2013 Annual Report

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

Contents

Statement of the Board Chair and CEO 2

Farm Credit Administration 5
- Overview and Mission 5
- The Board 5

Farm Credit System—Role, Structure, and Safety and Soundness 9
- FCS Role 9
- FCS Structure 9
- The Safety and Soundness of the FCS 11

FCS Banks and Associations 12
- Financial Condition 12
- Borrowers Served 18
- System Funding for Other Lenders 20
- Farm Debt and Market Shares 22

Serving Young, Beginning, and Small Farmers and Ranchers 24
- Characteristics of YBS Borrowers 24
- FCS Lending to YBS Producers 24
- YBS Borrowing Trends, 2001–2013 27
- Assessing YBS Results for Individual Associations 30
- YBS Programs 31

Regulatory Policy and Approvals 33
- Regulatory Activity in 2013 33
- Corporate Activity in 2013 35
- Funding Activity in 2013 35
- Mission-Related Investments 38

Maintaining a Dependable Source of Credit for Farmers and Ranchers 39
- Conducting a Risk-Based Examination and Oversight Program 39
- Meeting Statutory Examination Requirements 39
- Measuring the System's Safety and Soundness 40
- Providing Differential Supervision and Enforcement 41
- Protecting Borrower Rights 42

Condition of Farmer Mac 43
- Capital 44
- Program Activity 45
- Asset Quality 45
- Earnings 47

Challenges Facing the Agricultural Economy and the Farm Credit System 49
- The Farm Economy 49
- The General Economy 53
- Farm Credit System Portfolio 57

Appendix 60
- Farm Credit Administration Offices 61
- Agency Officials 63
- Glossary 67
- Acronyms and Abbreviations 70
- Additional Information 71

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Statement of the Board Chair and CEO

June 2014

On behalf of the Board and the staff of the Farm Credit Administration, I present the 2013 Annual Report on the Farm Credit System (FCS or System). I am pleased to report the System's overall condition and performance remained sound in 2013, and 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 the System fulfills its responsibilities to this important segment of the farm economy.

Condition of the Farm Economy

Despite the challenges presented by weather, price volatility, and the global economy, U.S. agriculture as a whole remains in good financial condition. Based on USDA data, net cash income for the farm sector in 2013 was $130.1 billion, down about 3.0 percent from 2012. Crop receipts declined 3.3 percent, but livestock receipts were up by 6.2 percent, bringing much-needed relief to this sector.

While the farm economy remains healthy, farm sector net cash income is expected to be down in 2014. Lower grain prices have helped boost profitability in the protein and dairy sectors, but crop producers face tighter margins.

Because of lower crop prices, the market for farmland has also cooled, particularly in the Midwest. Other concerns include persistent drought in California and the spread of the porcine epidemic diarrhea virus in the hog sector.

Financial Condition of the FCS

The System's financial results continue to be strong. The System's net income was $4.64 billion in 2013, up 12.7 percent from 2012. The increase in System earnings was driven largely by lower provisions for loan losses and, to a lesser extent, higher net interest income.

Credit quality of System loans remained strong in 2013. As of December 31, 2013, nonperforming loans amounted to $2.0 billion, or 1.01 percent of gross loans, down from $2.6 billion, or 1.36 percent, at year-end 2012.

During 2013, the System continued to experience reliable access to the debt capital markets, and investor demand for all System debt security products was strong. Total Systemwide debt increased by 4.8 percent, compared with 7.1 percent in 2012.

Overall, the System remained financially sound, and weaker institutions continued to strengthen. For the first time since 2007, no institution in the System received a Financial Institution Rating System rating lower than 3.

Young, Beginning and Small Farmer Lending

Along with a slight decline in overall new farm lending, the dollar volume of new loans to YBS farmers also declined in 2013. The dollar volume to small farmers decreased the most, representing a 13.3 percent drop from 2012. One of the main reasons for this decline is the growth in farm incomes since the mid-2000s. 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.

The dollar volume of new loans made to young farmers declined by 6.0 percent, and the dollar volume to beginning farmers fell by 4.2 percent from 2012 to 2013. On the other hand, the number of new loans made to young and beginning farmers in 2013 increased by 2.3 percent and 5.0 percent, respectively.

Because of a decline in repayments, the number and dollar volume of loans outstanding increased in all three YBS categories. The dollar volume increased by 3.5 percent to beginning farmers, 3.0 percent to young farmers, and 1.8 percent to small farmers.

FCA's Supervision and Oversight of the System

As the arm's-length regulator of the System, we examine System institutions for their safety and soundness and their compliance with laws and regulations, providing heightened oversight of institutions with higher risk. We evaluate risks that can affect an institution, a group of institutions, and the System as a whole. In addition to the areas normally considered, our examiners are currently emphasizing the following areas:

- ***Business Planning and Diversity and Inclusion.*** Through examinations, we focus on the compliance of System institutions with FCA regulation 618.8440, which requires them to develop human capital and marketing plans that promote diversity and inclusion.
- ***Underwriting in Volatile Times.*** Volatility in the agricultural industry may increase borrower stress over the next several years. We are emphasizing the need for proactive underwriting standards and practices that can safeguard FCS institutions.
- ***Board Governance.*** Because of fast-changing business conditions and the growing complexity of financial institutions, effective board governance is critical to the success of System institutions. Our examiners are focusing on board committees, governance assessments, and the committees of stockholders that nominate individuals for board positions.
- ***Standards of Conduct.*** Our examiners evaluate institutions' policies, processes, and disclosures to ensure the effectiveness of their programs on standards of conduct.

Condition of Farmer Mac

The Federal Agricultural Mortgage Corporation (Farmer Mac) remained safe and sound throughout 2013. On December 31, Farmer Mac's net worth was $574.5 million, compared with $593.0 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 $71.8 million for the year ended December 31, 2013, up from the $43.9 million reported at year-end 2012. Farmer Mac's asset quality also improved from 2012 to 2013.

Major Regulatory Actions

In June 2013, we issued a revised liquidity regulation requiring banks to maintain three levels of liquidity. It also requires each bank to maintain a supplemental liquidity buffer to provide a stable source of funding beyond the 90-day liquidity reserve. The rule helps ensure that Farm Credit banks keep enough liquidity to continue operating if their access to the capital markets is interrupted.

In addition, FCA staff worked throughout 2013 and into 2014 on extensive revisions to the agency's capital regulations. The proposed rule, which the Board adopted in May 2014, would modernize our capital requirements while ensuring that System institutions continue to hold enough regulatory capital to fulfill their mission. It would ensure that the System's capital requirements are appropriate for the System's cooperative structure and comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted.

Oversight of FCA

The FCA Office of Inspector General oversees FCA by conducting and supervising audits and investigations related to our programs and operations. As an agent of positive change, the FCA Office of Inspector General encourages integrity and promotes economy, efficiency, and effectiveness within FCA.

FCA's Commitment

American agriculture is critical to meeting the food demands of this nation and this world. And the Farm Credit System, which accounts for more than 40 percent of the nation's farm business debt, is a critical source of financing for America's farmers and ranchers. As the regulator of the FCS and Farmer Mac, we are committed to helping maintain this source for generations to come.

Sincerely,

Jill Long Thompson

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 is an independent agency in the Executive branch of the U.S. Government. We are responsible for regulating and supervising the Farm Credit System (its banks, associations, and related entities) and 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.

FCA 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. We do this in two specific ways:

- We ensure that System institutions, including Farmer Mac, operate safely and soundly and comply with applicable laws and regulations. Our 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. We examine 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, we use our supervisory and enforcement authorities to bring about appropriate corrective action.

- We issue 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. We also approve corporate charter changes, System debt issuances, and other financial and operational matters.

Our headquarters and one field office are in McLean, Virginia. We also have field offices in Bloomington, Minnesota; Dallas, Texas; Denver, Colorado; and Sacramento, California.

FCA does not receive a Federal appropriation. We maintain a revolving fund financed primarily by assessments from the institutions we regulate. Other sources of income for the revolving fund are interest earned on investments with the U.S. Treasury and reimbursements for services we provide to Federal agencies and others.

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 our Chief Executive Officer.

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.

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.

As head of FCA, Long Thompson also oversees the Agency's ethics program. Her goal is to ensure that the Agency adheres to the highest ethical standards in carrying out its mission as the arm's-length regulator of the Farm Credit System. For more information, see "Ethics and Arm's-Length Role" on the FCA website at www.fca.gov.

Long Thompson is also a strong advocate for diversity and inclusion. In 2012, the FCA Board adopted a diversity and inclusion regulation to encourage System institutions to reach out to all eligible, creditworthy producers in their lending territories, including members of underserved groups such as women and minorities. Under her leadership as Board Chair, the Agency has emphasized compliance with this rule.

In addition, during her term as Board Chair, the FCA Board issued a policy statement on its commitment to equal employment opportunity and diversity. Through leadership training programs and monthly presentations on a host of diversity-related issues, she has stressed the importance of diversity and inclusion among FCA staff.

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.

Long Thompson has been dedicated to integrity in Government for many years. As a member of the U.S. House of Representatives, 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 three agencies comprising 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 non-profit 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.

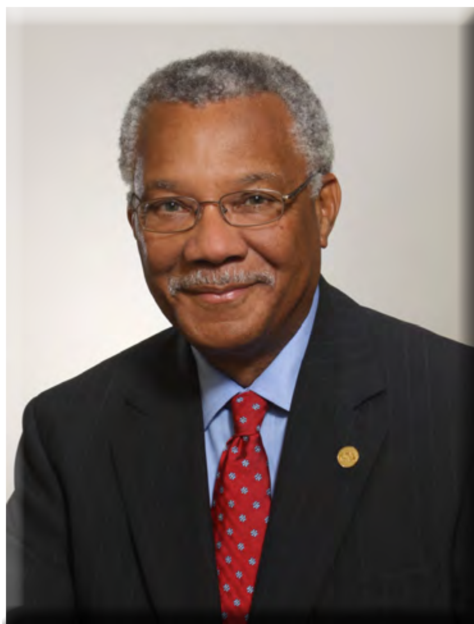
Long Thompson also has many years of experience as an educator, having taught at Indiana University, Valparaiso University, and Manchester College. She is also a former fellow at the Institute of Politics at Harvard University's John F. Kennedy School of Government. She holds an M.B.A. and Ph.D. in Business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

Although Long Thompson's FCA Board term expired on May 21, 2014, she continues to serve as Board Chair and CEO until the President appoints a new Board Chair and CEO. She may continue to serve as a member of the Board until a new member is appointed by the President and confirmed by the Senate.

Kenneth A. Spearman

Board Member



Kenneth A. Spearman was appointed to the FCA Board by President Barack Obama on October 12, 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 Farm Credit System 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 35 years he has been active in the agriculture industry. He served for more than 25 years on the board of 1st Farm Credit Services, a Farm Credit System institution in Illinois, holding various positions, including chairman. During the agriculture crisis of the 1980s, he was selected to serve on the Restructuring Task Force of the Sixth Farm Credit District.

From 2000 to 2006, he served on the Federal Reserve Bank of Chicago Advisory Council on Agriculture, Labor, and Small Business. 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 the Farm Credit System 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 has attended the Harvard Kennedy School Executive Leadership program and the Harvard Business School Agribusiness Seminar.

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 fourth-generation family farm in Illinois that produces corn and soybeans. He and his wife, Twyla, have three children and two grandchildren.

Farm Credit System—Role, Structure, and Safety and Soundness

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, 2014, the System was composed of 82 banks and associations. The following four banks provide loans to 76 Agricultural Credit Association (ACA) parent organizations and 2 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 26 ACAs and 1 FLCA.

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 97 percent of all direct-lender associations as of January 1, 2014.

The ACA and its two subsidiaries operate with a common board of directors and staff, and each of the three entities is responsible for the debts of the others. For most regulatory and examination purposes, FCA treats the ACA and its subsidiaries as a single entity; however, when appropriate, we may choose to treat the parent and subsidiaries as separate entities.

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.

The ACA's parent-subsidiary structure enables the ACA to preserve the tax-exempt status of the FLCA. This structure offers several other benefits as well. It allows the ACA to build and use capital more efficiently, and it enables members to hold stock in only the ACA but to borrow either from the ACA or from one or both of its subsidiaries. This gives the ACA and its subsidiaries greater flexibility in serving their customers, and it 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 16 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; five associations affiliated with CoBank; one association affiliated with AgriBank, FCB; and two System-related entities. It is owned by CoBank, ACB, and the six 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 45 participating organizations, including AgriBank, FCB, and its affiliated associations; associations affiliated with CoBank, ACB; and AgVantis.

Farmer Mac

The Federal Agricultural Mortgage Corporation (Farmer Mac), which is also recognized by law as an FCS institution, 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 all agricultural and rural lenders, including insurance companies, credit unions, and FCS lending institutions.

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.

The Farm Credit Act established Farmer Mac as a federally chartered instrumentality and an institution of the FCS. However, it has no liability for the debt of any other System institution, and the other System institutions have no liability for Farmer Mac debt.

Farmer Mac is owned by its investors—it is not a member-owned cooperative. Investors in voting stock may include commercial banks, insurance companies, other financial organizations, and FCS institutions. Any investor may own nonvoting stock.

FCA regulates and examines Farmer Mac through its Office of Secondary Market Oversight, whose director reports to the FCA Board on matters of policy.

Although Farmer Mac is an FCS institution under the Farm Credit Act, we discuss Farmer Mac separately from the other entities of the FCS. Therefore, throughout this report, unless Farmer Mac is explicitly mentioned, the Farm Credit System refers only to the banks and associations of the System. For more information about Farmer Mac, see "Condition of Farmer Mac" on page 43.

The Safety and Soundness of the FCS

FCA regulates the FCS—its lending institutions, the Funding Corporation, the service corporations, and Farmer Mac. Our regulatory activities and examinations 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, 2013, was $3.5 billion. For more information about FCSIC, go to www.fcsic.gov. Also see FCSIC's 2013 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.

FCS Banks and Associations

Financial Condition

The overall condition and performance of the FCS[5] was strong in 2013, and the System remained safe and sound. For 2013, the System reported increased earnings, higher levels of capital, and strong portfolio credit quality. The System continued to have reliable access to capital markets; demand was strong for all Systemwide debt security products. See tables 1 and 2 for a breakdown of the System's major financial indicators.

While the overall FCS remained financially sound, a small number of individual System institutions exhibited weaknesses. As the System's regulator, we addressed these weaknesses by increasing our supervision of these institutions. For more information on measures we took to address these weaknesses, see "Maintaining a Dependable Source of Credit for Farmers and Ranchers" on pages 39 to 42 of this report. For more information on the condition of the System, see the 2013 Annual Information Statement of the Farm Credit System on the website of the Federal Farm Credit Banks Funding Corporation at www.farmcreditfunding.com.

The System faced a generally favorable but volatile operating environment in 2013. Agricultural exports hit a record high in 2013 because of strong demand from developing economies, especially China. Grain prices fell significantly, especially in the second half of 2013 when favorable weather and large plantings led to record corn and near-record soybean production. Although it delayed planting, a wet spring helped ease the severe drought that has affected much of the upper Midwest and Great Plains since the latter part of 2012. However, dry conditions linger in California and the Southwest.

Because of high feed costs, livestock and dairy producers remained under considerable financial stress throughout early 2013 despite strong product pricing. Profitability for these sectors improved significantly in the latter part of 2013 as the decline in grain prices accelerated. The sharp drop in commodity prices has also had a cooling effect on the farmland market, with land prices across much of the Midwest leveling off in the fourth quarter.

Crop and livestock disease also affected certain farm sectors in 2013. The citrus industry remains under considerable stress because of a bacterial infection of citrus trees known as "citrus greening." Stress also increased for the hog industry because of the spread of porcine epidemic diarrhea virus.

For a detailed discussion of potential risks facing the System in 2014 and beyond, see "Challenges Facing the Agricultural Economy and the Farm Credit System" on pages 49 to 59.

5. Throughout this chapter, when referring to the Farm Credit System, we mean only the banks and direct-lending associations of the System, excluding Farmer Mac. The analyses in this section are based on data that System institutions provided to FCA or to the Federal Farm Credit Banks Funding Corporation. These analyses are based on publicly available information and, except where noted, are based on the 12-month period ended December 31, 2013. They 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-13	31-Dec-12	31-Dec-11	31-Dec-10	31-Dec-09
Farm Credit System Banks[a]					
Total Assets	230,427,442	219,043,177	205,087,928	207,098,256	194,497,747
Gross Loan Volume	179,260,572	173,227,170	158,420,741	161,069,141	152,412,187
Nonaccrual Loans	275,228	365,478	384,795	477,341	759,134
Cash and Marketable Investments	49,241,806	43,618,788	44,047,407	43,289,148	39,305,172
Net Income	2,057,199	2,011,314	1,860,347	1,917,143	1,442,328
Nonperforming Loans/Total Loans[b]	0.18%	0.23%	0.27%	0.33%	0.52%
Capital/Assets[c]	6.58%	6.51%	6.49%	6.00%	5.59%
Unallocated Retained Earnings/Assets	3.39%	3.23%	3.25%	3.03%	2.80%
Return on Assets	0.91%	0.94%	0.92%	0.95%	0.74%
Return on Equity	13.31%	13.86%	13.68%	15.00%	13.13%
Net Interest Margin[d]	1.15%	1.25%	1.28%	1.22%	1.17%
Operating Expense Ratio[e]	0.32%	0.31%	0.31%	0.30%	0.33%
Efficiency Ratio[f]	22.20%	20.00%	20.14%	18.24%	20.49%
Payout Ratio[g]	54.61%	47.79%	53.76%	50.43%	56.31%
Associations					
Total Assets	157,131,836	148,778,120	136,717,742	134,048,892	128,291,508
Gross Loan Volume	146,917,046	138,314,966	126,187,799	124,140,035	118,575,715
Nonaccrual Loans	1,456,381	1,932,706	2,353,352	2,744,528	2,634,046
Net Income	3,308,036	2,989,912	3,007,154	2,408,449	1,585,984
Nonperforming Loans/Gross Loans[b]	1.17%	1.59%	2.03%	2.29%	2.33%
Capital/Assets[c]	18.50%	17.80%	17.84%	16.54%	15.82%
Unallocated Retained Earnings/Assets	17.27%	16.65%	16.78%	15.07%	14.56%
Return on Assets	2.14%	2.06%	2.24%	1.84%	1.29%
Return on Equity	11.34%	11.23%	12.42%	10.88%	8.13%
Net Interest Margin[d]	2.80%	2.83%	2.94%	2.79%	2.64%
Operating Expense Ratio[e]	1.48%	1.45%	1.43%	1.38%	1.49%
Efficiency Ratio[f]	37.14%	39.13%	31.27%	35.12%	39.05%
Payout Ratio[g]	25.42%	25.82%	22.57%	22.62%	21.51%
Total Farm Credit System[h]					
Gross Loan Volume	201,060,000	191,904,000	174,664,000	175,351,000	164,830,000
Bonds and Notes	210,704,000	200,365,000	186,889,000	189,575,000	178,358,000
Nonperforming Loans	2,040,000	2,608,000	2,997,000	3,386,000	3,535,000
Nonaccrual Loans	1,736,000	2,300,000	2,738,000	3,229,000	3,369,000
Net Income	4,640,000	4,118,000	3,940,000	3,495,000	2,850,000
Nonperforming Loans/Gross Loans[b]	1.01%	1.36%	1.72%	1.93%	2.14%
Capital/Assets[c]	16.34%	15.65%	15.60%	14.46%	13.90%
Surplus/Assets	13.44%	12.94%	12.90%	11.80%	11.48%
Return on Assets	1.84%	1.73%	1.71%	1.59%	1.32%
Return on Equity	11.28%	10.89%	11.17%	10.85%	9.86%
Net Interest Margin[d]	2.78%	2.87%	2.86%	2.82%	2.65%

Sources: FCA's Consolidated Reporting System as of December 31, 2013, and the Farm Credit System Quarterly Information Statement provided by the Federal Farm Credit Banks Funding Corporation.

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

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) and 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.
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. This ratio is only valid at year-end (December 31).
h. Cannot be derived by adding the categories above because of intradistrict and intra-System eliminations used in Reports to Investors.

Table 2

Farm Credit System Major Financial Indicators, by District

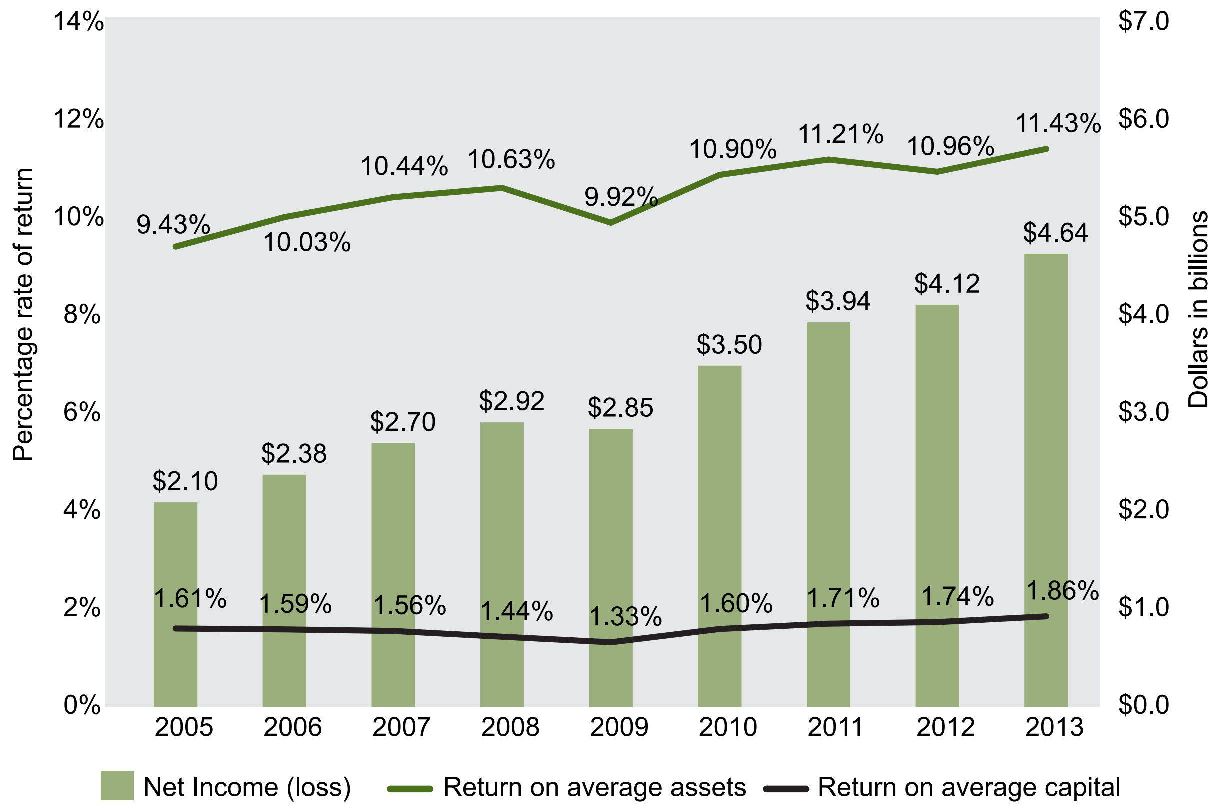
As of December 31, 2013
Dollars in Thousands

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	28,844,342	20,201,234	59,594	22,908	8,348,307	470,801	1,578,403	2,146,747	0.53%
AgriBank	87,725,991	73,677,222	39,653	10,100	13,549,274	2,359,843	2,552,005	4,921,318	0.15%
CoBank	97,644,392	73,603,375	147,849	447,126	23,077,161	3,639,235	3,103,926	6,704,616	0.39%
Texas	16,212,717	11,778,741	28,132	13,660	4,267,064	820,543	605,817	1,393,247	0.63%
Total	230,427,442	179,260,572	275,228	493,794	49,241,806	7,290,422	7,840,151	15,165,928	0.32%
Associations									
AgFirst	18,276,193	17,085,676	348,481	164,527	275,091	221,144	3,423,870	3,624,979	2.16%
AgriBank	80,860,611	74,845,181	586,751	226,214	2,138,393	338,165	13,771,455	14,109,620	1.34%
CoBank	44,250,611	41,727,316	387,753	292,618	418,374	1,152,532	7,767,788	8,866,981	1.45%
Texas	13,744,421	13,258,873	133,396	60,507	65,862	80,694	2,387,250	2,470,194	1.50%
Total	157,131,836	146,917,046	1,456,381	743,866	2,897,720	1,792,535	27,350,363	29,071,774	1.48%
Total Farm Credit System[f]	**260,782,000**	**201,060,000**	**1,736,000**	**1,238,000**	**51,893,000**	**1,645,000**	**35,060,000**	**42,601,000**	

Sources: Farm Credit System Call Report as of December 31, 2013, 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 $3.496 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.

Figure 1
FCS Net Income, 2005–2013
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.

Earnings

In 2013, the System posted strong net income of $4.64 billion, up 12.7 percent from 2012 (See figure 1). System earnings increased primarily because of lower provisions for loan losses and, to a lesser extent, higher net interest income. The System recognized a loan loss reversal of $31 million in 2013 as compared with a loan loss provision of $313 million in 2012. The loan loss reversal in 2013 reflected the continued improvement in portfolio credit quality at certain System institutions.

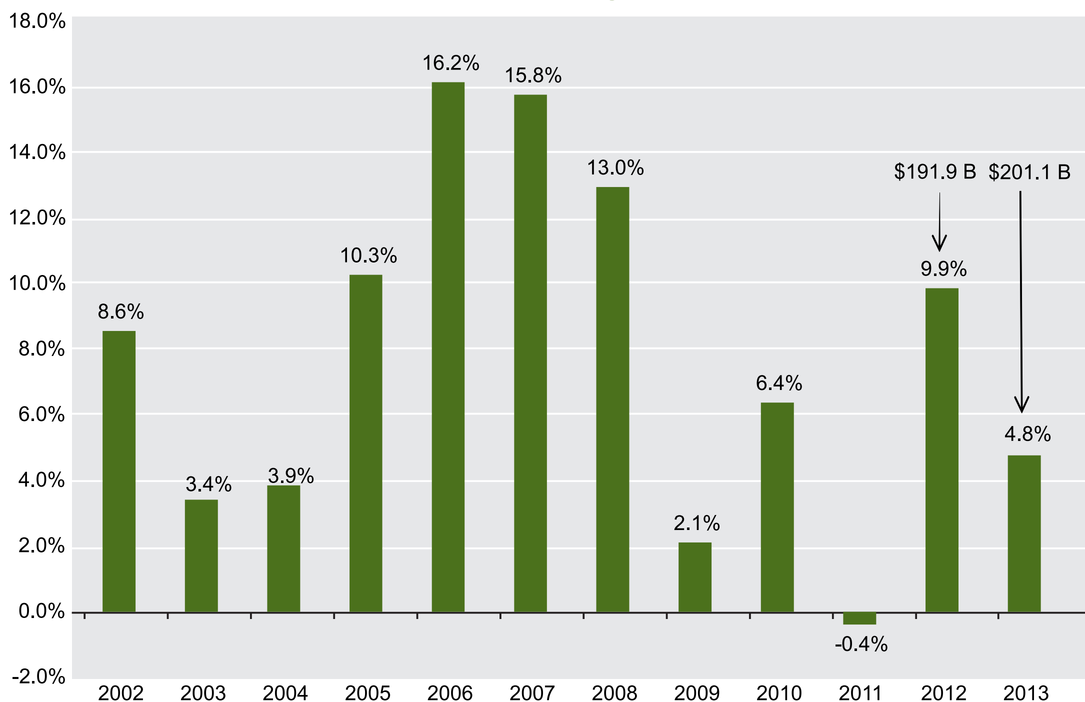
Net interest income was up by $197 million in 2013, primarily because of an increase in average earning assets. Driven largely by increased loan volume, average earning assets grew by $14.19 billion or 6.3 percent to $240 billion in 2013. Net interest margin decreased nine basis points to 2.78 percent. The System's return on average assets increased to 1.86 percent from 1.74 percent the prior year. The return on average capital increased to 11.43 percent from 10.96 percent in 2012.

As cooperative institutions, FCS banks and associations typically pass a portion of their earnings on to their borrower-owners as patronage distributions. For 2013, System institutions declared a total of $1.449 billion in patronage distributions—$937 million in cash, $457 million in allocated retained earnings, and $55 million in stock. This represents 31 percent of the System's net income for 2013 as compared with 30 percent in 2012. Also in 2013, the System distributed $163 million in cash from patronage allocations of earlier years.

System Growth

In total, System assets grew to $260.8 billion, up $14.1 billion or 5.7 percent from 2012. Loan growth was modest in 2013, with gross loan volume up by 4.8 percent (see figure 2).

Figure 2
Annual Growth Rate of FCS Loans Outstanding, 2002 to 2013



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

Gains in real estate mortgage lending and, to a lesser extent, production and intermediate-term lending primarily accounted for the increase. Real estate mortgage loans were up $5.93 billion or 6.7 percent mainly because of continued demand for cropland, especially in the Midwest. Production and intermediate-term lending increased $1.55 billion or 3.5 percent largely because of seasonal financing needs and increases in equipment financing. Lending to processing and marketing operations and to rural utilities was also up, increasing $1.25 billion and $913 million, respectively.

Asset Quality

In general, the credit quality of System loans was strong in 2013. High feed costs challenged livestock, poultry, ethanol, and dairy producers through the first half of 2013, but profit margins improved significantly for these sectors in the latter half of the year when record corn and near-record soybean production caused a substantial drop in grain prices. Because of the sluggishness of the U.S. economic recovery, stress continued to affect certain agricultural sectors, such as the forestry and nursery industries, throughout 2013.

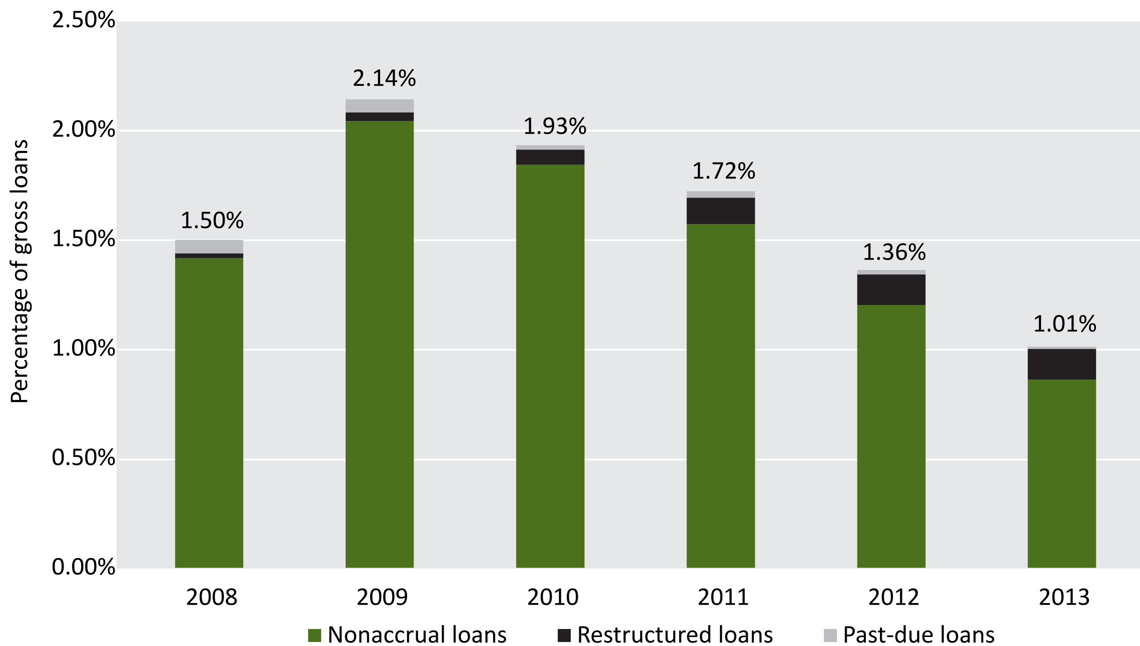
As of December 31, 2013, nonperforming loans totaled $2.0 billion, or 1.01 percent of gross loans, down from $2.6 billion or 1.36 percent of gross loans, at year-end 2012 (see figure 3). Loan delinquencies (that is, accruing loans that are 30 days or more past due) remained a low 0.23 percent of total accruing loans, declining from 0.28 percent at year-end 2012.

The allowance for loan losses equaled $1.24 billion or 0.62 percent of loans outstanding at year-end 2013, compared with $1.34 billion or 0.70 percent of loans outstanding at year-end 2012. For 2013, the System recognized a loan loss reversal of $31 million, reflecting the continued improvement in credit quality in the System's loan portfolio. Provisions for loan losses totaled $313 million in 2012 and $430 million in 2011. Net charge-offs were also down significantly in 2013, dropping to $62 million from $236 million in 2012.

Funding

During 2013, the System continued to have reliable access to the debt capital markets. Investor demand for all System debt products was favorable, allowing the System to refinance outstanding debt at favorable inter-

Figure 3
FCS Nonperforming Loans, 2008–2013
As of December 31



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

est rates. In 2013, Systemwide debt increased by 4.8 percent. Securities due within a year increased by 8.3 percent while securities with maturities greater than one year increased by 3.1 percent.

The System's funding composition also changed slightly. Securities due within a year accounted for 33.8 percent of total Systemwide debt compared with 32.7 percent a year ago. (See "Funding Activity in 2013" on page 35 for further discussion of the System's funding environment.)

Liquidity

Each System bank maintains a liquidity reserve to ensure that it can withstand market disruptions. As of December 31, 2013, the System's liquidity position equaled 194 days, up from 185 days at year-end 2012 and significantly above the 90-day regulatory minimum.

Investments available for sale (based on fair value) increased 4.3 percent to $43.6 billion in 2013, with a weighted average yield of 1.3 percent. Investments held to maturity decreased to $2.8 billion, with a weighted average yield of 3.1 percent.

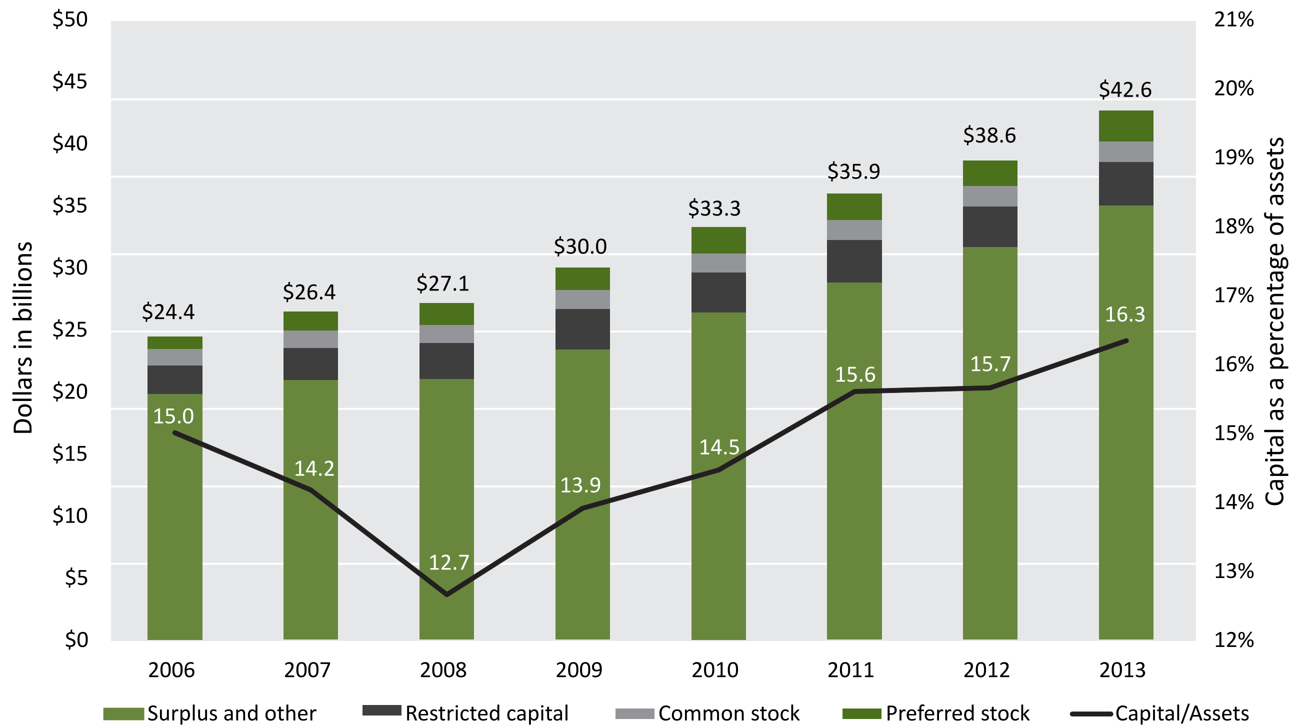
Each System bank may hold Federal funds and available-for-sale securities in an amount not to exceed 35 percent of its average loans outstanding for the quarter. If an investment no longer meets the eligibility criteria, it becomes ineligible for liquidity calculation purposes, but the bank may continue to hold the investment provided certain requirements are met.

At year-end, the FCS had 218 securities that no longer satisfied eligibility criteria because of rating downgrades after purchase. At fair value, these ineligible securities represented 3.4 percent of Federal funds and available-for-sale investments. For 2013, the System included $11 million in earnings of net other-than-temporarily impaired losses on investments.

Capital

The System maintained a strong capital position in 2013. Total capital was $42.6 billion at December 31, 2013, compared with $38.6 billion a year before. The most significant contributing factor to the increase in capital was net income earned and retained. At year-end 2013, the System's capital-to-assets ratio was 16.3 percent, compared with 15.7 percent in 2012.

Figure 4
FCS Capital, 2006–2013
As of December 31



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

As figure 4 shows, surplus accounts for the vast majority of capital. FCA regulations establish the mini-mum capital requirements that each System bank and association must achieve and maintain.

As of December 31, 2013, the permanent capital ratios for all System banks and associations were above the regulatory minimum of 7.0 percent. The ratios ranged between 16.7 percent and 22.9 percent for System banks and between 13.3 percent and 35.7 percent for System associations. In addition, as of December 31, 2013, the FCS had $3.5 billion of restricted capital in the Farm Credit Insurance Fund.

Borrowers Served

The System fulfills its overall mission by lending to agriculture and rural America. Its lending authorities include the following:

- Long-term agricultural real estate loans and rural home loans
- Short- and intermediate-term agricultural loans
- Loans to producers and harvesters of aquatic products
- Loans to certain farmer-owned agricultural processing facilities and farm-related businesses
- Loans to farmer-owned agricultural cooperatives
- Loans that finance agricultural exports and imports
- Loans to rural utilities
- Limited portions of loans to entities that qualify under the System's similar-entity authority[6]

Nationwide, the System had $201.1 billion in gross loans outstanding as of December 31, 2013 (see table 3). Agricultural producers represented by far the largest borrower group, with $139.6 billion, or 69.4 percent, of the total dollar amount of loans outstanding.[7] As of December 31, 2013, 46.8 percent of the dollar volume of the System's loans outstanding was in long-term real estate loans, 22.6 percent in short- and intermediate-term loans to agricultural producers, and 13.5 percent in agribusiness loans. Agribusiness loans are broken

6. A similar-entity borrower is not eligible to borrow directly from an FCS institution, but because the similar-entity borrower's operation has a similar function as that of an eligible borrower, the System can participate in these loans (the participation interest must be less than 50 percent).
7. This amount includes real estate mortgage loans and production (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, 2009–2013
As of December 31
Dollars in Millions

	2009	2010	2011	2012	2013	Percent change from 2009	Percent change from 2012
Production agriculture							
Long-term real estate mortgage loans	75,352	78,021	80,658	88,263	94,194	25.0	6.7
Short- and intermediate-term loans	39,610	40,584	41,276	43,861	45,412	14.6	3.5
Agribusiness loans[a]	23,626	29,581	24,734	27,090	27,242	15.3	0.6
Rural utility loans[b]	14,562	15,091	15,606	18,702	19,615	34.7	4.9
Rural residential loans	4,977	5,475	5,832	6,210	6,557	31.7	5.6
Agricultural export finance	3,956	4,036	3,834	4,674	4,588	16.0	-1.8
Lease receivables	2,160	2,021	2,139	2,415	2,706	25.3	12.0
Loans to other financing institutions	587	542	585	689	746	27.1	8.3
Total	**164,830**	**175,351**	**174,664**	**191,904**	**201,060**	**22.0**	**4.8**

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

a. At December 31, 2013, agribusiness loans consisted of $11.6 billion in loans to cooperatives, $12.7 billion in loans to processing and marketing operations, and $3.0 billion in loans to farm-related businesses.

b. At December 31, 2013, rural utility loans consisted of $15.5 billion in loans to energy and water/wastewater utilities and $4.1 billion in loans to communication utilities..

down further into 5.7 percent for loans to cooperatives, 6.3 percent for processing and marketing enterprises, and 1.5 percent for farm-related businesses.

Loans to finance rural utilities represented 9.8 percent of the System's loan volume, while rural residential loans made up 3.3 percent of the System's total loans. Agricultural export loans represented 2.3 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 nearly 1.1 million loans and 500,000 stockholders in 2013. 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 3.2 percent since year-end 2009.

Total loans outstanding at FCS banks and associations (net of intra-System

lending) increased by $9.2 billion, or 4.8 percent, during the year ended December 31, 2013. This compares with an increase of 9.9 percent in 2012, 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 2009, total System loans outstanding have increased by $36.2 billion, or 22 percent.

The increase in 2013 was driven by increases in real estate mortgage, production and intermediate-term, processing and marketing, and energy loans. Demand for real estate mortgage loans was the most important factor. Real estate mortgage loans increased $5.93 billion, or 6.7 percent, primarily because of the strong demand for cropland in the Midwest. Short- and intermediate-term production loans also increased, going up $1.55 billion, or 3.5 percent, mostly because of an increase in equipment financing.

Because of low grain inventory levels, lower commodity prices, and the strong cash positions of cooperatives and farmers, demand declined for seasonal financing from farm supply and grain marketing cooperatives. As a result, loans to agribusiness cooperatives (which mostly include farm supply and grain marketing businesses) decreased $1.21 billion or 9.5 percent. Processing and marketing loans increased $1.25 billion or 10.9 percent because of increased marketing efforts and higher participations with non-System institutions.

Rural utility loans increased by $913 million, or 4.9 percent, largely because of increased lending to electric power distribution and power generation cooperatives. Rural residential loans increased $347 million, or 5.6 percent. The other categories also posted substantial increases for the year; however, agricultural export loans fell 1.8 percent from 2012.[8]

System Funding for Other Lenders

Other Financing Institutions

Under the Farm Credit Act, System banks may further serve the credit needs of rural America by providing funding and discounting services to certain non-System lending institutions described in our regulations as "other financing institutions." OFIs include commercial banks, savings institutions, credit unions, trust companies, agricultural credit corporations, and other specified agricultural lenders that are significantly involved in lending to agricultural and aquatic producers and harvesters.

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

As of December 31, 2013, the System served 26 OFIs, unchanged from 2012, but down from 28 in 2010 and 2009. Outstanding loan volume to OFIs was $746 million at year-end, up $57 million from 2012. OFI loan volume continues to be less than half of one percent of the System's loan portfolio. About two-thirds of the OFIs are in the AgriBank district.

Syndications and Loan Participations 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 syndications and participations.

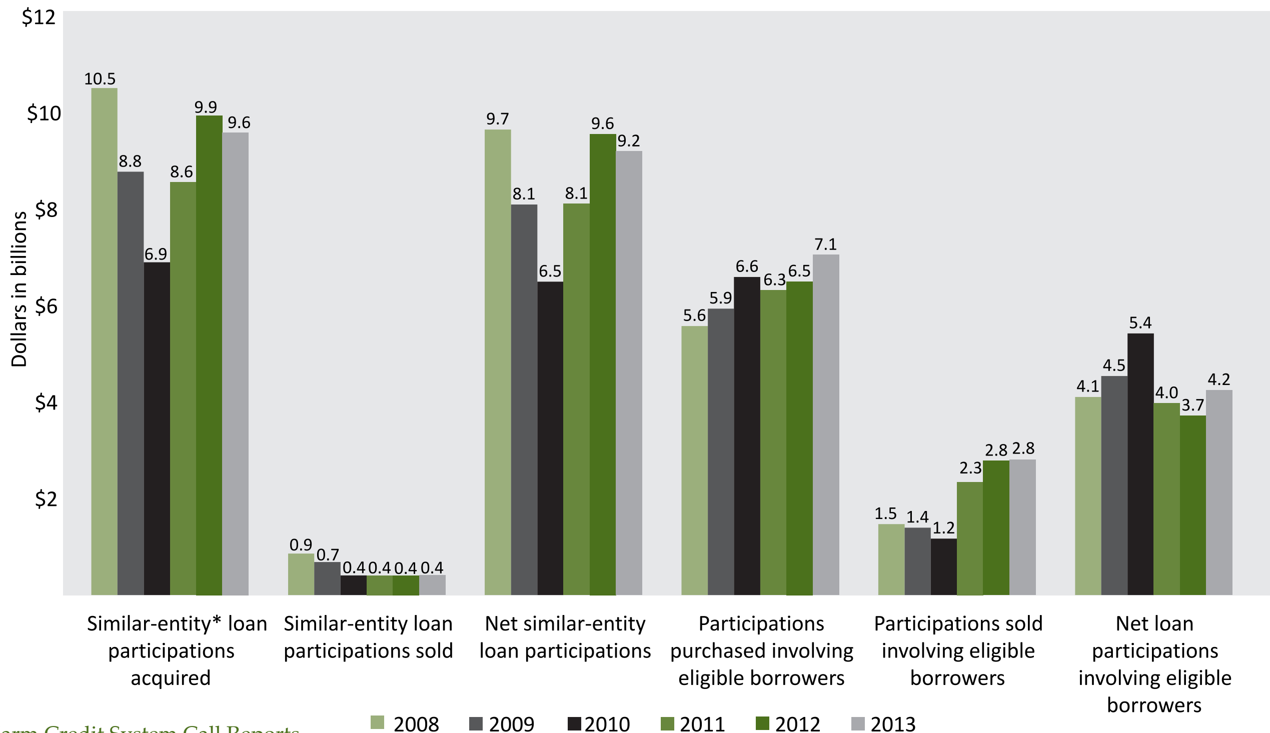
- A loan syndication (or "syndicated bank facility") is a large loan in which a group of financial institutions work together to provide funds for a borrower. Usually one financial institution takes the lead, acting as an agent for all syndicate members and serving as a liaison between them and the borrower. All syndicate members are known at the outset to the borrower.
- Loan participations are large loans in which two or more lenders share in providing loan funds

8. 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, 57 percent of the System's agricultural export finance transactions in 2013 carried a guarantee from the Commodity Credit Corporation.

Figure 5

Loan Participations with Non-System Lenders, 2008–2013

As of December 31



Sources: Farm Credit System Call Reports.

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

Note: In past reports, in addition to loan participations involving non-System lenders, this chart included other items as well. For this report, we are including only participations involving non-System lenders, and we have revised the totals for prior years accordingly.

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.

Financial institutions primarily use loan syndications and participations 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.

The System's gross loan syndication volume has grown by more than $3 billion during the past three years to $13.3 billion at year-end 2013. However, FCA's Call Report does not break out the portion that is associated with non-FCS 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. A similar-entity borrower is not eligible to borrow directly from an FCS institution, but because the borrower's operation is similar in function to that of an eligible borrower's operation, the System can participate in the borrower's loans (the participation interest must be less than 50 percent).

The System had $9.2 billion in net similar-entity loan participations as of December 31, 2013, down from $9.6 billion the prior year. As figure 5 indicates, the volume of similar-entity participations that System institutions sell to non-System institutions is relatively small, amounting to less than half a billion dollars over the past four years.

However, the volume of eligible-borrower loan participations purchased from non-System lenders has been rising; it grew from $5.6 billion in 2008 to $7.1 billion in 2013. The volume of eligible-borrower loan participations sold to non-System lenders has also grown in recent years, rising from $1.2 billion in 2010 to $2.8 billion in 2012 and 2013. Net eligible-borrower loan participations peaked in 2010 at $5.4 billion when sales of these participations were at a low point. At year-end 2013, the System had $4.2 billion in net loan participations involving eligible borrowers.

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 loans 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 2013, FCA approved investments by an additional three System associations, bringing the total number of institutions participating in AgDirect to 13.[9] AgDirect financing is now available in many states. As of December 31, 2013, the total outstanding participation interests in loans purchased was nearly $2.5 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, 2013, was $309 billion, up 3 percent from its $300 billion estimate for year-end 2012. Farm loan data reported by Farm Credit System and commercial banks show that their total farm loan portfolios grew during 2013 by 5.7 percent and 5.5 percent, respectively.[10] The farm real estate debt portfolios of FCS institutions rose more than their non-real estate loan portfolios in 2013, while these portfolios grew equally at commercial banks.

Lender-reported data also show that the demand for farm credit in 2013 was generally more robust in the Midwest but weakened somewhat in the latter half of the year. Lower prices for major crops in the latter half of 2013 curtailed what had been strong investments in equipment, farm structures, and farmland. During previous years, farmers have taken advantage of record-high farm incomes and low interest rates to invest heavily in these items.

On the supply side, lenders had ample funds to lend in 2013 because demand for credit remained below their capacity to lend. However, despite the competitive lending environment, credit underwriting practices were relatively conservative.

Even with the prospect for lower crop revenues and weaker farmland markets, demand for credit should be strong in 2014 because of higher livestock incomes, low interest rates, and an improving nonfarm economy. 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 2012. USDA's estimate of debt by lender shows that commercial banks held 39.6 percent of total farm business debt, just below the System's market share of 40.7 percent. FCS market share of total farm business debt has grown slightly more than commercial bank market shares 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 2012, the System held 46.1 percent of this debt, compared with 34.1 percent for commercial banks. Commercial banks have historically dominated non-real estate farm lending—the market share of commercial banks increased to 47.0 percent at the end of 2012. The System's share of non-real estate farm business debt increased to 33.4 percent at year-end 2012.

9. One association that was previously approved to participate in AgDirect (High Plains Farm Credit, FLCA) is no longer participating; as of January 1, 2014, this association had no share in the ownership of AgDirect.
10. USDA calculates market share for farm business debt only (i.e., debt that is used for farm production purposes).The estimate for 2013 will be revised in August 2014. 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 banks and direct-lending associations 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 to very large operations, from producers of grain staples for export to producers of organic foods for local markets.

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 increasing retirement ages for farmers.

According to the 2012 Census of Agriculture, less than 6 percent of all principal farm operators were under 35 years of age in 2012.[11] This percentage has remained relatively constant in recent years, with the latest Ag Census showing a slight increase in the numbers of young operators relative to the 2007 Ag Census. The Ag Census also reports on secondary and third operators involved in the farming operation. When these operators are included, 8 percent of farm operators were under the age of 35 in 2012.

Young farmers are somewhat less likely than all farmers to operate small farms—that is, farms with less than $250,000 in gross sales. The Ag Census indicates that 86 percent of principal farm operators that are young farmers operated a small farm in 2012.

Beginning

The 2012 Census of Agriculture shows that approximately 18 percent of all farms had principal operators who are beginning farmers—those who operated a farm for less than 10 years. The Census also shows that second and third operators in the farming operation have less farming experience than the primary operator. Nearly 27 percent of second operators and 41 percent of third operators had less than 10 years of experience operating a farm.

Many beginning farmers operate small farms, but not all are young farmers. The vast majority of beginning farmers—95 percent—operated small farms in 2012. While 20 percent of young farmers are also beginning farmers, over 12 percent of farmers 65 or older were also beginning farmers in 2012.

Small

Small farms—those with $250,000 or less in farm sales—represent 88 percent of all farms in the 2012 Census of Agriculture. Small farm numbers declined from 2007 when they represented more than 90 percent of U.S. farms. Because of their great diversity, the 1.9 million small farms in the United States are difficult to characterize.

More than 75 percent of farms have sales of less than $50,000. These very small farms typically have negative farm incomes and small amounts of farm debts, and they account for just 3 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.

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

11. FCA's definitions of a young farmer and a beginning farmer differ slightly from the Ag Census measures. See the note below table 4B.

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 and agriculture 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 31.)

FCA regulations require each System lender's YBS program to 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 continuously consider ways to support and strengthen the System's YBS programs.

Comparing the System's YBS Lending in 2013 with YBS Lending in 2012[12]

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. Relative to 2012, the dollar volume of new loans made to each of the three YBS categories declined in 2013. This contrasts to loan numbers, which increased modestly in the young and beginning categories but declined slightly in the small category.[13]

New dollar volume lending to small farmers decreased the most during 2013, with a 13.3 percent decrease from 2012 in the dollar volume of new loans made. The dollar volume of new loans made to beginning farmers declined 4.2 percent from 2012, while the dollar volume of new loans made to young farmers fell 6 percent. The number of new loans to beginning farmers rose 5.0 percent and the number to young farmers rose 2.3 percent in 2013. The average size of loans made in 2013 fell for all three YBS categories.

The number and dollar volume of loans outstanding increased from 2012 in all three YBS categories because of a decline in repayments. The dollar volume of loans outstanding increased by 3.5 percent to beginning farmers, 3.0 percent to young farmers, and 1.8 percent to small farmers. Similar increases also occurred in the number of loans outstanding for each YBS category.

Comparing the System's YBS Lending with Overall Lending

In 2013, lending to the three YBS categories generally did not keep pace with overall System lending to farmers. Therefore, the share of total System farm loans going to the YBS categories fell from that of 2012. The only exception to this trend was a slight increase in the share of new loans made that went to beginning farmers.

12. The loan number and dollar volume data for 2012 were revised slightly after FCA's 2012 Annual Report on the Farm Credit System was issued last year.
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.

Table 4A

YBS Loans Outstanding

As of December 31, 2013

	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	**175,583**	**17.8**	**$23,788**	**11.2**	**$135,478**
Beginning farmers/ranchers	**253,272**	**25.7**	**$36,968**	**17.3**	**$145,960**
Small farmers/ranchers	**484,745**	**49.3**	**$44,894**	**21.1**	**$92,613**

Table 4B

YBS Loans Made During 2013

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	**57,854**	**16.3**	**$8,294**	**11.0**	**$143,360**
Beginning farmers/ranchers	**72,662**	**20.5**	**$10,989**	**14.6**	**$151,228**
Small farmers/ranchers	**142,357**	**40.1**	**$11,433**	**15.2**	**$80,310**

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.

In 2013, the volume of all System farm loans made (including commitments) during the year was $75.2 billion, down 0.4 percent from that of 2012, and the volume of outstanding farm loans (including commitments) at year-end was $213.2 billion, up 5.6 percent from that of 2012. The total number of farm loans made in 2013 (354,996) was up 3.3 percent from 2012, while the number of outstanding loans (984,076) at the end of 2013 was 4.4 percent higher than at the end of 2012.

In the section below on YBS borrowing trends, 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 2013.

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 2013, the System made 57,854 loans to young farmers—that is, to those who are 35 years old or younger—amounting to $8.3 billion. During 2012, the System made 56,568 loans to young borrowers, totaling $8.8 billion. The loans made to young borrowers in 2013 represented 16.3 percent of all farm loans the System made during the year and 11.0 percent of the dollar volume of loans made. The average size of loans made to young farmers in 2013 decreased to $143,360 from $155,955 in 2012. At the end of 2013, the System had $23.8 billion in outstanding loans to young farmers as compared with $23.1 billion at the end of 2012.

Beginning—The System made 72,662 loans to beginning farmers—that is, to those who have been farming for 10 years or less—amounting to $11.0 billion in 2013. During 2012, the System made 69,213 loans, totaling $11.5 billion, to beginning borrowers. The loans made to beginning farmers in 2013 represented 20.5 percent of all farm loans made during the year and 14.6 percent of the dollar volume of loans made. The average size of loans made decreased to $151,228 in 2013 from $165,655 in 2012. At the end of 2013, the System had $37.0 billion in outstanding loans to beginning farmers as compared with $35.7 billion at the end of 2012.

Small—FCS institutions made 142,357 loans, totaling $11.4 billion, to small farmers (those with gross annual sales of less than $250,000) in 2013. By comparison, the System made 143,039 loans, totaling $13.2 billion, to small farmers in 2012. The loans made in 2013 to farmers in this category represented 40.1 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 fell to $80,310 from $92,147 in 2012. At the end of 2013, the System had $44.9 billion in outstanding loans to small farmers as compared with $44.1 billion at the end of 2012.

The YBS information is reported separately for each of the three YBS borrower categories because the YBS mission is focused on each borrower group separately. Also, loans cannot be added across categories because some loans belong in more than one category. If, for example, a borrower is less than 35 years old, sells less than $250,000 in farm products per year, and has farmed for less than 10 years, the borrower's loan would be included in each category. Therefore, adding the categories together would produce a misleading measurement of the System's YBS lending involvement.

YBS Borrowing Trends, 2001–2013

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.

Figures 6A, 6B, and 6C

Loans Made to, and Loans Outstanding for, YBS Farmers and Ranchers, 2001–2013

As of December 31

Figure 6A

Young Farmers and Ranchers

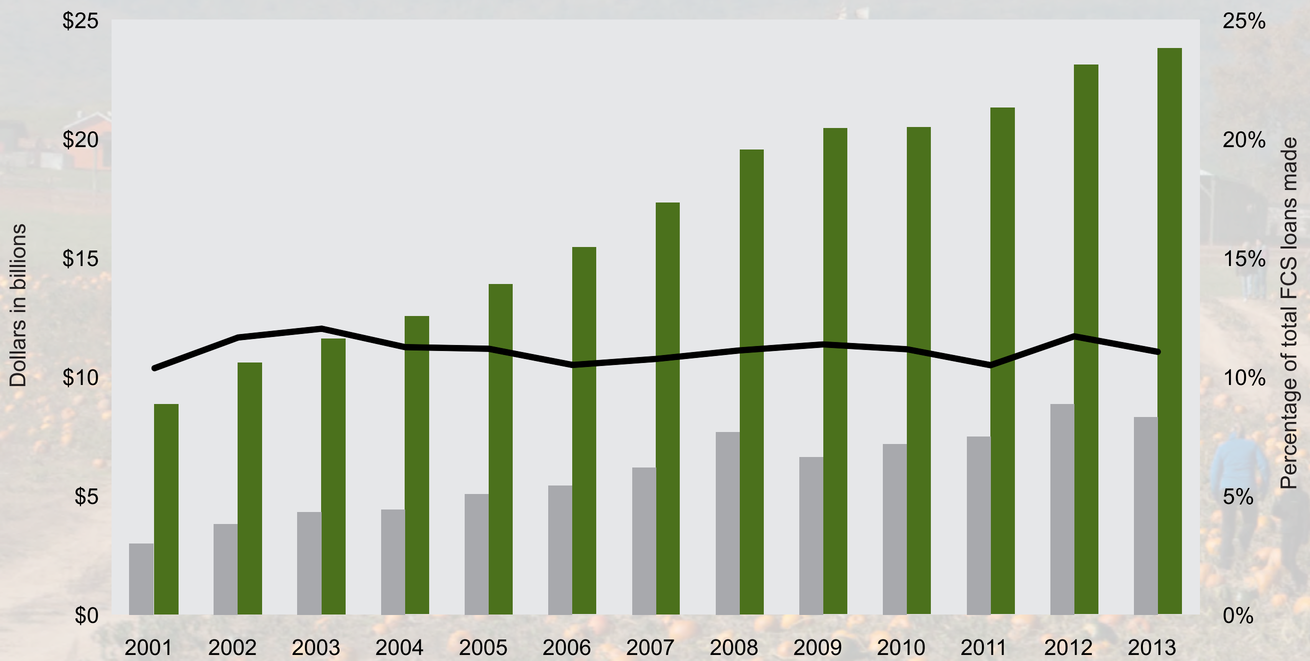


Figure 6B
Beginning Farmers and Ranchers

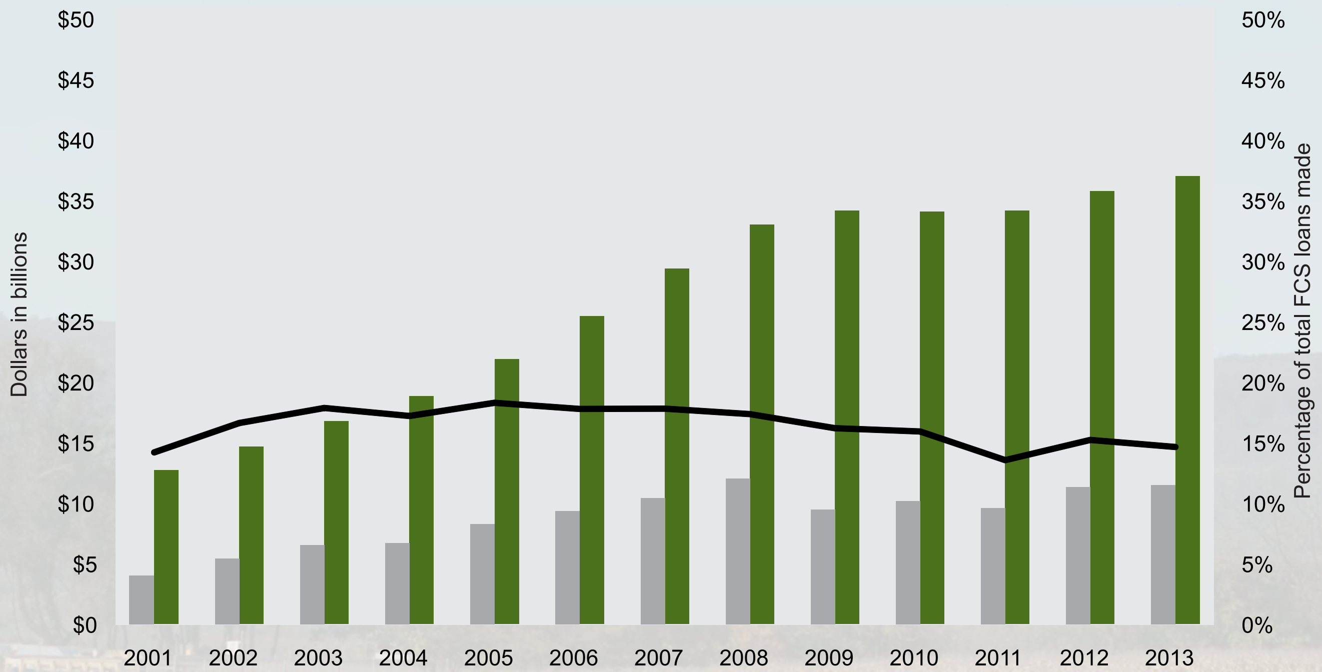
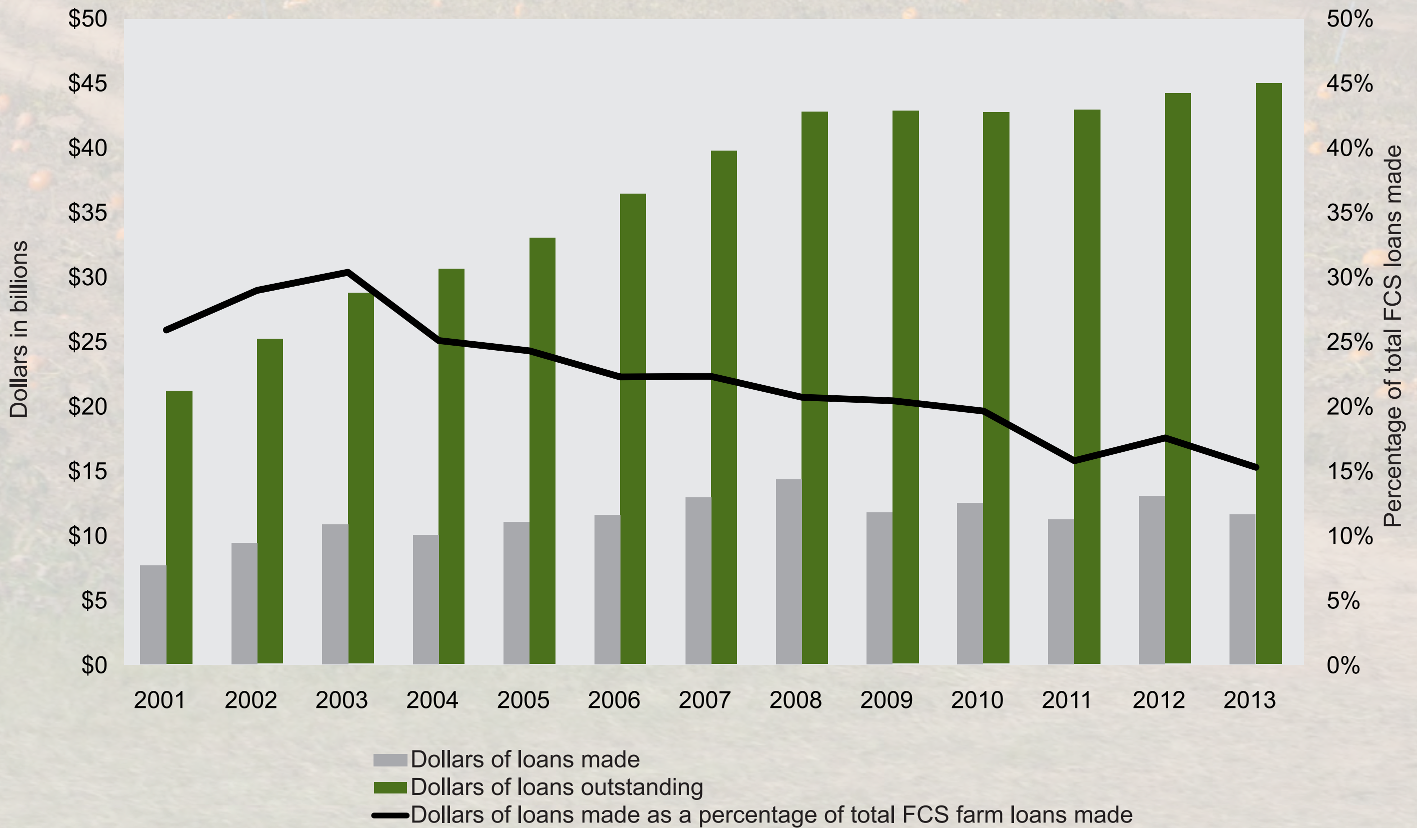


Figure 6C
Small Farmers and Ranchers



In 2013, the volume of new loans to each YBS category declined as did the volume of all new System farm loans. However, because of slower repayment rates, the dollar volume of loans outstanding in each YBS category, which had been relatively flat prior to 2012, once again increased in 2013.

Figures 6A, 6B, and 6C also show that the percentage of total new farm loan volume going to all YBS categories continued to decline in 2013. In the past year the share of total dollar value of farm lending going to beginning farmers fell to 14.6 percent, the share to small farmers fell to 15.2 percent, and the share to young farmers fell to 11.0 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 2013, gross cash farm income rose from $280 billion to an estimated $445 billion—a 59 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. Citing a 41 percent increase in farm commodity prices from 1995 (when the $250,000 threshold was defined) to 2010, the USDA's Economic Research Service raised its definition of a small farm in 2013 to a threshold of $350,000 in gross cash farm income.

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. Outstanding volumes and loan numbers are more stable from one year to the next, especially for larger institutions.

While the share of total outstanding System farm loans made to young farmers was 17.8 percent, this share ranged from 5 percent to more than 25 percent at individual associations. The ranges in the share of total outstanding loans to beginning farmers were even greater. Whereas 25.7 percent of the System's total farm loans outstanding were to beginning farmers in 2013, this share ranged across associations from as little as 13 percent to as much as 65 percent.

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.

The ranges for the small farmer category are greater still. In 2013, 49.3 percent of the System's total farm loans outstanding went to small farmers, but the percentage for individual associations ranged from less than 13 percent to more than 87 percent. For this YBS category, almost 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 generally declined during 2013 for the System as a whole, many associations did experience gains in the share of their total farm lending to YBS groups. The share of total new loans made in 2013 to beginning farmers rose in 58 percent of the associations, while the share to young farmers and small farmers rose in 52 percent and 45 percent of the associations, respectively.

The share of total dollar volume made in 2013 to YBS farmers showed a similar pattern. Here, just under half of the associations had positive gains in the share of total dollar volume loaned to beginning and small farmers, and over a third had positive gains in the share going to small.

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 and cultivated YBS programs to provide this assistance. Using such programs, System 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 via their YBS programs to help these borrowers be successful.

In 2013, System institutions used the following methods to help them make loans to young, beginning, or small farmers.

- Interest rate concessions—offered to young and beginning farmers by 54 percent of associations, up from 48 percent in 2012
- Exceptions to underwriting standards—offered to young and beginning farmers by approximately 60 percent of associations, unchanged from 2012
- Concessionary loan fees—offered to beginning farmers by 37 percent of associations, up from 34 percent in 2012
- Loan covenants designed specifically for YBS borrowers—offered to young and beginning farmers by 17 percent of associations, unchanged from 2012

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, guarantees, or loan participations for YBS borrowers. By partnering with these Government programs, FCS institutions are able to better mitigate the credit risk to these borrowers. In 2013, 29 percent of System institutions used Government loan participations for loans to young and beginning borrowers, and 24 percent used these participations for loans to borrowers in the small category.

In 2013, System institutions continued to make use of guaranteed lending programs from Federal, State, and local sources for YBS lending. About two-thirds of associations indicated they had obtained loan guarantees for YBS loans made in 2013.

YBS Program Management

FCS institutions are using various approaches and sources of information to more effectively manage and assess their YBS programs. In 2013, around 41 percent of System associations used YBS advisory committees to provide input on YBS-related issues to their boards of directors.

Advisory committees were composed of a variety of stakeholders—both internal and external. In 2013, these stakeholders consisted of the following:

- Current YBS borrowers (35 percent)
- Potential YBS borrowers (17 percent)
- Association board members (21 percent)
- Government organizations (7 percent)
- Representatives from other ag-related groups and organizations (18 percent)

Approximately half of YBS advisory committees provided input to their institutions' board members annually, with the other half providing input more frequently.

In addition, in 2013, around one-third of all associations linked YBS performance criteria to the performance evaluations of management or lending staff.

Training, Outreach and Other Services

System institutions offer a myriad of opportunities to educate existing and potential YBS borrowers. System associations offer 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 training and, in some cases, provide funding to allow YBS borrowers to attend training.

Examples of training opportunities provided by System associations include the following:

- Next Generation Program
- AgLeadership Institute
- Emerging Entrepreneurs' Conference
- Ag Biz Planner
- Farm Credit College seminars
- Young Farmer and Rancher Executive Institute

In 2013, System associations continued to be actively involved in marketing to potential YBS borrowers. Many associations attended or helped sponsor local trade shows, fairs, and training workshops specifically targeting YBS borrowers.

Associations also continue to conduct outreach and marketing activities in partnership with State or national young farmer groups, colleges of agriculture, land grant extensions, 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, policy statements, and other guidance to ensure that the System, including its banks, associations, Farmer Mac, and other related entities, 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. With our regulations, we seek to meet two general objectives. The first is to enhance the System's relevance in the marketplace and in rural America while ensuring that System institutions comply with the law and with the principles of safety and soundness. The second is to promote participation by member-borrowers in the management, control, and ownership of their System institutions.

Regulatory Activity in 2013

The following paragraphs describe some of FCA's regulatory efforts in 2013, along with several projects that will remain active in 2014. 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

Advisory Vote—The FCA Board adopted an interim final rule in March 2014 to remove requirements for a nonbinding, advisory vote on compensation for an institution's chief executive officer or other senior officers. Adoption of this rule effectively nullified the petition from the Farm Credit System requesting FCA to repeal the advisory voting rule.

Standards of Conduct—The FCA Board approved a proposed rule in January 2014 that would modify the standards of conduct regulations to clarify the rules, strengthen responsibility and accountability, require System institutions to establish a Code of Ethics, and enhance the role of the Standards of Conduct Official.

Guidelines for Requesting Certificates of Good Standing, Authenticity, and Merger or Consolidation—We issued an Informational Memorandum in January 2014 to System institutions providing guidelines for requesting certificates. The document describes the types of certificates we issue and explains how to submit requests.

Unincorporated Business Entities—The FCA Board adopted a final rule in May 2013 that establishes a regulatory framework for the formation of unincorporated business entities organized under State law. In addition, we issued an Informational Memorandum in July 2013 to provide guidance to System institutions that invest in or organize unincorporated business entities to carry out authorized business functions, services or activities.

Compensation for 2014—We issued an Informational Memorandum in February 2014 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

Reports of Accounts and Exposures—The FCA Board approved a proposed rule in June 2013 and a final rule in December 2013 to establish a regulatory framework for reporting System accounts and exposures. We use these reports in examining institutions and evaluating risk.

Flood Insurance—The FCA Board approved a proposed rule in October 2013 to amend our regulations on flood insurance to conform to the Biggert-Waters Flood Insurance Reform Act of 2012.

Repeal of the Regulations Governing Registration of Mortgage Loan Originators—The FCA Board approved an interim final rule in August 2013 that repealed our regulations governing the registration of residential mortgage loan originators at System institutions.

Social Media: Consumer Compliance Risk Management Guidance—We issued an Informational Memorandum in April 2014 to provide guidance to System institutions on the applicability of Federal consumer protection and compliance laws, regulations, and policies to activities conducted via social media.

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. The Informational Memorandum also informed institutions that the private flood insurance and escrow provisions of the act would not be effective until regulations were issued.

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

Investments in Rural America, Conclusion of Pilot Investment Programs—The FCA Board adopted a resolution in November 2013 to withdraw the proposed rule on Rural Community Investments and to conclude the pilot investment programs on December 31, 2014. The proposed rule had been published in the Federal Register (73 FR 33931) on June 16, 2008.

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.

Capital Requirements—The FCA Board approved a proposed rule in May 2014 to modify the regulatory capital requirements for System banks and associations. The purpose of the rule is to modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as a Government-sponsored enterprise. The rule would ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but would also recognize the cooperative structure and the organization of the System.

Farmer Mac

Farmer Mac Capital Planning—The FCA Board approved a final rule to revise capital requirements to place more emphasis on the quality and level of Farmer Mac's capital base and to promote best practices for capital adequacy planning and stress testing.

Farmer Mac Liquidity Management—The FCA Board adopted a final rule in October 2013 to strengthen the management of liquidity risk at Farmer Mac, improve the quality of assets in its liquidity reserves, and bolster its ability to fund obligations and continue operations during market disruptions.

Farmer Mac Board Governance and Standards of Conduct—The FCA Board approved an advance notice of proposed rulemaking in February 2014 to solicit comments on possible regulatory changes related to board governance and standards of conduct at Farmer Mac. The notice asks for public input on a series of questions related to three topics: nomination of directors, fiduciary responsibilities, and risk governance.

Other

National Oversight and Examination Program for 2014—We issued an Informational Memorandum in August 2013 that summarized the National Oversight Plan for 2014. The plan detailed strategies for addressing critical risks and other areas of focus in the System.

Regulatory Burden, Notice of Intent—The FCA Board approved a notice of intent in July 2013 requesting public input and comments on regulations that may duplicate other requirements, are not effective in achieving stated objectives, are not based on law, or impose burdens that are greater than the benefits received.

Adjusting Civil Money Penalties for Inflation—The FCA Board adopted a final rule in April 2013 to adjust our civil money penalties as required by Federal law.

GAAP References and Conforming Amendments—The FCA Board adopted a direct final rule to amend our regulations by conforming certain references to U.S. generally accepted accounting principles to the Financial Accounting Standards Board Accounting Standards Codification.

Corporate Activity in 2013

In 2013 and early 2014, we analyzed and approved six corporate applications.

- On January 31, 2013, an ACA affiliated with AgriBank, FCB, changed its name. The names of its subsidiaries also changed.
- On January 1, 2014, two ACAs affiliated with CoBank, ACB, merged their operations following stockholder approval. The PCA and FLCA subsidiaries associated with the ACAs also merged.
- On January 1, 2014, four ACAs affiliated with the Farm Credit Bank of Texas, merged their operations into two continuing ACAs following stockholder approval. The PCA and FLCA subsidiaries associated with the ACAs also merged.
- On January 1, 2014, a FLCA and an ACA affiliated with CoBank, ACB, merged their operations following stockholder approval. In addition, the names of the continuing ACA and its subsidiaries were also changed.
- On January 1, 2014, an ACA affiliated with AgriBank, FCB, changed its name. The names of the subsidiaries also changed.

The total number of associations as of January 1, 2014, was 78 (76 ACAs and 2 FLCAs), compared with 82 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 2013

During 2013 the System had ready access to the debt capital markets. Investors were attracted by the System's status as a Government-sponsored enterprise, as well as its overall financial performance and strength.

Even as the Federal Reserve started to slowly taper its quantitative easing policy at the end of 2013, risk spreads and pricing on System debt securities remained favorable relative to corresponding U.S. Treasuries. Also, because of the substantial 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 continue to issue debt on a wide maturity spectrum at very competitive rates.

The System had $2.47 billion in outstanding perpetual preferred stock at the end of 2013, $412 million more than the previous year-end. It had $1.55 billion in outstanding subordinated debt at year-end 2013, unchanged from year-end 2012.

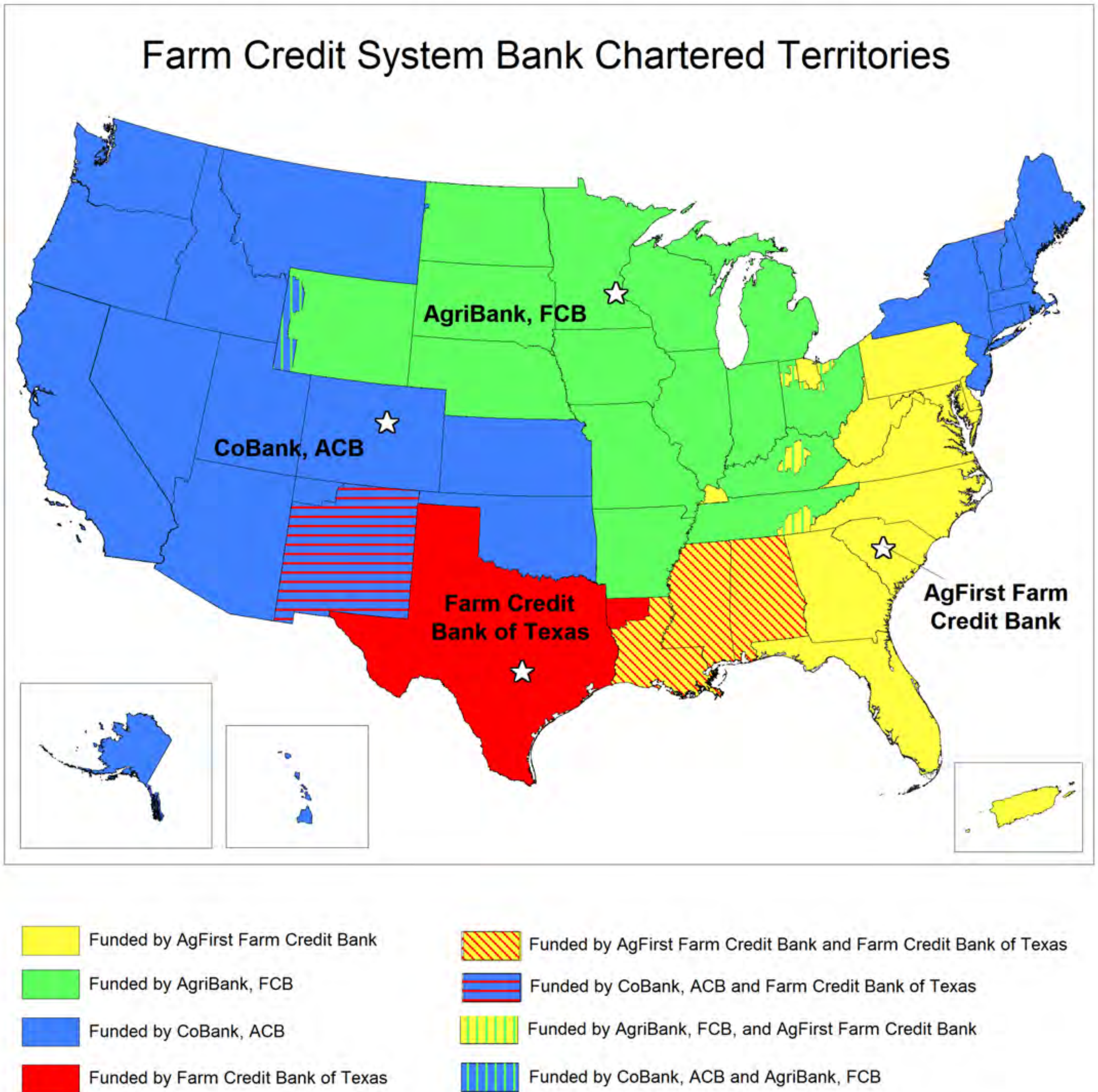
The System funds its loans with a combination of consolidated System-wide debt and capital. The Funding Corporation, the fiscal agent for the System banks, sells debt securities such as discount notes, bonds, and designated bonds on behalf of the System.[16] This process allows funds

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.

Figure 7

Chartered Territories of FCS Banks

As of January 1, 2014



Note: As of January 1, 2014, CoBank was funding 27 associations in the indicated areas and serving cooperatives nationwide; Farm Credit Bank of Texas was funding 15 associations; AgriBank, FCB, was funding 17 associations; and AgFirst Farm Credit Bank was funding 19 associations. The FCS contains a total of 82 banks and associations.

to flow from worldwide capital-market investors to agriculture and rural America, providing rural communities with efficient access to global resources. At year-end 2013, Systemwide debt outstanding was $206.6 billion, crossing the $200 billion mark for the first time and representing a 4.3 percent increase from the preceding year-end.[17]

Several factors contributed to the $8.6 billion increase in Systemwide debt outstanding. Gross loans increased $9.2 billion in 2013, while the System's combined investments, Federal funds, and cash balances increased by $5.0 billion during the year.

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, 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 2013, we approved $154.0 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 106.4 percent being the lowest for any single bank as of December 31, 2013.

In addition, in June of 2013, our amended liquidity regulation required the banks to maintain a minimum of three levels of liquidity:

- Level 1: Initial 15 days
- Level 2: Next 15 days
- Level 3: Subsequent 60 days

These three levels amount to 90 days of liquidity. Each bank also has a supplemental liquidity buffer tailored to its contingency funding plan. Together, the 90 days of liquidity and the supplemental liquidity buffer provide alternative funding sources if a bank's access to the capital markets is curtailed or interrupted.

All System banks have kept their respective days of liquidity above the required minimum levels, with the lowest at any single bank as of December 31, 2013, being 23 days of Level 1 assets, 28 days of Level 2 assets, 57 days of Level 3, and 128 days overall (including the supplemental liquidity buffer).

In addition to the protections provided by the joint and several liability provision, the Funding Corporation and the System banks have

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.

entered into the following voluntary agreements.

- First, the amended and restated Market Access Agreement establishes certain financial thresholds, and it provides the Funding Corporation with operational oversight and control over the System banks' participation in Systemwide debt obligations.[18]

- Second, 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 2013, 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 increased again after a slight pullback during 2012. For the 12 months ended December 31, 2013, the System issued $377 billion in debt securities, compared with $371 billion for 2012, $563 billion for 2011, $534 billion for 2010, and $523 billion for 2009. The System has continued to exercise call options on higher-cost debt because of the relatively steep slope of the yield curve. However, the System has exercised far fewer call options than it did when the yield curve dropped precipitously immediately after the financial crisis.

Investor interest and continued low yields on the full spectrum of debt instruments allowed the System to continue to extend its debt maturities. Their weighted average of remaining maturity increased by one month during 2013 to 3.0 years. The weighted-average interest rates for insured debt continued to decrease but at a much reduced rate, going from 0.98 percent as of December 31, 2012, to 0.93 percent as of December 31, 2013.

Mission-Related Investments

In January 2005, we issued guidance that gave System institutions an opportunity to participate in pilot programs supporting investments in rural America (see FCA Informational Memorandum dated January 11, 2005, Investments in Rural America—Pilot Investment Programs). The pilot programs were intended to provide FCS institutions greater flexibility to partner with Government agencies and other agricultural and rural lenders in fulfilling FCS mission objectives.

On November 14, 2013, the Farm Credit Administration Board voted to conclude, effective Dec. 31, 2014, each pilot program approved after 2004 as part of the Investments in Rural America program. The Board's action permits each System institution that is participating in a pilot program to continue to hold its investments through the maturity dates for the investments, provided the institution continues to meet all approval conditions. Although we are concluding these pilot programs, we will consider investment requests on a case-by-case basis under our existing investment regulations.

Because of the Investments in Rural America program, we now have a better understanding of the diverse financing needs of agriculture and rural communities and the ways System institution investments can help increase the availability and efficiency of funds to these markets. The information gathered and experience gained through the pilot programs will be useful as we evaluate future investment requests.

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.

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 that present the greatest risk. This approach also considers 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 require FCS institutions to have the programs, policies, procedures, and controls to effectively identify and manage risks. Our oversight program also requires 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.

We use 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:

- Business Planning and Diversity and Inclusion. We are focusing on business plan quality, the institution's ability to identify key risk factors, and how the institution manages those risks. We are also examining how the System is complying with revised FCA regulation 618.8440, which requires 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.
- Underwriting in Volatile Times. Volatility in the agricultural sector and the potential for reduced profitability and increased borrower stress are expected over the next several years. We are emphasizing the need for proactive and diligent underwriting standards and practices that can safeguard FCS institutions through good and bad times.
- Board Governance. Effective and informed board governance is paramount in today's increasingly complex financial institutions and fast-changing business conditions. Our examiners are focusing on board committees, governance assessments, and the committees of stockholders that nominate individuals for board positions.
- Standards of Conduct. Directors and employees of System institutions must maintain high standards of honesty, integrity, impartiality, and conduct. Our examiners are evaluating institutions' policies, processes, and disclosures to ensure the effectiveness of their standards of conduct programs. Examiners are also reviewing their findings for systemic or strategic risks and communicating these results to the institutions.

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 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.[19]

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 nec-

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

essary 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 FIRS ratings for 2013 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.

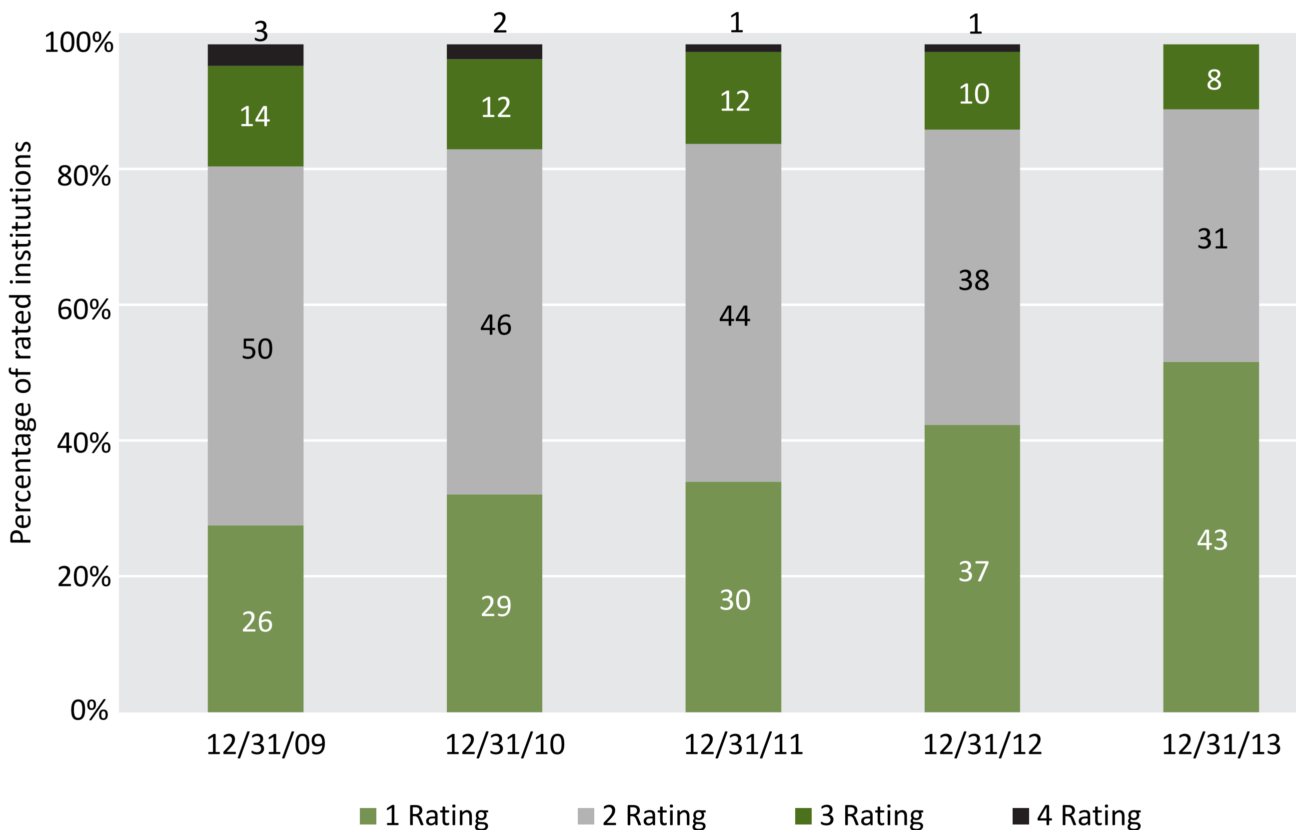
At December 31, 2013, 43 FCS institutions were rated 1 (52 percent), 31 were rated 2 (38 percent), 8 were rated 3 (10 percent). Most of the institutions rated 3 were relatively small and collectively represent about 2 percent of the System's total assets. There were no institutions with ratings of 4 or 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

Figure 8

Financial Institution Rating System (FIRS) Composite Ratings for the FCS, 2009–2013



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.

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 institutions to take corrective action to mitigate the risks. Some corrective actions include reducing risk exposures, increasing capital and enhancing earnings, and strengthening risk management.

We use a three-tiered supervision program: normal supervision, special supervision, and enforcement actions.

Institutions under normal supervision are performing in a safe and sound manner and are complying with laws and regulations. These institutions are able to correct weaknesses in the normal course of business.

For those institutions displaying more serious or persistent weaknesses, we shift from normal to special supervision, and our examination oversight increases accordingly. Under special supervision, we give an institution clear and firm 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, 2013, we had formal written agreements with eight associations, whose assets totaled $4.8 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 or governance. Two of these institutions returned to normal supervision in January 2014 because of improved performance and conditions.

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 a System institution acquires agricultural property through liquidation, 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 2013, we received 46 borrower complaints. The number of complaints has been higher in recent years because of the increase in financial stress on System borrowers.

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:

- Farm & Ranch (formerly Farmer Mac I), which involves mortgage loans secured by first liens on agricultural real estate and rural housing
- USDA Guarantees (formerly Farmer Mac II), which involves certain agricultural and rural loans guaranteed by the U.S. Department of Agriculture, including farm ownership loans, operating loans, and rural business and community development loans
- Rural Utilities program, which involves loans to finance cooperatively owned rural electrification and telecommunications systems

Farmer Mac purchases eligible loans directly from lenders; provides advances against eligible loans by purchasing obligations secured by those loans; securitizes assets and guarantees the resulting securities; and issues long-term standby purchase commitments (standbys) for eligible loans. Securities guaranteed by Farmer Mac may be held either by the originator of the underlying assets or by Farmer Mac, or they may be sold to third-party investors.

FCA regulates Farmer Mac through the Office of Secondary Market Oversight (OSMO), which was established by the Food, Agriculture, Conservation, and Trade Act Amendments of 1991. This office provides for the examination and general supervision of Farmer Mac's safe and sound performance of its powers, functions, and duties. The statute requires OSMO to be a separate office within our Agency and to report directly to the FCA Board. The law also stipulates that OSMO's activities must, to the extent practicable, be carried out by individuals who are not responsible for supervising the banks and associations of the FCS.

Through OSMO, we perform the following functions:

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

OSMO reviews Farmer Mac's compliance with statutory and regulatory minimum capital requirements and supervises its operations and condition throughout the year. Table 5 summarizes Farmer Mac's condensed balance sheets at the end of each year from 2008 to 2013.

Table 5
Farmer Mac Condensed Balance Sheets, 2008–2013
As of December 31
Dollars in Millions

	2008	2009	2010	2011	2012	2013	Percentage growth rate 2012–2013
Total assets	$5,107.3	$6,138.8	$9,479.9	$11,883.5	$12,622.2	$13,361.8	5.9%
Total liabilities	$4,947.7	$5,798.4	$9,001.0	$11,329.0	$12,029.2	$12,787.3	6.3%
Net worth or equity capital	$15.3	$196.2	$478.9	$554.5	$593.0	$574.5	-3.1%

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

Capital

On December 31, 2013, Farmer Mac's net worth (that is, equity capital determined using generally accepted accounting principles [GAAP]) was $574.5 million, compared with $593.0 million a year earlier. Net worth was 4.3 percent of on-balance-sheet assets as of December 31, 2013, compared with 4.7 percent at the end of 2012. The ratio declined because on-balance-sheet assets grew and net worth declined despite favorable earnings results (discussed in greater depth below). When Farmer Mac's off-balance-sheet program assets (that is, essentially its guarantee obligations) are added to its total on-balance-sheet assets, net worth was 3.3 percent as of December 31, 2013, compared with 3.6 percent in 2012. As of December 31, 2013, Farmer Mac continued to be in compliance with all statutory and regulatory minimum capital requirements.

At year-end 2013, 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.[20] Farmer Mac's core capital as of December 31, 2013, totaled $590.7 million, exceeding the statutory minimum capital requirement[21] of $398.5 million by $192.2 million.

Farmer Mac's regulatory capital totaled $604.0 million as of December 31, 2013, exceeding the regulatory risk-based capital requirement of $90.8 million by $513.2 million. Regulatory capital was 4.9 percent of total Farm & Ranch and rural utility program volume (including both on- and off-balance-sheet agricultural and utility program volume but excluding USDA Guarantees). Risk exposure on USDA Guarantee 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 2008 through 2013.

We published a final rule in January 2014 to revise regulations governing Farmer Mac's capital planning activities. The final rule requires annual stress testing of Farmer Mac's capital position; it also requires Farmer Mac to notify FCA of any changes in dividend policy.

Table 6
Farmer Mac Capital Positions, 2008–2013
As of December 31
Dollars in Millions

	2008	2009	2010	2011	2012	2013
GAAP equity	$15.3	$196.2	$478.9	$554.5	$593.0	$574.5
Core capital	$207.0	$337.2	$460.6	$475.2	$519.0	$590.7
Regulatory capital	$223.4	$351.3	$480.7	$492.7	$535.9	$604.0
Statutory requirement	$193.5	$217.0	$301.0	$348.6	$374.0	$398.5
Regulatory risk-based capital requirement	$57.3	$35.9	$42.1	$52.9	$58.1	$90.8
Excess core capital over statutory requirement*	$13.5	$120.2	$159.6	$126.5	$145.0	$192.2
Capital margin excess over the minimum	7.0%	55.4%	53.0%	36.3%	38.8%	48.2%

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.

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

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. We published a final rule governing Farmer Mac's liquidity management in November 2013. This rule increased minimum regulatory liquidity requirements. Farmer Mac was in compliance with its liquidity policy throughout the year.

Program Activity

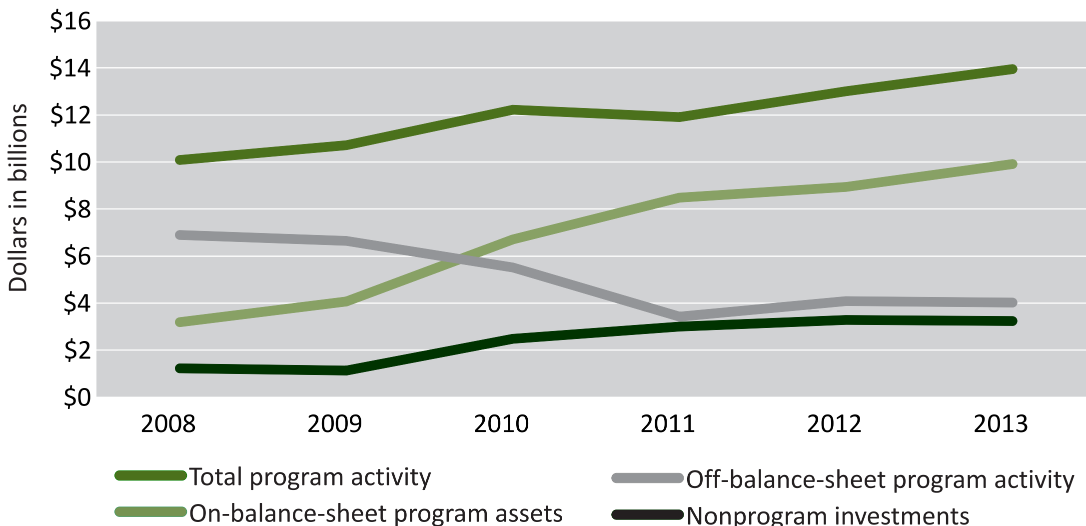
Farmer Mac's total program activity increased to $14.0 billion on December 31, 2013, from $13.0 billion a year earlier (see figure 9). Farmer Mac experienced steady growth in its Farm & Ranch loan purchases, as well as its AgVantage products. AgVantage transactions are general obligations of the issuing 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 amount of the security.

Farmer Mac's Long-Term Standby Purchase Commitment product is 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 under specified conditions at the option of the institution. As shown in figure 10, standbys represented 16.2 percent of Farmer Mac's total program activity in 2013.

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 2013, 28.9 percent of program activity consisted of off-balance-sheet obligations, as compared with 31.3 percent a year earlier.

Asset Quality

On December 31, 2013, $194.9 million of the Farm & Ranch program portfolio was substandard, representing 3.78 percent of the principal balance of Farm & Ranch loans purchased, guaranteed, or committed to be purchased.[22] This compares with $186.5



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

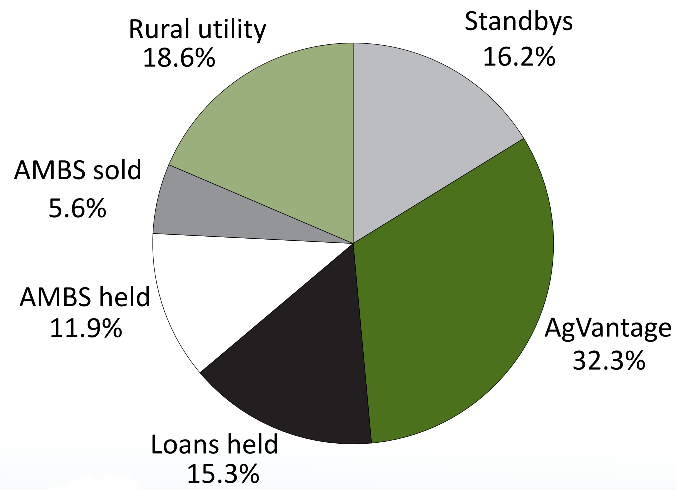
22. We have excluded AgVantage volume from the Farm & Ranch loan volume because AgVantage products carry significantly less risk.

Figure 10

Farmer Mac Total Program Activity

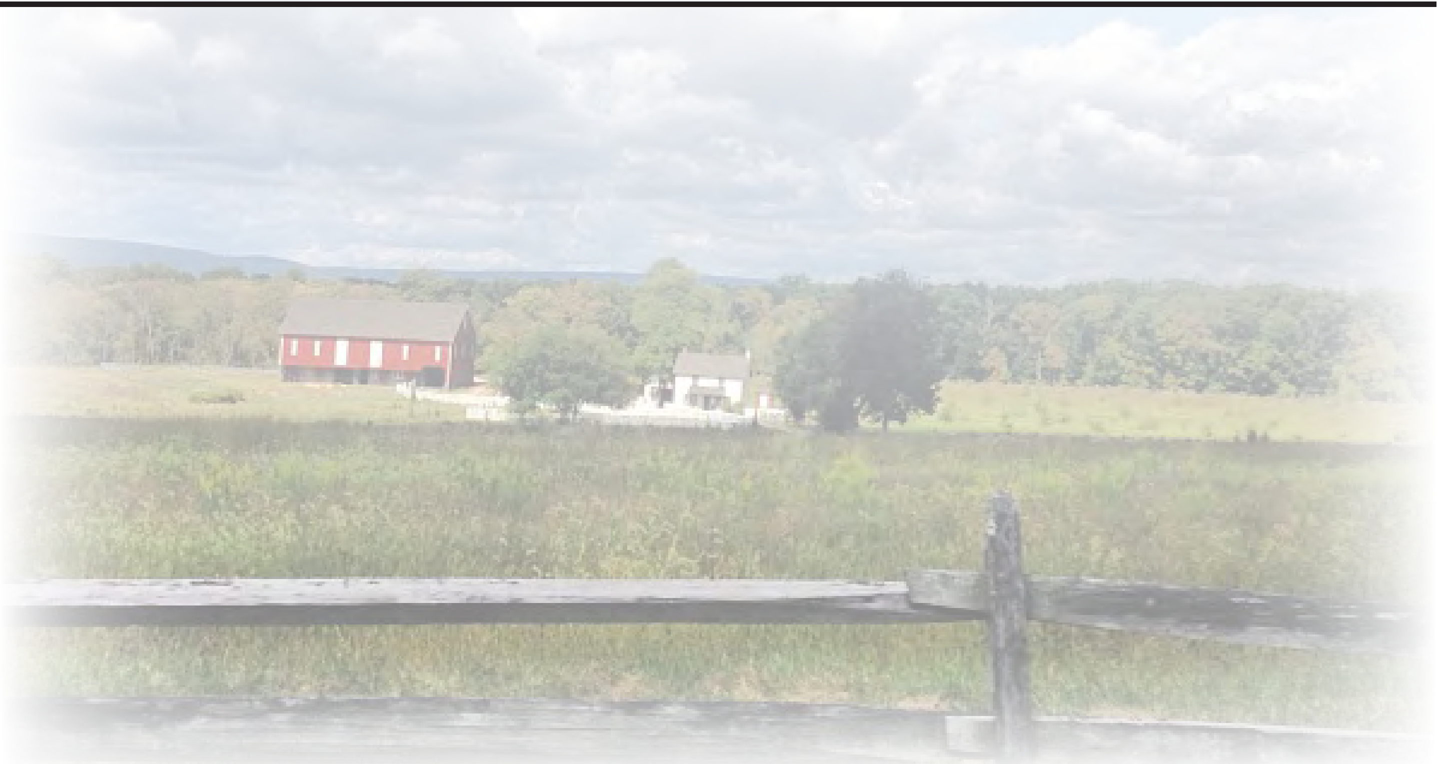
As of December 31, 2013

Total = $13.95 billion



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

AMBS = agricultural mortgage-backed securities



million, or 3.93 percent, on December 31, 2012. Assets are considered to be substandard when they have a well-defined weakness or weaknesses that, if not corrected, are likely to lead to some losses.

As of December 31, 2013, Farmer Mac's 90-day delinquencies improved for the fourth consecutive year to $28.3 million, or 0.55 percent of non-AgVantage Farm & Ranch loans, compared with $33.2 million, or 0.70 percent as of December 31, 2012. Real estate owned as of December 31, 2013, was $2.6 million, down from $4.0 million a year earlier. Farmer Mac reported no delinquencies in its pools of rural utility cooperative loans.

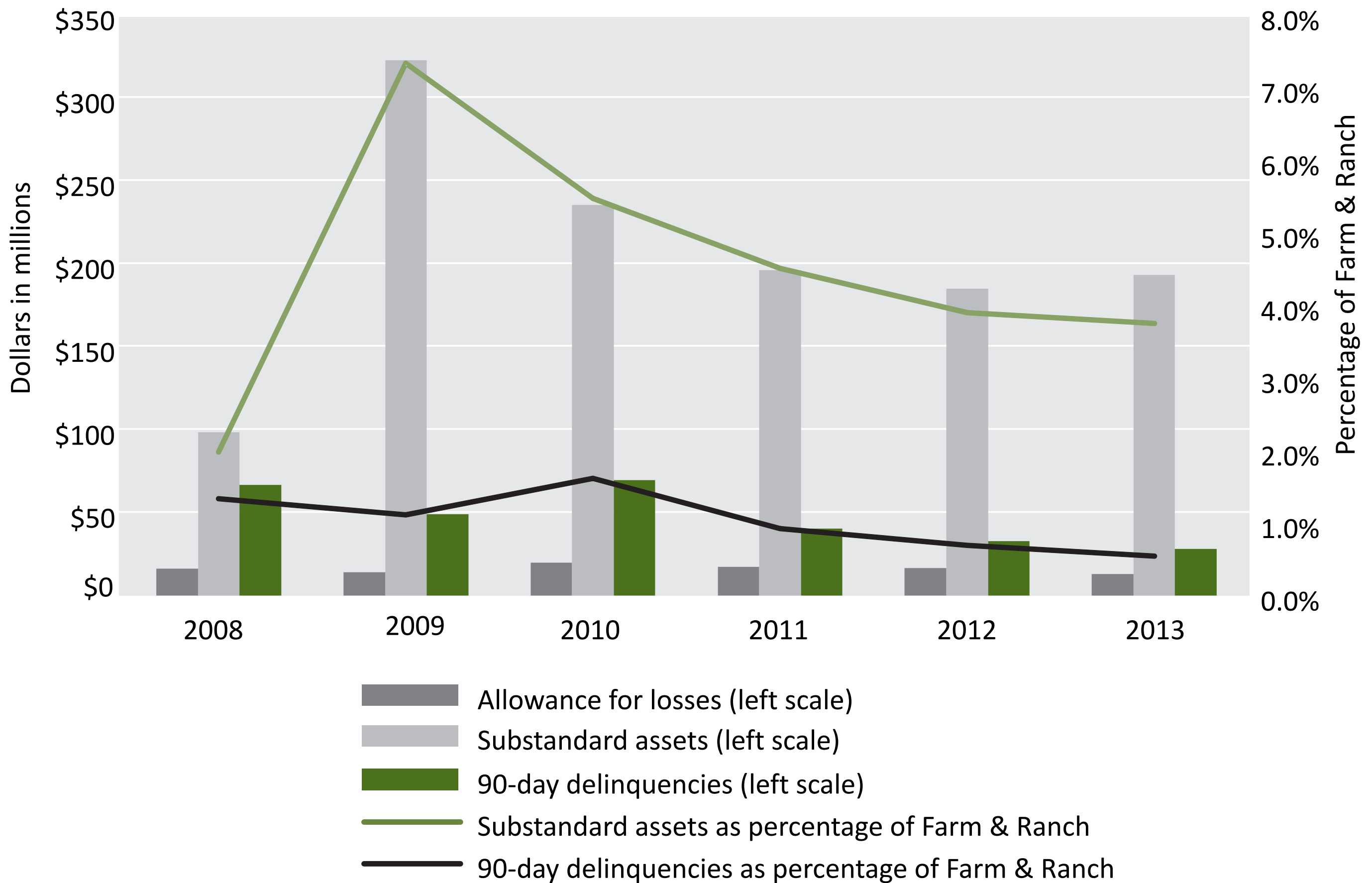
On December 31, 2013, Farmer Mac's allowance for losses totaled $13.3 million, compared with $16.9 million on December 31, 2012. Figure 11 shows the levels of Farmer Mac's substandard Farm & Ranch assets and its 90-day delinquencies relative to outstanding program volume, excluding AgVantage loan volume.

Earnings

Farmer Mac reported net income available to common stockholders of $71.8 million (in accordance with GAAP) for the year ended December 31, 2013, up from $43.9 million reported at year-end 2012. Core earnings for 2013 were $54.9 million, compared with $49.6 million in 2012.[23] Net interest income, which excludes guarantee fee income, was $98.6 million in 2013, down from $118.3 million in 2012.[24] Guarantee fee income was $27.0 million, compared with $25.0 million in 2012. Nonprogram investments accounted for an estimated 9.32 percent of interest income for 2013, down from 9.34 percent for 2012. Table 7 shows a six-year trend for the basic components of income.

23. 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.
24. In our 2012 Annual Report, we reported net interest income as $122.0 million for 2012 and $121.3 million for 2011 because we mistakenly calculated net interest income on a pre-provision basis. The figures should have been $118.3 million for 2012 and $121.0 million for 2011.

Figure 11
Allowance, Nonperforming Asset, and Delinquency Trends, 2008–2013
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, 2008–2013
As of December 31
Dollars in Millions

	2008	2009	2010	2011	2012	2013	Growth Rate 2012–2013
Total revenues	($140.6)	$181.8	$99.1	$73.3	$122.0	$164.4	35%
Total expenses	$13.5	$99.5	$77.0	$59.5	$78.1	$92.5	18%
Net income available to common shareholders	($154.1)	$82.3	$22.1	$13.8	$43.9	$71.8	64%
Core earnings	($81.5)	$16.1	$25.4	$42.9	$49.6	$54.9	11%

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 ability of the Farm Credit System and Farmer Mac to fulfill their missions. The factors include weather conditions, the farm economy, the macro-economy, 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

Drought affected more than half of the continental United States in 2013, mostly to the west of the Mississippi. It sharply reduced crop harvests and damaged pastures. The August 6, 2013, map in figure 12 shows how pervasive the drought was for much of the country at that time. Exceptionally wet conditions during the spring of 2013 brought much relief to the Midwest and Southeast, which were ravaged by drought in 2012.

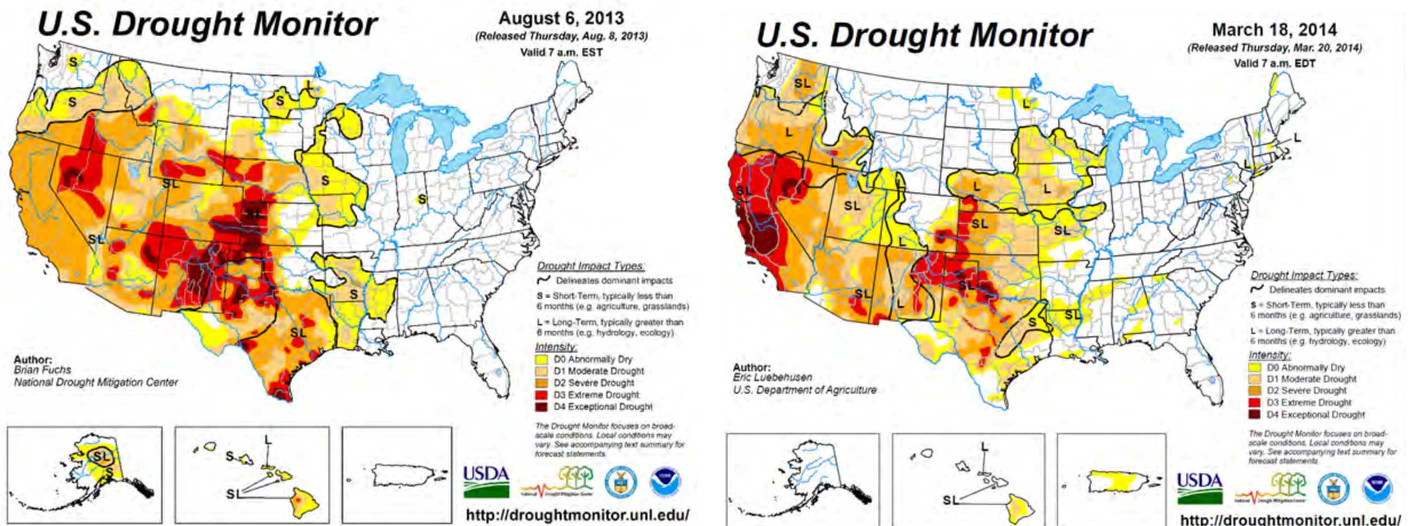
As the March 18, 2014, map shows, drought conditions west of the Continental Divide continued into 2014. The snowpacks in the Sierra Nevada and southern half of the Cascades remain in deficit. California has the largest moisture deficits among western states, with most of the state in severe or extreme drought as of late April 2014. Major reservoirs in California remain significantly below historical average levels. In the Southern Plains and the western Corn Belt, dry conditions prevailed at the beginning of the spring planting season.

The continuing drought poses a risk for certain System borrowers. Exceptionally dry conditions in California have major implications for System borrowers and consumers in general. The persistent drought may lead to price increases and shortages of agricultural products, and it could create credit stress for these producers. Forecasts call for lower than normal precipitation during the planting season.

Farm Income

Despite the planting delays caused by both wet weather and drought, U.S. agriculture as a whole remained strong in 2013, with near-record farm incomes buoyed by high prices throughout most of the year. However, by November, the USDA projected U.S. corn and soybean production to be at or near record levels, which would cause a drop in crop prices. As a result, farm income is forecast to decline significantly in 2014.

Figure 12
U.S. Drought Moniter



Debt use increased moderately in 2013, and asset values remain high. Both debt use and total asset values are forecast to increase in 2014.

Total indemnity payouts for crop insurance in 2013 were forecast to decline from 2012 levels because farmers were able to produce near record-sized crops. As of March 24, 2014, indemnity payouts totaled $11.5 billion for 2013, down nearly 34 percent from 2012.

Livestock producers experienced another year of record feed costs and low or negative returns, with limited insurance or other Government programs. Relief during the fourth quarter of 2013 came in the form of lower feed costs because of the drop in crop prices. In addition, tightening supplies of hogs and cows has led to an increase in product prices, boosting the profitability for these producers. The tight supplies of hogs and cows have led to very high prices for beef and pork. Consequently, consumers may shift consumption to more competitively priced meats such as poultry. According to industry analysts, most livestock producers can expect to have profitable margins for 2014 because feed costs are forecast to remain low.

Net cash income for 2013 reached $130.1 billion, down about 3 percent from 2012. Crop receipts declined 3.3 percent over 2012 levels, but livestock receipts were up 6.2 percent. Farm expenses were up 3.3 percent, mostly because of a rise in feed costs, higher land rental rates, and higher costs for seeds and pesticides.

For 2014, the U.S. Department of Agriculture in February forecasted that net cash income will fall to $101.9 billion, a decline of nearly 22 percent. The projected decrease in net cash income is due to sharp declines in cash receipts for crops and direct Government payments, and a small decrease in farm-related income. The elimination of direct payments under the Agricultural Act of 2014 is the primary reason behind the expected large reduction in Government payments for 2014. Net farm income is also projected to fall in 2014 to $95.8 billion, a decline of nearly 27 percent, due mostly to a projected decrease in crop cash receipts, a decrease in the value of crop inventories, and a reduction in Government payments. Both measures of farm income are expected to remain at historically high levels in 2014 even after they are adjusted for inflation.

Acreage and Yields by Commodity

USDA's March 31 Prospective Plantings Report provides the numbers of acres that producers of various commodities expect to plant in 2014. Table 8 shows the projections for four major crops.

Yields of corn are expected to hit a new record in 2014; soybean yields are expected to be stable. According to climate forecasts, the Corn Belt region will receive normal precipitation through the planting season. Soybean-producing states, specifically Nebraska, should also have normal precipitation, which would alleviate the drought they have experienced in the past couple of years.

Table 8
Projected Number of Acres per Major Commodity in 2014

Commodity	Acres to Be Planted	Change from 2013
Corn	91.7 million acres, the lowest since 2010, but fifth most since 1944	-4%
Soybeans	81.5 million acres, if realized will set be a record level	6%
Wheat	55.8 million acres, down 1 percent from 2013	-1%
Cotton	11.1 million acres, up 7 percent from last year	7%

Source: USDA's March 31, 2014, Prospective Plantings report.

If the climate forecasts hold true, corn and soybean prices should be well below those of the 2012–13 marketing year, which should lead to higher profits for livestock, dairy, and ethanol producers. Large harvests of corn and soybeans in Brazil and Argentina in early 2014 will also place downward pressure on prices in 2014.

Farm Expenses

USDA forecasts that farm production expenses will fall roughly 1 percent in 2014 to $348 billion. This marks only the second time in the past 10 years that expenses have declined. Moderate declines in expenses for feed and fertilizer are expected to offset higher expenses for seed, petroleum products, and labor in 2014.

The lower crop prices are expected to have a positive impact for producers and processors who purchase these commodities as inputs in the production of livestock, poultry, dairy products, and ethanol. However, lower commodity prices are expected to have a negative impact on crop producers.

Farm Asset Values and Farm Debt Levels

Because of moderate to strong commodity prices and favorable interest rates, U.S. farm asset values rose 4.2 percent in 2013 to a record $2.93 trillion according to USDA estimates. Real estate debt increased by nearly 5 percent, while non-real estate debt increased by less than 1 percent, for a total debt increase of around $9 billion, or 2.9 percent. Based on conditions in early February 2014, USDA projected that farm real estate assets could increase a little more than 2 percent in 2014 to a record $3.0 trillion.

The net impact on the balance sheet of the farm sector for 2013 was a 4.4 percent increase in farm equity to a record $2.6 trillion, resulting in a debt-to-equity ratio of 11.8 percent, the lowest level since USDA began calculating the measure in 1960. The debt-to-asset ratio of 10.6 percent for 2013 is also a record low and is forecast even lower at 10.5 percent in 2014.

Farmland Values

Land values continued to climb to new highs in the Plains and Midwest in 2013. By the fourth quarter, however, agricultural bankers indicated that the growth in farmland values had begun to moderate and even decline in some areas of the country. The rebound in grain and soybean production, which caused a drop in crop prices, triggered the adjustment in farmland values.

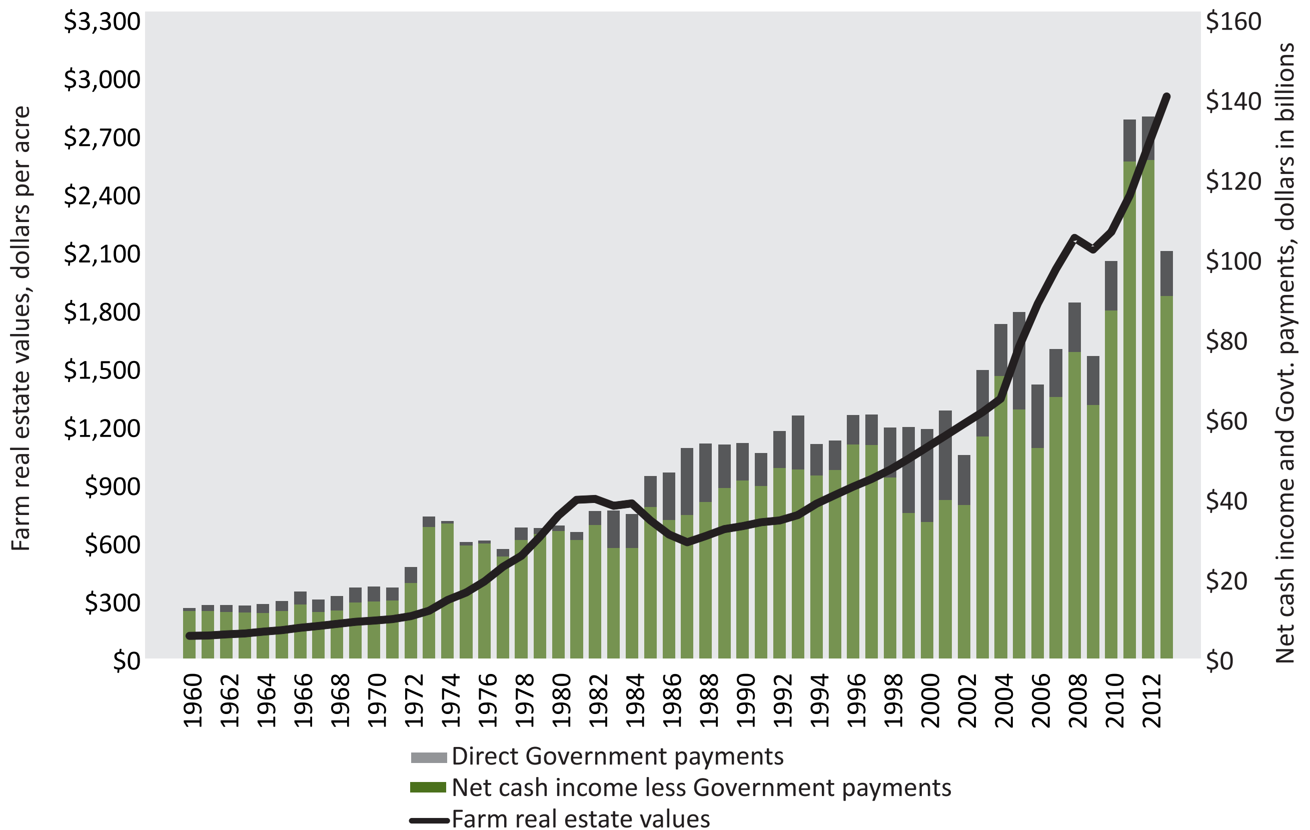
Based on its August 2013 Land Values Report, USDA reported that U.S. farm real estate values (all land and buildings) rose 9.4 percent from 2012 values. Regional changes ranged from a 23.1 percent increase in the Northern Plains to no change in the Southeast. At the state level, farm real estate values ranged from declines of 2.2 percent for Florida and New Hampshire to increases of 36 percent for North Dakota and 29 percent for South Dakota. Cropland values across the United States increased by 13 percent on average. This compares to regional increases of 25 percent in the Northern Plains and 16.1 percent in the Corn Belt. However, cropland values in the Southeast declined by 2.8 percent from values a year ago.

In its fourth quarter 2013 survey of agricultural bankers, the Federal Reserve reported results from seven districts. Three (Chicago, Richmond, and St. Louis) indicated increases in farmland values, while four districts (Dallas, Kansas City, Minneapolis, and San Francisco) had mixed results, with declines in some land types.

Creighton University's monthly Farmland-Price Index, which surveys agricultural bankers in 10 Midwestern and Plains States, indicated that farmland prices on average continued to weaken in April 2014 but at a slightly slower pace than in the previous two months. The slower rate of decline is attributed to two factors, weather-related planting delays and trade tensions caused by the crisis in Ukraine, both of which helped strengthen crop prices since the lows of January. Farmland prices declined for 7 of the 10 States, increased for 2 States, and remained unchanged for 1 State. Based on the March 2014

Figure 13

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



report of the Iowa Realtors Land Institute, Iowa cropland values have declined an average 5.4 percent in the six months through February 2014.

To address the 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 working to identify portfolio risk through land-value studies and the stress testing of changes in land value.

As the regulator of the System and Farmer Mac, 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 and Farmer Mac continued to have reliable access to the debt capital markets in 2013. With the Federal Reserve's low interest rate policies continuing throughout 2013, interest rates paid by System borrowers remained near or at historic lows. The three-month Treasury bill was virtually unchanged at 0.1 percent at year-end 2013, while the 10-year Treasury bond was up 120 basis points to 3.0 percent, compared with 1.8 percent at year-end 2012.

Interest rates on intermediate- and longer-term loans have begun to rise, but they still remain well below the rates seen before the financial crisis. Nonetheless, rising interest rates affect the cost of credit, and the impacts of higher rates are immediate on floating-rate loans and fixed-rate loans that reprice in the near term.

Interest rates are expected to continue to be low through mid-2015, remaining at current levels through the summer of 2014 and gradually rising in 2015 in line with expected improvements in the economy.

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 rates to rise quickly, leading to higher production costs for farmers and ranchers and a decrease in farmland values.

U.S. Agricultural Exports

Agricultural exports set a new record of $140.9 billion in fiscal year 2013 according to the USDA. In addition, the period from 2009 to 2013 was the strongest five-year period for agricultural exports in history. Overall growth in exports could be tempered if economic growth in key importing countries like China, India and Russia slows as expected in 2014.

Economic developments as well as policy decisions in China and other Asian countries are expected to continue to have a significant effect on U.S. agricultural trade. Asia accounted for 43 percent of U.S. agricultural exports in 2013, with China alone accounting for 18 percent, ahead of Canada, Mexico, and Japan.

China, along with many other nations, banned imports of U.S. beef starting in late December 2003 because of the discovery of a single cow infected with bovine encephalopathy, more commonly known as mad cow disease. While most nations have eased or lifted their restrictions on U.S. beef, China has not yet done so.

In early May 2014, China lifted its seven-year ban on Virginia poultry. Instituted in response to an avian flu outbreak at a single farm, this ban cost commonwealth turkey and chicken farmers access to the fast-growing Chinese market. China's decision to lift the ban could significantly boost the state's poultry exports.

The General Economy

The U.S. economy decelerated in 2013, with real gross domestic product (GDP) growth slowing to 1.9 percent from 2.8 percent in 2012. Restrictive fiscal policy and a slowdown in nonresidential fixed investment held back growth. Tax increases for high-income households at the beginning of 2013 and an expiration of the temporary payroll tax cut restrained consumer spending. Moreover, sequestration, budget caps on discretionary spending, and the drawdown in foreign military operations pushed down Federal purchases.

Although real Federal spending declined to an annual rate of more than 7 percent in the second half of 2013, real GDP increased to 3.75 percent during this period, up from 1.75 percent in the first half of 2013. Leading the way was the biggest increase in consumer spending in three years and improved exports. Real personal consumption expenditures rose at a 2.75 percent rate during the second half of 2013 after increasing at an annual rate of 2 percent in the first half of the year. Real exports of goods and services rose at an annual rate of 7.5 percent. An improvement in business investment added to the growth. Business fixed investment rose at an annual rate of 4.25 percent in the second half of 2013 after changing little in the first half.

However, investment in the housing market was the softest in 14 quarters; builders became cautious in the waning months of 2013 when rising home prices and higher mortgage rates put off would-be buyers.

Despite the generally positive news for the second half of 2013, the economic recovery slowed again in the final quarter of 2013. The real GDP growth rate dropped to 2.6 percent compared with the 4.1 percent expansion in the third quarter. A downturn in private inventory and residential investment and a decrease in Government spending accounted for the slowdown.

In the first quarter of 2014, real GDP decreased at an annual rate of 1 percent according to a report by the Bureau of Economic Analysis on May 29, 2014. The decrease largely reflects reductions in private inventory investment, exports, nonresidential fixed investment, State and local Government spending, and residential fixed investment and a rise in imports (which are a subtraction from GDP). The decrease in GDP was partly offset by increases in personal consumption expenditures (mainly on health care, heating, and other utilities) and an increase in Federal Government spending. The last time the economy contracted was in the first quarter of 2011 when GDP decreased 1.3 percent.

Experts seem split on whether the slowdown is the temporary result of extreme winter weather or whether it is a sign of some underlying weakness. However, signs indicate that economic growth is picking up again. Investment activities have increased, and the employment report for the first quarter of 2014 was positive. In addition, capital goods orders have gone up as businesses replace capital stock that has depreciated since the recession.

Economic forecasters project real GDP for the U.S. economy to expand somewhere in the range of 2.2 to 3.1 percent for 2014, up from 1.9 percent in 2013, but possibly at a slightly slower rate than in 2012. Fiscal policy drag (higher tax burden from the end of payroll tax cuts, the Government shutdown, and sequester cuts) is expected to ease further. In addition, further increases in the price of corporate equities and housing are expected to boost household net worth and spending, while financing conditions are expected to remain favorable in capital markets and throughout the banking industry. Moreover, the domestic boom in oil and gas production is expected to continue and to provide needed jobs and spending, particularly in rural areas in the Northern Plains and in the Southwest.

Because of the Federal Open Market Committee's policy known as "quantitative easing," interest rates are expected to remain low through 2014, and these low rates are expected to stimulate the economy and improve the job market. The committee began tapering the program last year by reducing its bond purchases as the unemployment rate continued to decline.

Employment Prospects

The labor market continued to improve. Payroll employment increased an average of about 175,000 jobs per month in the second half of 2013. The unemployment rate declined in 2013 from a high of 7.9 percent in January to a low of 6.7 percent by year-end and averaged 7.4 percent versus 8.1 percent for 2012. For April 2014, payroll employment rose by 288,000 jobs, and the unemployment rate fell to 6.3 percent.

An alternative measure of labor underutilization provided by the Bureau of Labor Statistics is the "underemployment rate," 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 plus all marginally attached workers." Labor that falls into this category includes workers who are highly skilled but working in low-skill or low-paying jobs, and part-time workers who would prefer to work full-time. During 2013, the underemployment rate dropped from a high of 14.1 percent in January to 13.1 percent in December and averaged 13.8 percent for the year, down from an average of 14.7 percent for 2012.

The net labor force participation rate continued to decline; it was 63 percent in 2013 versus 67 percent in 2000. As a result, the employment-to-population ratio, a measure that combines the unemployment rate and the labor force participation rate, has changed little. It remained low at about 59 percent in 2013 versus 65 percent in 2000.

Despite its recent declines, the unemployment rate remains well above the Federal Open Market Committee's estimates of the long-run sustainable rate of unemployment and well above rates that prevailed before the recent recession. Moreover, beyond labor force participation, some other aspects of the labor market remain

a concern. For example, the share of the unemployed who have been out of work longer than six months and the percentage of the workforce that is working part-time but would like to work full-time have declined only modestly over the recovery. The number of long-term unemployed declined to 3.5 million and part-time workers (7.5 million) changed little in April 2014. In addition, the quit rate, an indicator of workers' confidence in the availability of other jobs, remains low.

The trend for wages also shows the relatively weak labor market; the modest gains in labor compensation seen earlier in the recovery continued in 2013. The 12-month change in the employment cost index for private industry workers, which measures both wages and the cost to employers of providing benefits, has remained at around 1.9 percent throughout the recovery. However, average hourly earnings for all employees increased close to 2 percent in 2013.

Employment in Nonmetropolitan Areas

The recovery of the job market from the Great Recession in nonmetro areas has lagged behind that of metro areas. At the end of 2007, the nonmetro unemployment rate of 5.2 percent (seasonally adjusted) was about half a percentage point higher than the metro rate at 4.7 percent. Both rates peaked in the fourth quarter of 2009 at around 9.9 percent for metro areas and 10.1 percent for nonmetro areas. Since then, both rates have been steadily declining. In the fourth quarter of 2013, the unemployment rate declined to 6.9 percent in metro areas and 7.2 percent in nonmetro areas.

Housing Sector Recovery

Another risk factor for the economy is the housing sector, which historically has accounted for 17 to 18 percent of GDP. After increasing at close to a 15 percent annual rate in 2012 and the first part of 2013, residential investment was little changed in the second half of last year.

Mortgage interest rates increased about 1 percentage point to around 4.25 percent over May and June of 2013 and have remained near this level since then. Soon after the increase, mortgage refinancing dropped sharply, while home sales declined somewhat and the issuance of new single-family housing permits leveled off.

However, relative to historical norms, mortgage rates remain low and housing is still quite affordable. Moreover, steady job growth is likely continuing to support growth in housing demand. Because new home construction is still well below levels consistent with population growth, the potential for further growth in the housing sector is considerable.

Home prices continued to rise in the second half of 2013, although somewhat less quickly than in the first half. Over the 12 months that ended in December, home prices increased 11 percent.

Much of the recent gain in home prices has occurred in areas with the largest price declines during the recession and early recovery. During the housing crisis, the price of homes in these hard-hit areas often dropped below their value as rentals, spurring both large and small investors to convert some homes into rental properties. This increase in investor demand likely accounts for the price gains in these areas. The top five states experiencing the biggest appreciations in 2013 were Nevada, California, Arizona, Oregon, and Florida.

Consumer Price Inflation

Inflation affects agriculture by raising input costs and by curbing consumer demand for high-value products like dairy, meat, and processed foods; it also curbs consumption of food away from home. Inflation remained low in 2013, with the personal consumption expenditure (PCE) price index increasing at an annual rate of 1 percent, noticeably below the Federal Open Market Committee's long-run objective of 2 percent. Core PCE prices—or prices of PCE goods and services excluding food and energy—also increased at an annual rate of about 1 percent. Other measures of core consumer price inflation, such as the core consumer price index, were

also low, though not as low as core PCE inflation.

Although most economists believe inflation will remain mostly in check for 2014, inflationary pressures are expected to pick up in 2015 and beyond. The U.S. Federal Reserve Board, as well as other central banks, is expected to boost interest rates to contain inflationary pressures. The outlook is for a slight uptick in consumer price inflation in 2014 to somewhere between 1.5 and 1.9 percent for the year, with the possibility of its rising to slightly above the Federal Open Market Committee's long-run goal of 2 percent for 2015.

International Trade

U.S. exports of goods and services continued to support the U.S. economy in 2013, increasing 3 percent to a record $2.3 trillion. Over this period, exports of foods, feeds, and beverages increased by 2 percent. Imports also reached a record in 2013, increasing slightly to $2.75 trillion. Over this period, imports of foods, feeds, and beverages increased by 4 percent. On balance, the trade deficit narrowed to $474 billion.

Exports increased at a higher rate in the second half of 2013 than in the first half. This increase was driven by stronger growth in foreign GDP and by soaring sales of petroleum products and agricultural goods. Higher shipments to Canada, China, and other emerging economies in Asia contributed to the robust increase in exports.

Real net trade added an estimated 0.75 percent to GDP growth over the second half of 2013, whereas in the first half it had a small negative impact. Owing in part to the improvement in net petroleum trade, the nominal trade deficit shrank over the second half of 2013.

Canada, the EU, and other major destinations for U.S. exports are projected to have faster economic growth in 2014, while China and Japan are projected to have slower growth this year. In addition, the value of the dollar is projected to depreciate somewhat in 2014 against the currencies of many trading partners, such as the Canadian dollar and the Chinese Renminbi, making U.S. goods relatively more competitive. This, coupled with faster economic growth, could provide a lift to U.S. exports in 2014.

Household and Business Borrowing

Household debt increased in 2013 after a steady decline since its peak of $13.8 trillion during the first quarter of 2008, just prior to the recession. Residential mortgage debt outstanding has fallen more than $1 trillion since the end of 2007, making mortgages the major contributor to the phenomenon known as "household deleveraging." In contrast to mortgages, consumer credit has expanded in each of the past four years. The growth in consumer credit has been driven by student loans and auto loans, while aggregate credit card balances have been relatively flat.

Financing conditions for businesses were generally quite favorable. Interest rates on corporate bonds have stayed low relative to historical norms, and net issuance of nonfinancial corporate debt appears to have remained strong in the second half of 2013. Conditions in business loan markets also continued to improve. A modest fraction of loan officers surveyed by the Federal Reserve indicated that they had eased standards on commercial and industrial loans over the second half of 2013.

Financing conditions for small businesses also improved. Reductions in loan spreads have been most notable for the types of loans that are generally made to small businesses—that is, loans of $1 million or less, or those originated by small domestic banks. Standards on commercial real estate bank loans also eased, moving closer to long-term norms. Still, standards for construction and land development loans, a subset of commercial real estate loans, likely remained relatively tight.

Federal Deficit

Other factors that may limit economic growth are the Federal budget deficit and the Federal debt held by the public. The Federal budget deficit for fiscal year 2013 totaled $680 billion (or 4.1 per-cent of GDP), a drop of 38 percent from the previous year. The Congressional Budget Office projects that the deficit will decline again in fiscal 2014 to $514 billion, the smallest deficit since 2008.

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 6.2 percent to $11.98 trillion in fiscal 2013. This amounts to 72.1 percent of GDP, more than double the level of 2007. 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 Bill

The President signed the Agricultural Act of 2014 into law on February 7, 2014. The new five-year farm legislation includes federally subsidized insurance programs, which cover individual losses, and traditional farm programs, which support prices or incomes. Most notable among the changes were the elimination of direct payments to farmers and a new milk support program, which provides support payments based on dairy margins (milk price less feed costs) instead of price targets.

Producers of supported commodities, such as feed grains, food grains, and oilseeds, will make important one-time choices between commodity programs that provide "shallow-loss" revenue payments through an Agricultural Risk Coverage option and "deeper-revenue" guarantees through a Price Loss Coverage option. For livestock producers, the legislation reauthorizes the Livestock Indemnity Program, the Livestock Forage Program, and the Emergency Livestock Assistance Program. These programs were made retroactive to cover losses incurred by livestock producers in fiscal years 2012 and 2013.

While existing crop insurance products and subsidy levels for more than 100 insurable crops remained intact, the Farm Bill created some new programs and enhanced some existing products. Examples include new shallow-loss county-based revenue protection policies beginning in 2015, separate coverage for organic or irrigated crops, and a directive for USDA to develop new insurance policies for crop and livestock production. In return, insurance purchasers must be in compliance with conservation provisions for highly erodible land and wetlands beginning in 2015. The legislation also strengthened the financial support available to producers of noninsured crops.

Among the legislation's many other provisions are those that support the next generation of farmers, local and regional food systems, and organic production. The legislation increases access to credit and risk management tools for beginning farmers. For example, it reduces crop insurance premiums during the first five years of farming. It also increases funding for development programs for beginning farmers and ranchers and for the promotion of farmers' markets, and it increases grants to support the development of local and regional food systems.

Farm Credit System Portfolio[25]

System loan volume grew almost 5 percent in 2013 despite stress in some sectors and regions. Higher farmland values and continued high commodity prices primarily accounted for the increase. While loan volume continued to grow in many areas where cash grain is produced, it spread to other regions and sectors of agriculture. Lending to finance production inputs, inventories, machinery, and real estate purchases increased.

Although weather conditions were challenging, yields in many parts of the Midwest returned to more normal levels, driving prices down for most crops. However, continued high farm income and rising agricultural real estate values continued to benefit grain producers, particularly in the middle part of the United States.

The price drop for corn and other feedstuffs brought welcome relief to producers in stressed sectors, such as animal protein and biofuels. In addition, commodity prices for producers in the animal-based protein sectors have also improved, helping most producers return to profitability. As a result, the quality of loans to these sectors has improved.

Sectors with a direct tie to housing, such as horticulture and forestry, are recovering as housing demand improves. However, these sectors still have some borrowers who are having

25. When referring to the Farm Credit System in this section, we mean only the banks and direct-lending associations of the System, excluding Farmer Mac.

difficulty recovering from the loss of key markets, a high debt burden, or dramatically reduced borrowing capacity.

When all these sectors are combined, System nonaccrual loans to the dairy, cattle, poultry, forestry, horticulture, and biofuel sectors accounted for about $1.0 billion of the $1.7 billion total. The System also reported $88 million in charge-offs on loans to these sectors. This represented about 72 percent of all of the System's net charge-offs. These sectors accounted for $54.7 billion, or 27 percent, of all System loans. See table 9 for a breakdown of financial information by sector.

Dairy

System loans outstanding to the dairy sector totaled $15.2 billion in 2013, up 3 percent from a year earlier. Producers benefitted from higher milk prices as well as lower feed costs. Most producers reduced their debt or improved their financial standing in 2013 although some drought-affected areas saw less profit improvement.

The System's nonaccrual dairy loans declined 6 percent from 2012 to $337 million at year-end 2013. The System recognized $60 million in recoveries on loans to this sector because improved conditions allowed some distressed borrowers to refinance or pay down more debt than expected. Loans to this sector totaled 8 percent of the dollar volume of all System loans and 36 percent of its capital. Dairy accounted for 19 percent of the System's nonaccrual loan volume as of December 31, 2013.

Cattle

The System's loans outstanding to the cattle industry totaled $18.5 billion at year-end 2013, up about 5 percent from year-end 2012. Cattle prices rose in response to reduced production during the year. As a result, some producers were able to remain profitable, but the high costs of feed cut into the profits of producers in drought-affected areas who must purchase feed.

The System's nonaccrual cattle loans declined 27 percent from 2012 to $177 million at year-end 2013. These loans accounted for 10 percent of the System's nonaccrual loans. Loans to cattle operations totaled more than 9 percent of the System's loan dollar volume and 43 percent of its capital.

Poultry

System loans outstanding to the poultry and eggs sector totaled $5.2 billion, down 4 percent from a year earlier. Most producers reported good profitability as a result of higher poultry and egg prices and reduced feed costs. For the most part, producers used improved profits to pay down debt rather than expanding production. As a result, prices stayed high enough to offset high feed costs.

The System's nonaccrual poultry loans increased 21 percent from 2012 to $86 million at year-end 2013. Loans to this sector totaled nearly 3 percent of the System's loan dollar volume and 12 percent of its capital.

Forestry

System loans outstanding to the forestry sector totaled $12.2 billion, up about 19 percent from a year earlier. Improved demand for housing and higher prices for some lumber prod-

Table 9

Stressed Sectors of the System's Loan Portfolio

As of December 31, 2013

Dollars in Billions

	Loan Dollar Volume	Change from Prior Year-end	Percentage of System's Total Loan Volume	Percentage of System's Nonaccrual Loan Volume
Dairy	$15.2	3%	8%	19%
Cattle	$18.5	5%	9%	10%
Poultry	$5.2	(4%)	3%	5%
Forestry	$12.2	19%	6%	8%
Horticulture	$2.5	(6%)	1%	12%
Biofuels	$1.1	(33%)	<1%	2%

Source: USDA.

ucts spurred loan volume higher, and most regions of the United States saw improved demand.

The System's nonaccrual forestry loans fell 29 percent from 2012 to $141 million at year-end 2013, and the System recorded $15 million in charge-offs. Loans to this sector totaled about 6 percent of the System's loan dollar volume and 29 percent of its capital.

Horticulture

Loans outstanding to horticulture operations declined about 6 percent from last year to $2.5 billion. The decline reflected debt reduction and continued soft demand for landscaping material in the housing sector. Because many of these operations are located in and around urban areas, these properties continued to suffer from distressed values for real estate used in their operations.

The System's nonaccrual horticulture loans fell 29 percent from 2012 to $203 million at year-end 2013. Despite this reduction, these loans accounted for 12 percent of System nonaccrual loans and $33 million in charge-offs. Loans to horticulture totaled just over 1 percent of the System's loan dollar volume and 6 percent of System capital.

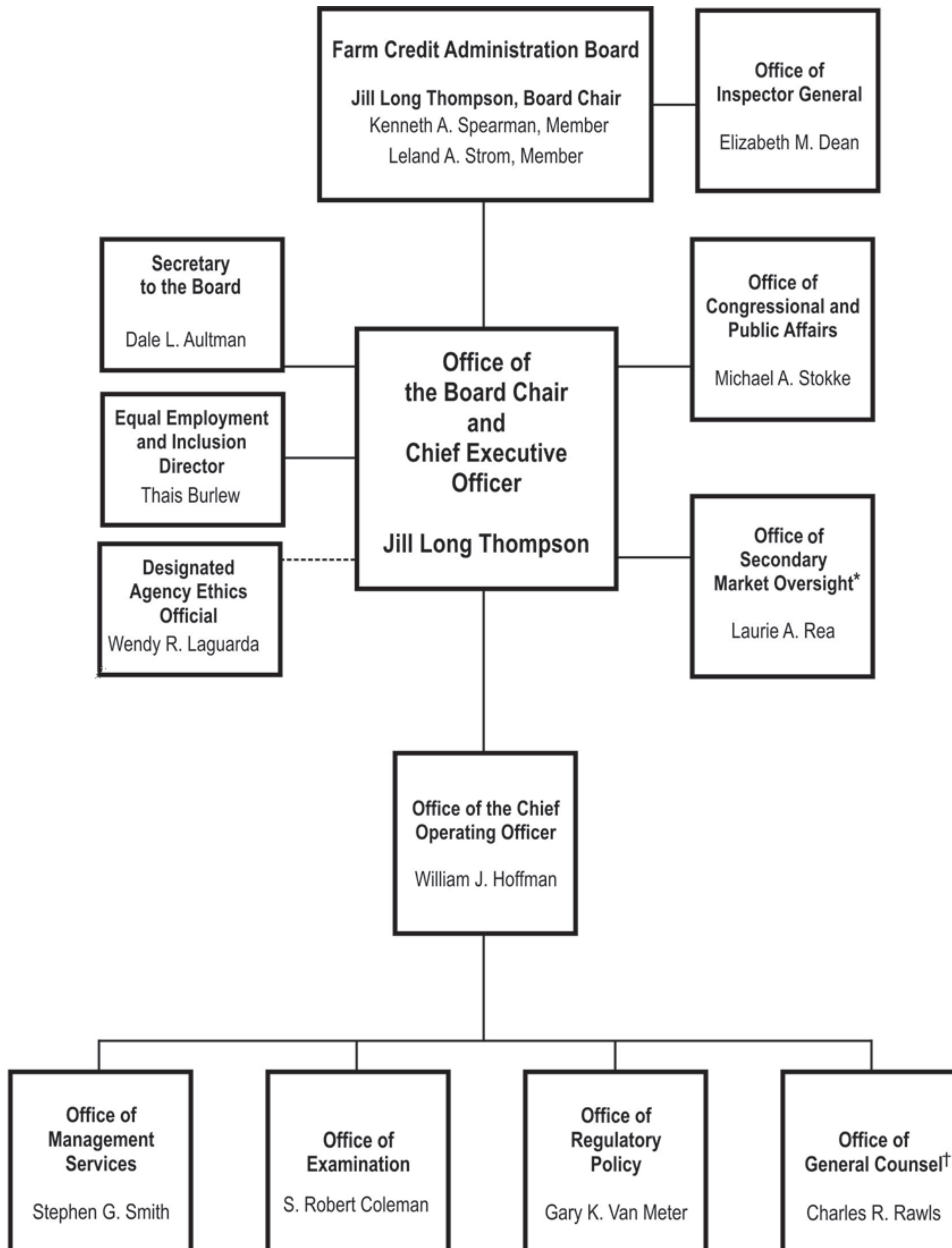
Biofuels

At the end of 2013, loans outstanding to the biofuels (primarily ethanol) industry totaled $1.1 billion, down 33 percent from a year earlier. Most plants were profitable and generated enough cash flow to pay down debt although a few plants remained idle or operated below capacity.

The System's nonaccrual biofuel loans totaled $30 million at year-end 2013, a drop of 68 percent from a year earlier. However, charge-offs totaled $18 million, up 50 percent from a year earlier. Biofuel loans outstanding represented only 3 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 14
FCA Organizational Chart
As of January 2014



***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, 2013, FCA had 281 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 accepting 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. From 2005 until 2011, 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 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 finan-

cial 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 2013 Annual Report on the Farm Credit System is available on FCA's website at www.fca.gov. For questions about this publication, contact FCA:

Office of Congressional and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
Telephone: 703-883-4056
Fax: 703-790-3260
E-mail: info-line@fca.gov

With support from the system banks, 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. These documents are available on the Funding Corporation's website at www.farmcreditfunding.com. For copies of these documents, contact the Funding Corporation:

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

The Farm Credit System Insurance Corporation's annual report is available on its website at www.fcsic.gov. To receive copies of this report, contact FCSIC:

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

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McLean, VA 22102
703-883-4056
www.fca.gov

0614/100