketing plans.

### Other

**Capital and Margin Requirements for Covered Swap Entities—**The FCA Board approved a proposed rule in April 2011 to establish margin and capital requirements for swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants as required by the Dodd-Frank Act. The proposed rule was issued jointly by FCA, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Office of the Comptroller of the Currency.

**National Oversight and Examination Program for 2012—**We issued an Informational Memorandum in January 2012 that summarized the National Oversight Plan for 2012. The plan detailed strategies for addressing critical risks or other areas of focus in the System.

## CORPORATE ACTIVITY IN 2011

In 2011 and early 2012, we analyzed and approved four corporate applications.

- 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.

- On December 12, 2011, a Farm Credit Bank was chartered as a subsidiary of CoBank, ACB. Then, on January 1, 2012, following stockholder approval, U.S. AgBank merged with the Farm Credit Bank subsidiary of CoBank. The resulting entity was an Agricultural Credit Bank with a Farm Credit Bank subsidiary.

- On January 1, 2012, two ACAs affiliated with U.S. AgBank, FCB, merged their operations following stockholder approval. The PCA and FLCA subsidiaries associated with the ACAs also merged.

- On January 1, 2012, a new service corporation was chartered.

The total number of associations as of January 1, 2012, was 83 (80 ACAs and 3 FLCAs), compared with 84 associations a year earlier. The January 1, 2012, merger of two banks reduced the number of System banks to four. 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.

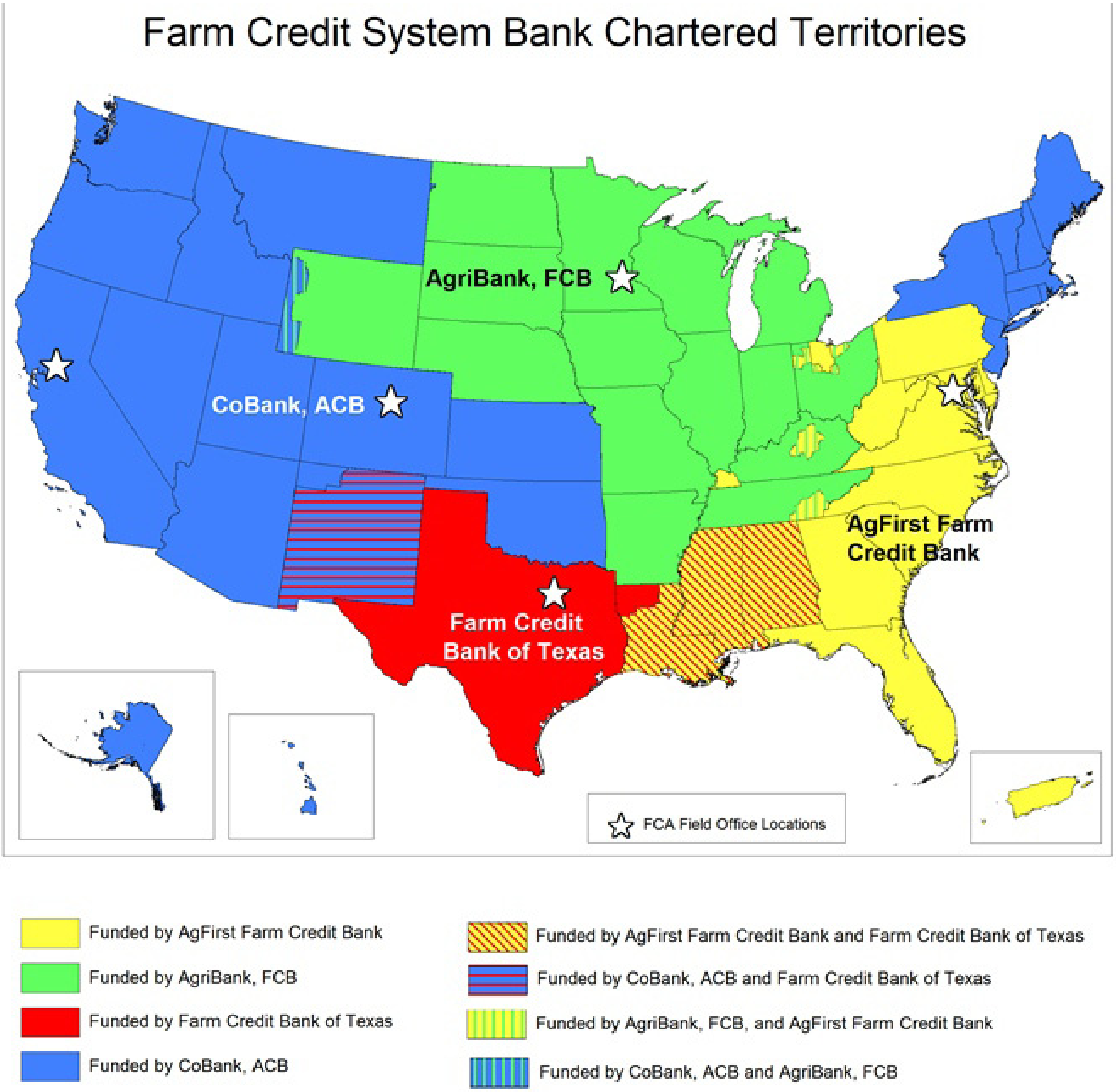
## FUNDING ACTIVITY IN 2011

During 2011, the System had ready access to the debt capital markets despite several sizable shocks to the markets, including the August 2011 downgrade of Standard and Poor's long-term sovereign credit rating of the United States. As a result of Standard and Poor's Government-related entity criteria, the System received a similar downgrade. Despite this downgrade, however, the System continued to have regular access to the debt capital markets.

In addition, further easing in the Federal Reserve's monetary policy continued to benefit the System's funding cost—both in terms of the overall pricing of securities as well as their corresponding spreads to U.S. Treasuries. The System also benefited from investors seeking safe haven from eurozone concerns; investors were attracted by the System's status as a Government-sponsored enterprise, as well as its overall financial strength. In addition, because of the reduction in debt issuances by the two housing-related Government-sponsored enterprises,[14] which are in conservatorship, investors have turned to the System as a desirable alternative. As a result, the System was able to issue debt at very competitive rates.

14. The Government-sponsored enterprises are the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

Figure 8
**Chartered Territories of FCS Banks**
As of January 1, 2012




Note: As of January 1, 2012, CoBank was funding 29 associations in the indicated areas and serving cooperatives nationwide; 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 87 banks and associations.

The System continued to enhance its marketing programs and strengthen its internal liquidity reserve requirements. It introduced a new retail bond program in May of 2011 to further diversify its investor base. All mandatorily redeemable preferred stock outstanding was redeemed in 2011, resulting in a decrease of $225 million from December 31, 2010. The System's outstanding perpetual preferred stock and outstanding subordinated debt were unchanged from 2010 at $2.12 billion and $1.65 billion, respectively.

The System funds its loans with a combination of consolidated Systemwide debt and capital. The Funding Corporation, the fiscal agent for the System banks, sells debt securities such as discount notes, bonds, and designated bonds on behalf of the System.[15] 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 2011, outstanding Systemwide debt was $184.8 billion, down from $188.8 billion a year earlier, representing a 2.1 percent decrease.[16]

Several factors contributed to the $4 billion decrease in Systemwide debt outstanding. Gross loans decreased $0.6 billion in 2011 while the System's combined investments, Federal funds, and cash balances increased by $1 billion in 2010. Record net income in 2011 of $3.9 billion and an increase in other liabilities provided the funding necessary to decrease Systemwide debt outstanding.

As the System's regulator, we have several responsibilities pertaining to System funding activities. As required by the Farm Credit Act, the System must obtain our approval before distributing or selling debt issuances. We have systems and processes that enable us to respond to requests quickly and efficiently. For example, we have 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 us with periodic reports on this activity. In addition, we approve the majority of longer-term debt issuances through a monthly "shelf" approval program. For 2011, we approved $352 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. 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.

To ensure safety and soundness, our regulations require each System bank 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, we require certain System banks 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 105.2 percent being the lowest for any single bank as of December 31, 2011.

In addition, our 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 2010, the System banks agreed to improve the quality of liquidity by establishing a framework under which each bank must at all times meet 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 support of joint and several liability on Systemwide debt obligations. First, the System banks have 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 establishes certain financial thresholds that provide the Funding Corporation with operational oversight and control

15. The primary function of the Funding Corporation, whose headquarters are in Jersey City, New Jersey, is to issue, market, and handle debt securities on behalf of the System's four 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.

16. Payment of principal and interest on Systemwide debt securities is insured by the Farm Credit System Insurance Corporation's Farm Credit Insurance Fund to the extent provided in the Farm Credit Act. 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.

over the System banks' participation in Systemwide debt obligations.[17] Third, the amended and restated Contractual Interbank Performance Agreement (CIPA) is tied to the Market Access Agreement and establishes certain measures that monitor the financial condition and performance of the institutions in each System bank's district. For all of 2011, all Farm Credit banks maintained scores in excess of the established CIPA benchmarks.

Debt issuances have increased for each of the preceding five years as a result of favorable economic conditions in agriculture and strong loan demand from System borrowers. Declining interest rates, particularly since the end of 2008, have also contributed to the increase in debt issuances; the System has continued to exercise call options on higher-cost debt. For the 12 months ended December 31, 2011, the System issued $563 billion in debt securities, compared with $534 billion for 2010, $523 billion for 2009, $519 billion for 2008, and $484 billion for 2007.

Investor interest and a continued decrease in yields on the full spectrum of debt instruments allowed the System to continue to extend its debt maturities in 2011. The System's weighted-average remaining maturity for all outstanding insured debt was 3.6 years as of December 31, 2011, compared with 3.5 years as of December 31, 2010, and 3.1 years as of December 31, 2009. The weighted-average interest rates for insured debt continued to decrease, going from 1.5 percent as of December 31, 2010, to 1.3 percent as of December 31, 2011.

## MISSION-RELATED INVESTMENTS

At FCA, we are 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. Agriculture and rural America face new challenges that require innovative solutions. Investments in rural communities can help create infrastructure improvements that promote the economic vitality of these communities for current and future generations of American farmers and rural residents. We believe that farm 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 young, beginning, and small farmers and other rural entrepreneurs who provide essential services for agricultural production.

Our 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, which Farmer Mac issues or guarantees. As of December 31, 2011, the mission-related investment securities held under these regulatory authorities totaled

- $1.19 billion in agricultural mortgage-backed securities ($707.0 million in held-to-maturity securities and $480.6 million in available-for-sale securities),
- $1.30 billion in securities backed by guaranteed portions of USDA loans and agricultural equipment loans, and
- $11.5 million in farmer's notes.

In addition, in 2005 we approved System institution investments in successor-in-interest contracts created as a result of the Tobacco Transition Payment Program.[18] As of December 31, 2011, investments in successor-in-interest contracts totaled $459.1 million.

We realize, 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, we recognize that rural areas increasingly need additional sources of capital to support economic growth and infrastructure improvements. In response, we have given System institutions a provisional opportunity to make additional mission-related investments through pilot programs supporting investments in rural

17. The banks and the Funding Corporation entered into the Amended and Restated Market Access Agreement in the late 1990s. The agreement is periodically updated to adjust financial targets, economic incentives, and other matters. In 2011, FCA approved the draft of the Second Amended and Restated Market Access Agreement. The agreement became effective on January 1, 2012.

18. On October 22, 2004, Congress enacted the Fair and Equitable Tobacco Reform Act of 2004 as part of the American Jobs Creation Act of 2004. The Tobacco Act repeals the Federal tobacco price support and quota programs, provides payments to tobacco quota owners and producers for the elimination of the quota, and includes a provision that allows the quota holders to assign to a financial institution the right to receive payments under a contract with the Secretary of Agriculture. FCA determined that FCS institutions meet the Tobacco Act's financial institution criteria and are therefore eligible to participate in the Tobacco Transition Payment Program.

America (see the FCA Informational Memorandum dated January 11, 2005, "Investments in Rural America—Pilot Investment Programs," which is available on our 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 us 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 us to better understand rural financial markets.

We have 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, we have approved a number of pilot programs and specific investments involving the following investment areas and structures.

**Rural Housing Mortgage Securities (RHMS)—**During 2011, three Farm Credit banks continued to be authorized to purchase and hold RHMS through pilot programs. 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 housing loans by giving 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, 2011, only one of the Farm Credit banks was participating in this program; it had $686.0 million in RHMS classified as held to maturity.

**Agriculture and Rural Community Bonds and Securities—**During 2011, 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 foster FCS partnerships and alliances with other agricultural and rural lenders to increase the availability of cost-effective funds to agriculture and to rural communities. Many of these projects include collaboration with U.S. Department of Agriculture Rural Development programs, rural community banks, and regional and local economic development authorities. As of December 31, 2011, FCS institutions held $759.5 million of investments in these programs.

**Equity Investments—**We have 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 passage of the Farm Security and Rural Investment Act of 2002, several FCS institutions have made equity investments in a rural business investment company to promote economic development and job opportunities in rural areas.[19] As of December 31, 2011, the amount of mission-related equity investments outstanding totaled $7.2 million for investments in the starter farmer program, venture capital funds, and a rural business investment company.

19. The Farm Security and Rural Investment Act of 2002 authorizes FCS institutions to establish or invest in rural business investment companies, provided that these 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 a rural business investment company, the company 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 cooperatives, the banks and associations of the Farm Credit System are limited-purpose lenders. According to Congress, the purpose of the FCS is to "improve the income and well-being of American farmers and ranchers" by providing credit and related services to them, their cooperatives, and to "selected farm-related businesses necessary for efficient farm operations."

Making loans exposes the System to risk. To manage this risk, System institutions must have both sufficient capital and effective risk-management controls.

As the independent regulator of the FCS, the Farm Credit Administration examines and supervises System institutions. We monitor specific risks in each institution; we also identify and monitor risks that affect the System as a whole.

Through our risk-based examination and supervisory program, our examiners determine how issues facing an institution or the agriculture industry may affect the nature and extent of risk in that institution.

Our examiners also evaluate whether each institution is meeting its public mission. They do so by determining whether each institution is complying with laws and regulations and whether it is serving the credit needs of eligible agricultural producers and cooperatives, including young, beginning, and small (YBS) farmers and ranchers.

## CONDUCTING A RISK-BASED EXAMINATION AND OVERSIGHT PROGRAM

We have designed our examination and oversight program to monitor and address FCS risk as effectively and efficiently as possible. Therefore, we assign 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 laws and regulations, we take appropriate supervisory or enforcement action.

Through our oversight practices, we ensure that FCS institutions have the programs, policies, procedures, and controls to effectively identify and manage risks. Our oversight program also ensures compliance with laws and regulations. For example, our regulations require FCS institutions to have effective loan underwriting and loan administration processes. We also have specific regulations requiring FCS institutions to maintain strong asset-liability management capabilities.

For more than 20 years, we have used a comprehensive regulatory and supervisory framework for ensuring System safety and soundness. FCS institutions, on their own and in response to our efforts, continue to improve their risk management systems.

## MEETING STATUTORY EXAMINATION REQUIREMENTS

As required by the Farm Credit Act, FCA examines each FCS institution at least once every 18 months. In the interim between these statutory exams, we also monitor and examine institutions as risk and circumstances warrant. In addition, we develop a National Oversight Plan every year that takes systemic risks into account. This approach allows us to customize our examination activities to each institution's specific risks.

As of January 1, 2012, we were overseeing and examining the following FCS institutions:[20]

- 83 FCS direct-lender associations
- 3 Farm Credit Banks
- 1 Agricultural Credit Bank
- 6 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 effec-

20. On a reimbursable basis, FCA performs examinations of certain entities that are not part of the Farm Credit System. As mandated by 12 U.S.C. 3025, FCA examines the National Consumer Cooperative Bank, which specializes in non-agriculture cooperative loans. In 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 responsibility.

tively identify and manage risks. We employ various processes for evaluating systemic risks in both agriculture and the financial services industry that can affect an institution, a group of institutions, and the System as a whole. Currently, we are emphasizing the following areas:

- **Loan Portfolio Management.** Our examiners review the systems and processes that institution boards of directors and management use to plan, direct, control, and monitor lending operations.
- **Collateral Risk Management.** We evaluate how institutions routinely monitor collateral risk, and we assess whether they are adjusting their operations to manage the risk.
- **Profitability and Repayment Capacity.** Our examiners evaluate systemic and prospective risks that may affect borrowers' profits and their ability to repay loans.
- **Public Mission.** We assess whether FCS institutions are fulfilling their chartered mission to provide credit and related services to all eligible, creditworthy customers.

When we identify systemic issues, we inform the institutions about those issues by producing the following:

- FCA Board Policy Statements
- Informational Memoranda
- Bookletters

We keep an online inventory of these documents. Go to our website at www.fca.gov, click on the Law & Regulations tab, and select Info Memos, Bookletters, and Other Guidance from the dropdown menu.

## MEASURING THE SYSTEM'S SAFETY AND SOUNDNESS

FCA uses the Financial Institution Rating System (FIRS) to indicate safety and soundness threats in each institution. Similar to the systems used by other Federal financial regulators, the FIRS 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 process includes quantitative benchmarks for evaluating institution performance, qualitative rating criteria for evaluating risk management practices, and outlook ratings for evaluating perspective risks.

Our examiners assign component and composite ratings to each institution on a scale of 1 to 5 based on their evaluation of measures and ratings. A composite rating of 1 indicates an institution is sound in every respect. A rating of 3 means an institution displays a combination of financial, management, or compliance weaknesses ranging from moderately severe to unsatisfactory. A 5 rating represents an extremely high, immediate or near-term probability of failure.[21]

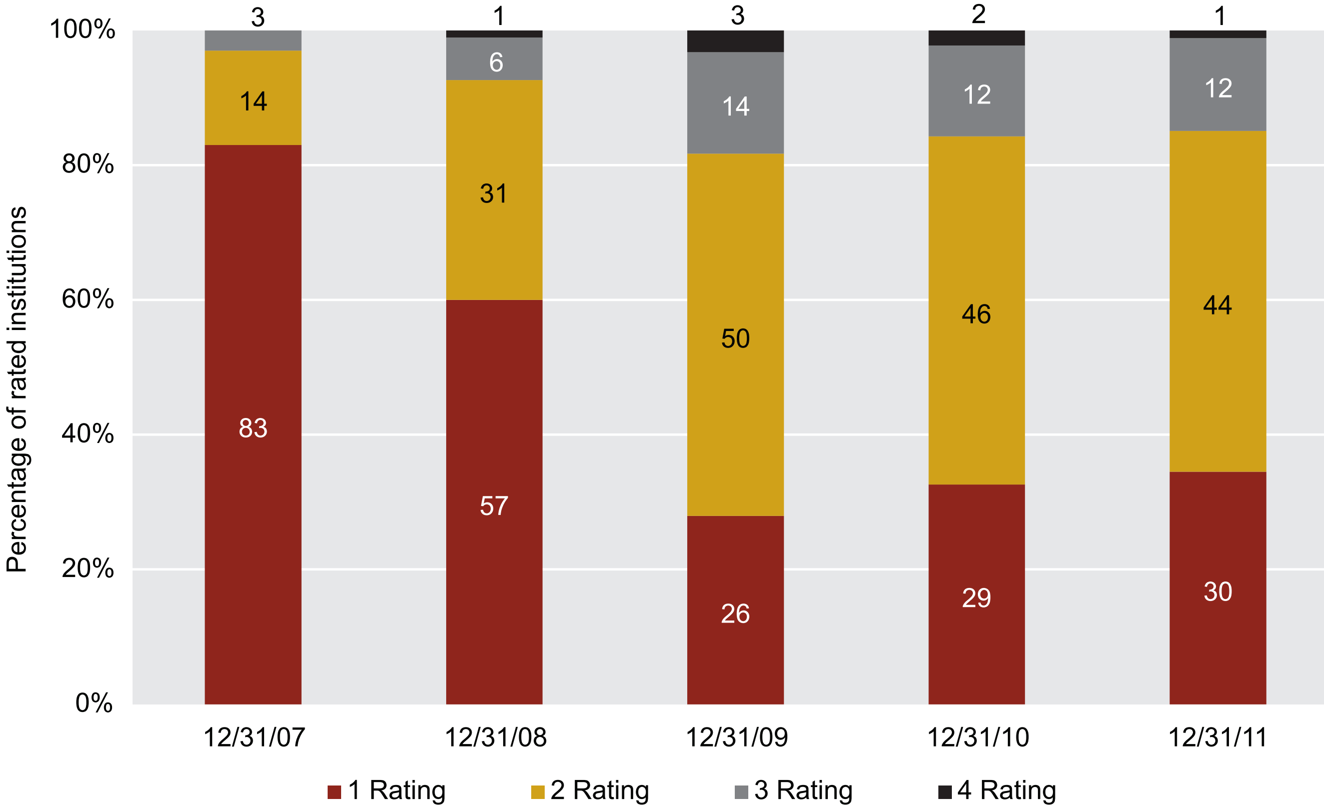
Through our monitoring and oversight programs, our examiners continually evaluate institutional risk and regularly review and update FIRS ratings to reflect current risks and conditions. We use both quantitative and qualitative benchmarks to help examiners apply FIRS ratings consistently from one institution to the next.

We disclose the FIRS composite and component ratings to the institution's board and CEO to give them perspective on the safety and soundness of their institution. We also disclose these ratings to each institution's funding bank to ensure that the bank takes any actions necessary to safely and soundly oversee its direct loan with the institution. In addition, we issue examination reports and other communications to provide the institution board with an assessment of management's performance, the quality of assets, and the financial condition and performance of the institution.

As figure 9 shows, risks increased considerably in 2009 when stresses from the general economy, the credit crisis, and volatility in commodity prices surfaced and affected some institutions. Although the ratings have not improved very much from that time, the FIRS ratings assigned for 2011 show that the financial condition and performance of the FCS remained relatively strong and stable throughout the year.

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

Figure 9
**Financial Institution Rating System (FIRS) Composite Ratings for the FCS, 2007–2011**




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.

At December 31, 2011, 30 FCS institutions were rated 1 (34 percent), 44 were rated 2 (51 percent), 12 were rated 3 (14 percent), and 1 was rated 4 (1 percent). Most of the institutions rated 3 or 4 were relatively small and collectively represent less than 2 percent of the System's total assets. 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.)

Stresses in the dairy, livestock, nursery, timber, and ethanol industries continue to keep FIRS ratings low in comparison with ratings from five years ago; however, the System remains financially strong overall. And its strength reduces the risk to investors in FCS debt, to the Farm Credit System Insurance Corporation, and to FCS institution stockholders.

## PROVIDING DIFFERENTIAL SUPERVISION AND ENFORCEMENT

FCA uses a risk-based supervisory and enforcement program to respond to the risks and particular oversight needs of each FCS institution. 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 lend-

ers. If we discover unacceptable risks, we require corrective action to ensure that institutions mitigate the risks. Corrective actions include reducing risk exposures; increasing capital and enhancing earnings, which improves an institution's ability to bear risk; and strengthening risk management.

We use a three-tiered supervision program: normal supervision, special supervision, and enforcement actions. Institutions under normal supervision are performing in a safe and sound manner and are complying with laws and regulations. These institutions are able to correct weaknesses in the normal course of business.

For those institutions displaying more serious or persistent weaknesses, we shift from normal to special supervision, and our examination oversight increases accordingly. Under special supervision, we give an institution clear and firm regulatory guidance to address weaknesses, and we give the institution time to correct the problems.

If informal supervisory approaches have not been or are not likely to be successful, we will use our formal enforcement authorities to ensure that FCS institutions are safe and sound and that they comply with laws and regulations. We may take an enforcement action for a number of reasons:

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

Our 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 we take an enforcement action, the FCS institution must operate under the enforcement document and report back to us on its progress in addressing the issues identified. Our examiners oversee the institution's performance to ensure compliance with the enforcement action. As of December 31, 2011, we had entered into formal written agreements with seven associations, whose assets totaled $2.3 billion. The written agreements require the associations to take corrective actions in such areas as financial condition and performance, portfolio management, and asset quality.

## PROTECTING BORROWER RIGHTS

Agricultural production is risky for many reasons—bad weather, changes in Government programs, international trade issues, fluctuations in commodity prices, and crop and livestock diseases. These risks 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 notify borrowers of the right to seek restructuring of the loan before beginning foreclosure. It also provides borrowers an opportunity to seek review of certain credit and restructuring decisions. When the System acquires agricultural property through liquidation actions, the Farm Credit Act also provides borrowers the opportunity to buy or lease back their property.

FCA enforces the borrower rights provisions of the Farm Credit Act and examines institutions to make sure that they are complying with these provisions.

We also receive and review complaints from borrowers who believe their rights have been denied. In 2011, we received more than 40 borrower complaints. The number of complaints has increased in recent years as financial stress on System borrowers has increased. Generally, borrowers who contact us with complaints are seeking clarification, additional information, and options to redress their concerns. If we find violations of law or regulations, we have 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. Created in 1988, Farmer Mac provides 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 rural borrowers with the benefits of capital markets pricing and product innovation.

Farmer Mac conducts activities through three programs:

- Farmer Mac I, which involves mortgage loans secured by first liens on agricultural real estate and rural housing
- Farmer Mac II, which involves 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 involves loans to finance cooperatively owned rural electrification and telecommunications systems

Farmer Mac purchases eligible loans directly from lenders; provides advances against eligible loans by purchasing obligations secured by those loans; securitizes assets and guarantees the resulting securities; and issues long-term standby purchase commitments (standbys) 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.

FCA regulates Farmer Mac 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 OSMO to be a separate office within our agency and to report directly to the FCA Board. The law also stipulates that OSMO's activities must, to the extent practicable, be carried out by individuals who are not responsible for supervising the banks and associations of the FCS.

Through OSMO, we perform the following functions:

- Examine Farmer Mac at least annually for capital adequacy, asset quality, management performance, earnings, liquidity, and interest rate sensitivity
- Supervise and issue regulations governing Farmer Mac's operations
- Oversee and evaluate Farmer Mac's safety and soundness and mission achievement

OSMO reviews Farmer Mac's compliance with statutory and regulatory minimum capital requirements 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 2006 to 2011.

Table 5
**Farmer Mac Condensed Balance Sheets, 2006–2011**
As of December 31
Dollars in Millions

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Percentage growth rate 2010–2011 |
|---|---|---|---|---|---|---|---|
| Total assets | $4,953.7 | $4,977.6 | $5,107.3 | $6,138.8 | $9,479.9 | $11,883.5 | 25.4% |
| Total liabilities | $4,705.2 | $4,754.0 | $4,947.7 | $5,798.4 | $9,001.0 | $11,329.0 | 25.9% |
| Net worth or equity capital | $248.5 | $223.6 | $15.3 | $196.2 | $478.9 | $554.5 | 15.8% |

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

## CAPITAL

On December 31, 2011, Farmer Mac's net worth (that is, equity capital determined using generally accepted accounting principles [GAAP]) was $554.5 million, compared with $478.9 million a year earlier. Net worth was 4.7 percent of on-balance-sheet assets as of December 31, 2011, compared with 5.1 percent at the end of 2010. The ratio declined because of significant growth in on-balance-sheet assets, which more than offset a reduction in off-balance-sheet obligations during the year. When Farmer Mac's off-balance-sheet program assets (that is, its guarantee obligations) are added to its total on-balance-sheet assets, capital coverage is 3.6 percent—up from 3.2 percent a year earlier. As of December 31, 2011, Farmer Mac continued to be in compliance with all statutory and regulatory minimum capital requirements.

At year-end 2011, 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. Its regulatory capital (core capital plus allowance for losses) exceeded the required amount as determined by the Risk-Based Capital Stress Test.[22] Farmer Mac's core capital as of December 31, 2011, totaled $475.2 million, exceeding the statutory minimum capital requirement[23] of $348.6 million by $126.5 million.

Farmer Mac's regulatory capital totaled $492.7 million as of December 31, 2011, exceeding the regulatory risk-based capital requirement of $52.9 million by $439.8 million. Regulatory capital was 4.7 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 because they are guaranteed by the U.S. Department of Agriculture. Table 6 offers a historical perspective on capital and capital requirements for 2006 through 2011.

We published an advance notice of proposed rulemaking in June 2011 to revise the risk-based capital regulations. The revisions would update the Risk-Based Capital Stress Test in response to changing financial markets, new business practices, and the evolution of the loan portfolio at Farmer Mac. They would also address the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and continue to develop best industry practices in financial modeling and stress testing. In addition, we are working on a proposed rule to revise regulations governing Farmer Mac's capital planning activities.

In addition to supporting program assets, Farmer Mac's capital supports nonprogram investments. Nonprogram investments provide liquidity in the event of a short-term disruption in the capital markets that would prevent Farmer Mac from issuing new debt. Nonprogram investments consist of investment securities, cash, and cash equivalents. Our 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. In November 2011, we issued a proposed rule to revise our regulations governing Farmer Mac's nonprogram investment and liquidity management. The proposed rule also addresses certain requirements of the Dodd-Frank Act.

## PROGRAM ACTIVITY

Farmer Mac's total program activity decreased to $11.9 billion on December 31, 2011, from $12.2 billion a year earlier (see figure 10). Although program volume declined slightly overall, Farmer Mac shifted much of the volume from its Farmer Mac I AgVantage program from off the balance sheet to on the balance sheet, and this had a positive impact on earnings. 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 product also generates program activity. Under

22. See the FCA website at www.fca.gov/info/farmer_mac_test.html for more information about the Risk-Based Capital Stress Test.

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

Table 6

**Farmer Mac Capital Positions, 2006–2011**

As of December 31

Dollars in Millions

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| GAAP equity | $248.5 | $223.6 | $15.3 | $196.2 | $478.9 | $554.5 |
| Core capital | $243.5 | $226.4 | $207.0 | $337.2 | $460.6 | $475.2 |
| Regulatory capital | $248.1 | $230.3 | $223.4 | $351.3 | $480.7 | $492.7 |
| Statutory requirement | $174.5 | $186.0 | $193.5 | $217.0 | $301.0 | $348.6 |
| Regulatory requirement | $42.9 | $42.8 | $57.3 | $35.9 | $42.1 | $52.9 |
| Excess over statutory or regulatory requirement* | $69.0 | $40.4 | $13.5 | $120.2 | $159.6 | $126.5 |
| Capital margin excess > minimum | 39.6% | 21.7% | 7.0% | 55.4% | 53.0% | 36.3% |

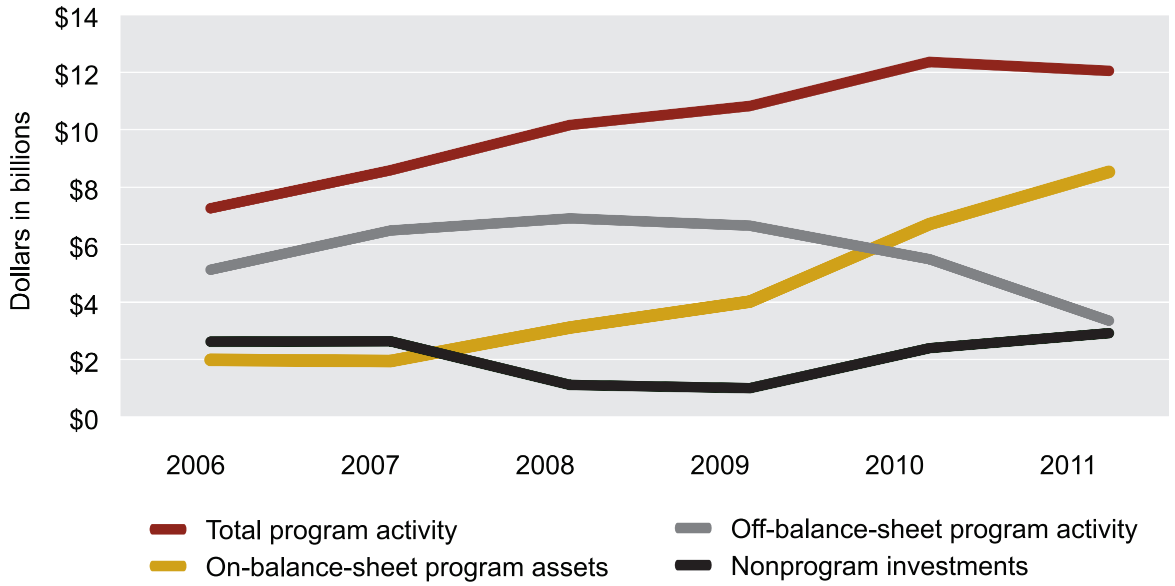
Sources: Farmer Mac's Securities and Exchange Commission Form 10-Ks.

* 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.

Figure 10

**Farmer Mac Program Activity and Nonprogram Investment Trends**

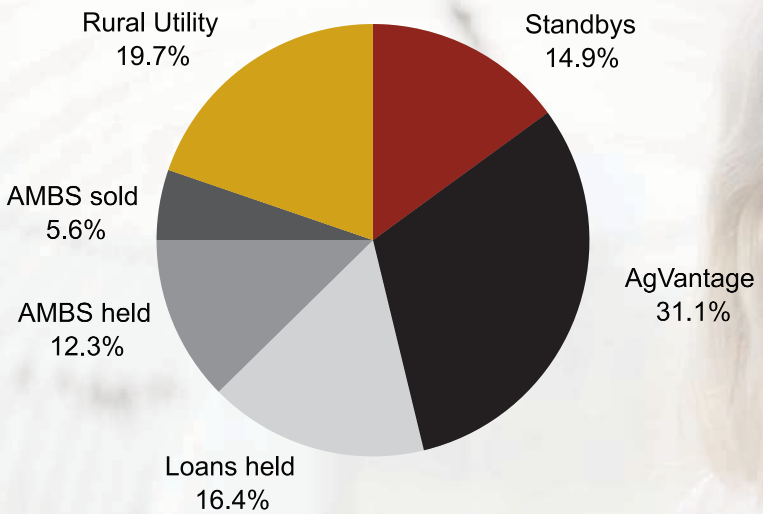
As of December 31




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

Figure 11
## Farmer Mac Total Program Activity
As of December 31, 2011

Total = $11.87 billion




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

AMBS = agricultural mortgage-backed securities 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 14.9 percent of Farmer Mac's total program activity in 2011.

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 2011, 28.8 percent of program activity consisted of off-balance-sheet obligations, as compared with 45 percent a year earlier.

## ASSET QUALITY

On December 31, 2011, $56.7 million of the Farmer Mac I program portfolio was nonperforming, representing 1.3 percent of the principal balance of all loans purchased, guaranteed, or committed to be purchased.[24] This compares with $81.8 million, or 1.9 percent, on December 31, 2010. 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, 2011, Farmer Mac's 90-day delinquencies were $40.6 million, or 0.93 percent of all loans, compared with $70.2 million, or 1.63 percent of all loans, as of December 31, 2010. Real estate owned as of December 31, 2011, was $3.1 million, up from $2 million a year earlier. Delinquencies decreased primarily because of improvements in the portfolio of loans on crops, permanent plantings, livestock, and ethanol. Farmer Mac reported no delinquencies or nonperforming loans in its pools of rural utility cooperative loans.

On December 31, 2011, Farmer Mac's allowance for losses totaled $17.5 million, compared with $20.1 million on December 31, 2010. Farmer Mac attributed the change in the allowance for losses primarily to a $2.3 million net release of funds in the provision for loan losses recognized during the year, as compared with a $4.3 million net release of funds in the provision for 2010. Figure 12 shows the levels of Farmer Mac's nonperforming assets and its 90-day delinquencies relative to outstanding program volume, excluding volume purchased before 1996, when the Farm Credit System Reform Act was passed.

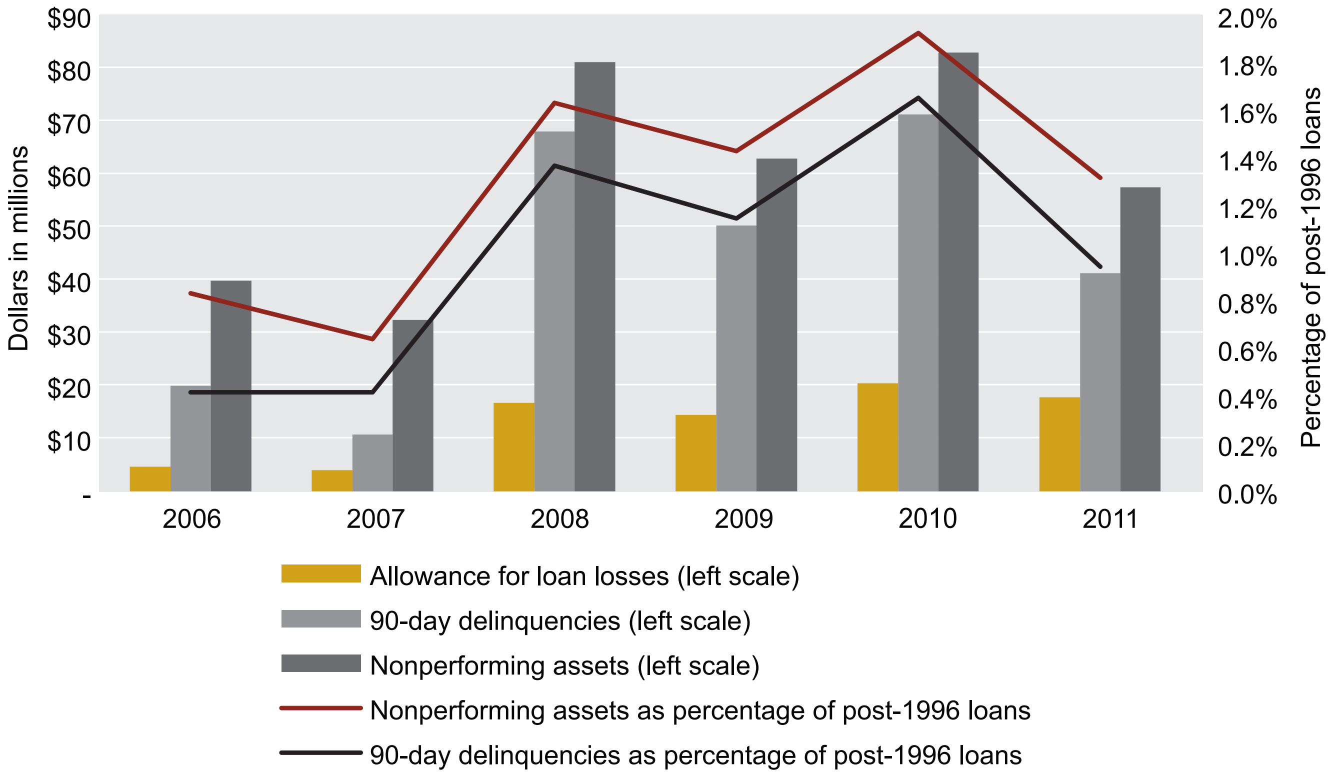
## EARNINGS

Farmer Mac reported net income available to common stockholders of $13.8 million (in accordance with GAAP) for the year ended December 31, 2011, down from the $22.1 million reported at year-end 2010. Core earnings for 2011 were $42.9 million, compared with $25.4 million in 2010.[25] Net interest income, which excludes guarantee fee income, was $121.3 million in 2011, up from $96.0 in 2010. Guarantee fee income was $24.8 million, compared with $24.1 million in 2010. The increase in net interest income was due in part to the fact that the net interest margin on new 2011 on-balance-sheet AgVantage volume exceeded the guarantee fee earned on off-balance-sheet AgVantage guarantees that matured over 2011. Nonprogram investments accounted for an estimated 10 percent of interest income for 2011, down from 12 percent for 2010. Table 7 shows a six-year trend for the basic components of income.

24. 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.

25. Core earnings provide 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, 2006–2011**
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, 2006–2011**
As of December 31
Dollars in Millions

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Growth Rate 2010–2011 |
|---|---|---|---|---|---|---|---|
| Total revenues | $67.8 | $31.5 | ($140.6) | $181.8 | $99.1 | $73.3 | (26%) |
| Total expenses | $38.0 | $27.1 | $13.5 | $99.5 | $77.0 | $59.5 | (23%) |
| Net income available to shareholders | $29.8 | $4.4 | ($154.1) | $82.3 | $22.1 | $13.8 | (38%) |
| Core earnings | $25.9 | $29.9 | ($81.5) | $16.1 | $25.4 | $42.9 | 69% |

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

# Challenges Facing the Agricultural Economy and the Farm Credit System

The U.S. farm economy was exceptionally robust in 2011. The farm economy benefitted from record prices for a number of agricultural commodities, record total agricultural exports, and record farm incomes. Rising demand for commodities from emerging markets and tight domestic supplies led to higher prices for major grains, oilseeds, and fibers, as well as for products from the livestock sector. Total receipts from crop sales are expected to have increased by 14 percent in 2011, with an even larger percentage increase for livestock products. As a result, USDA estimates that in 2011 net farm income topped $98 billion, up more than 24 percent from 2010. The large rise in farm income, combined with record low interest rates, propelled farm asset values higher again in 2011, boosting the farm sector's level of equity relative to debt to record levels.

With the strong farm economy and a favorable interest rate environment, System earnings grew despite a slight decline in outstanding lending volume during the year. However, growth in earnings was not uniform across the System because of weaknesses in certain regions and enterprises. Although loan performance improved during the year, financial stress remained high in some farm lending segments, such as dairy. Also, the slow recovery of the housing market continued to adversely affect segments of the System's horticulture portfolio.

Modest economic growth in the United States is expected again in 2012. Consensus forecasts predict growth in GDP to be less than 3 percent. In general, rural economies are also expected to grow modestly in 2012, bolstered in some areas by agricultural and energy sectors. The U.S. Department of Agriculture forecasts that net farm income for 2012 will fall 7 percent from 2011. If the forecast proves correct, net farm income will remain $16 billion above the 10-year average (2002–2011) of $80 billion. Because of low world stocks of key crops, the size of this year's harvest will greatly influence the level of farm income for 2012.

The following paragraphs identify several risk factors—both domestic and foreign—that could affect the System's long-term ability to profitably finance agricultural enterprises. The factors include conditions in the macro-economy and the farm economy, government policies, foreign trade, and other longer-term challenges. As the regulator of the System, we will continue to closely monitor and address these risks.

## PROSPECTS FOR THE GENERAL ECONOMY

According to key economic indicators in early 2012, the U.S. economy will probably continue to grow modestly in 2012. In 2011, real GDP growth averaged an anemic 1.7 percent, but economic momentum gained in the latter half of 2011, reaching 3.0 percent in the last quarter as consumer spending and commercial construction activity picked up and businesses rebuilt inventories. These and other positive trends carried over into early 2012, but other economic indicators showed weakness as the first quarter drew to an end. In particular, rising gasoline prices in the first quarter slowed consumer spending. As a result, economic growth for 2012 is forecast to remain in a modest 2 to 3 percent range.

High unemployment and a chronically weak housing market have made consumers cautious through much of this recovery. Nevertheless, the jobless rate has steadily come down as companies have hired more workers and the labor pool has shrunk. Unemployment rates, which averaged 9.0 percent in 2011, declined to 8.2 percent by March 2012. Consumer confidence has risen as the labor market improved, especially in the latter half of the year. Increases in real disposable incomes drove up retail sales, which rose for 10 consecutive months through March 2012. Consumer spending is a key factor in the economy's performance, representing 70 percent of the U.S. economy. For the job market to continue to improve throughout 2012, the pace of economic activity will probably have to accelerate.

The nation's manufacturing sector has helped drive economic expansion. Industrial production in the fourth quarter of 2011 rose 3.9

percent from that of a year earlier, and it rose even higher in the early months of 2012. Demand for cars is helping boost manufacturing output. Indicators of capital investment and confidence in both the manufacturing and the service sectors showed strength in early 2012. As a result, businesses borrowed more in 2011 than they did in 2010.

### Factors to Watch

While the economic outlook for 2012 looks relatively promising, several factors could hinder economic growth and even derail economic expansion. Household debt is one such factor. Total household debt eased again in 2011, declining to $13.2 trillion after reaching nearly $14 trillion before the recession. However, relative to disposable income, household debt remains high. Therefore, despite historically low interest rates, Americans are unable to use credit to finance consumer purchases as readily as they could in past economic cycles.

Another factor 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 long healing process of the housing sector is hampering recovery. Declining or stagnating home prices in many areas have weakened consumer balance sheets and eroded consumer confidence. Fortunately, the housing recovery appeared more solid in the first months of 2012. New housing starts and building permits increased modestly in early 2012 and may increase still more over the year. New home sales have a large impact on the forestry, sod, and nursery industries.

Another factor that may limit economic growth is the Federal budget deficit and its potential effect on inflation. The Congressional Budget Office expects the deficit for fiscal year 2012 to exceed $1 trillion. Ongoing deficits of this magnitude could lead to structural imbalances in capital and credit markets. These imbalances could threaten the confidence of market participants—both domestic and foreign—and spark inflationary fears and a rise in interest rates. Just as spending cuts by state and local governments have slowed GDP growth, Federal deficit cuts—whether they are achieved by raising taxes, cutting spending, or both—may create economic headwind.

The U.S. export sector has been expanding as the world economy has improved, but future economic activity in Europe and China could negatively affect the domestic economy in 2012. Sovereign debt burdens in Europe continue to rattle world financial markets as countries there try to grapple with how to repay their debts. The eurozone as a whole is now facing a deepening recession in 2012 because the problems first encountered by Greece, Ireland, and Portugal are now confronting larger European countries. To help their economies grow, some European countries have begun to adopt policies that make structural adjustments to their spending budgets and their economies. These adjustments have proven to be politically unpopular thus far. The course of economic activity that results from these adjustments will influence U.S. trade with the region not only for the balance of 2012, but for years to come.

Perhaps more critical to U.S. agriculture in the near future is economic growth in China and other Asian countries. Asia accounted for 43 percent of U.S. agricultural exports in 2011, and China alone accounted for about 16 percent. China remains the world's fastest-growing major economy, its largest exporting economy, and its second-largest importing economy. However, the Chinese economy has been weakening recently. Its annual growth during the first quarter of 2012 was 8.1 percent, its slowest pace in almost three years. China is working to transition its economy to one that is dependent on domestic, rather than foreign, demand. To do so, it is trying to keep inflation in check, to restrain excesses in its economy, to create jobs, and to raise incomes.

Over 2011, U.S. consumer price inflation was relatively modest despite jumps in energy prices. Consumer prices increased 3.1 percent on average in 2011, and the consensus

forecast for 2012 is just 2.3 percent. Although most observers believe inflation will remain in check for the rest of this year, inflation may rise more over the longer term. Inflation affects agriculture by causing increases in input costs and by reducing consumer demand for high-value products like meats.

Other factors affecting the outlook for the FCS are funding costs and borrower interest rates. As noted on page 36, the System had regular and flexible access to the debt markets in 2011. Because of the Federal Reserve's low interest rate policies, rates paid by System borrowers have been near historic lows. According to signals from the Federal Reserve, interest rates will probably continue to be low through late 2014. Over the longer term, however, rate increases are likely. Interest rates are highly unpredictable: events could occur at any time that could cause the nation's current low rates to rise quickly.

## ECONOMIC SETTING FOR AGRICULTURE AND THE RURAL ECONOMY

The rural economy has fared somewhat better than the general economy. Many rural areas benefited significantly from booms in agriculture and the extraction of minerals and energy. As a result, regions dependent on commodity production have added more jobs. In particular, rural states having both large agricultural production *and* mineral and energy extraction industries have fared well. For example, the plains states have had significantly lower unemployment rates than more urban states and have enjoyed stronger personal income growth. From 2010 to 2011, North Dakota, Iowa, Texas, Oklahoma, and South Dakota were the top five states in personal income growth.

Rural manufacturing has also grown during the recovery. Employment in manufacturing has grown faster in rural areas than in urban areas. The number of rural manufacturing jobs was up 3.8 percent in 2011. Rural manufacturing job growth was particularly strong in industries with strong export growth or close ties to energy or agriculture.

The agricultural sector, with its near-record farm incomes in 2011, has been a major contributor to the rural economy. USDA estimated net farm income for 2011 to have reached $98 billion, up from $79 billion for 2010. Net cash farm income (reflecting cash transactions during the year) rose even more, reaching nearly $109 billion, up from $92 billion in 2010 and $74 billion in 2009. USDA's forecast for 2012 suggests that net cash farm income will decline to $96 billion but will remain above that of 2010 (forecasts as of February 13, 2012).

The balance sheet of the farm sector improved in 2011. Larger profits and rising land values increased total asset values by 7 percent. In 2012, total farm assets are forecast to rise 6 percent more and reach nearly $2.5 trillion. If they do, total farm equity would surpass $2.2 trillion, breaking the inflation-adjusted record.

Debt usage rose modestly again in 2011. The sector's debt-to-asset ratio was 11 percent, one of the lowest in history. 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 operations remain weak financially. Producers of the major field crops, as well as hog, cow-calf, and dairy producers, had much higher incomes in 2011; however, poultry and beef producers—particularly those who had to purchase their feed—were still recovering from poor earnings and an erosion of their equity positions from previous years. Likewise, the financial circumstances for some producers of housing-related products, such as nursery plants and timber, have also improved more slowly. Naturally, conditions vary considerably from region to region, depending on the mix of enterprises and local economic conditions.

### Midwest Farmland Values Soar

With about 85 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 the creditworthiness of farmers. Surveys conducted by appraisers, universities, and by Federal Reserve district banks all suggest that farmland prices in the Midwest rose at a record-to-near-record pace in 2011.The strongest reported gains were for high-quality cropland in major corn- and soybean-producing regions. According to statewide surveys, cropland values increased by over 30 percent in some midwestern states. During the past winter, cropland values remained strong, but appreciation may have moderated somewhat during the spring planting season. The value of pasture and ranchland also went up considerably, with annual increases surpassing 10 percent in some states. These increases reflected a more robust livestock sector in 2011 and 2012, particularly for cow-calf operations.

Although interest in purchasing farmland has increased among nonfarmers, farmers remain the dominant purchasers of farmland. The use of debt to make such purchases is generally viewed as modest. Despite the rapid rise in farmland values, Systemwide farm real estate debt outstanding rose by a more modest rate of 3.5 percent during 2011. Yet, for some associations, farm real estate volumes increased much more significantly, particularly in the Midwest.

To address the rising risks associated with farmland values, we have issued guidance on collateral risk management to System lenders through a series of Informational Memorandums. Many System institutions are improving underwriting standards and appraisal guidelines on farmland collateral. They are also improving their efforts to identify portfolio risk through land value studies and the stress testing of changes in land value. As the regulator of the System, we continue to monitor agricultural land values and associated risks to loan collateral and to discuss these risks with other Federal financial regulators.

Besides farmland, farmers continued to make large investments in new buildings and equipment. The number of new, large farm tractors and combines sold in 2011 was relatively flat compared with sales in recent years; however, compared with sales from five years ago, the number of tractors sold was up by 60 percent, and the number of combines sold was up by 100 percent.

### Price and Production Risks

Many producers enjoyed strong profits in 2011 because prices were high for large-acreage crops like corn and soybeans, and because production costs, including land rental costs, did not rise as much as crop prices. Cropland rental rates are expected to rise significantly in 2012. Survey data suggest that rental rates may rise by double-digit percentages in many parts of the Midwest. Higher rental rates and other production expenses, such as fuel, fertilizer, and chemicals, are reducing profit margins and increasing the financial risk of buying land.

Although worldwide stocks of wheat, rice, and other crops have been rebuilt, world stocks of corn and soybeans are expected to be low at the end of the 2011/12 marketing year, with corn stocks the lowest since 1973/74. As a result, the size of this year's harvest will have a greater influence on corn and soybeans than on many other crops. If U.S. farmers plant an anticipated 96 million acres in corn and have yields that exceed expectations, the harvest will replenish world stocks, causing corn prices to fall significantly by harvest, squeezing profit margins for producers. Conversely, even if farmers plant large acreages, poor yields for a third year in a row could lead to another year of tight stocks and higher prices.

This uncertainty presents decision-making challenges for producers and lenders alike. 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. They are also 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 insurance.

High feed prices have made margins very tight for livestock producers for several years, but the impact of high feed ration costs is not always uniform in livestock. Rising grain prices particularly affect farrow-to-finish hog farmers and cattle feedlot operators because of the large amount of feed they have to purchase. As a result of weaker profit margins, these producers have become more reluctant to expand production.

With rising demand in 2011 and limited production, prices for livestock, dairy, and poultry have risen significantly; prices either hit record levels in 2011 or are forecasted to do so in 2012. Exports have been a key driver, with beef, pork, and broiler exports at record levels in 2011 and strong export outlook expected for 2012.

### Policy Concerns

Farm programs, energy policies, and foreign trade agreements are important policy forces that help shape farm income and thus affect borrower repayment risk. The flow of Government payments has generally supported farm income (although mostly for crop producers) and has helped stabilize prices. However, these advantages have sometimes come at a heavy cost to taxpayers. Recent policies have shifted more of this responsibility to Government-supported farm revenue insurance policies. Affordable insurance products not only protect farmers, they protect farm lenders as well, by helping borrowers meet debt payments if prices or yields decline significantly. The majority of crop producers purchase some type of insurance product to protect their revenues from production or price declines or both.

A key concern for agricultural lenders will be the outcome of the 2012 Farm Bill debate. The Federal safety net for agriculture will not automatically keep pace with structural changes in the industry and the rise in production costs. In its efforts to reduce the Federal budget, Congress may cut farm program payments. In fact, some legislative proposals that rely on crop insurance to deliver support may prove to provide less of a financial backstop than current policies.

Most observers attribute the increase in grain prices since 2005 to energy policies that require the use of U.S. ethanol in transportation fuels. However, without changes in policy, future growth in demand will be limited because corn-based ethanol production is nearing the 15-billion-gallon maximum set by the 2007 renewable fuel standards. Therefore, without changes in policy, the cost of gasoline in comparison to ethanol will largely determine how much the demand for corn-based ethanol will grow.

In 2011, because tax benefits were set to lapse at the end of the year, growth in production volume slowed considerably, with the industry producing 13.9 billion gallons of ethanol. Corn use for ethanol production is forecast to be relatively flat this year because the mandate for 2012 is set at 13.2 billion gallons.

U.S. agricultural exports have helped drive the growth in farm income in the past and will likely continue to do so in the future. In the past five years, the value of U.S. farm exports has nearly doubled. It was $136 billion in 2011. The weak trade-weighted value of the U.S. dollar has likely contributed to the export increases. Agricultural export volume is expected to decline somewhat in 2012, but still remain the second highest on record.  Export volume in 2012 could decline more, if this spring's trend towards a stronger dollar continues deeper into 2012.

While U.S. agricultural exports to many countries have increased, the most notable growth occurred in exports to China, which was the largest destination for U.S. agricultural exports last year. Exports to China are expected to fall somewhat in 2012, but the actual volume is dependent on bulk commodity trade—primarily soybeans. As in the past, the condition of the U.S. farm economy is subject to changes in the economic growth and trade policies of a handful of our nation's major trading partners.

## FARM CREDIT SYSTEM PORTFOLIO

System loan volume did not change from 2010 to 2011, and some sectors continued to face high stress levels. An increase in farm income and the value of farmland, particularly in the middle part of the United States, offset the impact of credit stress created from other regions and sectors on the System's overall portfolio. Lending to finance production inputs, inventories, machinery, and real estate increased in many areas where cash grain is produced.

Some sectors, such as dairy, hogs, cattle, and biofuels, became profitable again in 2011 after enduring significant credit stress in 2010; as a result, the quality of loans to these sectors improved. However, other sectors, such as poultry, horticulture, and forestry, saw continued distress in 2011. Continued weak demand for housing and tepid growth in the general economy did not provide enough revenue to cover operating costs and to reduce debt, and in some areas, real estate values continued to decline. As a result, nonaccrual loans to livestock, poultry, forestry, horticulture, and biofuel sectors accounted for $1.4 billion of the $2.7 billion in nonaccruing System loans. Also, the System reported $265 million in charge-offs for loans to these sectors; this represented about 53 percent of all FCS charge-offs. These sectors accounted for $50.1 billion, or 29 percent, of all System loans.

### Cattle

The System's loans outstanding to the cattle industry totaled $16.5 billion at year-end 2011, up about 2 percent from year-end 2010. Because cattle prices rose during the year, most producers were able to remain profitable; however, others suffered from increased feed costs, particularly in areas affected by drought. Prices rose in response to a return of strong export demand. System loans not accruing interest declined 8 percent to $302 million at year-end; the System recorded $43 million in charge-offs for loans to the cattle industry. Loans to cattle operations totaled more than 9 percent of the System's loan dollar volume and 46 percent of its capital.

### Dairy

System loans outstanding to the dairy sector totaled $14.0 billion, down slightly from a year earlier. Producers benefitted from higher milk prices though high feed costs continued to reduce the profits of farmers who purchased most of their feed. While many producers made progress in reducing their debt in 2011, many others remain vulnerable to factors such as reduced milk prices, higher feed costs, and interest rate increases. System loans not accruing interest fell 31 percent to $452 million at year-end 2011, and the System recorded $28 million in charge-offs. Loans to this sector totaled 8 percent of the dollar volume of all System loans and 39 percent of its capital.

### Forestry

System loans outstanding to the forestry sector totaled $9.5 billion, down about 4 percent from a year earlier. Loan volume fell because demand for housing and lumber products remained soft, particularly in the Southeast. Some producers reduced debt through scheduled loan paydowns, and some liquidated property to help address cash flow problems. System loans not accruing interest fell to $289 million at year-end, and the System recorded $77 million in charge-offs. Loans to this sector totaled about 5 percent of the System's loan dollar volume and 26 percent of its capital.

### Poultry

System loans outstanding to the poultry and eggs sector totaled $5.5 billion, up 3 percent from a year earlier. Most producers suffered substantial operating losses because they were unable to offset high feed costs through increased poultry prices. While most producers were able to borrow funds to offset their operating losses, a few large integrated broiler producers were unable to obtain financing and declared bankruptcy. In a few cases, lenders were unable to recoup their loans from the sale of the assets of bankrupt operations. System loans not accruing interest fell 19 percent to $76 million at year-end 2011, and the System recorded $48 million in charge-offs. Loans to this sector totaled 3 percent of the System's loan dollar volume and 15 percent of its capital.

**Horticulture**

System loans outstanding to horticulture operations declined about 6 percent from last year to $2.9 billion. The decline reflected the low demand for landscaping material in a persistently weak housing economy. Because many of these operations are located in and around urban areas, soft real estate values for properties used in their operations aggravated cash flow problems. As a result of these factors, System loans not accruing interest rose 32 percent to $289 million at year-end 2011, and the System recorded $19 million in charge-offs. Loans to horticulture totaled about 2 percent of the System's loan dollar volume and 8 percent of System capital.

**Biofuels**

At the end of 2011, loans outstanding to the biofuels (primarily ethanol) industry totaled $1.6 billion, down about 31 percent from a year earlier. Loans declined as firms paid down debt from their much-improved operating margins and their renewed ability to raise capital. Some of the firms that filed bankruptcy or idled plants during 2009 were able to restructure debt and restart plants, and FCS institutions were able to sell some of the plants they had acquired through loan collection actions. System loans not accruing interest totaled $57 million at year-end, and charge-offs totaled $50 million. Biofuel loans outstanding represented only 5 percent of capital and less than 1 percent of the System's total dollar volume, both of which are small numbers when compared with the System's exposure to other industries or commodities. Both losses and nonaccrual assets are concentrated in a few firms.

# Appendix

## FARM CREDIT ADMINISTRATION OFFICES

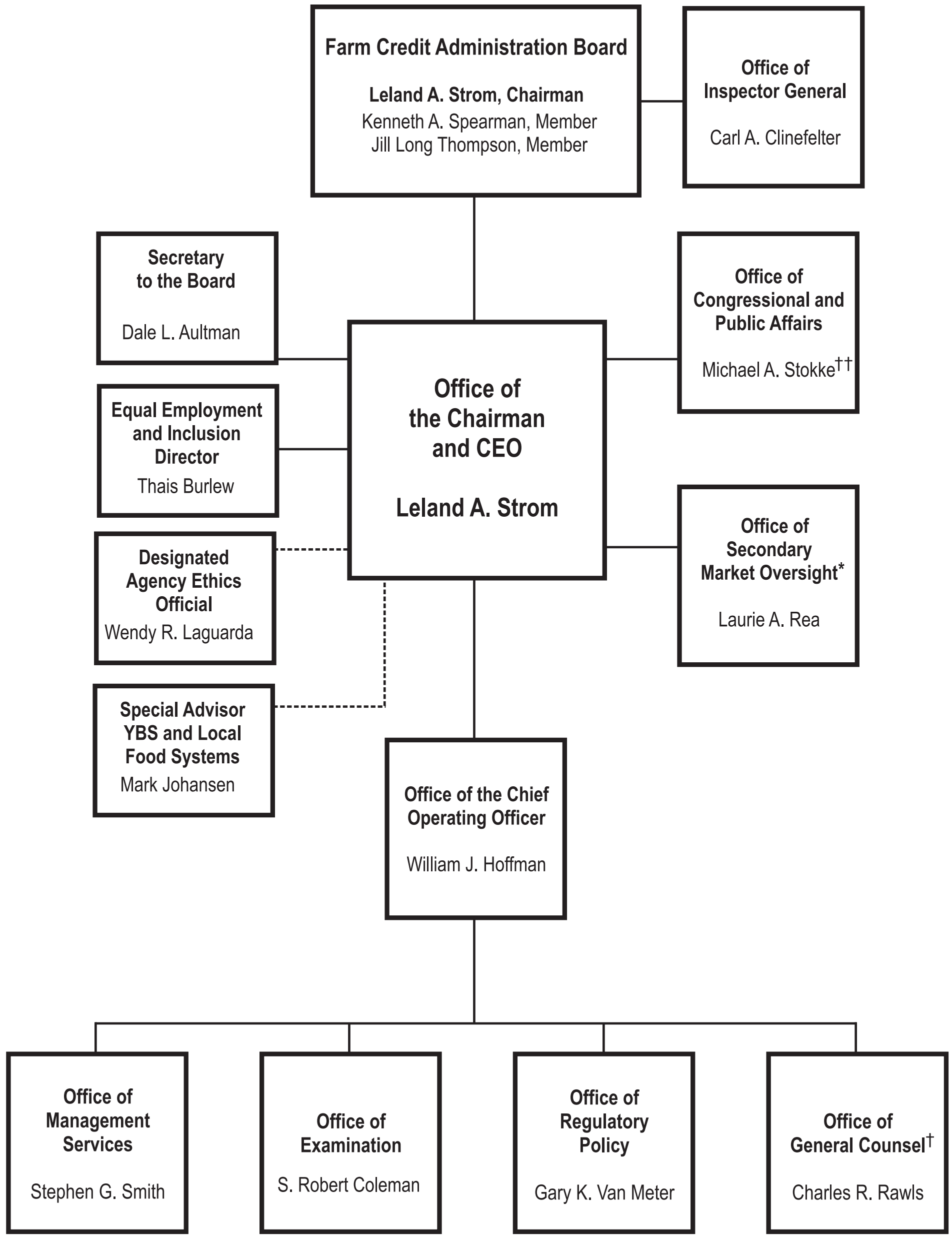
As of December 31, 2011, FCA had 282 full- and part-time employees. These employees are divided among the following offices, with the majority serving in the Office of Examination.

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 September 2011




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

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.

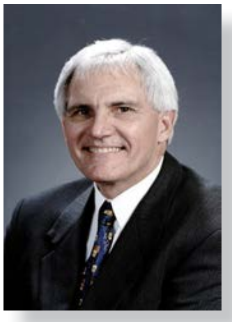
The **Office of Regulatory Policy** (ORP) manages policy and regulation development activities that ensure the safety and soundness of the FCS and support the System's mission. Policy and regulation development activities include the analysis of policy and strategic risks to the System on the basis of 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

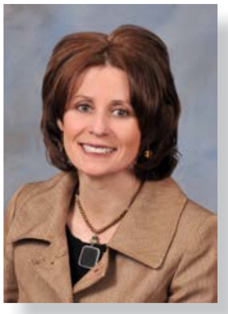
**William J. Hoffman** is Chief Operating Officer. Before accepting this position in July 2008, Mr. Hoffman was Executive Assistant to Board Member and former Chairman and CEO Nancy C. Pellett. Prior to this, he served as the Associate Director for Examination and Supervision in the Office of Secondary 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.

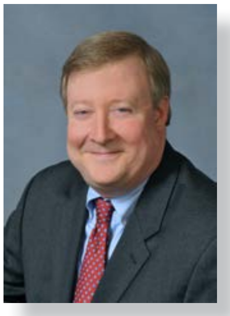
**Samuel Robert Coleman** is Director of the Office of Examination. Before being named to this position in October 2010, he was Director of the Agency's Office of Secondary Market Oversight for five years. Mr. Coleman joined FCA in 1986 as an examiner in the Office of Examination. He held various positions 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.

**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** 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.



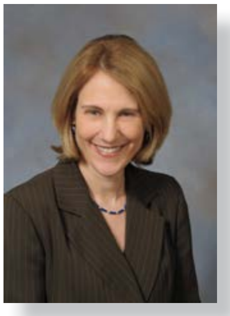
**Michael Stokke** is Director of the Office of Congressional and Public Affairs and Acting Executive Assistant to Leland A. Strom, Chairman and CEO of FCA. Prior to joining FCA, Mr. Stokke was founder and president of Prairie Strategies, a consulting firm based in Illinois, where he advised corporations 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 Director of the Office of Regulatory Policy (ORP). 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.

**Dale L. Aultman** became Secretary to the FCA Board in January 2011. 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.

**Thais Burlew** is Director of Equal Employment Opportunity and Inclusion. Before joining FCA in September 2011, she served as Executive Manager in the Office of EEO and Inclusiveness at the U.S. Postal Service. From 2001 to 2008, Ms. Burlew held several positions at the U.S. Equal Employment Opportunity Commission, including attorney advisor to Chair Naomi Churchill-Earp and Acting Chief for the Intake and Compliance Branch. Prior to this, she served as Advocate for the Housing and Consumer Law Clinic and for the Juvenile Special Education Clinic. Ms. Burlew earned a J.D. magna cum laude from David A. Clarke School of Law at the University of the District of Columbia, where she served as managing and associate editor of the school's law review. She also holds a B.S. in criminal justice from Middle Tennessee State University.

**Mark L. Johansen** is the Special Advisor for YBS and Local Food Systems for Chairman Strom and the FCA Board. In this position, he provides advice on issues related to lending to young, beginning, and small farmers and ranchers and borrowers involved in local food systems. He is also a senior policy analyst. Mr. Johansen began working at FCA in 1986 as an examiner, became a supervisor examiner in 1988 and joined the Office of Regulatory Policy in 1999. Before coming to FCA, Mr. Johansen served as a direct lender working with the Farmers Home Administration. He graduated from the Banking School of the South at Louisiana State University and holds an animal science degree from the University of New Hampshire, as well as an applied science degree from State University of New York at Cobleskill. Mr. Johansen also served in the Peace Corps as an agricultural extension agent in animal health from 1981 to 1983.



**Wendy R. Laguarda** is the Designated Agency Ethics Official (DAEO). As DAEO, Ms. Laguarda administers the ethics program for FCA and the Farm Credit System Insurance Corporation. This involves providing for the review of financial disclosure reports, creating and conducting ethics training programs, counseling Agency staff on ethics issues, and monitoring compliance with ethics rules. In addition to her responsibilities as DAEO, Ms. Laguarda serves as assistant general counsel in the Office of General Counsel and administers the Agency's Alternative Dispute Resolution Program. Before coming to FCA in 1990, Ms. Laguarda was an attorney advisor at the Office of Thrift Supervision and its predecessor Agency, the Federal Home Loan Bank Board. A graduate of Tufts University and George Washington University National Law Center, she is a member of the Maryland and District of Columbia Bars, as well as a mediator certified by the Supreme Court of Virginia.

## 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.

**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 2011 Annual Report on the Farm Credit System is available on FCA's website at www.fca.gov. For questions about this publication, contact

Office of Congressional and
Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
Telephone: 703-883-4056
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E-mail: info-line@fca.gov

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
Telephone: 201-200-8000

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

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