Annual Report 2012

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

Contents

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Statement of the Board Chair and CEO

June 2013

On behalf of the Board and the staff of the Farm Credit Administration, I present the 2012 Annual Report on the Farm Credit System (FCS or System). I am pleased to report that the System's overall condition and performance remained sound in 2012. Despite the most widespread drought in 50 years and the lingering effects of the 2008 financial crisis and recession, the System is well-positioned to withstand current and future challenges.

This document also contains our annual report on the System's service to young, beginning, and small (YBS) farmers and ranchers. At FCA we recognize that lending to YBS farmers and ranchers helps secure the future of U.S. agriculture, and we do all we can to ensure that the System fulfills its responsibilities to this important segment of the farm economy.

Condition of the Farm Economy

In spite of the significant stress caused by the drought to some segments of the U.S. farm economy, U.S. agriculture as a whole was in good financial condition in 2012, with near-record farm incomes buoyed by high prices and strong exports. In drought-affected regions, producers with crop insurance fared well despite their reduced yields, and producers outside those regions benefited from record prices. Debt use increased moderately, and asset values reached record levels.

Based on USDA data, net cash income for the farm sector in 2012 reached another record at $135.6 billion. Crop receipts rose 5.4 percent over 2011 levels, and livestock receipts were up 3.7 percent. Farm expenses were up nearly 8 percent, mostly because of a rise in feed costs, higher land rental rates, and higher costs for seeds and pesticides.

Financial Condition of the FCS

The condition and performance of the banks and direct-lending associations of the Farm Credit System remained safe and sound throughout 2012. Overall, the System reported strong earnings, improved asset quality, and higher capital levels.

System earnings remained strong in 2012, up 4.5 percent to $4.12 billion as compared with $3.94 billion in 2011. The increase in System earnings continues to be driven largely by higher net interest income and lower provisions for loan losses.

Credit quality in the System's loan portfolio continued to gradually improve in 2012. Although credit quality was generally good, the extensive drought, elevated commodity prices, and high input costs adversely affected certain System borrowers, particularly those in the protein, dairy, and ethanol sectors. In addition, certain sectors, such as the forestry and nursery industries, continue to be under stress. As of December 31, 2012, nonperforming loans amounted to $2.6 billion, or 1.36 percent of gross loans, down from $3.0 billion, or 1.72 percent, at year-end 2011.

During 2012, the System continued to have reliable access to the debt capital markets, and investor demand for all System debt security products was favorable. With the low interest rate environment, the System was able to refinance outstanding debt at favorable interest rates, improving net interest spreads from 2.68 percent in 2011 to 2.71 percent in 2012. Overall, total Systemwide debt increased by 7.1 percent in 2012.

While the overall System 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.

Young, Beginning and Small Farmer Lending

I am pleased to report that the System's YBS results indicate that lending to young, beginning, and small farmers increased from 2011 to 2012. The number of new loans made to beginning farmers rose 11.8 percent from 2011, while the number of new loans rose 7.3 percent to young farmers and 4.1 percent to small farmers.

The dollar volume of loans outstanding to young farmers increased by 8.5 percent. The dollar volume of loans outstanding to small farmers increased by 3.0 percent and to beginning farmers by 4.7 percent.

FCA's Supervision and Oversight of the System

As the arm's-length regulator of the System, we use several methods to evaluate systemic risks that can affect an institution, a group of institutions, and the System as a whole. Currently, our examiners emphasize the following areas:

- Drought and Related Risks. Our Office of Examination monitors drought conditions, collects drought-related information, and analyzes the System's exposure to risks associated with the drought.
- 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.
- Standards of Conduct. Directors and employees of System institutions must maintain high standards of honesty, integrity, impartiality, and conduct. Our examiners evaluate institutions' policies, processes, and disclosures to ensure the effectiveness of their standards of conduct programs.
- Diversity and Inclusion. Through examinations, we focus on how the System is complying with FCA regulation 618.8440, which requires System institutions to develop human capital and marketing plans that promote diversity and inclusion. Our examiners look for tangible strategies and actions to demonstrate that institutions are complying with the rule.

Borrower Rights

The Farm Credit Act provides most 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 they are complying with these provisions. We also receive and review complaints from borrowers who believe their rights have been denied or who have concerns about business practices at System institutions.

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 options to bring about corrective action.

Condition of Farmer Mac

The Federal Agricultural Mortgage Corporation (Farmer Mac) remained safe and sound throughout 2012. As a chartered institution of the Farm Credit System, Farmer Mac is a separate Government-sponsored enterprise with the mission to provide a secondary market for agricultural mortgages and rural lending activities.

On December 31, 2012, Farmer Mac's net worth was $593.0 million, compared with $554.5 million a year earlier, and Farmer Mac was in compliance with all statutory and regulatory minimum capital requirements. It reported net income available to common stockholders of $43.9 million for the year ended December 31, 2012, up from the $13.8 million reported at year-end 2011. Farmer Mac's asset quality also improved from 2011 to 2012.

FCA's Commitment

At FCA, we will continue to work hard to ensure that the System remains safe and sound and that it fulfills the mission for which Congress created it almost 100 years ago. We recognize that America's farmers and ranchers require a dependable source of affordable credit, and we are committed to helping maintain that source for generations to come.

Jill Long Thompson

The Farm Credit Administration ensures a safe, sound, and dependable source of credit and related services for all creditworthy and eligible persons in 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.

Jill Long Thompson

Board Chair and CEO

Jill Long Thompson is Chair of the Board and CEO of the Farm Credit Administration. Dr. Long Thompson was appointed to the FCA Board by President Barack Obama in March 2010 and was designated Chair and CEO on November 27, 2012. Her term expires in May 2014.

Long Thompson 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.

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, 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.

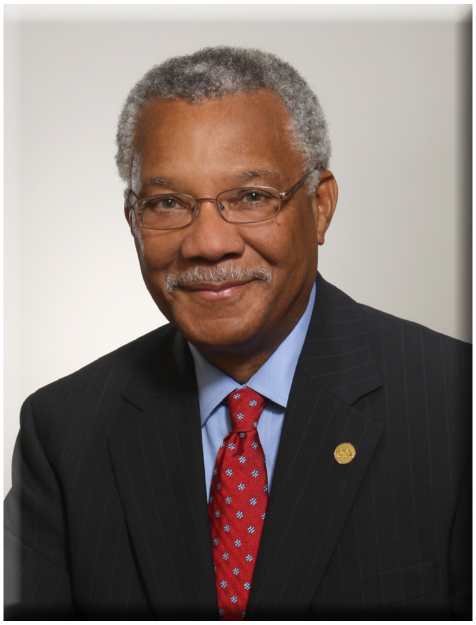
The first and only woman nominated by a major party to run for Governor of Indiana, Long Thompson is also the first and only Hoosier woman to be nominated by a major party to run for the U.S. Senate.

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.

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

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 to the balance of Dallas Tonsager's term and reappointed to 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 independently 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 in central Florida, Mr. Spearman served with the U.S. Army and is a Vietnam veteran. He later was employed by the public accounting firm Arthur Andersen & Co. and was involved with the development of a public accounting firm in Chicago, Illinois. 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, for which he served a term as national 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. He also attended Harvard Kennedy School Executive Education, where he completed a program with a concentration in Government Agency Strategic Planning.

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.

Leland A. "Lee" Strom

Board Member

Leland A. Strom was appointed to the Farm Credit Administration Board by President George W. Bush on December 12, 2006. He served as Chairman and CEO from May 22, 2008, until the designation of his successor on November 27, 2012. His statutory term expired on October 13, 2012; however, he continues to serve as a member of the Board until a successor is nominated by the President and confirmed by the U.S. Senate.

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.

In 2011, Mr. Strom received the Honorary Doctorate of Humane Letters from Northern Illinois University for his commitment to sustaining agricultural systems and food security. He studied agriculture business at Kishwaukee College and business administration at Northern Illinois University. He also attended the Harvard Kennedy School Executive Education program.

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 two grandchildren.

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.[1]

FCS institutions provide credit and financially related services to farmers, ranchers, producers or harvesters of aquatic products, and agricultural and aquatic cooperatives. They also make credit available for agricultural processing and marketing activities, rural housing, certain farm-related businesses, rural utilities, and foreign and domestic entities in connection with international agricultural trade.

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

When Congress established the FCS, its purpose was to provide a permanent, reliable source of credit and related services to agriculture and aquatic producers, farmer-owned cooperatives, and farm-related businesses in rural America. Congress intended the FCS to improve the income and well-being of American farmers and ranchers. It formed the FCS as a system of farmer-owned cooperatives to ensure 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 farmers, as well as rural homeowners.

FCS Structure

The Lending Institutions

As of January 1, 2013, the System was composed of 86 banks and associations. The following four banks provide loans to 79 Agricultural Credit Association (ACA) parent organizations and 3 stand-alone Federal Land Credit Associations (FLCAs)[2]:

- 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.[3] The parent-subsidiary structure, with an ACA as parent and its wholly owned PCA and FLCA as subsidiaries, accounted for 96 percent of all direct-lender associations as of January 1, 2013.

The ACA and its two subsidiaries operate with a common board of directors and staff, and each of the three entities is responsible for the debts of the others. For most regulatory and examination purposes, FCA

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. An FLCA is a Federal Land Bank Association that has received a transfer of direct long-term real estate lending authority under section 7.6 of the Farm Credit Act.
3. 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.

treats 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 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. Established under the Farm Credit Act, the Funding Corporation issues and markets debt securities on behalf of the Farm Credit banks to raise loan funds.

The System also contains the following five service corporations. These corporations exist under the authority of section 4.25 of the Farm Credit Act[4]:

1. AgVantis, Inc., provides technology-related and other support services to the associations affiliated with CoBank, ACB. AgVantis is owned by the bank and 17 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 FCA 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 Foundations provides human resource services to its employer-owners, including payroll processing, benefits administration, centralized vendor management, and workforce management and operations. It is owned by 46 participating organizations, including AgriBank, FCB, and its affiliated associations; 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,

4. 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.

insurance companies, other financial organizations, and FCS institutions. Any investor may own nonvoting stock.

FCA regulates and examines Farmer Mac through its 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 42.

The Safety and Soundness of the FCS

FCA 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.

FCSIC 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, 2012, was $3.3 billion. For more information about FCSIC, go to www.fcsic.gov. Also see FCSIC's 2012 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 FCA must call all nondefaulting banks to satisfy the security.

Financial Condition of the FCS[5]

The overall condition and performance of the FCS remained safe and sound during 2012. Despite volatile commodity prices and a severe drought throughout much of the United States, the System's financial position is solid. Overall, the System reported strong earnings, improved asset quality, and higher capital levels for 2012. The System continues to have reliable access to capital markets to support its mission. In 2012, investor demand for all Systemwide debt security products remained favorable. 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. 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 38 to 41 of this report. For more information on the condition of the System, see the 2012 Annual Information Statement of the Farm Credit System on the website of the Federal Farm Credit Banks Funding Corporation at www.farmcreditfunding.com.

Agriculture faced challenging conditions in 2012. During the second half of the year, severe drought developed throughout much of the Corn Belt, Great Plains, and Southwest. The drought significantly affected grain and oilseed production, especially corn. Below-average yields during 2012 and already tight supply levels drove up grain prices substantially. While the drought eased

5. 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, 2012. 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

At and for the 12 months ended	31-Dec-08	31-Dec-09	31-Dec-10	31-Dec-11	31-Dec-12
Farm Credit System Banks[a]					
Total Assets	194,533,214	194,497,747	207,098,256	205,087,928	219,043,177
Gross Loan Volume	149,491,137	152,412,187	161,069,141	158,420,741	173,227,170
Nonaccrual Loans	582,160	759,134	477,341	384,795	365,478
Cash and Marketable Investments	41,358,881	39,305,172	43,289,148	44,047,407	43,618,788
Net Income	1,231,430	1,442,328	1,917,143	1,860,347	2,011,314
Nonperforming Loans/Total Loans[b]	0.41%	0.52%	0.33%	0.27%	0.23%
Capital/Assets[c]	4.89%	5.59%	6.00%	6.49%	6.51%
Unallocated Retained Earnings/Assets	2.50%	2.80%	3.03%	3.25%	3.23%
Return on Assets	0.65%	0.74%	0.95%	0.92%	0.94%
Return on Equity	12.44%	13.13%	15.00%	13.68%	13.86%
Net Interest Margin[d]	0.97%	1.17%	1.22%	1.28%	1.25%
Operating Expense Ratio[e]	0.31%	0.33%	0.30%	0.31%	0.31%
Efficiency Ratio[f]	25.40%	20.49%	18.24%	20.14%	20.00%
Payout Ratio[g]	62.26%	56.31%	50.43%	53.76%	47.79%
Associations					
Total Assets	123,387,794	128,291,508	134,048,892	136,717,742	148,777,963
Gross Loan Volume	114,026,889	118,575,715	124,140,035	126,187,799	138,314,966
Nonaccrual Loans	1,706,613	2,634,046	2,744,528	2,353,352	1,932,706
Net Income	1,805,929	1,585,984	2,408,449	3,007,154	2,989,755
Nonperforming Loans/Gross Loans[b]	1.58%	2.33%	2.29%	2.03%	1.59%
Capital/Assets[c]	15.46%	15.82%	16.54%	17.84%	17.80%
Unallocated Retained Earnings/Assets	13.51%	14.56%	15.07%	16.78%	16.65%
Return on Assets	1.57%	1.29%	1.84%	2.24%	2.06%
Return on Equity	9.84%	8.13%	10.88%	12.42%	11.23%
Net Interest Margin[d]	2.50%	2.64%	2.79%	2.94%	2.83%
Operating Expense Ratio[e]	1.45%	1.49%	1.38%	1.43%	1.45%
Efficiency Ratio[f]	44.44%	39.05%	35.12%	31.27%	39.13%
Payout Ratio[g]	20.41%	21.51%	22.62%	22.57%	25.85%
Total Farm Credit System[h]					
Gross Loan Volume	161,423,000	164,830,000	175,351,000	174,664,000	191,904,000
Bonds and Notes	179,769,000	178,358,000	189,575,000	186,889,000	200,365,000
Nonperforming Loans	2,416,000	3,535,000	3,386,000	2,997,000	2,608,000
Nonaccrual Loans	2,282,000	3,369,000	3,229,000	2,738,000	2,300,000
Net Income	2,916,000	2,850,000	3,495,000	3,940,000	4,118,000
Nonperforming Loans/Gross Loans[b]	1.50%	2.14%	1.93%	1.72%	1.36%
Capital/Assets[c]	12.65%	13.90%	14.46%	15.60%	15.65%
Surplus/Assets	10.80%	11.48%	11.80%	12.90%	12.94%
Return on Assets	1.41%	1.32%	1.59%	1.71%	1.73%
Return on Equity	10.70%	9.86%	10.85%	11.17%	10.89%
Net Interest Margin[d]	2.41%	2.65%	2.82%	2.86%	2.87%

Sources: Farm Credit Administration's Consolidated Reporting System as of December 31, 2012, and the Farm Credit System Quarterly Information Statement provided by the Federal Farm Credit Banks Funding Corporation.

a. Includes Farm Credit Banks and the Agricultural Credit Bank.
b. Nonperforming loans are defined as nonaccrual loans, accruing restructured loans, and accrual loans 90 or more days past due.
c. Capital includes restricted capital (amount in Farm Credit Insurance Fund), excludes mandatorily redeemable preferred stock and protected borrower capital.
d. Net interest margin ratio measures net income produced by interest-earning assets, including the effect of loanable funds, and is a key indicator of loan pricing effectiveness.
e. Operating expenses divided by average gross loans, annualized.
f. The efficiency ratio measures total noninterest expenses for the preceding 12 months divided by net interest income plus noninterest income for the preceding 12 months.
g. The percentage of earnings paid out in dividends to shareholders.
h. Cannot be derived by adding the categories above because of intra-district and intra-System eliminations used in Reports to Investors.

Table 2

Farm Credit System Major Financial Indicators, by District

As of December 31, 2012

Dollars in Thousands

Farm Credit System Banks	Total Assets	Gross Loan Volume	Nonaccrual Loans	Allowance for Loan Losses	Cash and Marketable Investments[a]	Capital Stock[b]	Surplus[c]	Total Capital[d]	Operating Expense Ratio[e]
AgFirst	28,890,547	20,209,251	80,208	44,539	8,372,615	644,534	1,482,228	2,298,230	0.48%
AgriBank	82,299,203	69,698,631	51,366	13,275	12,081,321	1,990,047	2,330,060	4,255,781	0.14%
CoBank	92,477,758	71,980,458	170,207	437,376	19,286,722	3,567,683	2,729,031	6,441,144	0.38%
Texas	15,375,669	11,338,830	63,697	17,258	3,878,130	694,588	551,422	1,273,843	0.55%
Total	219,043,177	173,227,170	365,478	512,448	43,618,788	6,896,852	7,092,741	14,268,998	0.31%
Associations									
AgFirst	17,777,196	16,588,665	500,702	168,959	382,296	223,708	3,133,297	3,326,533	1.99%
AgriBank	75,410,105	69,201,166	649,465	249,810	2,650,858	235,703	12,452,285	12,687,988	1.36%
CoBank	42,406,562	39,843,495	559,645	322,251	586,465	1,059,253	7,148,891	8,133,179	1.38%
Texas	13,184,100	12,681,640	222,894	88,570	90,125	81,130	2,263,821	2,338,359	1.43%
Total	148,777,963	138,314,966	1,932,706	829,590	3,709,744	1,599,794	24,998,294	26,486,059	1.45%
Total Farm Credit System[f]	**246,664,000**	**191,904,000**	**2,300,000**	**1,343,000**	**46,928,000**	**1,621,000**	**31,919,000**	**38,609,000**	

Sources: Farm Credit Administration's Consolidated Reporting System as of December 31, 2012, and the Farm Credit System Quarterly Information Statement provided by the Federal Farm Credit Banks Funding Corporation

a. Includes accrued interest receivable on marketable investments.
b. Includes capital stock and participation certificates, excludes mandatorily redeemable preferred stock and protected borrower capital.
c. Includes allocated and unallocated surplus.
d. 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 $3.298 billion of restricted capital, which is the amount in the Farm Credit Insurance Fund. Excludes mandatorily redeemable preferred stock and protected borrower capital.
e. Operating expense per $100 of gross loans.
f. Cannot be derived by adding the categories above because of intradistrict and intra-System eliminations used in Reports to Investors.

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somewhat at the end of the year, especially in the eastern Corn Belt, severe drought persisted in a significant part of the upper Midwest and Great Plains. Nonetheless, farmland values continued to trend up in 2012, particularly in regions where cash grains are grown.

Livestock, dairy, and ethanol producers experienced a difficult operating environment during 2012. In general, feedlot and dairy producers faced negative margins for much of the year. As a result of high feed costs and extremely poor pasture conditions, farmers and ranchers continued to reduce the country's collective cattle herd, which has been declining for several years. Despite strong cattle prices in 2012, the herd dropped to a level not seen since the 1950s. High input costs, tight corn supplies, and pricing volatility also hurt ethanol producers.

We expect commodity price volatility and general economic uncertainty to continue to challenge the System in the coming year. For a discussion of how these challenges may affect the future, see "Challenges Facing the Agricultural Economy and the Farm Credit System" on pages 48 to 58.

Earnings

System earnings remained strong in 2012, up 4.5 percent to $4.12 billion as compared with $3.94 billion in 2011 (See figure 1). The increase in System earnings continues to be driven largely by higher net interest income and lower provisions for loan losses.

Net interest income increased by $218 million in 2012, primarily as a result of the increase in average earning assets. For 2012, average earning assets grew by $7.47 billion or 3.4 percent to $226 billion. The System's net interest margin increased one basis point to 2.87 percent. The System's return on average assets increased to 1.74 percent in 2012 from 1.71 percent the prior year. The return on average capital declined somewhat to 10.96 percent in 2012 from 11.21 percent in 2011.

Provisions for loan losses dropped by $117 million in 2012, although certain agricultural sectors, such as livestock, dairy, and ethanol, were negatively affected by severe drought and volatile input prices. In addition, the sluggishness in the U.S. economy and weakness in the housing market continued to affect System borrowers in agricultural sectors like forestry and nurseries.

As cooperative institutions, the FCS banks and associations pass a portion of their earnings on to their borrower-owners as patronage distributions. For 2012, System institutions declared a total of $1.249 billion in patronage distributions—$863 million in cash, $340 million in allocated retained earnings, and $46 million in stock. This represents 30 percent of the System's net income for 2012 as compared with 29 percent in 2011. Also in 2012, the System distributed $203 million in cash from patronage allocations of earlier years.

Asset Growth

Overall, the System experienced strong loan growth in 2012, with gross loan volume increasing by 9.9 percent, primarily because of gains in real estate mortgage, production and intermediate, agribusiness, and rural utility lending (see figure 2). Real estate mortgage loans were up 9.4 percent because of strong demand for cropland. Production and intermediate-term loans increased by 6.3 percent because of seasonal financing needs and prepayment of 2013 inputs for tax planning purposes. Because of the severe drought, low grain stocks, and commodity price volatility, agribusiness lending was up by 9.5 percent—mainly to farm supply and grain marketing businesses. Rural utility lending increased by 19.8 percent; loans to electric distribution and power supply cooperatives accounted for much of this increase. In total, System assets grew to $246.7 billion, up $16.3 billion or 7.1 percent from 2011.

Asset Quality

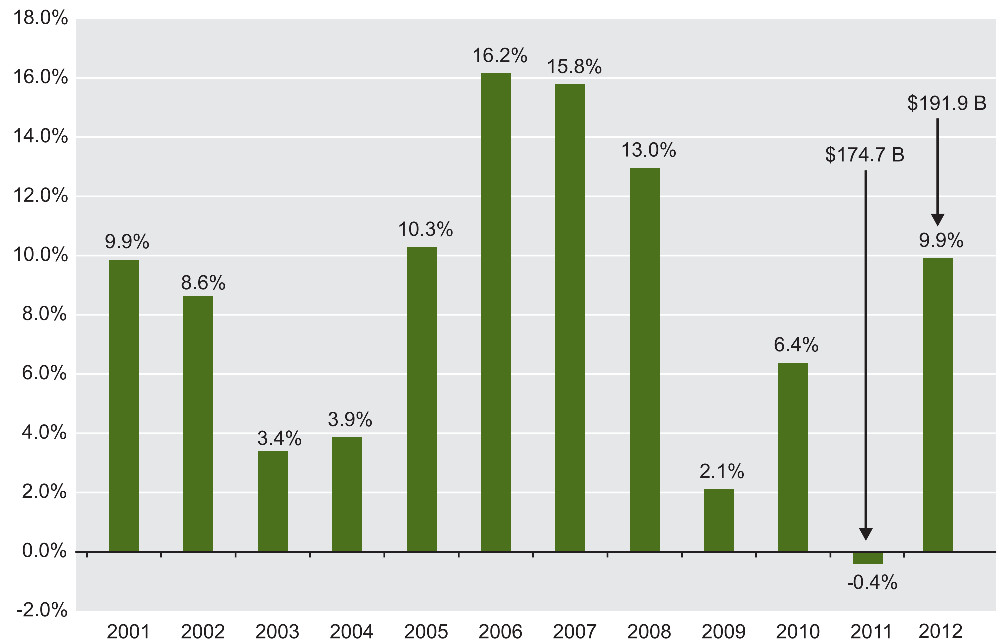
Credit quality in the System's loan portfolio continued to gradually improve in 2012. Although credit quality was generally good, the extensive drought, elevated commodity prices, and uncertain economic conditions adversely affected certain System borrowers, particularly those in the protein, dairy, and ethanol sectors. In addition, certain sectors such as the forestry and nursery industries continue to be under stress. As of December 31, 2012, nonperforming loans amounted to $2.6 billion, or 1.36 percent of gross loans, down

Figure 1
FCS Net Income, 2004–2012
As of December 31

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

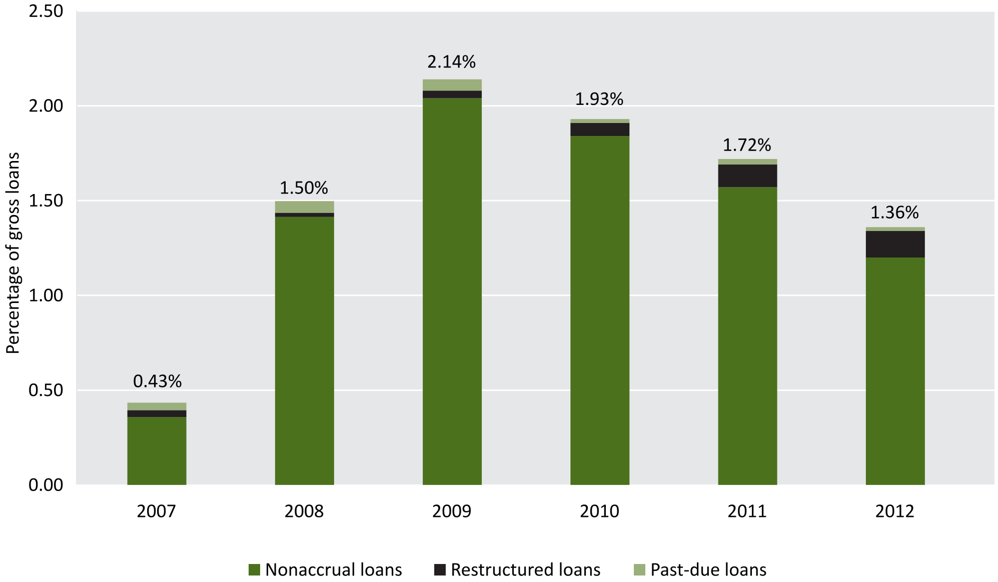
Note: The net income for 2004 includes $1.167 billion in net reversals of the allowance for loan losses.

Figure 2
Annual Growth Rate of FCS Loans Outstanding, 2001 to 2012



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

Figure 3
FCS Nonperforming Loans, 2007–2012
As of December 31



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

from $3.0 billion, or 1.72 percent, at year-end 2011 (see figure 3). Loan delinquencies (that is, accruing loans that are 30 days or more past due) remained a low 0.28 percent of total accruing loans, declining from 0.38 percent at year-end 2011.

The allowance for loan losses amounted to $1.34 billion, or 0.70 percent of loans outstanding at year-end 2012, compared with $1.29 billion, or 0.74 percent of loans outstanding at year-end 2011. Provisions for loan losses were down in 2012, declining to $313 million in 2012 from $430 million in 2011. Net charge-offs were also down in 2012, dropping to $236 million from $500 million in 2011.

Although the 2013 outlook for agriculture is favorable, considerable uncertainty surrounds both the general and agricultural economies. Weather and its influence on commodity prices will significantly affect System borrowers in at-risk sectors such as livestock, dairy, and ethanol. Although the current level of nonperforming loans continues to be well within the System's risk-bearing capacity, additional deterioration in asset quality is possible in these sectors if commodity prices remain high in 2013.

Funding

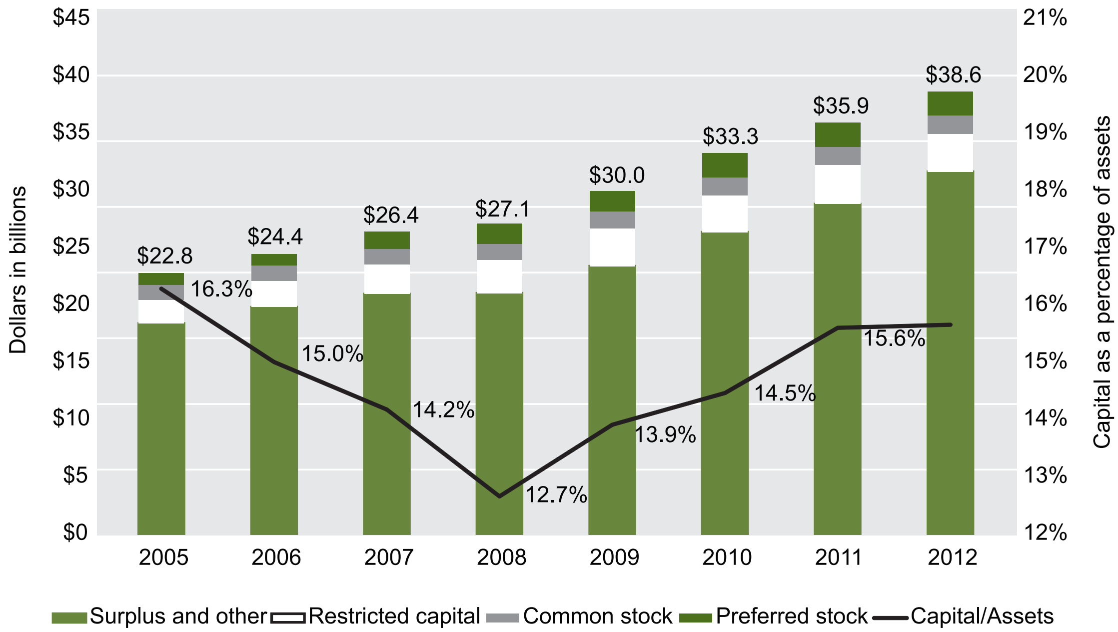
During 2012, the System continued to have reliable access to the debt capital markets, and investor demand for all System debt security products was favorable. With the low interest rate environment, the System was able to refinance outstanding debt at favorable interest rates. Overall, total Systemwide debt increased by 7.1 percent in 2012. The System's funding composition shifted somewhat—short-term debt made up 32.7 percent of total Systemwide debt at December 31, 2012, compared with 35.0 percent a year earlier. Securities due within a year remained essentially unchanged from 2011, while securities due after one year increased by 11 percent. (See "Funding Activity in 2012" on page 34 for further discussion of the System's funding environment.)

Liquidity

System banks maintain a liquidity reserve to cushion against negative events in the U.S. and global markets and to provide financial flexibility when the bank has fewer funding options. As of December 31, 2012, the System's liquidity position equaled 185 days, down slightly from 194 days at year-end 2011, but significantly above the 90-day regulatory minimum.[6] The percentage of highly liquid securities held by System banks decreased to 16 percent of the eligible investment portfolio as compared with 18 percent as of December 31, 2011.

6. 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. CoBank maintains a minimum of 150 days of liquidity as a condition of the January 1, 2012, merger with U.S. AgBank.

Figure 4
FCS Capital, 2005–2012
As of December 31



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

Investments available for sale (based on fair value) increased 4.3 percent to $39.4 billion in 2012, with a weighted average yield of 1.5 percent. Investments held to maturity decreased to $3.2 billion, with a weighted average yield of 3.2 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. Under FCA regulations in effect through December 30, 2012, a bank had to dispose of an ineligible investment within six months or receive written approval from FCA to divest the investment over a longer period. Effective December 31, 2012, if an investment is eligible when purchased but no longer satisfies the eligibility requirement, the bank may continue to hold the investment if certain requirements are met.

At year-end, the FCS had 186 ineligible securities because of rating downgrades, which, at fair value, represented 4.3 percent of Federal funds and available-for-sale investments. FCA has approved divestiture plans to hold these investments longer than six months. For 2012, the System recognized $47 million of net other-than-temporarily impaired losses on investments.

Capital

The System maintained its strong capital position in 2012. Total capital was $38.6 billion at December 31, 2012, compared with $35.9 billion a year before. The most significant contributing factor to the increase in capital was net income earned and retained. At year-end 2012, the System's capital-to-assets ratio was 15.7 percent, compared with 15.6 percent in 2011. As figure 4 shows, surplus accounts for the vast majority of capital.

FCA regulations establish the minimum capital requirements that each System bank and association must achieve and maintain. As of December 31, 2012, the permanent capital ratios for all System banks and associations were above the regulatory minimum of 7.0 percent. The ratios ranged between 16.1 percent and 23.6 percent for System banks and between 12.2 percent and 35.5 percent for System associations. In addition, as of December 31, 2012, the FCS had $3.3 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[7]

Nationwide, the System had $191.9 billion in gross loans outstanding as of December 31, 2012 (see table 3). Agricultural producers represented by far the largest borrower group, with $132.1 billion, or 68.8 percent, of the total dollar amount of loans outstanding.[8] As of December 31, 2012, 46.0 percent of the dollar volume of the System's loans outstanding was in long-term real estate loans, 22.8 percent in short- and intermediate-term loans to agricultural producers, and 14.1 percent in agribusiness loans. Agribusiness loans are broken down further into 6.6 percent for loans to cooperatives, 6.0 percent for processing and marketing enterprises, and 1.5 percent for farm-related businesses.

Loans to finance rural utilities represented 9.7 percent of the System's loan volume, while rural residential loans made up 3.2 percent of the System's total loans. Agricultural export loans represented 2.4 percent of the System's loan portfolio, and lease receivables accounted for 1.3 percent of the overall portfolio. Finally, loans outstanding to "other financing institutions" (OFIs) 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 more than 917,000 loans and 497,000 stockholders in 2012. Approximately 85.0 percent of the stockholders were farmers or cooperatives with voting stock. The remaining 15.0 percent were nonvoting stockholders, including rural homeowners and other financing institutions that borrow from the System. Over the past five years, the number of System stockholders has increased gradually, rising more than 4.4 percent since year-end 2008.

The U.S. Department of Agriculture has forecast $135.6 billion in net cash farm income in the United States for 2012, up $900 million from 2011 and up $51.8 billion from its 10-year average of $83.8 billion. The System's loan volume increased 9.9 percent. Several factors contributed to this increase.

Demand for real estate mortgage loans was the most important factor. Real estate mortgage loans increased $7.6 billion, or 9.4 percent. Two causes triggered the demand for more real estate mortgage loans: the strong demand for cropland in the Midwest and uncertainty surrounding tax law changes at the end of 2012.

Another contributing factor to the increase in gross loans was the increase in commodity prices. Because of the drought in the Midwest, grain supplies declined, triggering the commodity price increase. Because of the higher prices, the demand for seasonal loans to agribusiness cooperatives (e.g., farm supply and grain marketing businesses) increased. Loans to agribusiness increased by $2.4 billion, or 9.5 percent.

Short- and intermediate-term production loans also increased, going up $2.6 billion, or 6.3 percent. Short- and intermediate-term loan volume increased largely because of advance purchases of 2013 inputs, such as fertilizer, seed, and fuel.

Rural utility loans increased by $3.1 billion, or 19.8 percent, largely because of increased lending to electric power distribution and power generation cooperatives. Rural resi-

7. 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).
8. This amount includes real estate mortgage loans and production (short- 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, 2008–2012

As of December 31

Dollars in Millions

	2008	2009	2010	2011	2012	Percent change from 2008	Percent change from 2011
Production agriculture							
Long-term real estate mortgage loans	71,892	75,352	78,021	80,658	88,263	22.8	9.4
Short- and intermediate-term loans	37,468	39,610	40,584	41,276	43,861	17.1	6.3
Agribusiness loans[a]	26,901	23,626	29,581	24,734	27,090	0.7	9.5
Rural utility loans[b]	13,931	14,562	15,091	15,606	18,702	34.2	19.8
Rural residential loans	4,611	4,977	5,475	5,832	6,210	34.7	6.5
Agricultural export finance	4,077	3,956	4,036	3,834	4,674	14.6	21.9
Lease receivables	1,952	2,160	2,021	2,139	2,415	23.7	12.9
Loans to other financing institutions	591	587	542	585	689	16.6	17.8
Total	**161,423**	**164,830**	**175,351**	**174,664**	**191,904**	**18.9**	**9.9**

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

a. At December 31, 2012, agribusiness loans consisted of loans to cooperatives of $12.8 billion, processing and marketing loans of $10.3 billion, and farm-related business loans of $2.8 billion.

b. At December 31, 2012, rural utility loans consisted of loans to energy and water/waste water loans of $14.5 billion and communication loans of $4.2 billion.

dential loans increased $378 million, or 6.5 percent. The other categories also posted substantial increases for the year, including a 21.9 percent increase in agricultural export loans.[9]

Total loans outstanding at FCS banks and associations (net of intra-System lending) increased by $17.2 billion, or 9.9 percent, during the year ended December 31, 2012. This compares with a decline of 0.4 percent in 2011, and increases of 6.4 percent in 2010, and 2.1 percent in 2009. However, since year-end 2008, total System loans outstanding have increased by $30.5 billion, or 18.9 percent.

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 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

9. A majority of the System’s agricultural export loan portfolio is guaranteed by the Commodity Credit Corporation through the U.S. Department of Agriculture’s GSM-102 and GSM-103 export credit programs. Overall, 75 percent of the System’s agricultural export portfolio in 2012 carried a guarantee from the Commodity Credit Corporation.

for OFIs that demonstrate a need for additional funding to meet the credit needs of borrowers who are eligible to receive loans from the FCS. OFIs benefit by using the System as an additional source of liquidity for their own lending activities and by capitalizing on the System's expertise in agricultural lending.

As of December 31, 2012, the System served 26 OFIs, unchanged from 2011, but down from 28 in 2010 and 2009. Outstanding loan volume to OFIs was $689 million at year-end, up $104 million from 2011. 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 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.

- Loan participations are large loans in which two or more lenders share in providing loan funds to a borrower. 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. 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.
- 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.

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

As figure 5 shows, activity from net similar-entity loan participations and syndications with non-System lenders has increased since 2010. The first group of bars shows gross loan syndications outstanding by FCS banks and associations.[10] The System's gross loan syndications with non-System lenders increased to $12.4 billion, up $1.1 billion from that of 2011.

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 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 $8.5 billion, a 10.4 percent increase above 2011. Much of the lending activity in this group probably results from gross loan syndications (the first group of bars in this figure) and the subsequent sale of participations in these loan syndications to other System institutions.

In addition to participating in loans to eligible borrowers, FCS institutions have 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

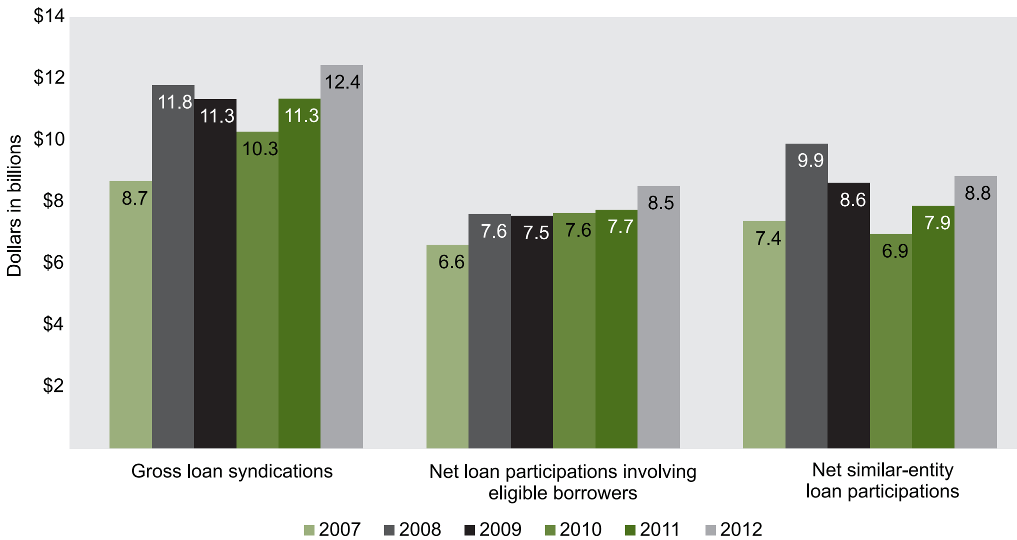
10. Typically, some of the syndication volume is sold and may be reported by FCS institutions as part of net loan transactions (purchases less sales) with non-FCS lenders (see second group of bars). Net loan transactions include traditional loan participations and assignments or other interest in loans

Figure 5

Syndications and Net Loan Participations Involving Non-System Lenders, 2007–2012

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).

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 2012, the net amount of similar-entity participations in the System amounted to $8.8 billion, an increase of less than $1 billion, or 11.4 percent above 2011 volume. The net total of all loan participations involving non-System lenders was $17.3 billion at year-end 2012, compared with $15.6 billion the year before.

AgDirect, LLP

AgDirect is a point-of-sale agricultural equipment financing program developed by Farm Credit Services of America, ACA, which is affiliated with AgriBank, FCB. AgDirect facilitates the financing or leasing of equipment for farmers and ranchers through participations in retail installment loan or leasing contracts originated by equipment dealerships. The program enhances financial options for customers and institutions, and provides a new revenue stream to AgDirect owners and AgriBank.

In 2012, FCA approved investments by an additional five System associations in AgDirect, LLP. In early 2013, we approved investments by two more associations, bringing the total number of institutions participating in AgDirect to 11. AgDirect financing is now available in many states. As of December 31, 2012, the total outstanding participation interests in loans purchased was $2.1 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, 2012, was $269 billion, up from its $254 billion estimate for year-end 2011. USDA's estimate for 2012 farm debt will be revised later in 2013, but farm loan data reported by Farm Credit System and commercial banks show that their total farm loan portfolios grew during 2012 by more than 8 percent and 6 percent, respectively.[11] The farm real estate debt portfolios of both FCS institutions and commercial banks grew more than their non-real estate loan portfolios in 2012.

Lender-reported data also show that the demand for farm credit grew more robustly in the Midwest, particularly late in the year. In 2012, farmers in the Midwest took advantage of record-high farm incomes and low interest rates to invest heavily in equipment, farm structures, and farmland.

On the supply side, lenders had ample funds to lend in 2012 because demand for credit remained below the capacity to lend. Credit underwriting practices were relatively conservative despite a competitive lending environment. Because of the forecasts for continued strong farm incomes, high real estate values, low interest rates, and an improving nonfarm economy, credit demand is expected to remain strong in 2013. However, a change in any one or more of these factors could change the outlook for credit demand.

The most current market share information from USDA is for year-end 2011. USDA's estimate of debt by lender shows that commercial banks held less than 44 percent of total farm business debt, just above the System's market share of 43 percent. FCS market share of total farm business debt has been growing relative to commercial banks in recent years.

Except for brief periods, the FCS has typically had the largest market share of farm business debt secured by real estate. At year-end 2011, the System held 46 percent of this debt, compared with 38 percent for commercial banks. Commercial banks have historically dominated non-real estate farm lending—commercial banks had a 51 percent market share at the end of 2011.The System's share of non-real estate farm business debt grew slightly to 38 percent at year-end 2011.

11. USDA calculates market share for farm business debt only (i.e., debt that is used for farm production purposes). The information for 2012 and previous years will be altered after USDA releases revisions to its farm debt estimations in August 2012. 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.

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, only 4 percent of all principal family farm operators were under 35 years of age in 2011. This percentage has remained relatively constant in recent years.[12]

Many young farmers are also small and beginning farmers. However, 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 2011. In addition, 76 percent of all young farmers are also beginning farmers—that is, they have farmed for 10 years or less. By contrast, only a third of farmers between ages 35 and 54 are beginning farmers. Although 2011 farm incomes of young farmers were similar to the incomes of older farmers, their farm net worth was much less.

Beginning

For 2011, the Agricultural Resource Management Survey shows that approximately 22 percent of all family farms had principal operators who are beginning farmers. Although beginning farmers are generally believed to be young, only 14 percent of these principal operators were under 35 years of age, and 12 percent were 65 years or older. The vast majority of beginning farmers—96 percent—operated small farms. 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 89 percent of all family farms in USDA's 2011 Agricultural Resource Management Survey, are difficult to characterize. Two-thirds of the 1.9 million small farms have less than $10,000 in gross farm sales. These very small farms on average have negative farm incomes and no or small amounts of farm debts. Their farm production amounted to just 1 percent of the total value of U.S. farm production. Those who operate small farms generally seek credit for consumer, rather than farm, products. 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. A higher percentage of very small farms are located in the East.

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 23 percent of farmers in the small category, but they make up just 9 percent of farmers who have over $250,000 in annual farm sales. Since a third of all small farmers are 65 years or older, many of them have retired from full-time farming or will retire soon. Also, because many small farmers do not use agricultural credit, many small farmers are not potential YBS borrowers.

12. 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.

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 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.

The Farm Credit Act stipulates that 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. Associations must also 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 30.)

FCA regulations require that each System lender's YBS program include a mission statement that describes the program's objectives and specific means to achieve the objectives. The regulations also require each program to include annual quantitative targets for credit to YBS producers; these targets should be based on reliable demographic data for the institution's lending territory. YBS programs must also include outreach efforts and annual qualitative goals for offering credit and related services that are responsive to the needs of YBS farmers.

The association's board oversight and reporting are integral parts of each YBS program. Each association's operational and strategic business plan must include the goals and targets for YBS lending. And each association must have an internal control program to manage the YBS program; it must also have methods in place to ensure that credit is provided in a safe and sound manner and within the lender's risk-bearing capacity.

FCA's 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 2012 with YBS Lending in 2011

The number and volume of loans (including new loans and renewals) made during the year indicates the extent to which System institutions are serving YBS producers. In general, during calendar year 2012, new lending activity increased across the System for each of the three YBS categories.[13] In recent years, new lending to YBS borrowers has been relatively flat.

Lending to small farmers increased the least during 2012, with a 4.1 percent increase in the number of loans made from the number made in 2011. The number of new loans made to beginning farmers rose 11.8 percent from 2011, while the number of new loans made to young farmers rose 7.3 percent. Because loans were generally larger in 2012 than in 2011, the percentage increases in the dollar volume to YBS borrowers were much higher than the percentage increases in loan numbers. The rise in average loan sizes reflected sizable increases in prices paid for farmland, equipment, and other production costs during the year. The dollar volume of new lending in 2012 was 17.9 percent higher to small farmers, 18.4 percent higher to young farmers, and 19.2 percent higher to beginning farmers.

The number and dollar volume of loans outstanding increased in all three YBS categories because repay-

13. System data on service to YBS farmers and ranchers cover the calendar year and are reported at year-end. The statistics show loans made during the year (both number of loans and dollar volume of loans), as well as loans outstanding at year-end (both number of loans and dollar volume of loans). The volume measure includes loan commitments to borrowers, which typically exceed actual loan advances. Borrowers may have more than one loan and thus the loan numbers reported here do not directly measure the number of borrowers.

ments did not keep pace with new loan volume. The dollar volume of loans outstanding to young farmers increased by 8.5 percent, but the increases were smaller for the other categories. The dollar volume of loans outstanding increased by 3.0 percent to small farmers and by 4.7 percent to beginning farmers.

Comparing the System's YBS Lending with Overall Lending

In 2012, lending to the three YBS categories exceeded the pace of overall System lending to farmers. Therefore, the share of total System farm loans going to the YBS categories rose from that of 2011. In 2012, the volume of all System farm loans made (including commitments) during the year was $75.6 billion, up 6.0 percent over that of 2011, and the volume of outstanding farm loans (including commitments) at year-end was $202.2 billion, up 6.7 percent from that of 2011. The total number of farm loans made in 2011 (343,610) was up less than 2.9 percent from 2011, while the number of outstanding loans (943,165) at the end of 2012 was 2.8 percent higher than at the end of 2011.

In the section on YBS borrowing trends (page 27), 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 made in each category during the year; table 4B provides information on loans outstanding at the end of 2012

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 2012, the System made 56,659 loans to young farmers—that is, to those who are 35 years old or younger—amounting to $8.8 billion. During 2011, the System made 52,800 loans to young borrowers, totaling $7.5 billion. The loans made to young borrowers in 2012 represented 16.5 percent of all farm loans the System made during the year and 11.7 percent of the dollar volume of loans made. The average size of loans made to young farmers in 2012 increased to $156,014 from $141,360 in 2011. At the end of 2012, the System had $23.1 billion in outstanding loans to young farmers as compared with $21.3 billion at the end of 2011.

Beginning—The System made 69,304 loans to beginning farmers—that is, to those who have been farming for 10 years or less—amounting to $11.5 billion in 2012. During 2011, the System made 61,995 loans, totaling $9.6 billion, to beginning borrowers. The loans made to beginning farmers in 2012 represented 20.2 percent of all farm loans made during the year and 15.2 percent of the dollar volume of loans made. The average size of loans made increased to $165,697 in 2012 from $155,406 in 2011. At the end of 2012, the System had $35.7 billion in outstanding loans to beginning farmers as compared with $34.1 billion at the end of 2011.

Small—FCS institutions made 143,200 loans, totaling $13.2 billion, to small farmers (those with gross annual sales of less than $250,000) in 2012. By comparison, the System made 137,529 loans, totaling $11.2 billion, to small farmers in 2011. The loans made in 2012 to farmers in this category represented 41.7 percent of all farm loans made during the year and 16.8 percent of the dollar volume of loans made. The average size of loans made rose to $92,161 from $81,413 in 2011. At the end of 2012, the System had $44.1 billion in outstanding loans to small farmers as compared with $42.9 billion at the end of 2011.

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

Table 4A

YBS Loans Outstanding

As of December 31, 2012

	Number of loans	Percentage of total number of System farm loans	Dollar volume of loans in millions	Percentage of total volume of System farm loans	Average loan size
Young farmers/ranchers	**170,875**	**18.1**	**$23,110**	**11.4**	**$135,247**
Beginning farmers/ranchers	**243,354**	**25.8**	**$35,733**	**17.7**	**$146,834**
Small farmers/ranchers	**477,248**	**50.6**	**$44,123**	**21.8**	**$92,453**

Table 4B

YBS Loans Made During 2012

As of December 31

	Number of loans	Percentage of total number of System farm loans	Dollar volume of loans in millions	Percentage of total volume of System farm loans	Average loan size
Young farmers/ranchers	**56,659**	**16.5**	**$8,840**	**11.7**	**$156,014**
Beginning farmers/ranchers	**69,304**	**20.2**	**$11,483**	**15.2**	**$165,697**
Small farmers/ranchers	**143,200**	**41.7**	**$13,197**	**17.4**	**$92,161**

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. Also, the totals listed in tables 4A and 4B include loans, advancements, and commitments to farmers, ranchers, and aquatic producers, and exclude rural home loans, loans to cooperatives, and activities of the Farm Credit Leasing Services Corporation.

years, the borrower's loan would be included in each category. Therefore, adding the categories together would produce a misleading measurement of the System's YBS lending involvement.

YBS Borrowing Trends, 2001–2012

Figures 6A, 6B, and 6C show that, under the definitions and reporting requirements that became mandatory in 2001, the dollar volume of System loans made to YBS producers increased steadily until 2008. Since then, lending trends have been less consistent, particularly for the beginning and small farmer categories. In 2012, lending to all three YBS categories rose, reflecting the increase in new Systemwide farm lending volume.

The number of new loans made during 2012 also increased for each YBS category. However, the percentage increase in dollar volume was greater than the increase in loan number because higher prices for production expenses, farmland, and other capital assets drove up the average loan size. The dollar volume of loans outstanding in each YBS category had been relatively constant the past several years but rose in 2012 with the greater new lending activity.

Figures 6A, 6B, and 6C also show that the percentage of total new farm loan volume going to all YBS categories turned upward in 2012. In the past year the share of total dollar value of farm lending going to beginning farmers rose to 15.2 percent, the share to small farmers rose to 17.4 percent, and the share to young farmers rose to 11.7 percent.

One of the main reasons for the downward trend 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 2012, gross cash farm income rose from $280 billion to an estimated $433 billion—a 55 percent increase. As a result of rising prices and gross incomes, more farms now have gross farm sales in excess of $250,000 and therefore no longer qualify as small farms.

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.[14] 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. Activity can vary considerably from one year to the next, especially for institutions with a small lending base. While the share of total new System farm loans made to young farmers was 16.4 per-

14. 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 6A, 6B, and 6C

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

As of December 31

Figure 6A

Young Farmers and Ranchers

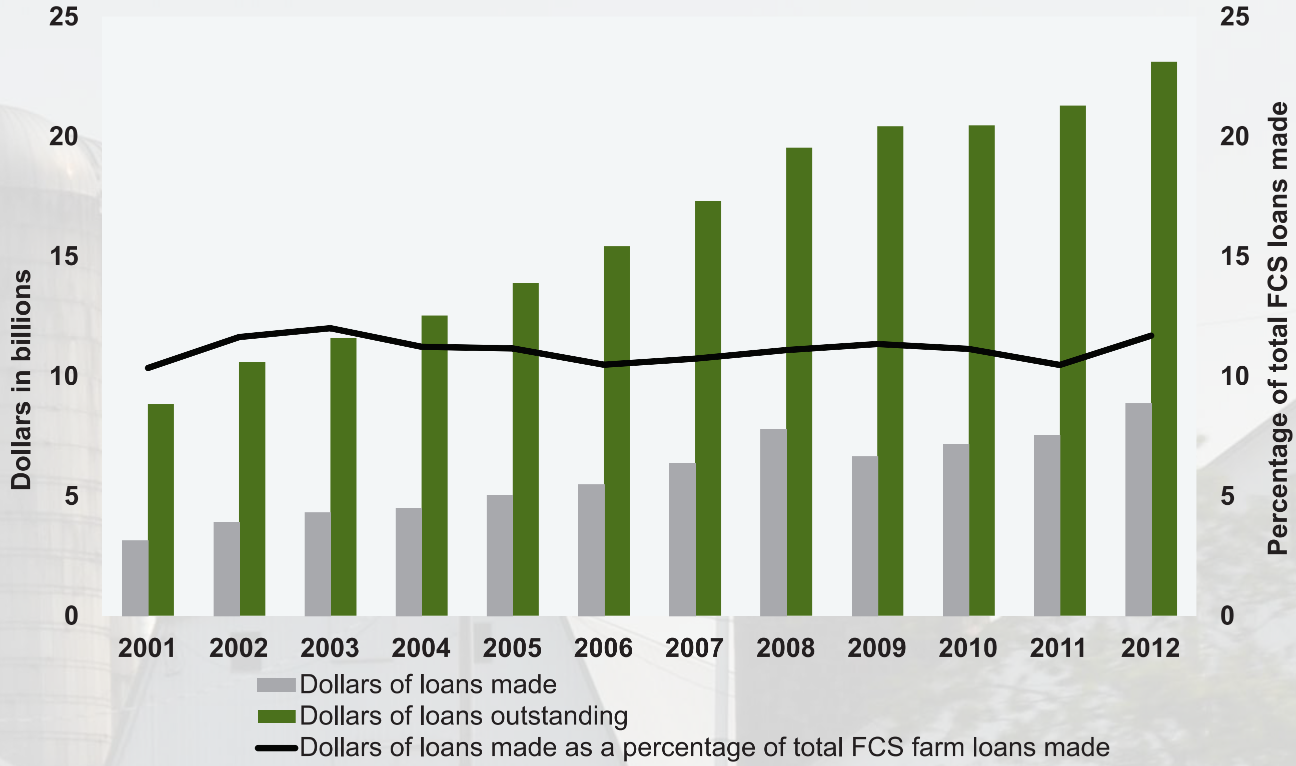


Figure 6B
Beginning Farmers and Ranchers

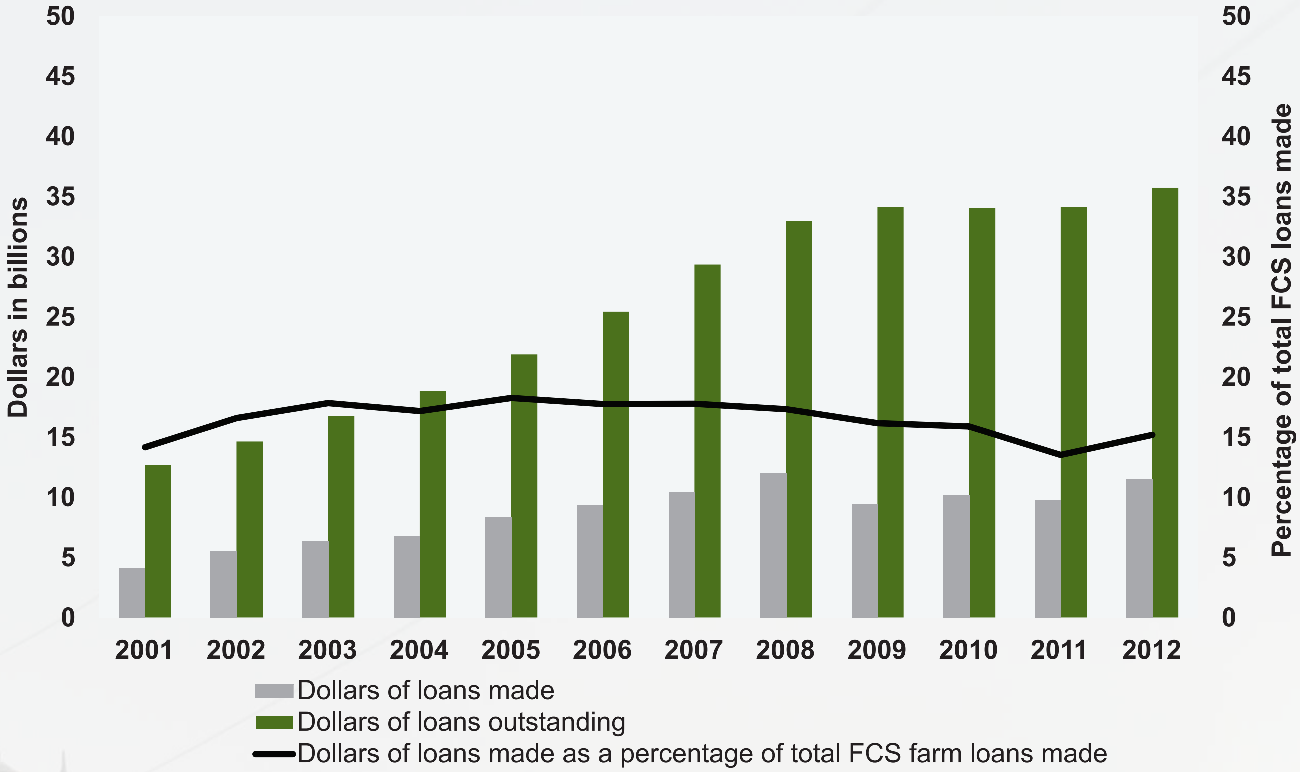
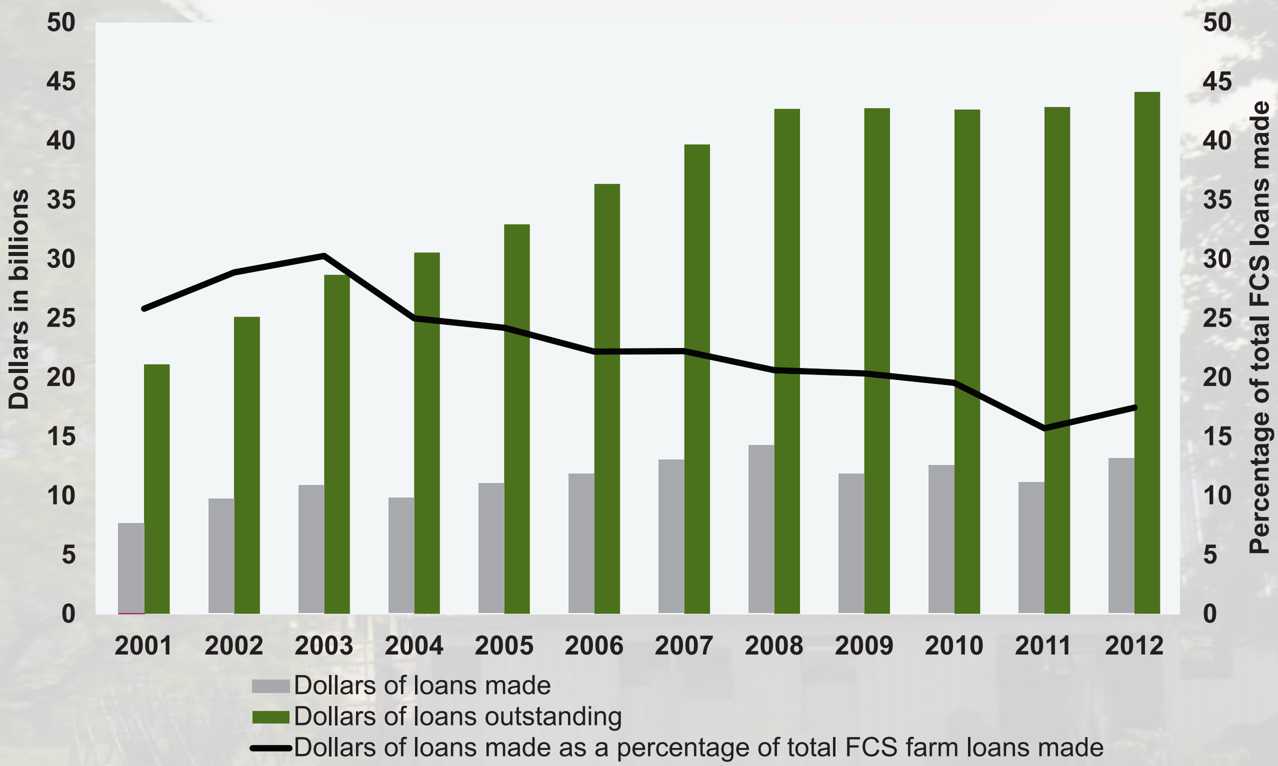


Figure 6C
Small Farmers and Ranchers



cent, this share ranged from less than 5 percent to as much as 28 percent. 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.

The ranges in the share of total new loans made to beginning farmers were even greater. Whereas 20.2 percent of the System's total farm loans went to beginning farmers in 2012, this share ranged across associations from as little as 6 percent to as much as 64 percent.

The ranges for the small farmer category are greater still. In 2012, 41.7 percent of the System's total farm loans went to small farmers, but the percentage for individual associations ranged from less than 7 percent to more than 90 percent. For this YBS category, a little fewer than half of all associations had lending shares that exceeded the Systemwide average.

While the share of total farm loan numbers and loan volume that went to YBS farmers rose during 2012 for the System as a whole, some associations did not experience gains in their lending to certain YBS groups. For example, one-third of associations reported declines in the dollar volumes of new loans made to young farmers, while just over one-quarter reported declines in loan dollar volumes made to small farmers. 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

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.

In 2012, System institutions used the following methods to help them make YBS loans.

- Interest rate concessions—offered by 48 percent of associations, up from 41 percent in 2011
- Exceptions to underwriting standards—offered by 60 percent of associations, up from 52 percent in 2011
- Lower loan fees—offered by 34 percent of associations, up from 24 percent in 2011
- Loan covenants designed specifically for YBS borrowers—offered by 16 percent of associations, similar to 2011

As a whole, the System offered slightly more loan concessions to young and beginning farmers than it did to small farmers. In 2012, 73 percent of the System's associations provided some form of loan concessions to young borrowers, 73 percent provided concessions to beginning borrowers, and 70 percent provided concessions to small farmers. Results for 2012 exceeded those of 2011 by an average of 10 percent.

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 2012, all but three associations used USDA Farm Service Agency loan guarantees for some of their YBS lending, while 21 percent used Small Business Administration loan guarantees and 57 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 36 percent of the System's overall loans made in 2012 with guarantees went to young farmers; about 39 percent went to beginning farmers; and about 45 percent went to small farmers (numbers do not necessarily add up to 100 percent because categories overlap).

In 2012, the System made 2,265 loans with guarantees to young farmers, 2,439 loans with guarantees to beginning farmers, and 2,811 loans with guarantees to small farmers. System associations obtained guarantees on more loans in 2012 than in 2011, an increase of about 660 loans to young farmers, 840 loans to beginning farmers, and 600 loans to small farmers.

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 provided by System associations include the Emerging Entrepreneurs' Conference, Ag Biz Planner, Farm Credit College seminars, 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 the System 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 2012

The following paragraphs describe some of FCA's regulatory efforts in 2012, along with several projects that will remain active in 2013. 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 rules and final rules whose effective dates are pending, 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 and a final rule in September 2012 to expand the authorities of the System Audit Committee.

Senior Officer Compensation Disclosures—The FCA Board approved a proposed rule in December 2011 and a final rule in September 2012 that amended 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.

Senior Officer Compensation Final Rule, Compliance Date Extension—We issued an Informational Memorandum in December 2012 informing System institutions that the FCA Board had extended the compliance date for the provisions of the final rule regarding disclosures to 30 days after the effective date of the rule. The Board also extended the baseline year to 2013 for the nonbinding advisory vote.

Senior Officer Compensation Disclosures—The FCA Board approved a Notice of Petition for Regulatory Change and Request for Comment in February 2013 related to the FCA's final rule on senior officer compensation disclosures. We solicited comments on the merits of the petition, and we solicited suggestions for reasonable alternatives to the nonbinding, advisory vote provisions of the rule. We stressed that the alternatives should comparably engage shareholders and increase the transparency of senior officer compensation practices.

Unincorporated Business Entities—The FCA Board approved a proposed rule in August 2012 that would create a regulatory framework for the formation of unincorporated business entities organized under State law.

Compensation for 2013—We issued an Informational Memorandum in February 2013 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 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.

Providing Credit to Farmers and Ranchers Operating in Local/ Regional Food Systems—We issued a Bookletter in October 2012 to provide guidance to System associations on how they can meet the credit and related services needs of farmers who market their agricultural products through local/regional food systems.

Interagency Statement on the Impact of Biggert-Waters Act—We issued an Informational Memorandum in March 2013 to inform financial institutions that provisions related to force placement and civil money penalties in the Biggert-Waters Flood Insurance Reform Act of 2012 took effect when the act was signed, and that the private flood insurance and escrow provisions of the act will not be effective until regulations are issued.

Establishment and Implementation of a Shared-Asset Identifier—We issued a Bookletter in October 2012 stating that we expect each System institution and its board of directors to establish and implement an automated mechanism to consistently identify shared-asset exposures.

Long-Term Standby Purchase Commitments—We issued an Informational Memorandum in May 2012 that described treatment of System loans covered by the Farmer Mac Long-Term Standby Purchase Commitment program. It described the lending limits on these loans, how to risk-weight the loans for regulatory capital ratios, and how to report and disclose asset-quality statistics and System risk ratings.

Loan Syndications and Assignment Markets Study—We continued to study loan syndications 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 final rule in March 2013 to ensure that FCS funding and liquidity requirements are safe, sound, and appropriate.

Investment Management—The FCA Board approved a final rule in October 2012 to amend our investment management regulations and related regulations governing interest rate risk management. The purpose of the rule is to enhance the safety and soundness of System institutions.

Association Investments—We issued an Informational Memorandum in May 2012 to remind System associations that under FCA regulations they may hold eligible investments for only two purposes—reducing interest rate risk and managing surplus short-term funds.

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.

Farmer Mac

Farmer Mac Investment Management—The FCA Board approved a proposed rule in October 2012 to revise regulations governing Farmer Mac's liquidity and investment management.

Farmer Mac Capital Planning—The FCA Board approved a proposed rule in December 2012 to consider amending the existing capital planning requirements to ensure that Farmer Mac's capital planning process and strategies are robust enough to meet regulatory and statutory minimum requirements under expected and stressed conditions.

Other

National Oversight and Examination Program for 2013—We issued an Informational Memorandum in October 2012 that summarized the National Oversight Plan for 2013. The plan detailed strategies for addressing critical risks and other areas of focus in the System.

Corporate Activity in 2012

In 2012 and early 2013, we analyzed and approved four corporate applications.

- 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.
- On July 1, 2012, two 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.

The total number of associations as of January 1, 2013, was 82 (79 ACAs and 3 FLCAs), compared with 83 associations a year earlier. Figure 7 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 2012

During 2012, the System had ready access to the debt capital markets despite several sizable shocks to the markets stemming primarily from the eurozone financial crisis.

In addition, the Federal Reserve's continued efforts to support economic recovery have benefited the System by providing favorable pricing of securities and favorable spreads to U.S. Treasuries. The System also continued to benefit 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. Furthermore, because of the reduction in debt issuances by the two housing-related Government-sponsored enterprises,[15] 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.

All mandatorily redeemable preferred stock outstanding was redeemed in 2011. The System had $1.72 billion in outstanding perpetual preferred stock at the end of 2012, $400 million less than the previous year-end. It had $1.55 billion in outstanding subordinated debt at year-end 2012, down by $95 million from year-end 2011.

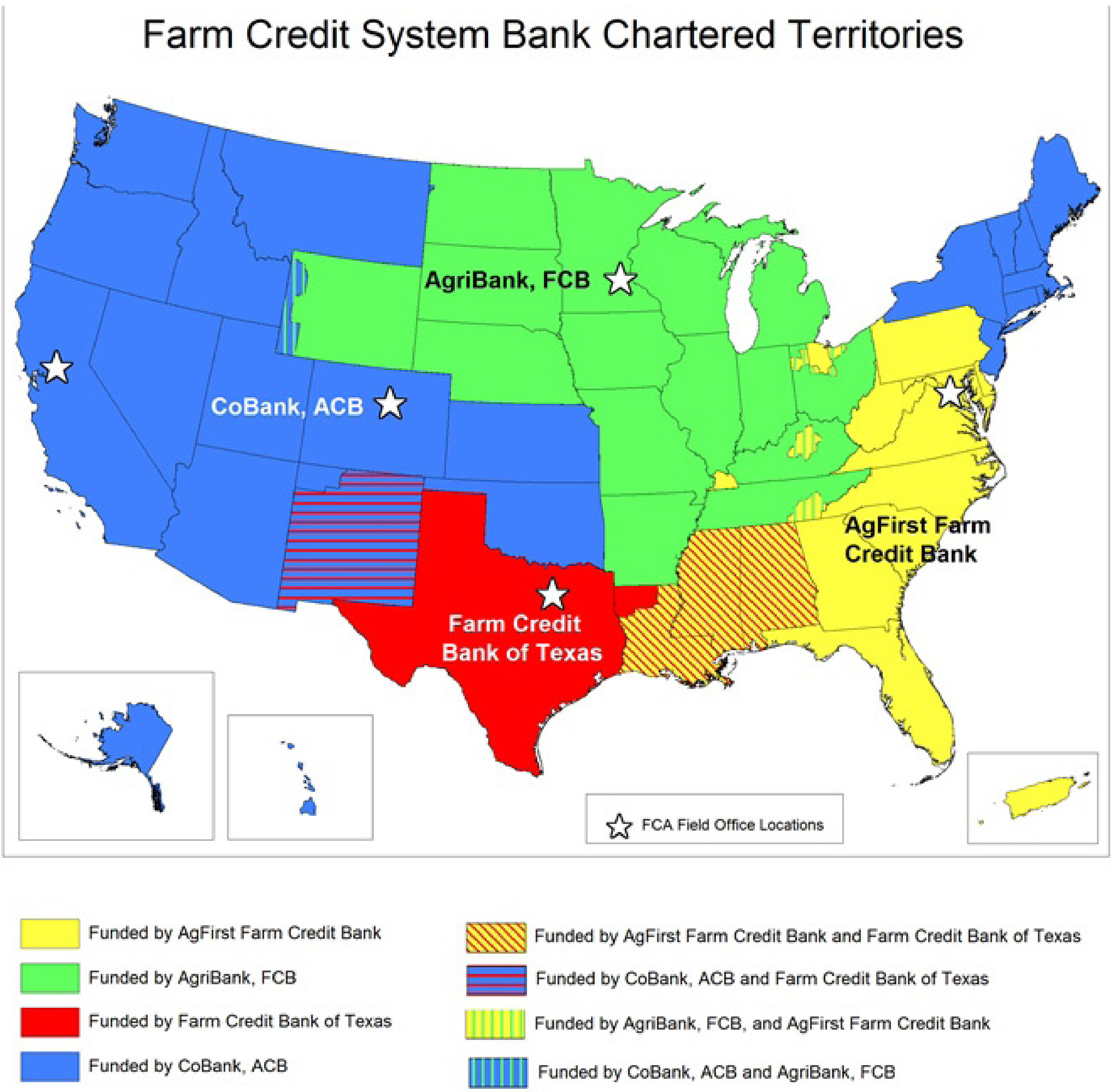
The System funds its loans with a combination of consolidated Systemwide debt and capital. The Funding Corporation, the fiscal agent for the System banks, sells debt securities such as discount notes, bonds, and designated bonds on behalf of the System.[16] This process allows funds to flow from worldwide capital-market investors to agriculture and rural America, providing rural communities with efficient access to global resources. At year-end 2012, outstanding Systemwide debt was $198.0 billion, up from $184.8 billion a year earlier, representing a 6.3 percent increase.[17]

Several factors contributed to the $13.2 billion increase in Systemwide debt outstanding. Gross loans increased $17.2 billion in 2012 while the System's combined investments, Federal funds, and cash balances decreased by $353 million in 2012.

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. We respond quickly and efficiently to the System's requests for debt issuance approvals. For example,

15. The Government-sponsored enterprises are the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).
16. 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.
17. 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.

Figure 7
Chartered Territories of FCS Banks
As of January 1, 2013



Note: As of January 1, 2013, 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 19 associations. The FCS contains a total of 86 banks and associations.

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 2012, we approved $179.6 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. We require certain System banks to maintain higher minimum net collateral ratios. All System banks have kept their net collateral ratios above the required minimum, with 105.2 percent being the lowest for any single bank as of December 31, 2012.

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. All System banks have kept their days of liquidity above the required minimum, with 135 days being the lowest for any single bank as of December 31, 2012.

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 over the System banks' participation in Systemwide debt obligations.[18]

- Third, the amended and restated Contractual Interbank Performance Agreement 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 2012, all Farm Credit banks maintained scores in excess of the benchmarks in the Contractual Interbank Performance Agreement.

The amount of debt issued by the System decreased for the first time in five years. Because interest rates were generally stable after declining for a prolonged period, there were fewer opportunities to refund callable debt at lower rates. For the 12 months ended December 31, 2012, the System issued $371 billion in debt securities, compared with $563 billion for 2011, $534 billion for 2010, $523 billion for 2009, and $519 billion for 2008. Despite the decrease in debt issuances in 2012, the System has continued to exercise call options on higher-cost debt.

Investor interest and continued low yields on the full spectrum of debt instruments allowed the System to continue to extend its debt maturities in 2012 because average maturity of new issuances increased by nearly five months over 2011. The System's weighted-average remaining maturity for all outstanding insured debt was 2.9 years as of December 31,

18. 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.

2012. The weighted-average interest rates for insured debt continued to decrease, going from 1.32 percent as of December 31, 2011, to 0.98 percent as of December 31, 2012.

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, 2012, the mission-related investment securities held under these regulatory authorities totaled

- $1.0 billion in agricultural mortgage-backed securities ($502.6 million in held-to-maturity securities and $502.4 million in available-for-sale securities),
- $1.36 billion in securities backed by guaranteed portions of USDA loans and agricultural equipment loans, and
- $16.6 million in farmer's notes.

In addition, in 2005 we approved System institution investments in successor-in-interest contracts created through the Tobacco Transition Payment Program.[19] As of December 31, 2012, investments in successor-in-interest contracts totaled $313.1 million.

We have also given System institutions a provisional opportunity to make additional mission-related investments through pilot programs supporting investments in rural America (see the FCA Informational Memorandum dated January 11, 2005, "Investments in Rural America—Pilot Investment Programs," which is available on our website at http://www.fca.gov/law/guidance.html).

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.

Since creation of the Investments in Rural America program, we have approved several pilot programs and specific investments, such as rural housing mortgage securities, agriculture and rural community bonds and securities, and equity investments. We plan to evaluate the results of the pilot programs, take a hard look at the key legal and policy questions, and make a decision on the future direction of the pilot programs and the related Rural Community Investments rulemaking project.

19. 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.

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 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, 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 examinations, we also monitor and examine institutions as risk and circumstances warrant. This approach allows us to customize our examination activities to each institution's specific risks. In addition, we develop a National Oversight Plan every year that takes systemic risks into account.

Identifying and Responding to Potential Threats to Safety and Soundness

Because of the dynamics and risks in the agricultural and financial industries, FCA must ensure that FCS institutions have the culture, governance, policies, procedures, and management controls to effectively identify and manage risks. 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:

- Drought and Related Risks. FCA's Office of Examination monitors drought conditions, collects drought-related information, and analyzes the System's exposure to risks associated with the drought. Our examiners consider risks to the System overall, as well as risks to the institutions most affected by the drought.

- 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.

- Standards of Conduct. Directors and employees of System institutions must maintain high standards of honesty, integrity, impartiality, and conduct. Our examiners evaluate institutions' policies, processes, and disclosures to ensure the effectiveness of their standards of conduct programs. Examiners also review their findings for systemic or strategic risks.

- Diversity and Inclusion. Through examinations, we focus on how the System is complying with revised FCA regulation 618.8440, which requires System institutions to develop human capital and marketing plans that promote diversity and inclusion. Our examiners look for tangible results to demonstrate that institutions are complying with the rule.

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

- FCA Board Policy Statements
- Informational Memoranda
- Bookletters

We keep an online library 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 moderate to severe. A 5 rating represents an extremely high immediate or near-term probability of failure.[20]

Through our monitoring and oversight program, 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 8 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. The ratings have gradually improved each year, and the

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

FIRS ratings for 2012 show that the financial condition and performance of the FCS was relatively strong. The System's strength reduces the risk to investors in FCS debt, to the Farm Credit System Insurance Corporation, and to FCS institution stockholders.

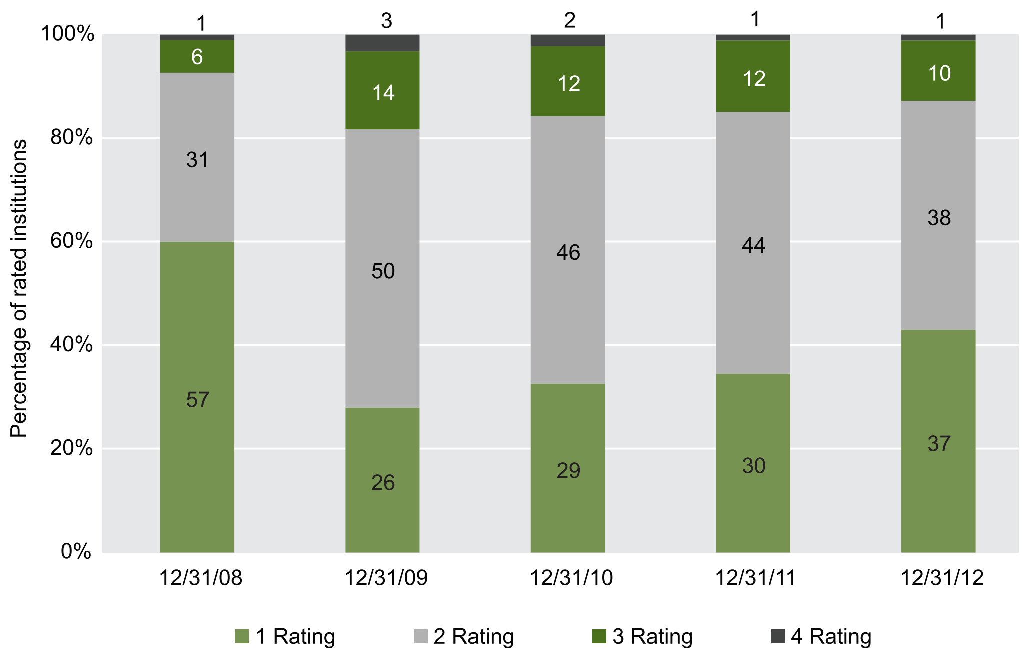
At December 31, 2012, 37 FCS institutions were rated 1 (43 percent), 38 were rated 2 (44 percent), 10 were rated 3 (12 percent), and 1 was rated 4 (1 percent). Most of the institutions rated 3 or 4 were relatively small and collectively represent less than 3 percent of the System's total assets. There 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 included in figure 8.)

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 lenders. 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, and strengthening risk management.

Figure 8

Financial Institution Rating System (FIRS) Composite Ratings for the FCS, 2008–2012



Source: FCA's FIRS Ratings Database.

Note: Figure 8 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.

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 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, 2012, we had formal written agreements with seven associations, whose assets totaled $4.0 billion. The written agreements require the associations to take corrective actions in such areas as financial condition and performance, portfolio management, asset quality, and institution management.

Protecting Borrower Rights

Agricultural production is risky for many reasons—adverse 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 loans before the institutions begin 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 former properties.

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 2012, we received more than 50 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 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 cer tain 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 supervision of Farmer Mac and issues a comprehensive Report of Examination annually. Through its oversight, OSMO helps ensure the safety and soundness of Farmer Mac; it also helps ensure that Farmer Mac fulfills its public mission. 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

Table 5
Farmer Mac Condensed Balance Sheets, 2007–2012
As of December 31
Dollars in Millions

	2007	2008	2009	2010	2011	2012	Percentage growth rate 2011–2012
Total assets	$4,977.6	$5,107.3	$6,138.8	$9,479.9	$11,883.5	$12,622.2	6.2%
Total liabilities	$4,754.0	$4,947.7	$5,798.4	$9,001.0	$11,329.0	$12,029.2	6.2%
Net worth or equity capital	$223.6	$15.3	$196.2	$478.9	$554.5	$593.0	6.9%

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

summarizes Farmer Mac's condensed balance sheets at the end of each year from 2007 to 2012.

Capital

On December 31, 2012, Farmer Mac's net worth (that is, equity capital determined using generally accepted accounting principles [GAAP]) was $593.0 million, compared with $554.5 million a year earlier. Net worth was 4.7 percent of on-balance-sheet assets as of December 31, 2012, unchanged from the year before. When Farmer Mac's off-balance-sheet program assets (essentially its guarantee obligations) are added to its total on-balance-sheet assets, capital coverage is 3.6 percent—also unchanged from a year earlier. As of December 31, 2012, Farmer Mac continued to be in compliance with all statutory and regulatory minimum capital requirements.

At year-end 2012, 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.[21] Farmer Mac's core capital as of December 31, 2012, totaled $519.0 million, exceeding the statutory minimum capital requirement[22] of $374 million by $145.0 million.

Farmer Mac's regulatory capital totaled $535.9 million as of December 31, 2012, exceeding the regulatory risk-based capital requirement of $58.1 million by $477.8 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 2007 through 2012.

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 research emerging best

Table 6
Farmer Mac Capital Positions, 2007–2012
As of December 31
Dollars in Millions

	2007	2008	2009	2010	2011	2012
GAAP equity	$223.6	$15.3	$196.2	$478.9	$554.5	$593.0
Core capital	$226.4	$207.0	$337.2	$460.6	$475.2	$519.0
Regulatory capital	$230.3	$223.4	$351.3	$480.7	$492.7	$535.9
Statutory requirement	$186.0	$193.5	$217.0	$301.0	$348.6	$374.0
Regulatory requirement	$42.8	$57.3	$35.9	$42.1	$52.9	$58.1
Excess over statutory or regulatory requirement*	$40.4	$13.5	$120.2	$159.6	$126.5	$145.0
Capital margin excess > minimum	21.7%	7.0%	55.4%	53.0%	36.3%	38.8%

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

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

21. See the FCA website at www.fca.gov/info/farmer_mac_test.html for more information about the Risk-Based Capital Stress Test.
22. The statute requires minimum capital coverage of 2.75 percent for on-balance-sheet assets and 0.75 percent for off-balance-sheet obligations.

industry practices in financial modeling and stress testing.

In addition, we published a final rule in November 2012 to revise regulations governing Farmer Mac's nonprogram investment management. 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. FCA plans to publish a final rule governing Farmer Mac's liquidity management in the spring of 2013.

In January 2013, we issued a proposed rule to revise regulations governing Farmer Mac's capital planning activities. The rule would, among other things, require Farmer Mac to annually stress test its capital position and to notify FCA of changes in dividend policy.

Program Activity

Farmer Mac's total program activity increased to $13.0 billion on December 31, 2012, from $11.9 billion a year earlier (see figure 9). Farmer Mac experienced steady growth in its AgVantage products. AgVantage transactions are general obligations of the issuing financial institution that are purchased or 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 of the security.

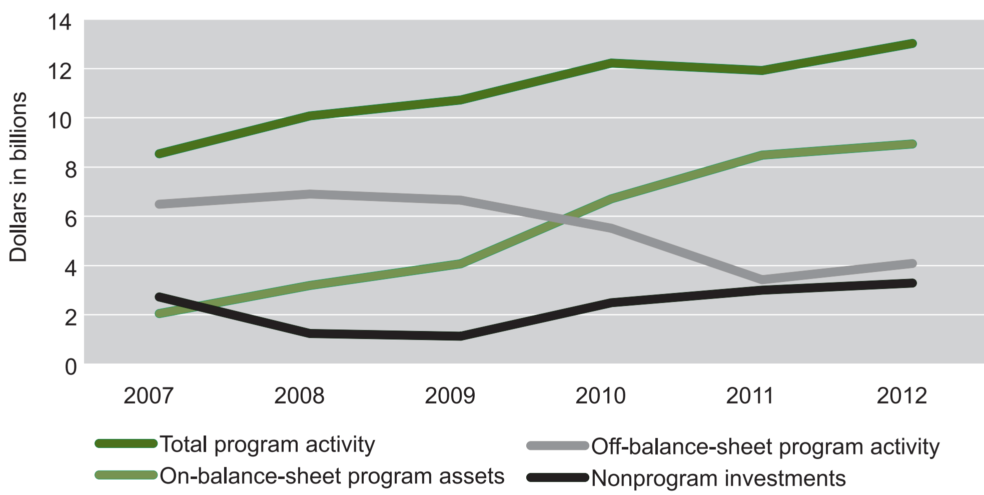
Farmer Mac's Long-Term Standby Purchase Commitments are similar to a guarantee of eligible pools of program loans. Under the standbys, a financial institution pays an annual fee in return for Farmer Mac's commitment to purchase loans in a specific pool if their credit quality deteriorates. As shown in figure 10, standbys represented 16.6 percent of Farmer Mac's total program activity in 2012.

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 2012, 31.3 percent of program activity consisted of off-balance-sheet obligations, as compared with 28.8 percent a year earlier.

Figure 9

Farmer Mac Program Activity and Nonprogram Investment Trends

As of December 31



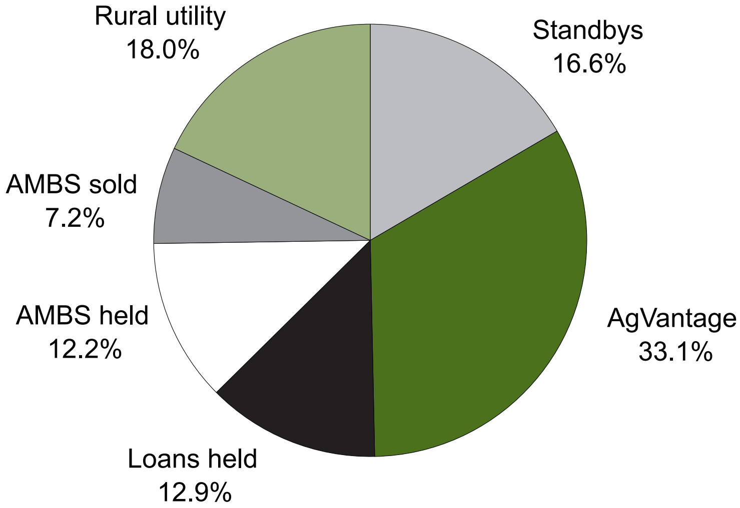
Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-K.

Figure 10

Farmer Mac Total Program Activity

As of December 31, 2012

Total = $11.87 billion



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

AMBS = agricultural mortgage-backed securities

Asset Quality

On December 31, 2012, $186.5 million of the Farmer Mac I program portfolio was substandard, representing 3.93 percent of the principal balance of Farmer Mac I loans purchased, guaranteed, or committed to be purchased.[23] This compares with $197.5 million, or 4.55 percent, on December 31, 2011. Substandard assets have a well-defined weakness or weaknesses and may result in some loss if the deficiencies are not corrected.

As of December 31, 2012, Farmer Mac's 90-day delinquencies improved marginally to $33.2 million, or 0.70 percent of non-AgVantage Farmer Mac I loans, compared with $40.6 million, or 0.93 percent as of December 31, 2011. Real estate owned as of December 31, 2012, was $4.0 million, up from $3.1 million a year earlier. Farmer Mac reported no delinquencies or nonperforming loans in its pools of rural utility cooperative loans.

On December 31, 2012, Farmer Mac's allowance for losses totaled $16.9 million, compared with $17.5 million on December 31, 2011. Figure 11 shows the levels of Farmer Mac's substandard assets and its 90-day delinquencies relative to outstanding program volume, excluding AgVantage volume.

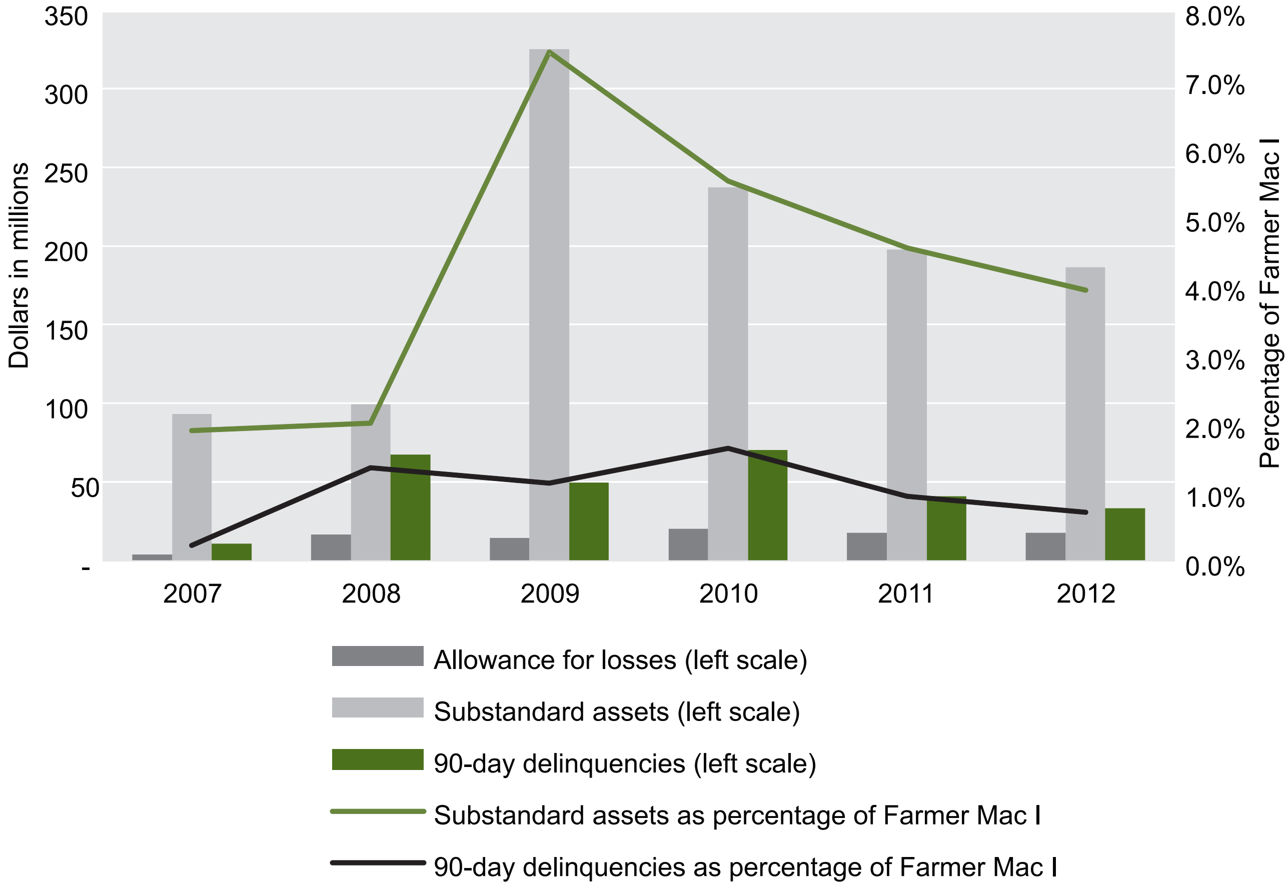
Earnings

Farmer Mac reported net income available to common stockholders of $43.9 million (in accordance with GAAP) for the year ended December 31, 2012, up from the $13.8 million reported at year-end 2011. Core earnings for 2012 were $49.6 million, compared with $42.9 million in 2011.[24] Net interest income, which excludes guarantee fee income, was $122.0 million in 2012, up from $121.3 million in 2011. Guarantee fee income was $25.0 million, compared with $24.8 million in 2011. Nonprogram investments accounted for an estimated 9 percent of interest income for 2012, down from 10 percent for 2011. Table 7 shows a six-year trend for the basic components of income.

23. This ratio excludes AgVantage volume because the risk associated with AgVantage products is significantly mitigated by the general obligation of the issuer or over-collateral requirements, or both.

24. 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 11
Allowance, Nonperforming Asset, and Delinquency Trends, 2007–2012
As of December 31



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

Table 7
Farmer Mac Condensed Statements of Operations, 2007–2012
As of December 31
Dollars in Millions

	2007	2008	2009	2010	2011	2012	Growth Rate 2011–2012
Total revenues	$31.5	($140.6)	$181.8	$99.1	$73.3	$122.0	66%
Total expenses	$27.1	$13.5	$99.5	$77.0	$59.5	$78.1	31%
Net income available to shareholders	$4.4	($154.1)	$82.3	$22.1	$13.8	$43.9	218%
Core earnings	$29.9	($81.5)	$16.1	$25.4	$42.9	$49.6	16%

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

Challenges Facing the Agricultural Economy and the Farm Credit System

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

The Farm Economy

Drought

In 2012, U.S. agriculture was buffeted by the most widespread drought in more than 50 years, which may turn out to be the most costly in U.S. history. The drought affected more than half of the continental United States, most notably in Kansas, Oklahoma, and Nebraska in the Plains States; Missouri, Illinois, and Indiana in the Midwest; Arkansas and Georgia in the South; and Colorado in the West. In all of these States, crop harvests were sharply reduced, and pasture conditions were poor. Figure 12 shows how widespread the drought was on August 14, 2012.

While rain and snow during the winter of 2012 and 2013 brought relief to the Midwest and the South, extreme to exceptional drought conditions persisted into the spring of 2013 in most of the Plains States and some parts of the West. The continuing drought poses a heightened risk environment to certain System borrowers going forward.

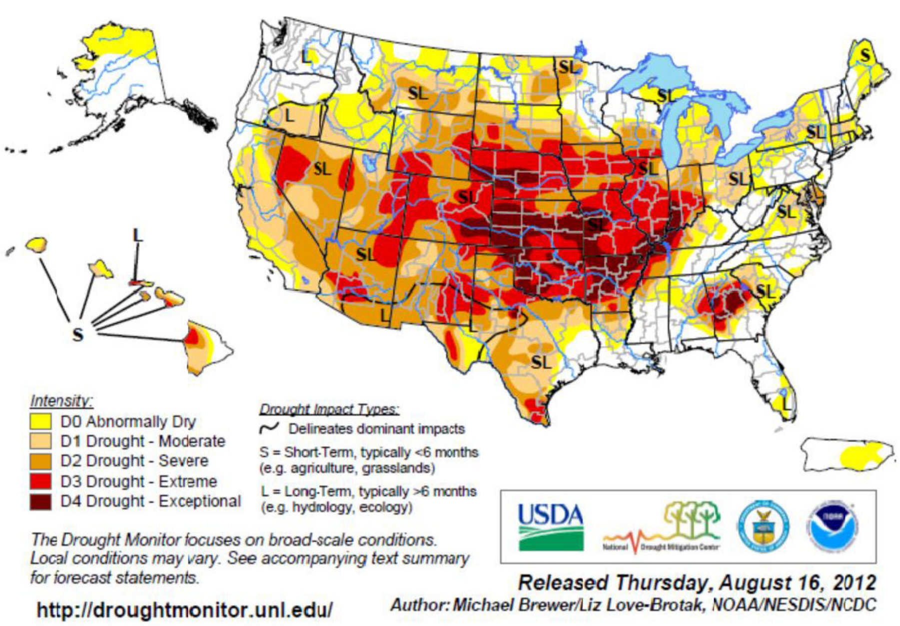
Farm Income

In spite of the significant stress caused by the drought to some segments of the U.S. farm economy, U.S. agriculture as a whole was in good financial condition in 2012, with near record farm incomes buoyed by high prices and strong exports. Debt use increased moderately, and asset values reached record levels.

Crop producers outside of the drought-affected regions benefited from record prices, while producers with crop insurance fared well despite their reduced yields. Total indemnity payouts for crop insurance are estimated at a record $16.2 billion for crop year 2012, a 50 percent increase from 2011. Those without crop insurance, including those who produce crops for which insurance is not available, were not as fortunate.

Livestock producers experienced another year of record feed costs and low or negative returns (the third since 2007), with limited insurance or other government programs.

Figure 12
U.S. Drought Moniter



Ethanol producers found themselves in a cost-price squeeze for most of the second half of 2012, with corn and ethanol prices insufficient to fully offset costs. As a result, 22 of the 211 U.S. ethanol refineries were shut down at the end of 2012. A return to a more favorable operating environment for ethanol depends largely on improved growing conditions and a more normal grain harvest this fall.

Net cash income for 2012 reached another record at $135.6 billion. Crop receipts rose 5.4 percent over 2011 levels, and livestock receipts were up 3.7 percent. Farm expenses were up nearly 8 percent, mostly because of a rise in feed costs, higher land rental rates, and higher costs for seeds and pesticides.

For 2013, the U.S. Department of Agriculture in February forecasted that net cash income will fall to $123.5 billion. Large increases in production expenses (particularly feed, labor, and land rent) are expected to offset a smaller projected increase in cash receipts. While net cash income is projected to fall in 2013, net farm income is forecast to increase to a record $128 billion, mostly because of a projected rise in the value of farm inventories and an expected rebound in crop production. Both measures of farm income are expected to remain at historically high levels in 2013 even after they are adjusted for inflation.

Acreage by Commodity

USDA's March 28 Prospective Plantings Report provides the numbers of acres that producers of various commodities expect to plant in 2013. Table 8 shows the projections for four major crops.

Yields for the 2013 corn and soybean crops are expected to be near trend levels. However, the likelihood of some planting delays, along with lingering drought conditions in western areas and possible expansion of those conditions into the Midwest, creates considerable uncertainty regarding yields and prices for corn and soybeans for the 2013–14 marketing year.

While corn may drop below $6 and soybeans below $13 if U.S. crop output returns to normal levels, any significant weather damage to Midwest crops would lead to prices similar to those of the 2012–13 marketing year, resulting in another crushing blow to livestock, dairy, and ethanol producers. Record harvests of corn and soybeans in Brazil and Argentina in early 2013 contributed to downward pressure on prices.

Table 8

Projected Number of Acres per Major Commodity in 2013

Commodity	Acres to Be Planted
Corn	97.3 million acres, the highest since 1936
Soybeans	77.1 million acres, down slightly from last year but the fourth highest on record
Wheat	56.4 million acres, up 1 percent from 2012
Cotton	10.0 million acres, 19 percent below last year

Source: USDA's March 28, 2013, Prospective Planning Report.

Farm Expenses

On the cost side, farm production expenses are projected to rise nearly 6 percent in 2013 to a record $353 billion, mainly reflecting increases in rent, labor, and feed. Crop producers could face a cost-price squeeze in 2013 and 2014 if production rebounds to trend levels or higher, while livestock and ethanol producers would see some relief from elevated feedstock costs. The price puzzle may not be solved until the fall.

This great uncertainty surrounding crop yields and prices presents challenges for both producers and their lenders. Price volatility on both the output and input side increases the need for good risk management practices, including enterprise diversification and greater use of insurance products and the futures markets. Price volatility may also increase the need for producers to keep more working capital. To reduce risk, many lenders are now requiring borrowers to have more collateral and higher cash flow levels relative to debt. Lenders are also taking borrower risk management practices into account when setting loan terms.

Farm Asset Values and Farm Debt Levels

Strong farm income growth combined with record low interest rates continued to fuel the rise in U.S. farm asset values in 2012, which rose 6 percent according to USDA estimates. Real estate debt increased by 5 percent, while non-real estate debt increased by 7 percent, for a total debt increase of around $15 billion, or 6 percent.

The net impact on the balance sheet of the farm sector was a 6.5 percent increase in farm equity in 2012 to a record $2.3 trillion, resulting in a debt-to-equity ratio of 11.9 percent, the lowest level since USDA began calculating the measure in 1960. The debt-to-asset ratio of 10.6 percent for 2012 is also a record low.

Farmland Values

Land values continued their upward climb during 2012, raising concerns of a possible asset bubble that would make land values vulnerable to increases in interest rates or decreases in exports stemming from an economic or political crisis abroad.

With more than 85 percent of the farm sector balance sheet made up of farm real estate assets, land values have an outsized influence on the strength of farm balance sheets and the creditworthiness of farmers. Based on its June 2012 survey, USDA reported that U.S. farm real estate values, which include the value of farm buildings, rose 10.9 percent from 2011 values.

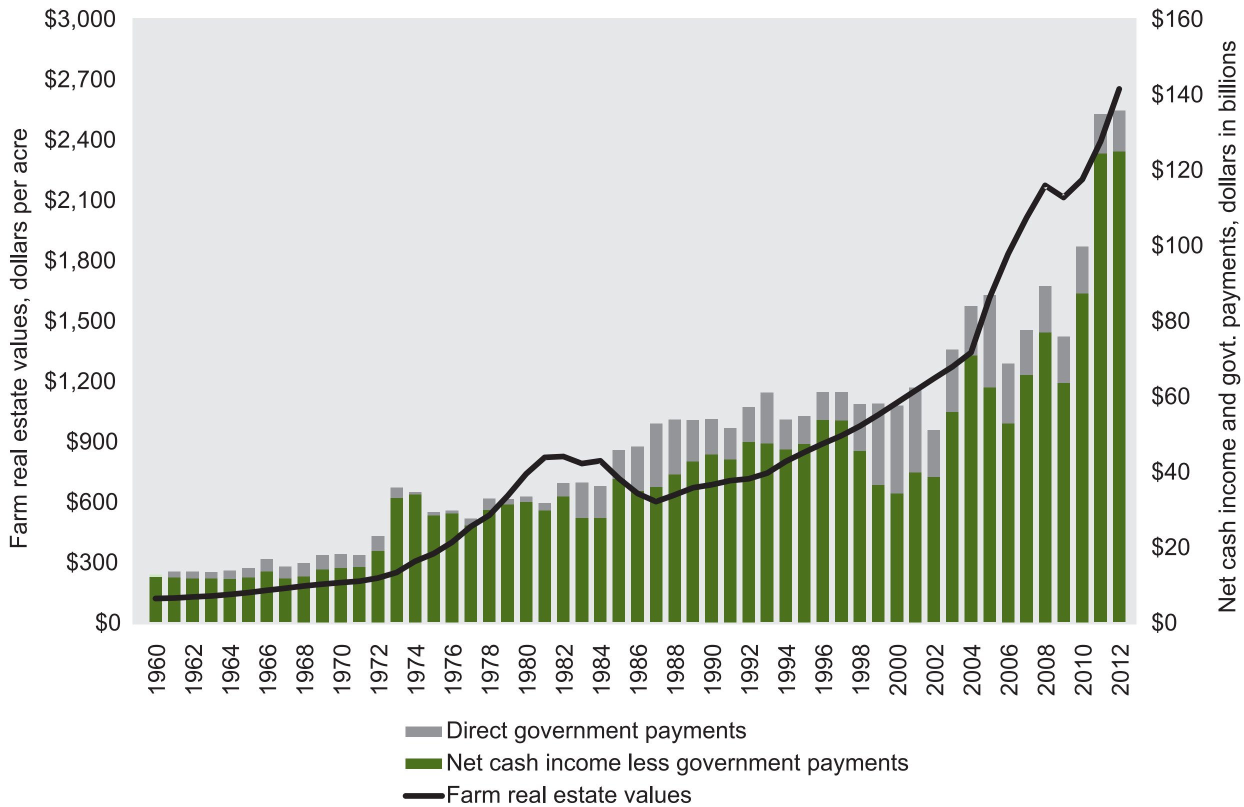
Regional changes ranged from a 26.7 percent increase in the Northern Plains to a 4.1 percent decline in the Southeast. Cropland markets were more robust, with average values increasing by 14.5 percent, and values in the Northern Plains and Corn Belt regions increasing 30.4 percent and 18.5 percent, respectively.

More recent land surveys conducted by appraisers, universities, and by Federal Reserve district banks suggest that Midwest cropland prices continued to rise throughout the latter half of 2012 and into 2013. Midwest prices have risen sharply for the past three years. In some States, average cropland values have more than doubled over that period to set historic highs. Steep hikes in crop prices resulting from last summer's drought, coupled with historically low interest rates, fueled the demand for land. Falling profit margins and rising rates would reduce demand for land, causing prices to drop even though the supply of land that has been put up for sale is limited.

According to the Midwest surveys, the strongest price rises have been for high-quality corn- and soybean-producing land. Also, in the aftermath of last summer's drought, buyers have placed a premium on irrigation, driving up the prices for irrigated land in relation to un-irrigated land. Surveys show irrigated cropland in some States rose more than 30 percent in 2012. In areas of severe drought, land markets were somewhat less robust.

The value of pasture and ranchland was more of a mixed picture in 2012, with declines in some regions but

Figure 13
Net Cash Income, Government Payments, and Farm Real Estate Values (Nominal Dollars)



gains exceeding 20 percent in the central and northern plains States. Some of the higher increases are as high as the large increases in cropland values.

Besides farmland, farmers continued to make large investments in new buildings, equipment, irrigation, and other land improvements in 2012. Record farm incomes and proposed tax law changes encouraged these investments, particularly in the latter part of the year. According to the Association of Equipment Manufacturers, the number of new, large farm tractors sold in 2012 was up nearly 16 percent—57 percent above that of just five years ago. USDA price data show that prices for new farm machinery rose nearly 5 percent in 2012.

Although interest in farmland has been high among nonfarmers, farmers remained the primary purchasers in 2012. While the use of debt to make such purchases has been generally viewed as modest, in 2012 the growth of farm real estate debt was much less restrained, particularly in regions of rapidly rising farmland prices. The value of outstanding farm real estate loans at System associations within the AgriBank district at the end of 2012 was nearly 18 percent above that of the previous year. Commercial banks that are defined as farm banks by the Federal Deposit Insurance Corporation saw their farm real estate lending portfolios grow by nearly 15 percent in 2012.

To address the rising risks associated with farmland values, FCA has 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. For perspective on the changes in farmland values over the past five decades, see figure 13.

Interest Rate Environment

Other factors affecting the outlook for the Farm Credit System are funding costs and borrower interest rates. The System continued to have reliable access to the debt capital markets here and abroad in 2012. With the Federal Reserve's low interest rate policies continuing throughout 2012, interest rates paid by System borrowers remained near or at historic lows. The three-month Treasury bill was up slightly at 0.1 percent at year-end 2012, while the 10-year Treasury bond was down slightly at 1.8 percent at year-end 2012, compared with 1.9 percent at year-end 2011.

Interest rates are expected to continue to be low through late 2014, with Consensus Forecast projecting the three-month Treasury Bill to remain at 0.1 percent for the end of June 2013, rising slightly to 0.2 percent by end of March 2014; the 10-year Treasury Bond is projected to rise to 2.1 percent by end of June 2013, with a further increase to 2.6 percent by end of March 2014. Interest rates are highly unpredictable, so a change in Federal Reserve monetary policy or a sudden increase in inflation from an oil price spike or food price shock could cause the current low interest rate environment to change quickly, leading to higher production costs for farmers and ranchers and a decrease in farmland values.

U.S. Agricultural Exports

Economic developments in China and other Asian countries are expected to continue to have a profound impact on the U.S. agricultural economy going forward. Asia accounted for 44 percent of U.S. agricultural exports in 2012, and China alone accounted for about 17 percent, making China the principal export destination for the second year in a row, ahead of Canada, Mexico, Japan, and the European Union.

China remains the world's fastest-growing major economy; it's the largest exporting economy; and it's the second-largest importing economy. However, the Chinese economy has been slowing recently. Its annual growth dropped to 7.8 percent in 2012, down from 9.3 percent the year before and the slowest in 13 years, though sufficiently ahead of the Chinese government's 7.5 percent target. Both the International Monetary Fund and the Organisation for Economic Co-operation and Development are projecting China's economy to grow in the 8.2 to 8.5 percent range in 2013 and slightly higher in 2014.

Global Agricultural Commodity Stocks and Price Volatility

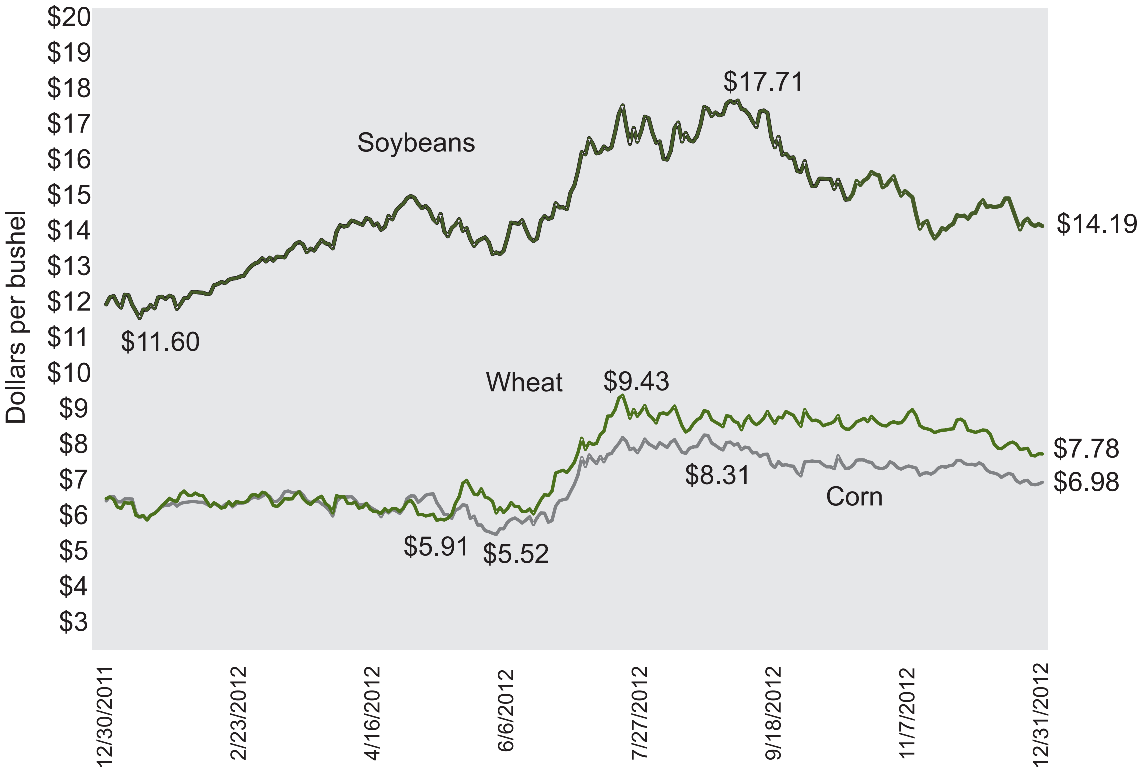
The historic drought in the United States in 2012, combined with severe droughts in southern Europe and the Black Sea region, sharply reduced global corn, soybean, and wheat supplies, leading to tight stocks and volatile prices. As figure 14 shows, wheat futures jumped 60 percent between their low in May and their high in July 2012; corn futures were up 51 percent in late August from their low in early June; and soybean futures were up 53 percent in early September 2012 from their low in mid-January.

Global corn stocks as a percentage of expected use for the 2012–13 marketing year are projected to be the lowest since the 1973–74 marketing year, while global wheat stocks are projected to be at their lowest since 2008–09. Soybeans stocks are expected to increase as a result of heavy production in the Southern Hemisphere, but stocks as a percentage of use will remain historically low. Barring extreme weather events, large anticipated global supplies of principal grain and oilseed crops in 2013 should rebuild stocks and lower prices in the 2013–14 marketing year, but markets will remain volatile until production volumes are better known.

The General Economy

The U.S. economy grew moderately in 2012 from 2011. However, it grew less than it did in 2010. The modest

Figure 14
Crop Futures, Nearby Contract, Daily Closing Price, 2012



Source: FCA's Office of Regulatory Policy, based on Chicago Board of Trade data.

growth rate in 2012 can be attributed to the limited expansion of business over concerns about higher health care costs, new regulations, budget cuts, and possible tax increases beginning in 2013. Businesses with a foreign exposure were further limited by the continued financial crisis in Europe and a slowdown in China's economy. Severe weather—from droughts to hurricanes—also disrupted business activity in 2012.

Real GDP grew at an average annual rate of 2.2 percent for 2012, a slight improvement over 2011's 1.8 percent growth. The economy slowed sharply in the fourth quarter of 2012, with GDP growth dropping to 0.4 percent from 3.1 percent in the third quarter. The decline was due largely to the sharp cuts in defense spending that began with the new fiscal year on October 1, 2012. The economy was also affected by a drop in exports in the fourth quarter, a decline in business inventories, and business disruptions along the East Coast caused by Hurricane Sandy, the second-costliest storm in U.S. history.

Moderate economic growth in the United States is projected to continue in 2013, but at a slightly slower pace than in 2012 as the budgetary changes that are scheduled to occur under current law affect those sectors of the economy that rely heavily on these expenditures. According to Consensus Economics' panel of 31 financial forecasters (April 2013), real GDP for the U.S. economy is projected at 2.1 percent in 2013, little changed from 2012.

There is still much uncertainty as to how cuts in Government spending from the sequestration,[25] which took effect on March 1, 2013, will ultimately affect economic growth over the next few years. On the positive side, overall manufacturing orders increased 3 percent in February 2013, the largest gain in five months. Orders for autos and computers and other electronics helped drive the increase.

A consumer-led slowdown was underway in the first quarter of 2013, due in part to an increase in Federal taxes that began on January 1. This contributed to a drop in disposable income, which slowed consumer spending, particularly for lower-income households, which were also buffeted by high prices at both the grocery store and the gas station.

Continued low interest rates contributed to the improvement in home sales and home values in the first quarter of 2013; segments of the Farm Credit System's loan portfolio that are tied to housing will likely benefit, too. Also, the Institute of Supply Management survey for February 2013, which showed gains in both the manufacturing and service sectors, provides a positive outlook for U.S. industry and off-farm employment opportunities. The U.S. stock market showed significant strength in the first three months of the year; if the trend continues, spending should increase later in the year.

Sectors of the economy tied to the export market, however, could be adversely affected by the strengthening of the U.S. dollar against key currencies, such as Japan's yen. These sectors may also suffer if China fails to meet its official growth target this year.

Employment Prospects

The U.S. unemployment rate declined in 2012 from a high of 8.3 percent in January to a low of 7.8 percent by year-end. This compares with unemployment of 8.9 percent for 2011 and 9.6 percent for 2010. From State to State, the unemployment rate varied widely, ranging from lows of 3.2 percent in North Dakota to double-digit highs in California (11.1 percent).

An alternative measure of labor underutilization provided by the Bureau of Labor Statistics is the so-called "underemployment rate," or U-6, which measures "total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force." This rate dropped from 15.9 percent in 2011 to 14.7 percent in 2012, with Nevada recording the highest rate at 20.3 percent.

After a slight uptick in the unemployment rate to 7.9 percent in January 2013 because of softer labor demand, the rate dropped to 7.7 percent in February 2013 on expanded hiring in professional and business services, construction, and health care. The unemployment rate in February declined in 22 states, remained unchanged in 16 states, and increased in 12 states. Illinois had the largest increase, going from 9.0 percent in January to 9.5 percent in February.

According to Consensus Forecasts, unemployment for 2013 will slowly decline throughout the year, reaching a low of 7.5 percent for the fourth quarter and averaging 7.6 percent for the year versus 8.1 percent for 2012. In general, rural economies are expected to grow modestly in 2013, but much will hinge on the relative strength of the farm economy and energy markets.

Employment in Nonmetropolitan Areas

The impacts of the 2007–2009 U.S. recession were generally less severe in nonmetropolitan areas since two of the most affected sectors, financial services and housing, play a much smaller roll in employment and income for nonmetro residents. Metro areas and nonmetro areas had nearly identical unemployment rates of 4.8 percent at the end of 2007. Both rates peaked in the fourth quarter of 2009 at around 10 percent for metro areas and 9.5 percent for nonmetro areas. Since then, both rates have trended down slowly. In the third quarter of 2012, the unemployment rate was 8.2 percent in metro areas and 7.7 percent in nonmetro areas.

25. "Sequestration," a term adopted by Congress in recent years to describe a new fiscal policy procedure for reducing the size of the Federal Government's budget deficit. On March 1, 2013, $1.2 trillion in automatic spending cuts took effect, divided equally between defense and various domestic spending programs.

Nonmetro employment growth slowed in the first half of 2012 to only 0.1 percent. By contrast, metro areas saw the number of jobs rise 1.1 percent in the first half of 2012. The slowdown in the first half of 2012 was due primarily to lagging employment growth in nonfarm sectors like manufacturing, health services, education, and the hospitality and leisure industries.

Despite slower employment growth in nonmetro areas, 40 States had nonmetro job growth between the first half of 2011 and the first half of 2012, while 8 States suffered nonmetro job losses. States that realized nonmetro job growth of 2 percent or more include Alaska, Delaware, Arkansas, Montana, Oklahoma, and North Dakota. Many of the nonmetro counties that experienced rapid job growth in the past year have significant employment in agriculture or mining. Record farm incomes over the past two years have benefited farm-dependent counties, while a strong expansion by the oil and gas industry stimulated double-digit job growth in mining, particularly in North Dakota, Pennsylvania, Oklahoma, Texas, New Mexico, and Colorado.

Housing Sector Recovery

Another risk factor is the housing sector, which historically has accounted for 17 to 18 percent of GDP. In 2012, housing's share of GDP dropped to 15 percent, reflecting lower investment in housing following the financial crisis of 2007–2008. The average price of existing homes sold in the United States peaked at $230,300 in June 2007 and bottomed out at $154,600 in January 2012, representing a one-third loss in the average price of a U.S. home over this period.

Since its collapse, the housing market has been on a slow recovery for the past five years, but continued low interest rates and slight improvements in employment and income in 2012 contributed to a strong rebound in new and existing home sales in 2012. This pattern continued in early 2013 for existing home sales; increases for new home sales were more subdued.

Consumer Price Inflation

The U.S. Consumer Price Index for All Urban Consumers increased only 1.7 percent in 2012, down from 3.0 percent in 2011, making this the third smallest annual increase of the past 10 years. The average annual inflation rate over the past 10 years was 2.4 percent. The energy index rose 0.5 percent in 2012, substantially less than the 6.6 percent increase in 2011. The index for food rose just 1.8 percent in 2012, down from an increase of 4.7 percent in 2011.

The consensus forecast for consumer price inflation in 2013 is for a slight uptick to 1.9 percent. Although most economists believe inflation will remain in check for 2013, inflationary pressures are expected to pick up in 2014 and beyond. The U.S. Federal Reserve Board, as well as other central banks, is expected to boost interest rates to contain inflationary pressures. Inflation affects agriculture by raising input costs and by curbing consumer demand for high-value products like dairy, meat, and processed foods, as well as curbing consumption of food away from home.

International Trade

U.S. exports of goods and services continued to assist the U.S. economy in 2012, increasing 4.3 percent to a record $2.2 trillion. Over this period, foods, feeds, and beverages contributed nearly 10 percent to this increase. Imports also reached a record in 2012, increasing 2.7 percent to $2.73 trillion. Imports of automotive vehicles and capital goods accounted for most of the increase. Imports of foods, feeds, and beverages accounted for about 4 percent of the increase in imports. On balance, the trade deficit narrowed to $539 billion.

However, international trade accounted for a smaller amount of U.S. economic activity in 2012. Partly in response to a slowdown in world economic growth, the growth rate of exports in 2012 was almost 10 percentage points lower than the 14 percent pace in 2011. The euro zone, the second largest U.S. export market, continues to languish from the continuing debt crisis, austerity measures, and high unemployment. The unemployment rate for the euro zone reached 12 percent in February 2013, the highest level since the data series was started in 1995. The recession in the euro zone is expected to persist through the first three quarters of 2013, with a possible return to positive growth in the final quarter.

Canada, Mexico, and Japan, other major destinations for U.S. exports, are projected to have slower economic growth in 2013, while China is expected to show slightly higher growth. In addition, the value of the dollar appreciated about a half percent against major trading partner currencies in 2012 but is projected to depreciate somewhat in 2013, making U.S. goods relatively more competitive. This, coupled with higher expected growth in developing Asia, Latin America, and Eastern Europe, could provide a slight lift to U.S. exports in 2013, offsetting a likely drop in European demand.

Household Debt

Since it peaked at $13.8 trillion during the first quarter of 2008, just prior to the recession, total household debt has declined steadily, reaching a low of $12.8 trillion at the end of the second quarter of 2012, a drop of 7.7 percent. However, households took on more debt during the third quarter of 2012, rising 0.6 percent.

Household debt relative to disposable income has been on the decline since peaking at nearly 130 percent in the third quarter of 2007, dropping to 105.5 percent in the fourth quarter of 2012. This level of debt is still high when compared with the average debt levels of the 1990s (86 percent) and the 1980s (71 percent). Despite historically low interest rates and some pickup in borrowing activity, credit standards remain more stringent relative to the 2001 recession.

Federal Deficit

Other factors that may limit economic growth going forward are the Federal budget deficit and the Federal debt held by the public. The Federal budget deficit for fiscal year 2012 totaled $1.1 trillion (or 7.0 percent of GDP), a drop of 16 percent from the previous year. The Congressional Budget Office projects that the deficit will decline again in fiscal 2013 to an estimated $845 billion (5.3 percent of GDP).

While the deficit has been on a downward trend in recent years, the accumulation of these deficits continues to raise the Federal debt held by the public, which increased 11.4 percent to $11.3 trillion in fiscal 2012. This amounts to 72.5 percent of GDP, double the level of 2007. This makes U.S. indebtedness the third highest in the industrial world behind Japan and Italy. Ongoing deficits and debt of these magnitudes can lead to imbalances in capital and credit markets, which in turn can undermine the confidence of market participants, leading to inflation and higher interest rates.

Farm Policy Changes on the Horizon

Agricultural producers are affected by a myriad of Government policies and programs at the State, Federal and international levels. Farm programs, energy policies, interest rate targets, and foreign trade agreements influence markets and thus affect farm income and borrowers' ability to repay their loans. U.S. Government farm programs have been an important source of assistance to farmers for sustaining their business since the Great Depression. The programs mainly supply controls to stabilize commodity prices and support producers' incomes. Today Government assistance to farmers includes direct payments to producers under a variety of programs; direct purchases of certain commodities, like dairy, under price support programs; and marketing assistance loans for the major crops and some minor crops. Also included are crop insurance programs and emergency and disaster payments.

The total Federal budget appropriation for food assistance and agriculture-related programs was $137 billion for fiscal year 2012 (about $1,200 per household), an increase of $12 billion or nearly 9 percent from fiscal year 2011. Food assistance or nutrition programs accounted for 76 percent of the total, and farm-related spending accounted for about 14 percent, with the remaining 10 percent going to research, rural development, foreign aid, food safety, and conservation. Federal budget outlays for farm income stabilization programs totaled $13.17 billion in fiscal year 2012, down nearly 18 percent from the previous year and 37 percent below the average outlays for farm income stabilization from 2000 to 2005.

The primary framework for establishing agricultural policies and programs is a legislative process by both the House and the Senate, which occurs about every five years, to develop a farm bill that becomes law. The principal law addressing food and agricultural issues over the past five years has been the Food, Conservation, and Energy Act of 2008 (or 2008 Farm Bill), which was to be replaced by a new farm bill before it expired at the end of fiscal year 2012.

The House and Senate each introduced their own versions of a new farm bill in 2012 but were unable to reconcile the differences in the two bills before the end of the year, so the American Taxpayer Relief Act of 2012 extended most of the provisions of the 2008 Farm Bill through the end of fiscal year 2013. The outcome of the final legislation remains uncertain because some key differences in policies and costs remain between the two farm bills.

Over the 10-year period from 2014 to 2023, the House version would reduce spending by $26.6 billion compared with the baseline, and the Senate version would reduce spending half as much, at $13.1 billion. The final outcome of the farm bill debate is a key concern of financial lenders to the agriculture sector because of its implications for agriculture's safety net and, consequently, its impact on the farm income of its borrowers.

Farm Credit System Portfolio

System loan volume grew almost 10 percent in 2012, though high levels of stress continued to affect some sectors and regions. The increase in System loans was driven primarily by the increased value of farmland and higher commodity prices, particularly in the middle part of the United States. Lending to finance production inputs, inventories, machinery, and real estate purchases increased, particularly where cash grain is produced.

Although drought conditions reduced yields in many parts of the Midwest, most crop producers were buffered from the adverse impact through insurance and increased prices for their crops. Conversely, producers in stressed sectors, such as animal protein and biofuel, were adversely affected because of the higher cost for grain and feed. Other sectors, such as horticulture and forestry, continued to suffer from reduced profits as a result of the tepid growth of the economy and lingering problems in the housing sector.

While continued high farm income and rising agricultural real estate values benefited some sectors, particularly grain producers in the middle part of the United States, high costs and soft demand continued to affect other regions and sectors of agriculture. Some sectors, such as dairy, cattle, poultry, and forestry, saw the quality of loans improve modestly. However, other sectors, such as biofuels and horticulture, saw continued distress in 2012.

When all these sectors are combined, System nonaccrual loans to dairy, cattle, poultry, forestry, horticulture, and biofuel sectors accounted for $1.2 billion of the $2.3 billion total. Also, the System reported $174 million in charge-offs on loans to these sectors; this represented about 74 percent of all of the System's net charge-offs. These sectors accounted for $52.4 billion, or 27 percent, of all System loans. See table 9 for a breakdown of financial information by sector.

Table 9

Stressed Sectors of the System's Loan Portfolio

As of December 31, 2012

Dollars in Billions

	Loan Dollar Volume (in billions)	Change from Prior Year-end (as of Dec. 31)	Percentage of System's Total Loan Volume	Percentage of System's Nonaccrual Loan Volume
Dairy	$14.8	6%	8%	16%
Cattle	$17.7	7%	9%	11%
Poultry	$5.4	(2%)	3%	3%
Forestry	$10.2	7%	5%	9%
Horticulture	$2.7	(7%)	1%	12%
Biofuels	$1.7	2%	<1%	4%

Source: USDA.

Dairy

System loans outstanding to the dairy sector totaled $14.8 billion in 2012, up 6 percent from a year earlier. Producers benefitted from higher milk prices, though high feed costs reduced the profits of farmers who purchased most of their feed. While many producers made progress in reducing their debt in 2012, others remain vulnerable to factors such as reduced milk prices, higher feed costs, and interest rate increases.

System loans to the dairy industry that were not accruing interest fell 21 percent from 2011 to $357 million at year-end 2012, and the System recognized $60 million in charge-offs. Loans to this sector totaled 8 percent of the dollar volume of all System loans and 38 percent of its capital. Dairy accounted for 16 percent of the System's nonaccrual loan volume as of December 31, 2012.

Cattle

The System's loans outstanding to the cattle industry totaled $17.7 billion at year-end 2012, up about 7 percent from year-end 2011. Because cattle prices rose in response to reduced supply during the year, some producers were able to remain profitable. However, others suffered from increased feed costs, particularly if they depended on feed from drought-affected areas.

System loans to the cattle industry that were not accruing interest declined 20 percent from 2011 to $242 million at year-end 2012; the System recorded $16 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.

Poultry

System loans outstanding to the poultry and eggs sector totaled $5.4 billion, down 2 percent from a year earlier. Many producers suffered operating losses because poultry prices were not high enough to offset increased feed costs. While most producers were able to borrow funds to offset operating losses, a few integrated broiler producers either sold or curtailed operations.

System loans to the poultry industry that were not accruing interest fell 7 percent from 2011 to $71 million at year-end 2012. Loans to this sector totaled 3 percent of the System's loan dollar volume and 14 percent of its capital.

Forestry

System loans outstanding to the forestry sector totaled $10.2 billion, up about 7 percent from a year earlier. Improved demand for housing and some lumber products spurred loan volume higher, though all regions did not see improved demand. Some producers added debt to finance capital needs to fulfill increased demand, while others liquidated property to help address cash flow problems.

System loans to the forestry sector that were not accruing interest fell 31 percent from 2011 to $198 million at year-end 2012, and the System recorded $15 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.

Horticulture

Loans outstanding to horticulture operations declined about 7 percent from last year to $2.7 billion. The decline reflected low demand for landscaping material in the persistently weak housing sector. Because many of these operations are located in and around urban areas, reduced values for properties used in their operations aggravated cash flow problems.

As a result, System loans to the horticulture industry that were not accruing interest rose 12 percent from 2011 to $284 million at year-end 2012, and the System incurred $69 million in charge-offs. Loans to horticulture totaled about 2 percent of the System's loan dollar volume and 7 percent of System capital.

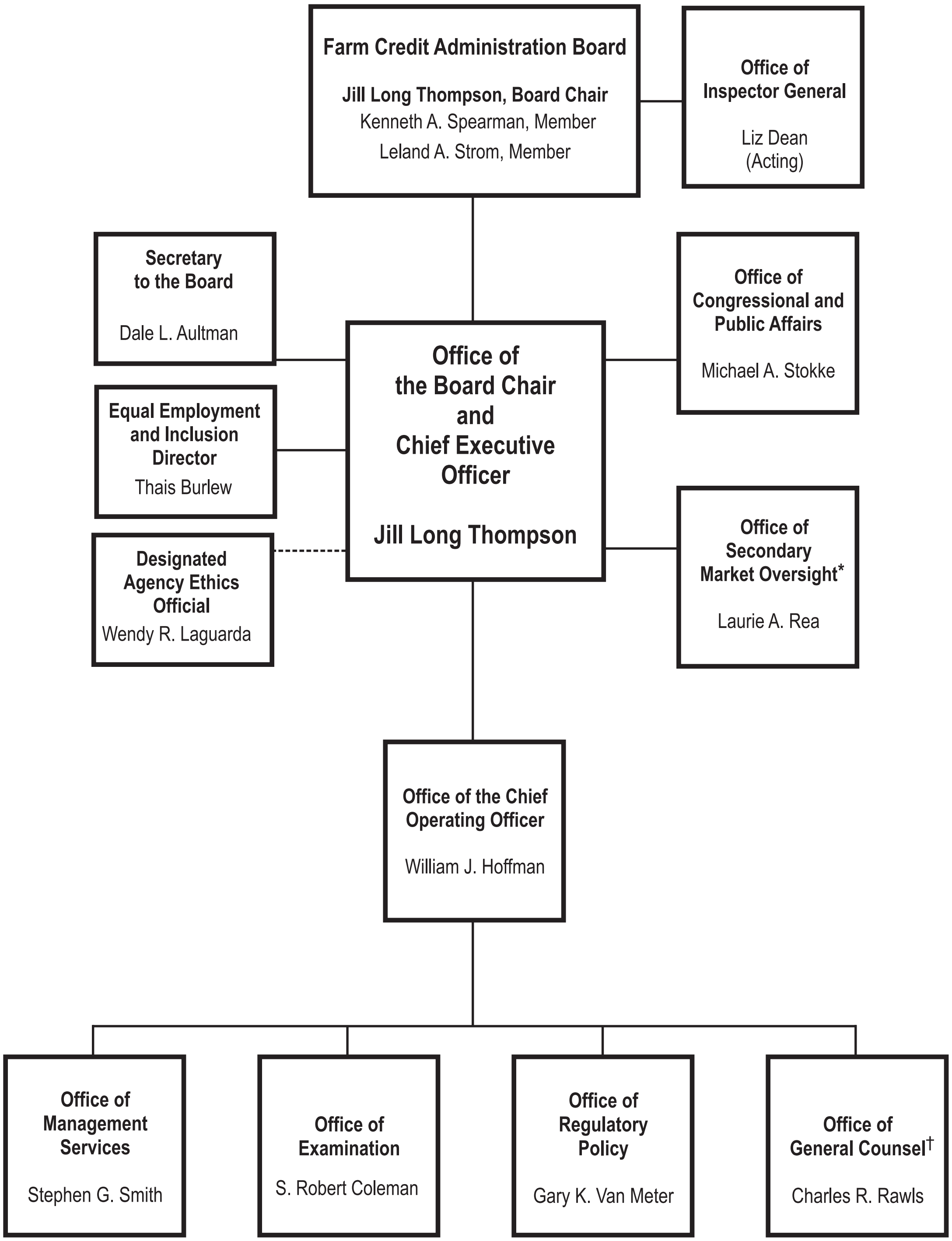
Biofuels

At the end of 2012, loans outstanding to the biofuels (primarily ethanol) industry totaled $1.7 billion, up slightly from a year earlier. While many of the firms generated cash flow sufficient to pay down debt during the early part of the year, numerous plants reported operating losses from either reduced or idled production during the last few months of 2012.

System loans to the biofuels industry that were not accruing interest totaled $95 million at year-end 2012, and charge-offs totaled $12 million. Biofuel loans outstanding represented only 4 percent of capital and less than 1 percent of the System's total dollar volume, both of which are small numbers when compared to the System's exposure to other industries or commodities. Both losses and nonaccrual assets are concentrated in a few firms.

Appendix

Figure 15
FCA Organizational Chart
As of January 2013



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

Farm Credit Administration Offices

As of December 31, 2012, FCA had 271 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 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.

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.

Elizabeth M. Dean is Acting Inspector General. Before assuming this position in 2013, Ms. Dean was the Deputy Inspector General and Counsel to the Inspector General since 1989. As Deputy IG and Counsel, she directed the investigative function of FCA's OIG, periodically conducted inspections and evaluations, performed legal duties, and comanaged the OIG. From 1986 to 1989, Ms. Dean served as a senior attorney in FCA's Office of General Counsel, Litigation and Enforcement Division. Ms. Dean served on active duty as a U.S. Navy Judge Advocate from 1982 until 1986; she retired from the U.S. Naval Reserves in 2000. Upon completing law school in 1981, she worked for the Attorney General of the State of Ohio in the Criminal Activities Branch.

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.

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 authorized farmers to organize PCAs, which could discount notes with FICBs. As a result, PCAs became the primary entities for delivery of short- and intermediate-term credit to farmers and ranchers. The FICBs and the Federal Land Banks in all Farm Credit districts 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
CAMELS—capital, assets, management, earnings, liquidity, and sensitivity
CEO—chief executive officer
Farm Credit 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
GAAP—generally accepted accounting principles
OFIs—other financing institutions
PCA—Production Credit Association
USDA—U.S. Department of Agriculture
YBS—young, beginning, and small (farmers and ranchers)

Additional Information

The Farm Credit Administration 2012 Annual Report on the Farm Credit System is available on FCA's website at www.fca.gov. For questions about this publication, contact

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

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

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