FCSIC

Farm Credit System Insurance Corporation

2017 Annual Report

Protecting Investors
in Agriculture
and Rural America

Mission Statement

The Farm Credit System Insurance Corporation, a government-controlled, independent entity, shall

- protect investors in insured Farm Credit System obligations and taxpayers through sound administration of the Farm Credit Insurance Fund,
- exercise its authorities to minimize Insurance Fund loss, and
- help ensure the future of a permanent system for delivery of credit to agricultural borrowers.

June 19, 2018

Dear Mr. President and Mr. Speaker:

In accordance with section 5.64 of the Farm Credit Act of 1971, as amended, the Farm Credit System Insurance Corporation is pleased to submit its annual report for calendar year 2017.

This report highlights our role as the independent federal corporation established to ensure the timely payment of principal and interest to investors in insured Farm Credit System debt securities. The balance in the Farm Credit Insurance Fund as of December 31, 2017, was $4.85 billion.

We earned $340.8 million in insurance premiums from Farm Credit System banks and earned $57.7 million in investment income in 2017, and expect to incur $4.2 million in operating costs in 2018.

FCSIC is proud of the role we play in supporting the safety and soundness of the Farm Credit System, and we are committed to faithfully fulfilling our mission.

Sincerely,

Jeffery S. Hall
Chairman

The President of the United States Senate
The Speaker of the United States House of Representatives

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Message from the Chairman

I am pleased to present the 2017 Annual Report of the Farm Credit System Insurance Corporation. It is gratifying to note that, for the 28th consecutive year since we began issuing financial statements, our independent public auditor has issued unmodified or unqualified opinions on those statements. In 2017, we expanded our audit coverage to include an audit of our internal control over financial reporting. The enclosed opinion letters indicate that the financial statements of the Farm Credit Insurance Fund, of which we are stewards, are fairly and accurately presented and FCSIC maintained effective internal control over financial reporting.

FCSIC's net income for 2017 was $394.8 million, compared with $414.7 million for the previous year. The Insurance Fund balance as of December 31, 2017, was $4.85 billion, compared with $4.45 billion at year-end 2016.

Revenue from insurance premiums paid by Farm Credit System banks was $340.8 million for 2017, compared with $372.6 million for 2016. Premium revenue decreased for two reasons. Premium assessment rates went down from an average of 17 basis points in 2016 to 15 basis points in 2017, and the growth in insured obligations outstanding was less in 2017. Interest income for 2017 totaled $57.7 million, compared with $45.8 million in 2016.

At the end of 2017, our Insurance Fund exceeded the statutory secure base amount and we transferred $175.8 million to the allocated insurance reserve accounts (AIRAs). In accordance with the Farm Credit Act of 1971, as amended, the FCSIC board subsequently voted to disburse the AIRAs to System banks and the holders of the Financial Assistance Corporation (FAC) stock. The payment of $13.1 million to the holders of the FAC stock, originally issued with $55.8 million par value, fully retired the FAC stock in March 2018.

In accordance with the requirements of the Federal Managers' Financial Integrity Act of 1982, FCSIC management conducts an annual assessment of the corporation's internal controls. The 2017 assessment found that, in the reviewed areas, internal controls comply with the standards prescribed by the U.S. Government Accountability Office and provide reasonable assurance that program objectives are being met.

We will continue to carry out our mission and work in 2018 to achieve our strategic goals and objectives. We are mindful of our public trust and will ensure that investors, Congress, the Farm Credit System, and other regulatory agencies receive timely and accurate information on issues concerning the Insurance Fund.

Sincerely,

Jeffery S. Hall

Board of Directors

The Farm Credit System Insurance Corporation (FCSIC) is managed by a three-member board of directors comprising the same three individuals who make up the Farm Credit Administration (FCA) board. However, the same member may not serve as chairman of both entities. FCA is the independent federal agency responsible for the regulation and examination of the Farm Credit System (System), a nationwide network of financial cooperatives that lend to agriculture and rural America.

Jeffery S. Hall was appointed to the FCA board by President Barack Obama on March 17, 2015, and was elected chairman of the FCSIC board of directors on November 29, 2016.

As chairman of the FCSIC board of directors, Mr. Hall succeeds Dallas P. Tonsager, who served as chairman from March 13, 2015, until November 22, 2016, when the president designated him FCA board chairman and CEO. Mr. Tonsager remains a member of the FCSIC board of directors.

Glen R. Smith was appointed to the FCA board by President Donald Trump on December 8, 2017. Mr. Smith also serves as a member of the board of directors of FCSIC.

Jeffery S. Hall

Jeffery S. Hall is chairman of the board of directors of FCSIC. He was elected to this position on November 29, 2016. Mr. Hall has served on the FCSIC board and on the FCA board since his appointment by President Barack Obama on March 17, 2015. He is serving a term that expires on October 13, 2018.

Before coming to FCSIC and FCA, Mr. Hall was president of The Capstone Group, an association management and consulting firm that he cofounded in 2009. From 2001 to 2009, he was the state executive director for the U.S. Department of Agriculture's (USDA's) Farm Service Agency in Kentucky. In that role, he was responsible for farm program and farm loan program delivery and compliance.

From 1994 to 2001, Mr. Hall served as assistant to the dean of the University of Kentucky, College of Agriculture, advising the dean on state and federal legislative activities and managing a statewide economic development initiative called Ag-Project 2000.

Mr. Hall also served as a senior staff member in the office of U.S. Senator Mitch McConnell from 1988 to 1994. During that time, he was the legislative assistant for agriculture, accountable for internal and external issue management.

Before joining Senator McConnell's staff, Mr. Hall served on the staff of the Kentucky Farm Bureau Federation. Over his 30-year career in agriculture, he has held leadership positions in the following nonprofits: the Kentucky Agricultural Council, the Agribusiness Industry Network, the Louisville Agricultural Club, the Kentucky Agricultural Water Quality Authority, and the Governor's Commission on Family Farms.

Mr. Hall was raised on a family farm in southern Indiana, which has been in his family for nearly 200 years. He is currently a partner in the farm with his mother and sister. Mr. Hall received a Bachelor of Science degree from Purdue University.

Dallas P. Tonsager

Dallas P. Tonsager has served on the FCSIC board of directors and on the FCA board since his appointment by President Barack Obama on March 13, 2015. He served as chairman of the FCSIC board of directors until he was appointed chairman and CEO of FCA on November 22, 2016.

Mr. Tonsager brings to his position on the FCSIC board extensive experience as an agriculture leader and producer, and a commitment to promoting and implementing innovative development strategies to benefit rural residents and their communities.

Mr. Tonsager served as under secretary for rural development at USDA from 2009 to 2013. In this position, he expanded broadband communication in rural America and implemented other key elements of the Recovery Act for rural America. He dramatically expanded USDA's water and wastewater programs, expanded funding for first- and second-generation biofuels, and funded hospitals and other public facilities in rural America.

In addition, Mr. Tonsager worked with the Farm Credit System and others to set up new venture capital investment funds. From 2010 to 2013, he was a member of the Commodity Credit Corporation board of directors.

From 2004 to 2009, Mr. Tonsager served as a member of the FCA board, as well as a member of the FCSIC board of directors.

From 2002 to 2004, he was the executive director of the South Dakota Value-Added Agriculture Development Center. In this position, he coordinated initiatives to better serve producers interested in developing value-added agricultural projects. Services provided by the center include project facilitation, feasibility studies, business planning, market assessment, technical assistance, and education.

In 1993, he was selected by President William J. Clinton to serve as USDA's state director for rural development in South Dakota. Mr. Tonsager oversaw a diversified portfolio of housing, business, and infrastructure loans in South Dakota. His term ended in February 2001.

A longtime member of the South Dakota Farmers Union, Mr. Tonsager served two terms as president of the organization from 1988 to 1993. During that same period, he was a board member of Green Thumb Inc., a nationwide job training program for senior citizens. In addition, he served on the board of National Farmers Union Insurance from 1989 to 1993, and he was a member of the advisory board of the Commodity Futures Trading Commission from 1990 to 1993.

Mr. Tonsager grew up on a dairy farm near Oldham, South Dakota. For many years, he and his older brother owned Plainview Farm in Oldham, a family farm on which they raised corn, soybeans, wheat, and hay. Mr. Tonsager is a graduate of South Dakota State University where he earned a Bachelor of Science degree in agriculture in 1976.

Glen R. Smith

Glen R. Smith was appointed to the Farm Credit System Insurance Corporation board of directors and Farm Credit Administration board by President Donald Trump on December 8, 2017. Mr. Smith will serve a term that expires May 21, 2022.

Mr. Smith is a native of Atlantic, Iowa, where he was raised on a diversified crop and livestock farm. His farm experience started at a very early age, after his father was involved in a disabling farm accident. He graduated from Iowa State University in 1979 with a Bachelor of Science in agricultural business and accepted a position with Doane Agricultural Services as state manager of the company's farm real estate division.

In 1982, Mr. Smith and his wife, Fauzan, moved back to his hometown and started farming and developing his ag service business. Today, their family farm, Smith Generation Farms Inc., has grown to encompass about 2,000 acres devoted to corn, soybeans, hay, and a small beef cow herd.

Mr. Smith is co-owner and founder of Smith Land Service Co., an ag service company that specializes in farm management, land appraisal, and farmland brokerage, serving about 30 Iowa counties. From 2001 to 2016, he was also co-owner and manager of S&K Land Co., an entity involved in the acquisition, improvement, and exchange of Iowa farmland.

Mr. Smith has served on numerous community, church, and professional boards. He was elected to the Atlantic Community School Board of Education on which he served for nine years; during most of this time, he served as either president or vice president.

In 1990, he earned the title of Accredited Rural Appraiser from the American Society of Farm Managers and Rural Appraisers. In 2000, he served as president of the Iowa chapter of that organization. He is a lifelong member of the Farm Bureau, Iowa Corn Growers Association, Iowa Soybean Association, and Iowa Cattlemen's Association.

The Smiths have four grown children and three grandchildren. Three of their children are involved in production agriculture. Their son Peter has assumed managerial responsibilities for both the family farm and business.

2017 — Year in Review

Insurance Fund

In 2017, the Insurance Fund finished the year at or above the statutory 2 percent secure base amount for the first time since 2012. We insured $266.01 billion of Farm Credit System debt securities (principal and interest) and the Farm Credit Insurance Fund (Insurance Fund) held $4.85 billion (2.08 percent of adjusted insured debt outstanding), which was $180 million above the secure base amount. (See table 2 on page 13 and "Insurance Fund Management" on pages 21-22.) Consequently, we transferred $175.8 million to the allocated insurance reserves accounts. (See "Notes to the Financial Statements" on pages F 9-11.) In March 2018, $175.8 million in excess funds were paid to accountholders (Farm Credit Banks and FAC stockholders). The FAC stockholders have been fully reimbursed and no further allocations will be made to this AIRA account.

FCSIC's Operations

FCSIC's first full year of operations was 1993. That year, the Insurance Fund grew to $642 million, insuring $53.70 billion in System debt. We had a nine-member core staff and contracted with FCA for examination and administrative support. Other specialized services were obtained through public and private sector contractual arrangements on an as-needed basis.

Twenty-four years later, the Insurance Fund is about eight times larger, insuring $266.01 billion of System debt. Yet we continue to operate effectively with our small 11-person staff. We continue to carry out our mission in a cost-effective manner by leveraging our resources and purchasing support services from FCA and other public and private sector contractors.

Our operating costs as a percentage of our total assets were 8 basis points (0.08 percent) for 2017, unchanged since 2014. In September 2017, the FCSIC board of directors approved budgets for 2018 and 2019. The 2018 budget is $4.2 million, which is a slight increase of 2.7 percent from the 2017 budget.

Legislative Initiative

As part of our strategic plan, FCSIC is pursuing a legislative initiative to enhance its receivership and conservatorship authorities. Our principal goal is to ensure that FCSIC will have authorities commensurate with those of other Federal receivers and conservators if it is appointed to act as a receiver or conservator for a System institution. In contrast to other federal insurers, our receivership/conservatorship powers and authorities have not been updated since FCSIC's creation in 1987. We have requested that Congress consider the need to amend the Farm Credit Act to add language generally modeled on statutory provisions applicable to other Federal receivers and conservators, but tailored for the Farm Credit System. FCSIC has not had to use its statutory receivership or conservatorship authority since it became operational in 1993. At this time, the System is in a safe and sound condition and no institution is in danger of failing.

New Capital Rule

At the beginning of 2017, FCA's new capital rules went into effect. Capital is one of six components under the Financial Institution Rating System — or FIRS — used to evaluate the safety and soundness of System institutions. The new rules were the product of many years of work by FCA staff and much input by System representatives, who urged FCA to adopt capital rules comparable to commercial bank rules. Table 1 lists the new minimum capital requirements for System institutions and most commercial banks. As indicated, they are comparable.

Table 1
Capital Requirements

New Farm Credit Administration Regulations					The Standardized Approach Rule for the Federal Banking Regulatory Agencies (FBRAs)		Year-end 2017 Ranges	
Ratio	FCS Primary Components of Numerator	Denominator	Minimum Requirement	Minimum Requirement with Conservation Buffer	Minimum Requirement	Minimum Requirement with Conservation Buffer	FCS Banks	FCS Associations
CET1 Capital	Unallocated retained earnings (URE) and equivalents, common cooperative equities (subject to certain conditions)	Risk-weighted assets	4.5%	7.0%	4.5%*	7.0%	10.5%-21.7%	12.3%-36.4%
Tier 1 Capital	CET1 capital, non-cumulative perpetual preferred stock	Risk-weighted assets	6.0%	8.5%	6.0%	8.5%	14.0%-22.2%	12.3%-36.4%
Total Capital	Tier 1 capital, allowance for loan losses, other common cooperative equities and other equity securities not included in tier 1 capital	Risk-weighted assets	8.0%	10.5%	8.0%	10.5%	15.2%-22.3%	13.5%-37.2%
Tier 1 Leverage	Tier 1 capital (1.5% must be URE or URE equivalents)	Total Assets	4.0%	5.0%	4.0%	**	5.7%-7.7%	10.8%-32.0%

*The FBRA's definition of CET1 capital includes common stock instead of common cooperative equities.
**Most U.S. depository institutions are not subject to a tier 1 leverage buffer, but they must maintain a 5.0 percent tier 1 leverage ratio to be considered well-capitalized under the FBRA's prompt corrective action framework.

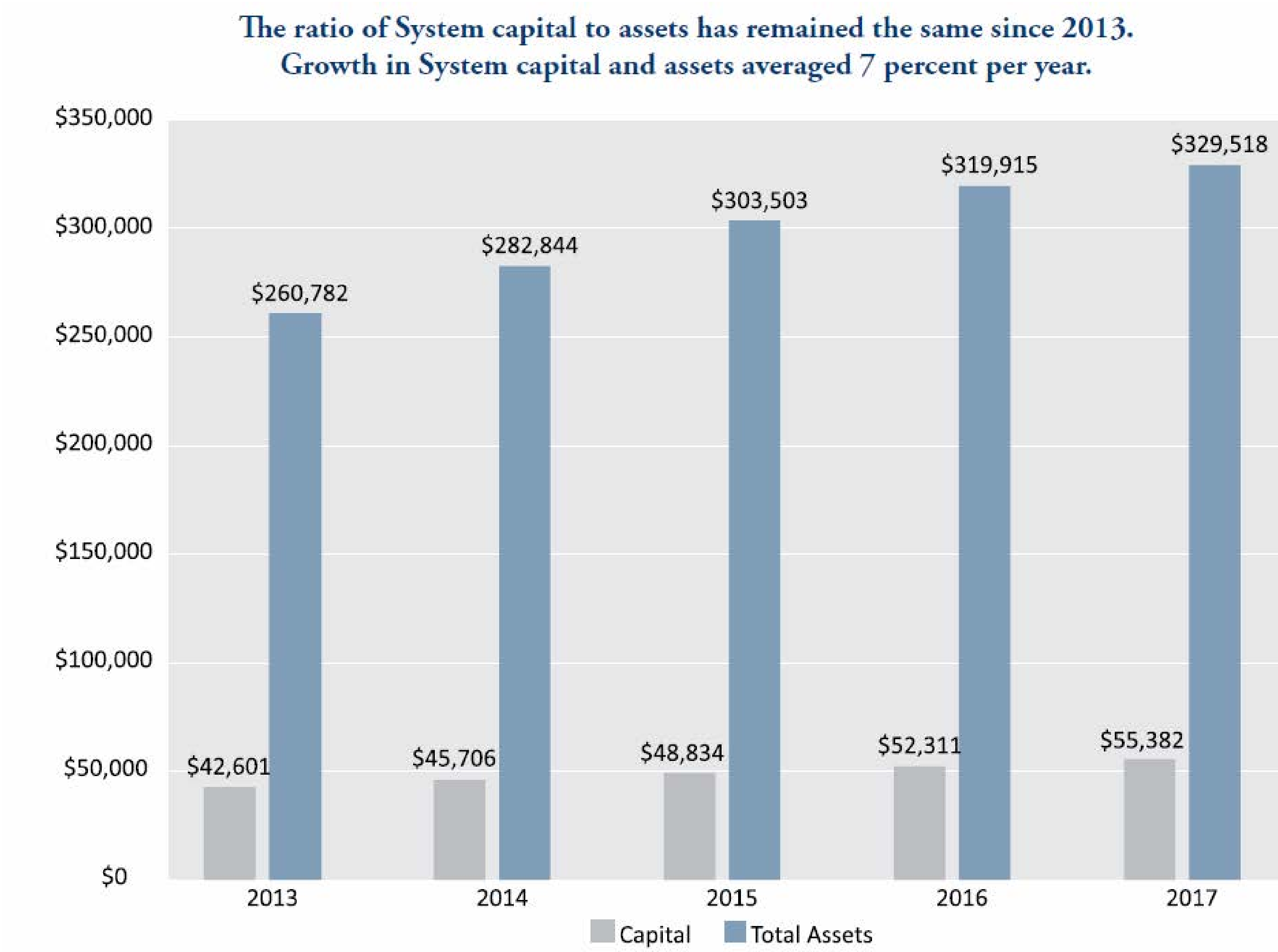
As the table above shows in the final columns, all System institutions exceeded the new required capital minimums at year-end 2017.

The System has grown significantly, averaging 7 percent per year in asset growth since 2013, increasing capital each year while posting a 1.62 percent return on average assets in 2017. The System reported net income of $5.2 billion and as a cooperative it returned $1.7 billion in patronage distributions to borrower-members in 2017.

Figure 1

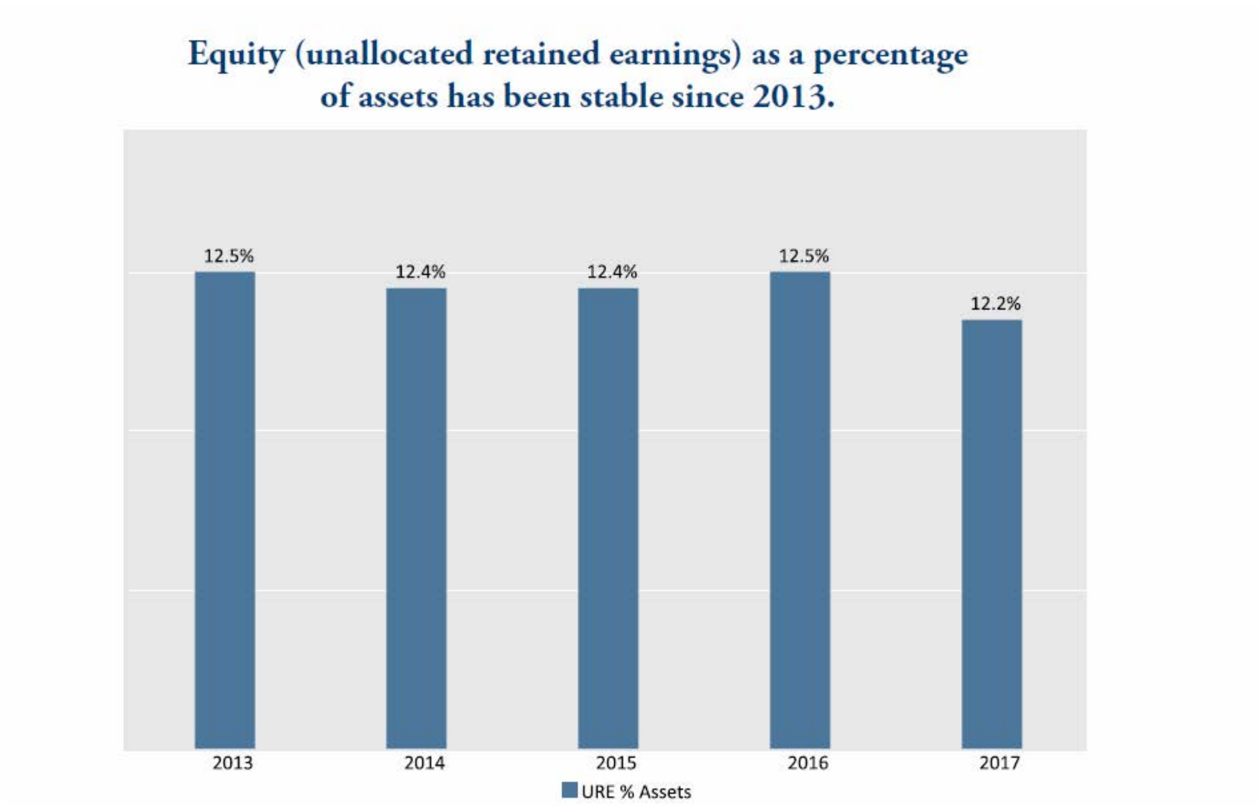
Ratio of System Capital to System Assets

(Dollars in Millions)



For 25 years FCSIC has played a role as insurer to mitigate the System's unique risk as a single-industry lender. FCSIC's $4.8 billion Insurance Fund is invested in U.S. Treasuries and adds a source of strength and liquidity for System lenders. The System includes the Insurance Fund as "restricted capital" on its combined financial statement. Maintaining a strong capital position is essential to retaining public and investor confidence. As figure 2 shows, the System's highest quality capital has remained stable with surplus (unallocated retained earnings) above 12 percent of assets since 2013. Surplus remains stable due to net income earned and retained by System institutions.

Figure 2
System Equity as a Percentage of Assets



Again in 2017, there was a surplus of agricultural commodities, which is projected to continue. This surplus has depressed prices and shrunk farmer working capital. These market conditions are causing a cyclical downturn in certain sectors — for example, grain, biofuels, and farm supply — that lenders will have to contend with in 2018 and beyond. As the data demonstrate, System institutions have grown steadily and performed well, posting competitive returns and adding surplus to build strong levels of capital. Better capitalized institutions can lend more and weather agricultural headwinds, while promoting financial stability and providing the investor confidence required to continue investing in them.

Policy Statement on Internal Controls and Audit Coverage

In January, the FCSIC board adopted a revised policy on internal controls and audit coverage and a revised audit committee charter to ensure the continuing quality, integrity, and transparency of FCSIC's financial reports and to establish the board's specific oversight responsibilities when acting as the corporation's audit committee. Through effective and informed oversight, the audit committee's primary responsibility is to oversee the design and conduct of an enterprise risk management program and internal control process that provides reasonable assurance regarding the achievement of FCSIC's objectives relating to operations, reporting, and compliance. Management is responsible for the design and implementation of an enterprise risk management program and internal control for day-to-day operations and business processes that produce accurate, reliable data for decision-making by management and members of the board and ultimately deliver value for our stakeholders. The board's role is to review and approve the strategy and business decisions proposed by management and to ensure that appropriate policies and systems are in place to control the business. Notable revisions to FCSIC's existing policy include the following:

- Requiring FCSIC's independent auditor to perform an audit of the effectiveness of internal control over financial reporting. This audit should be integrated with an audit of FCSIC's financial statements, and it should comport with requirements of section 404 of the Sarbanes-Oxley Act of 2002 for public companies (SOX 404).
- Formalizing the enterprise risk management process for identifying and assessing risks, establishing risk tolerance thresholds, and managing risks across the organizational structure and areas relative to strategic decisions, budget decisions, program management, and operations support.
- Incorporating whistleblower procedures governing employee complaints of questionable internal control, audit findings, or suspected fraud.
- Enhancing communication by requiring FCSIC staff to annually review their findings from the Federal Managers Financial Integrity Act (FMFIA) internal control review with the board.

This year our independent auditor, Baker Tilly Virchow Krause, LLP, conducted testing on the effectiveness of FCSIC's internal control over financial reporting and issued an opinion that it was effective.

Website Update

We enhanced our digital communications by modernizing the design and content of our website, which can be found at www.fcsic.gov. In addition to information on our investment portfolio, we added frequently asked questions on a variety of topics, including one on premium basics, which we hope stakeholders find useful.

Table 2

Selected Financial Statistics for the Farm Credit System Insurance Corporation

(Dollars in Millions)

BALANCE SHEET	2017	2016	2015
Total assets	$4,848.4	$4,453.5	$4,038.8
Total liabilities	0.7	0.6	0.5
Insurance Fund balance			
Allocated insurance reserves accounts	175.8	0	0
Unallocated Insurance Fund balance	4,671.9	4,452.9	4,038.3
OPERATIONS			
Revenues	398.5	418.4	291.9
Operating expenses	3.7	3.7	3.4
Insurance expense	0	0	0
Net income	$394.8	$414.7	$288.5

The Farm Credit System

Structure and Funding

The Farm Credit System is a network of federally chartered, cooperative lending institutions owned by the agricultural and rural customers it serves, including farmers, ranchers, producers or harvesters of aquatic products, agricultural cooperatives, and farm-related businesses. As of January 1, 2018, the System had 4 banks and 69 associations. Each association has its own chartered territory and is affiliated with one of the four banks. See table 3 for the combined financial statistics for the banks and associations.

Associations receive funding from their affiliated bank and lend directly to their owner-borrowers, providing a consistent and reliable source of agricultural and rural credit throughout the United States, including the Commonwealth of Puerto Rico. One of the System banks (CoBank) also has nationwide authority to make retail loans to cooperatives and other eligible entities.

The banks obtain funds for their operations primarily through the sale of consolidated Systemwide debt securities. The banks own and use the Federal Farm Credit Banks Funding Corporation to issue Systemwide debt securities in the capital markets. As the fiscal agent for the banks, the Funding Corporation partners with a select group of dealers to market and distribute the securities to investors throughout the world. Systemwide debt securities are the general unsecured joint and several obligations of the banks. Systemwide debt securities are not obligations of and are not guaranteed by the U.S. government. In addition, Systemwide debt securities are not the direct obligations of the System associations and, as a result, the capital of the associations may not be available to support principal and interest payments on Systemwide debt securities.

Table 3

Combined Farm Credit System Statistics

(Dollars in Billions)

	2017	2016	2015
Insured debt outstanding[1]	$266.0	$258.4	$243.8
Production agriculture:			
Real estate mortgage loans	119.5	114.5	107.8
Production and intermediate-term loans	51.7	50.3	49.2
Agribusiness loans[2]	42.2	39.6	36.6
Communication loans	6.3	6.0	6.2
Energy, water, and waste disposal loans	21.7	21.4	19.6
Rural residential real estate loans	7.3	7.2	7.1
Agricultural export loans	5.6	5.5	5.1
Lease receivables	3.7	3.5	3.4
Loans to other financing institutions	0.8	0.8	0.9
Cash and investments	61.8	62.6	59.4
Net income	5.2	4.8	4.7
Nonperforming loans as a percentage of total loans	0.8%	0.8%	0.7%

1. Insured debt outstanding is based on System institution call report information and reflects the book value of insured debt outstanding plus accrued interest as of December 31, 2017, 2016, and 2015. (Book value excludes fair-value adjustments.)
2. As of December 31, 2017, agribusiness loans consisted of loans to cooperatives of $17.33 billion, processing and marketing loans of $21.58 billion, and farm-related business loans of $3.29 billion.

Investor Protection

Investors provide the funds that the System lends to agriculture and rural America. FCSIC's primary purpose, as defined by the Farm Credit Act, is to insure the timely payment of principal and interest on Systemwide debt securities purchased by these investors.

Regulatory Oversight

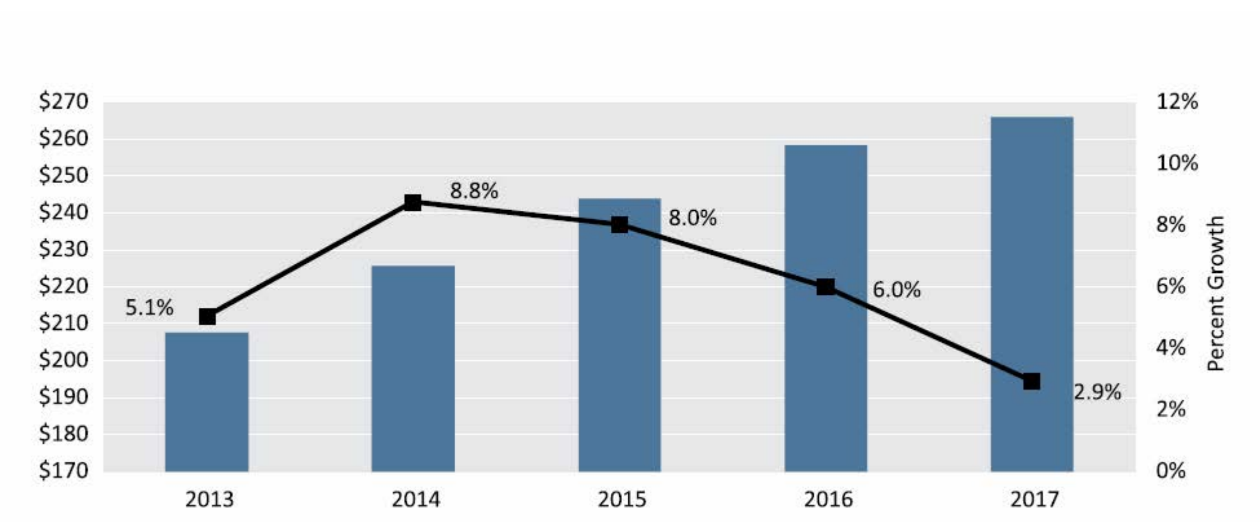
The Farm Credit Administration is the regulator of the Farm Credit System, responsible for the examination, supervision, and regulation of each System institution. FCA is an independent agency in the executive branch of the U.S. government and derives its authorities from the Farm Credit Act. These authorities include examination and enforcement authorities similar to those of commercial bank regulators. The U.S. Senate Committee on Agriculture, Nutrition, and Forestry and the U.S. House of Representatives Committee on Agriculture oversee FCSIC, FCA, and the System.

Insured and Other Obligations

FCSIC insures Systemwide and consolidated bonds, notes, and other obligations issued by System banks through the Federal Farm Credit Banks Funding Corporation under section 4.2(c) or (d) of the Farm Credit Act. Figure 3 shows that insured debt outstanding increased by 2.9 percent in 2017 to $266.0 billion, compared with an increase of 6.0 percent in 2016.

Figure 3

Insured Debt Outstanding:
Growth Averaged 6.2 Percent Over the Past 5 Years
(Dollars in Billions)



Note: Insured debt outstanding, which is based on the call report information provided by System institutions, reflects the book value of insured debt outstanding, plus accrued interest. (Book value excludes fair-value adjustments.)

We also ensure the retirement of eligible borrower stock, also known as protected borrower stock, at par value, as required by section 4.9A of the Farm Credit Act. At year-end 2017, protected borrower stock outstanding at System institutions totaled $1 million, unchanged since year-end 2013.

Farm Credit System Capital

The primary source of funds to repay insured Systemwide debt securities is the System's borrowers. Each borrower must have a minimum net worth and, in most cases, collateral posted in connection with his or her loan. The borrower makes payments on the loan to the lending bank or association, and it is the banks that ultimately repay Systemwide debt securities.

The lending association in turn makes payments on its loan to the lending bank. All the banks and associations currently exceed their minimum regulatory capital requirements as protection and support for the repayment of the outstanding insured debt.

If a bank were unable to repay its portion of an insured Systemwide debt obligation, FCSIC would use the Insurance Fund to make the payment on its behalf. If the assets in the Insurance Fund were exhausted, the Farm Credit Act's provisions for joint and several liability would be triggered, requiring the other System banks to repay the defaulting bank's portion of the debt.

As figure 4 shows, the amount of System bank capital plus the balance in the Insurance Fund increased 25 percent, from $18.6 billion at year-end 2013 to $23.2 billion at year-end 2017. However, bank capital plus the amount in the Insurance Fund as a percentage of insured debt outstanding decreased from 9.0 percent in 2013 to 8.7 percent in 2017 (see figure 5). Without the Insurance Fund, bank capital as a percentage of insured debt was 6.9 percent and 6.8 percent at year-ends 2017 and 2016, respectively.

Overall, the financial performance and condition of the System on a consolidated basis remain strong, although some institutions continue to experience stress from credit deterioration in certain agricultural sectors. (See trends in the Financial Institution Rating System [FIRS] in the "Risk Management" section beginning on page 29.)

A bank's credit exposure to borrowing associations is partially mitigated by the associations' capital levels. Increases in System associations' capital levels, the result of higher retention levels of strong association net incomes, further reduces credit risk. As figure 6 shows, from 2013 to 2017, combined association capital increased $9.1 billion — an annual average increase of approximately 7.8 percent. Since 2013, the associations have collectively achieved solid earnings and preserved capital, causing association capital as a percentage of total association assets to increase to 19.3 percent in 2017 from 18.5 percent in 2013 (see figure 7).

Figure 4

Bank Capital Plus Insurance Fund

(Dollars in Billions)

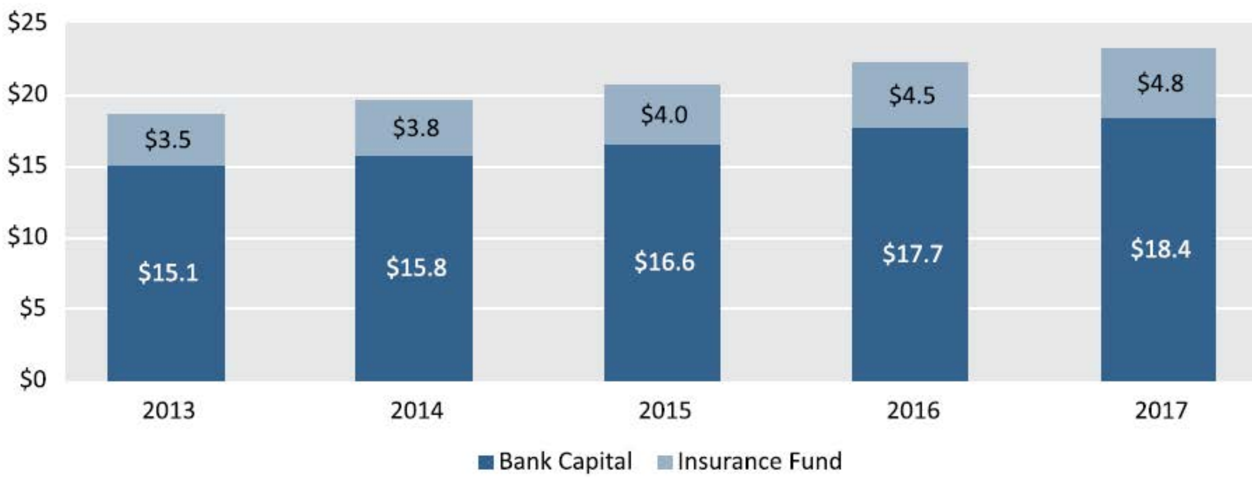


Figure 5

Bank Capital Plus Insurance Fund as Percentage of Insured Debt

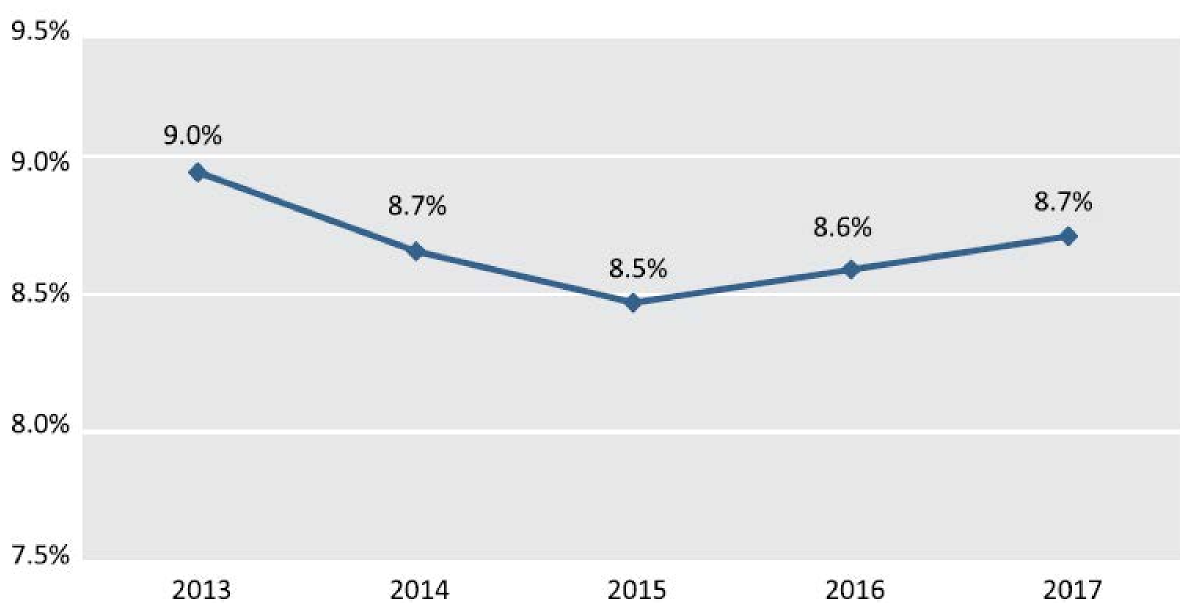


Figure 6

Combined Association Capital

(Dollars in Billions)

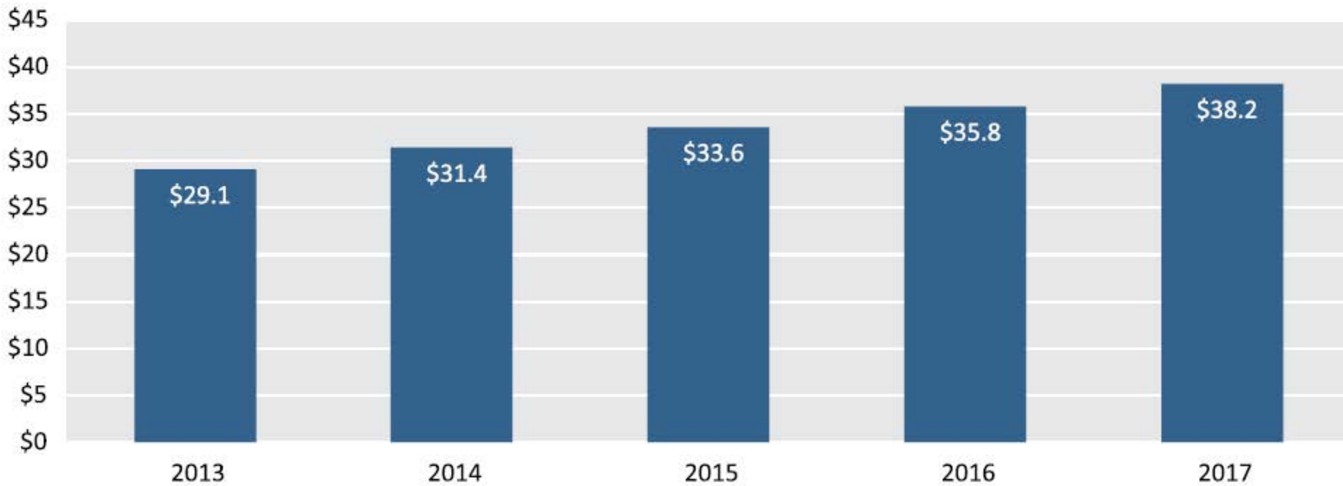
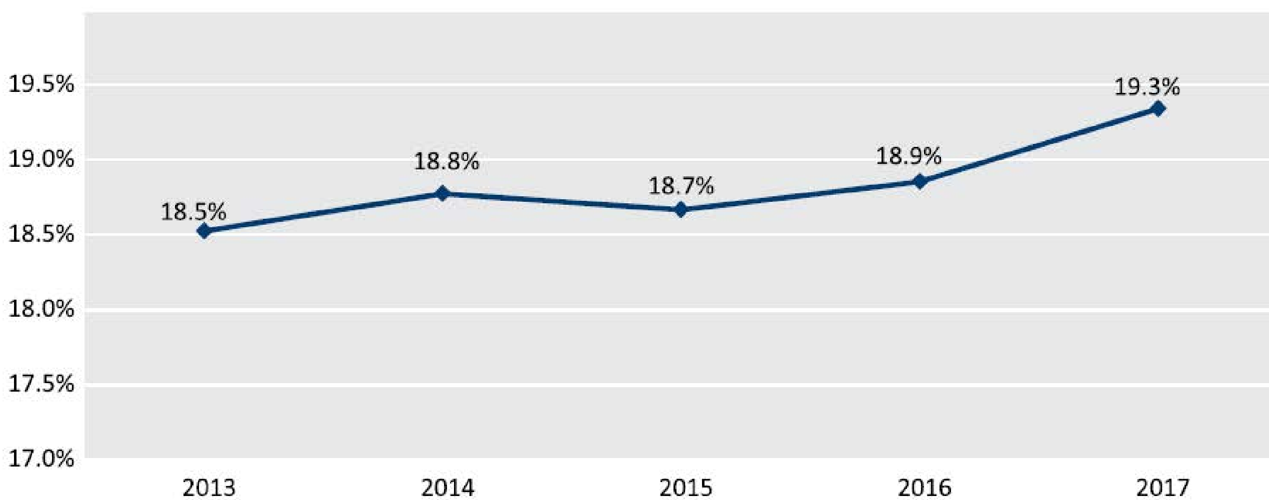


Figure 7

Combined Association Capital as Percentage of Total Association Assets



Additional Protections

Farm Credit System banks use additional risk management tools to protect investors. One tool is the Contractual Interbank Performance Agreement (CIPA). All System banks have entered into this agreement, which measures the financial condition and performance of each bank by using ratios that consider bank capital, asset quality, earnings, interest rate risk, and liquidity. The CIPA contains triggers that financially penalize banks that do not meet performance standards.

The System banks and the Federal Farm Credit Banks Funding Corporation have also entered into the Market Access Agreement. The Market Access Agreement establishes conditions for each bank's continued participation in the debt market. If a bank fails to meet agreed-upon performance measures, the bank may be restricted from issuing debt. The criteria used under the Market Access Agreement are the CIPA scores and the bank's tier 1 leverage and total capital ratios.

The Farm Credit Administration's liquidity regulation also requires the banks to strengthen management of liquidity risk and maintain a three-tiered liquidity reserve to better withstand a liquidity crisis.

Each System bank is authorized to hold eligible investments in an amount not to exceed 35 percent of its total outstanding loans for the purposes of maintaining a liquidity reserve, managing short-term surplus funds, and managing interest rate risk. The liquidity reserve must consist at all times of marketable investments that are sufficient to fund 90 days of on-balance-sheet maturing obligations. The System banks are further required to maintain a liquidity reserve, consisting of level 1 instruments to cover each bank's maturing obligations for the first 15 days; level 1 and 2 instruments sufficient to cover days 16 to 30; and level 1, 2, and 3 instruments to cover days 31 to 90. All four System banks exceeded these equirements in 2017.

Insurance Fund Management

The Insurance Fund and the Secure Base Amount

The Farm Credit Insurance Fund represents FCSIC's equity, the difference between total assets and total liabilities, including insurance obligations. The Insurance Fund is composed of an unallocated insurance fund (the portion of the Insurance Fund for which no specific use has been designated) and an allocated insurance fund (the portion of the Insurance Fund that has been transferred to the allocated insurance reserves accounts [AIRAs]). Insurance premiums are due until the unallocated portion of the Insurance Fund reaches the secure base amount.

The Farm Credit Act established the secure base amount as 2 percent of the aggregate outstanding insured obligations (adjusted to exclude 90 percent of federal government–guaranteed loans and investments and 80 percent of state government–guaranteed loans and investments). As an alternative, the act also gives FCSIC the discretion to choose another percentage that we determine to be actuarially sound to maintain in the Insurance Fund, considering the risk of insuring outstanding debt obligations.

Table 4

How the 2 Percent Secure Base Amount is Calculated

(Dollars in Millions)

For example at yearend:	December 31, 2017
Total Systemwide insured debt securities (principal + interest)	$266,008
Subtract:	
i. 90 percent federal government–guaranteed loans and investments ii. 80 percent state government–guaranteed loans and investments	-32,624
	$233,384
= Adjusted insured debt	x 2%
= Secure base amount	$4,668

FCSIC's premiums are set with the goal of reaching and maintaining the 2 percent secure base amount. However, if growth of insured debt is greater than forecast when premium rates are established (or the Fund is used for some authorized purpose), the Insurance Fund will end the year below the secure base amount, and FCSIC will need to collect additional premiums in the following year to make up the shortfall. If growth of insured debt is less than forecast when premium rates are set, then the Insurance Fund may end the year above the secure base amount (see table 5).

If the Insurance Fund exceeds the secure base amount at the end of any calendar year, FCSIC allocates those amounts, minus operating expenses and insurance obligations, to the allocated insurance reserve accounts established by Congress for the benefit of the System banks and holders of Financial Assistance Corporation stock (FAC stockholders). Once FCSIC determines that the allocation is appropriate and that the AIRA funds are not otherwise needed, FCSIC may pay the amounts in the AIRAs to the account holders in accordance with the formula specified in the Farm Credit Act. FAC stockholders receive 10 percent of any distribution until they have received $56 million under the terms of the act. In 2010, FCSIC returned a total of $205.3 million to System institutions, with $20.5 million paid to FAC stockholders. In 2012, FCSIC returned a total of $221.9 million, with $22.2 million paid to FAC stockholders. In 2018, FCSIC returned a total of $175.8 million, with $13.1 million paid to FAC stockholders, completing the payoff of outstanding FAC shares.

Table 5

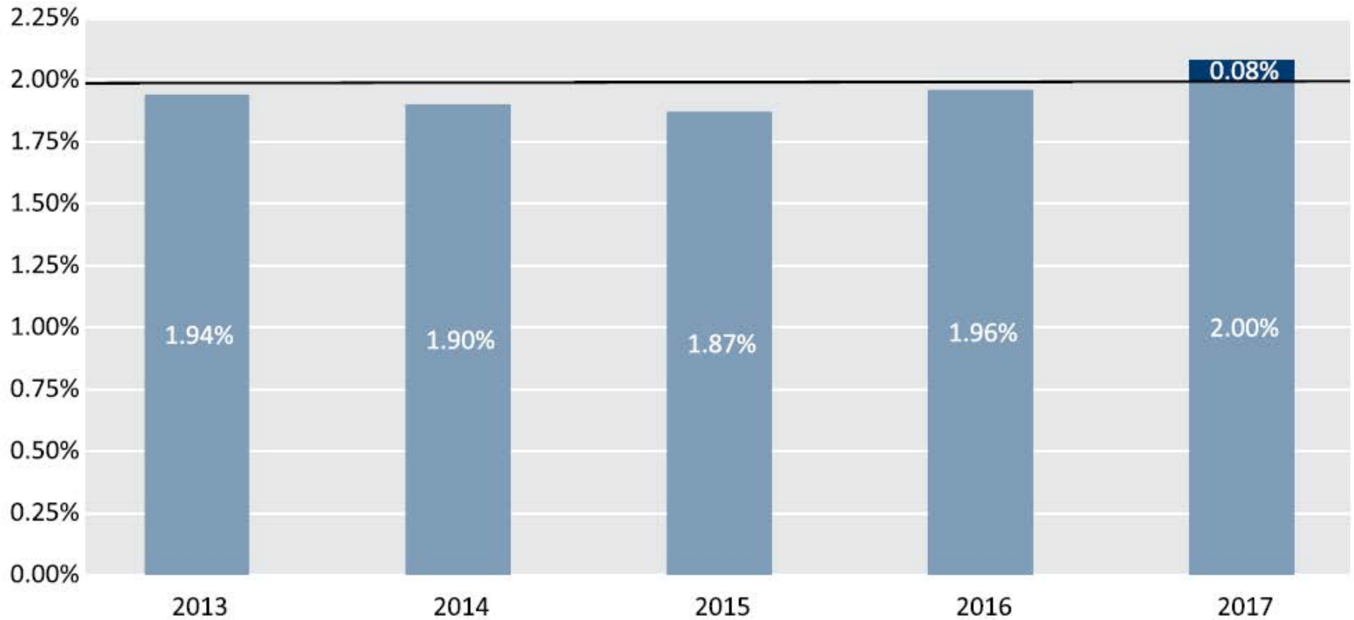
Calculation of Secure Base Amount

Results as of December 31, 2017
(Dollars in Millions)

Debt Outstanding	12/31/2016 (Final)	5/31/2017	12/31/2017 (Final)
Total Principal and Interest	$258,432	$257,932	$266,008
Less:			
90 percent federal government–guaranteed loans	(5,285)	(5,330)	(5,300)
80 percent state government–guaranteed loans	(21)	(21)	(21)
90 percent federal government–guaranteed investments	(26,088)	(27,968)	(27,303)
80 percent state government–guaranteed investments	-	-	-
Total deduction	(31,394)	(33,319)	(32,624)
Adjusted insured debt	227,038	224,613	233,384
Secure base amount (2%)	4,541	4,492	4,668
Unallocated and allocated Insurance Fund balance	4,453	4,618	4,848
Unallocated and allocated Insurance Fund as a percentage of adjusted insured debt	1.96%	2.06%	2.08%

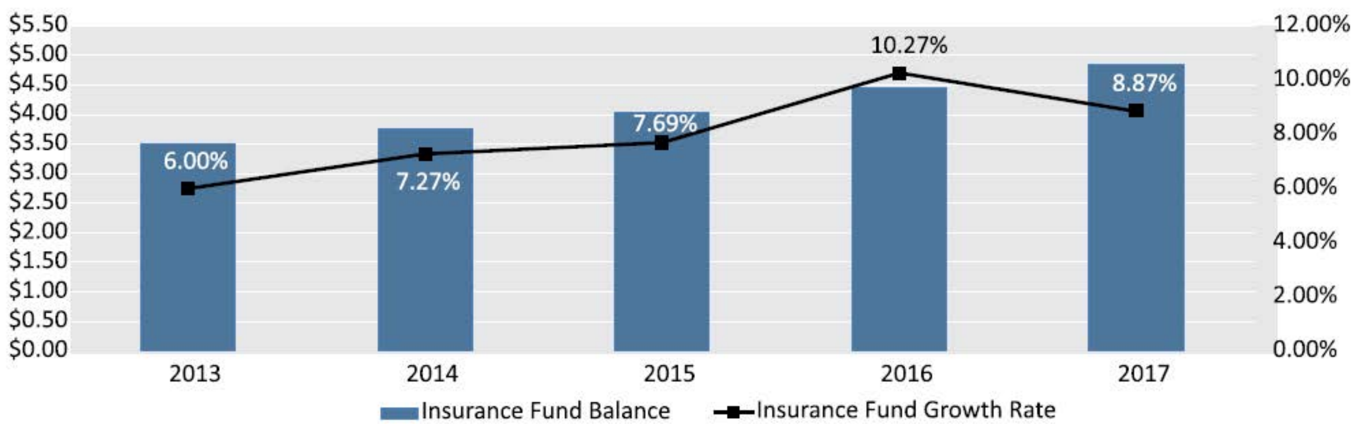
Both total Insurance Fund and total assets increased by 8.9 percent to $4.85 billion in 2017. Insured debt outstanding grew $7.6 billion in 2017 (2.9 percent). The Insurance Fund finished 2017 at 2.08 percent, which was $180 million above the secure base amount (see figure 8). Consequently, $175.8 million were transferred to the allocated insurance reserves accounts.

Figure 8
Insurance Fund Relative to 2 Percent Secure Base Amount



Total Insurance Fund growth over the past five years averaged 8.02 percent annually (see figure 9). We did not accrue a provision for insurance obligations in 2017.

Figure 9
Insurance Fund Balances and Growth Rates
(Dollars in Billions)



Premiums

The FCSIC board reviews premium assessment rates as often as necessary but at least semiannually. The review focuses on five factors:

- The level of the Insurance Fund relative to the secure base amount
- Projected losses to the Insurance Fund
- The condition of the System
- The health of the agricultural economy
- Risks in the financial environment

The Farm Credit Act requires premium assessments to be 20 basis points on adjusted insured debt outstanding unless they are reduced by the board of directors. There is a risk surcharge of up to 10 basis points on nonaccrual loans and on other-than-temporarily impaired investments. In addition, the Act reduces the total insured debt on which premiums are assessed. The Act requires that premiums be based on outstanding insured debt obligations adjusted downward by 90 percent of federal government-guaranteed loans and investments and by 80 percent of state government-guaranteed loans and investments.

The most important factors in determining premium rates for 2017 were the Insurance Fund balance and prospects for Systemwide debt growth during the year. The Insurance Fund began 2017 at $88 million below the 2 percent secure base level. Based on System growth projections that ranged from 4.5 percent to 6.2 percent, with a 5.0 percent weighted average, the FCSIC board set the assessment rate on adjusted insured debt at 15 basis points for 2017.

Through May 2017, insured debt outstanding decreased by $0.5 billion or 0.2 percent. We conducted a survey of the four System banks in May 2017 to update growth projections for the use of insured debt obligations for the remainder of 2017. Growth estimates ranged from 3.5 percent to 7.3 percent, with a weighted average growth rate of 4.6 percent, just slightly below the January projection.

Interim financial statements for May 31, 2017, indicated that the Insurance Fund was estimated to be at 2.06 percent of adjusted insured obligations, or $126 million above the secure base amount. This represented an improvement of $214 million from the beginning of the year. The board, at its June meeting, maintained the premium assessment rate on adjusted insured debt at 15 basis points for the second half of 2017 because the survey of the four system banks projected continued growth for Systemwide debt.

Systemwide use of insured debt obligations increased less than expected during the second half of 2017. Consequently, the Insurance Fund finished 2017 above the 2 percent secure base level, at 2.08 percent of adjusted insured obligations or $180 million above the target level.

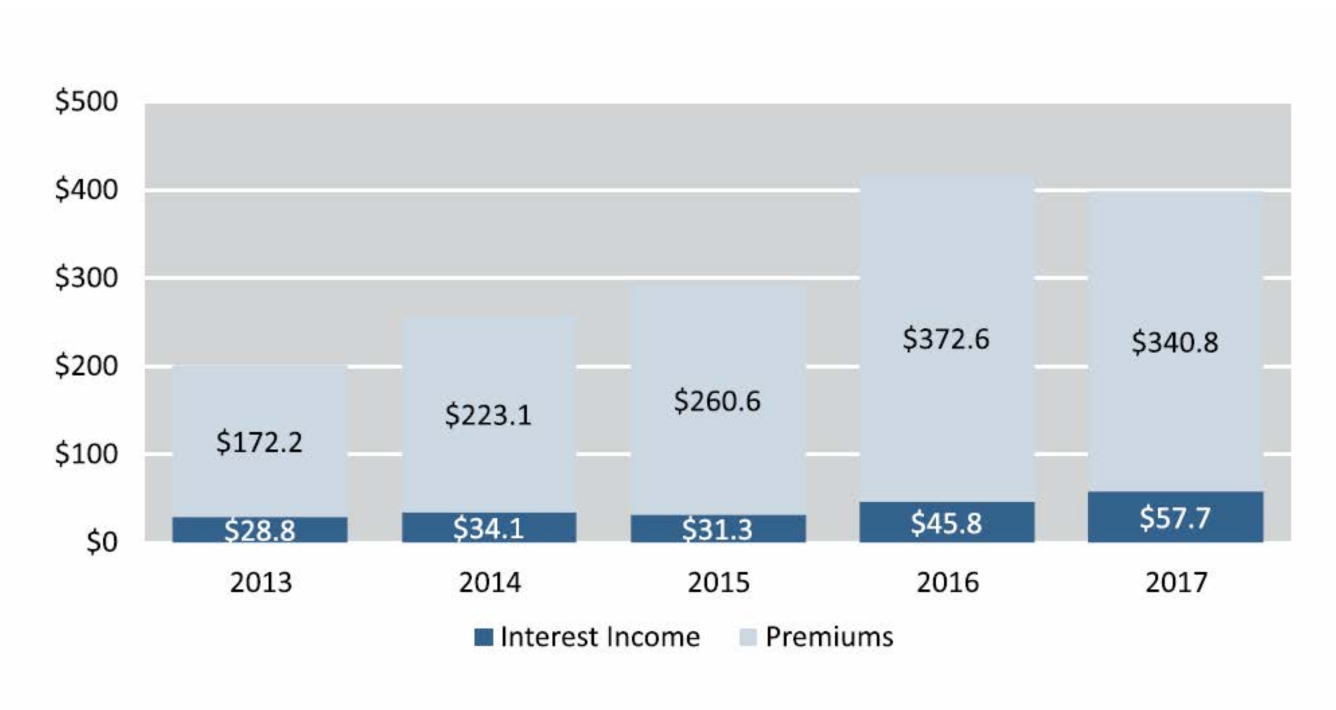
Our board of directors decreased the assessment rate on adjusted insured debt to 9 basis points for 2018 because of slower expected growth in insured debt obligations. The board also continued the risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments.

Revenues and Expenses

FCSIC operates with no annually appropriated funds. We collect insurance premiums from each Farm Credit System bank. These premiums and the income from our investment portfolio provide the funds necessary to fulfill our mission.

Our revenues decreased by 5 percent to $398.5 million in 2017 from $418.4 million in 2016 (see figure 10). Revenues decreased primarily because of lower insurance premiums in 2017. Interest income increased 26 percent in 2017 to $57.7 million from $45.8 million in 2016.

Figure 10
FCSIC Revenues
(Dollars in Millions)



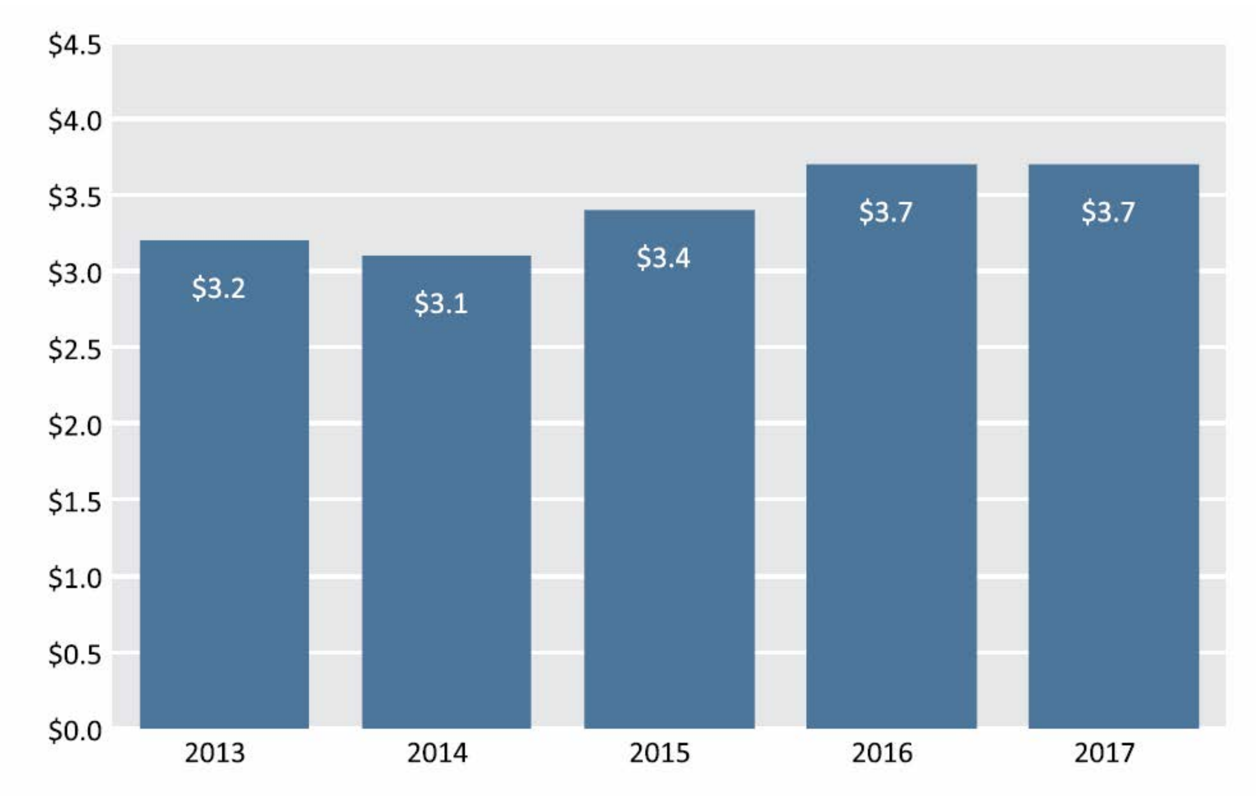
To avoid duplication of effort and to minimize costs, we operate with a small core staff and use private- and public-sector contractors to leverage our efforts. Our board of directors and management adopted this model as a cost-effective and efficient way to use available expertise, services, and resources to accomplish our mission.

Our operating costs as a percentage of total assets represented 8 basis points for 2017, unchanged since 2014. Costs for staff salaries, travel, rent, and miscellaneous expenses were $2.9 million of the $3.7 million total for the year (see figure 11). The remaining expenses of $0.8 million were for contract services.

Figure 11

FCSIC Operating Expenses

(Dollars in Millions)



Investments

FCSIC investments increased during the year from $4.0 billion as of December 31, 2016, to $4.5 billion as of year-end 2017 (see figure 12). An investment security of $30.0 million matured on December 31, 2017, and its proceeds were classified as "other receivables" on our balance sheet. An overnight investment of $1.413 million was classified as "cash and cash equivalents."

Our primary investment objective is to ensure adequate liquidity of the Insurance Fund to meet our mission, and our secondary objective is to optimize the rate of return on our investment portfolio. Funds are invested in U.S. Treasury securities in accordance with the Farm Credit Act and our investment policy.

We added new benchmarks in 2014 to enhance our ability to assess portfolio performance. Three weighted-average Treasury yield benchmarks serve as primary benchmarks. Two Treasury index funds serve as secondary benchmarks. These index funds are considered secondary benchmarks because a portion of their returns is generated through trading. The FCSIC Policy Statement Concerning Investments prohibits trading for capital gains purposes.

In 2017, the average portfolio yield was 1.31 percent, up from 1.14 percent the prior year, while the average return for the primary benchmarks ranged from 0.97 percent to 1.37 percent. The average return for the secondary benchmarks ranged from 0.74 percent to 0.83 percent for 2017.

In accordance with our investment policy, our portfolio is composed of a liquidity pool and an investment pool. The liquidity pool consists of short-term Treasury securities maturing in 2 years or less. The investment pool is composed of Treasury securities with maturities that vary from 2 to 10 years. Our investment policy requires the liquidity pool to be at least 20 percent of the portfolio. The policy also states that securities maturing in 5 to 10 years must not exceed 20 percent of the portfolio.

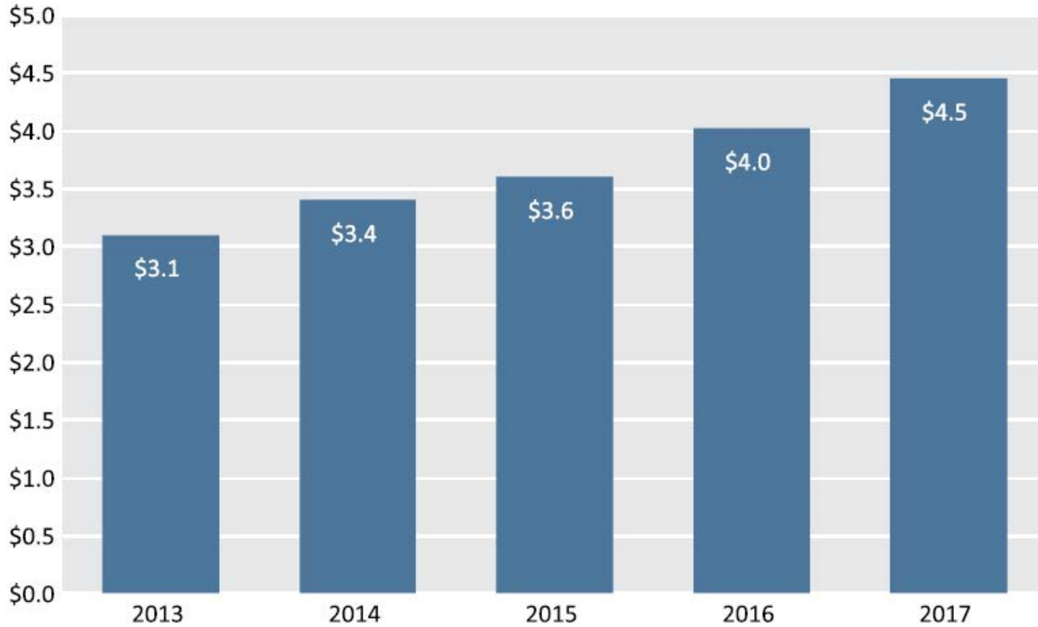
The weighted-average maturity of the portfolio at year-end was 1.84 years. The composition of the investment portfolio as of December 31, 2017, is shown in figure 13.

In June 2008, we began purchasing Treasury inflation protected securities (TIPS). TIPS have a stated rate of interest, payable semiannually, which is applied to the inflation-adjusted principal. TIPS provide a hedge against inflation, in terms of both yield and market value. TIPS have experienced monthly inflation or deflation adjustments, but the United States has not had an annual deflationary environment since 1954, more than 60 years ago. Because of the volatility of the monthly returns on TIPS and the risk of loss resulting from deflation, the FCSIC Investment Committee limits TIPS to no more than 20 percent of the portfolio. At year-end 2017, our TIPS investments totaled $134 million or 3 percent of the investment portfolio.

Figure 12

FCSIC Investments

(Dollars in Billions)

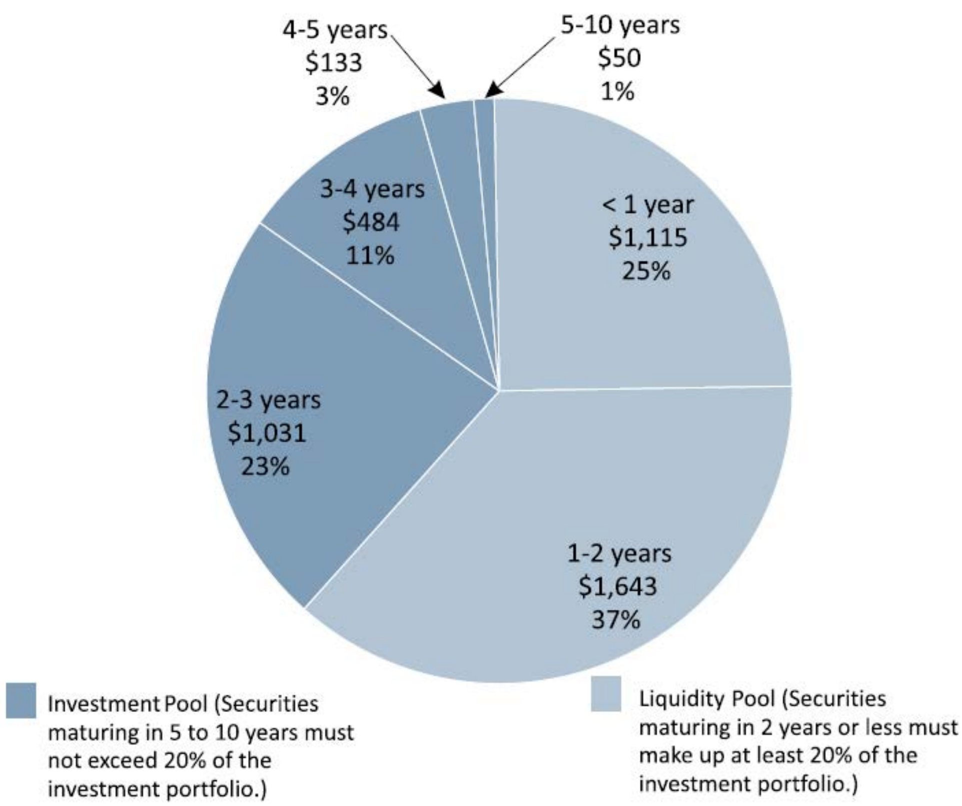


Note: Total investments reflected on this chart do not include overnight investments classified as "cash and cash equivalents" from the balance sheet.

Figure 13

Investment Portfolio by Maturity as of December 31, 2017

(Dollars in Millions)



Note: Total investments reflected in this chart include overnight investments classified as "cash and cash equivalents" from the balance sheet.

Risk Management

FCSIC's Risk Profile

FCSIC's primary purpose is to insure the timely payment of principal and interest on Systemwide debt securities. The System banks, through the jointly owned Federal Farm Credit Banks Funding Corporation, issue Systemwide debt securities, insured by FCSIC, to fulfill their mission.

The System is exposed to a variety of risks, some inherent in the financial services industry and others specific to providing credit to agriculture and rural America. Those risks include the following:

- Credit risk — risk of default on a debt that may arise from a borrower failing to make required payments
- Liquidity risk — risk that an institution may be unable to meet short-term financial demands without unacceptable losses
- Interest rate risk — risk that changes in interest rates may reduce the value of assets with a consequent negative impact on operating results and financial condition
- Operational risk — prospect of losses resulting from inadequate or failed procedures, controls, systems, or policies, including employee errors, systems failures, or fraud or other unauthorized activity
- Structural risk — risk related to the design of the Farm Credit System. For example, as a lender to a single industry (agriculture), the System has a built-in concentration risk.
- Reputational risk — risk resulting from events that affect the reputation of the System or the agriculture industry
- Political risk — risk of loss of support from federal and state governments

Risk to the Insurance Fund increases when adverse circumstances impair the ability of the System banks to repay their insured obligations. To carry out our mission, FCSIC monitors conditions in the farm, rural, domestic, and global economies that affect the System's ability to repay their insured debt obligations. We have identified risks, including the following, that when elevated, pose risks to the Insurance Fund:

- Changes in farmland values
- Price volatility for agricultural commodities
- Changes in government support programs for agriculture
- Changes in government support for government sponsored enterprises
- Loan concentrations in System institution portfolios
- Changes in supply and demand for U.S. agricultural products
- Changes in international trade and the value of the U.S. dollar
- Changes in production costs
- Changes in the domestic economy that affect incomes from off-farm jobs
- Weather conditions
- Environmental and regulatory costs
- Availability of agricultural workers

The Risk Environment in 2017

The U.S. economy continued a modest pace of expansion in 2017. The Bureau of Economic Analysis (U.S. Department of Commerce) reports economic output as measured by real gross domestic product (GDP) increased 2.3 percent in 2017 compared with an increase of 1.5 percent in 2016. The labor market continued to show resilience eight years into the economic expansion as unemployment declined from 10 percent at its peak in October 2009 to 4.1 percent at year-end 2017. Inflation gained momentum after hitting a soft patch in 2016. The year-over-year seasonally adjusted consumer price index increased 2.1 percent as of December 2017.

Consumer spending remained strong despite modest growth in wages. Consumer spending increased 2.8 percent in 2017, contributing about 1.89 percent to real GDP growth. Business investment improved after being negative in 2016. Business investment increased 3.3 percent in 2017, contributing about 0.54 percent to real GDP growth. Government expenditures were mostly unchanged, contributing 0.02 percent to real GDP growth. Net exports continued to be a drag on the economy, with a negative contribution of 0.18 percent to real GDP growth in 2017.

The Federal Open Market Committee, a committee of the Federal Reserve Board, raised the target range for the federal funds rate to between 1.25 percent and 1.50 percent in December 2017. It again raised the target range in March 2018 to between 1.50 percent and 1.75 percent. The Federal Open Market Committee continues to indicate that economic conditions, including inflation, will warrant only gradual increases in the federal funds rate.

Agriculture continued to experience stress in 2017. As in 2016, weak commodity prices, particularly for grains, continued to pressure producers and hurt rural economies. The U.S. Department of Agriculture's (USDA's) February 2018 outlook for the farm economy estimates farmers' net cash income for 2017 at $96.9 billion, up $2.9 billion from 2016 and down $9.0 billion from its 10-year average of $105.9 billion. USDA forecast 2018 farmers' net cash income will decrease by $5.0 billion to $91.9 billion, which is $14 billion below the 10-year average. The expected decline is primarily due to an increase in cash expenses of $3.0 billion and a decrease in cash receipts for crops and livestock of $2.0 billion.

USDA projects farm sector assets will rise 1.6 percent to $3.1 trillion in 2018 with most of that increase coming from a forecasted 2.1 percent increase in farm sector real estate, which comprises about 84 percent of farm sector assets. Farm sector debt is expected to grow by 1.0 percent to $388.9 billion during the year. As a result, farm sector equity (assets minus debt) is expected to rise 1.6 percent in 2018 to nearly $2.7 trillion.

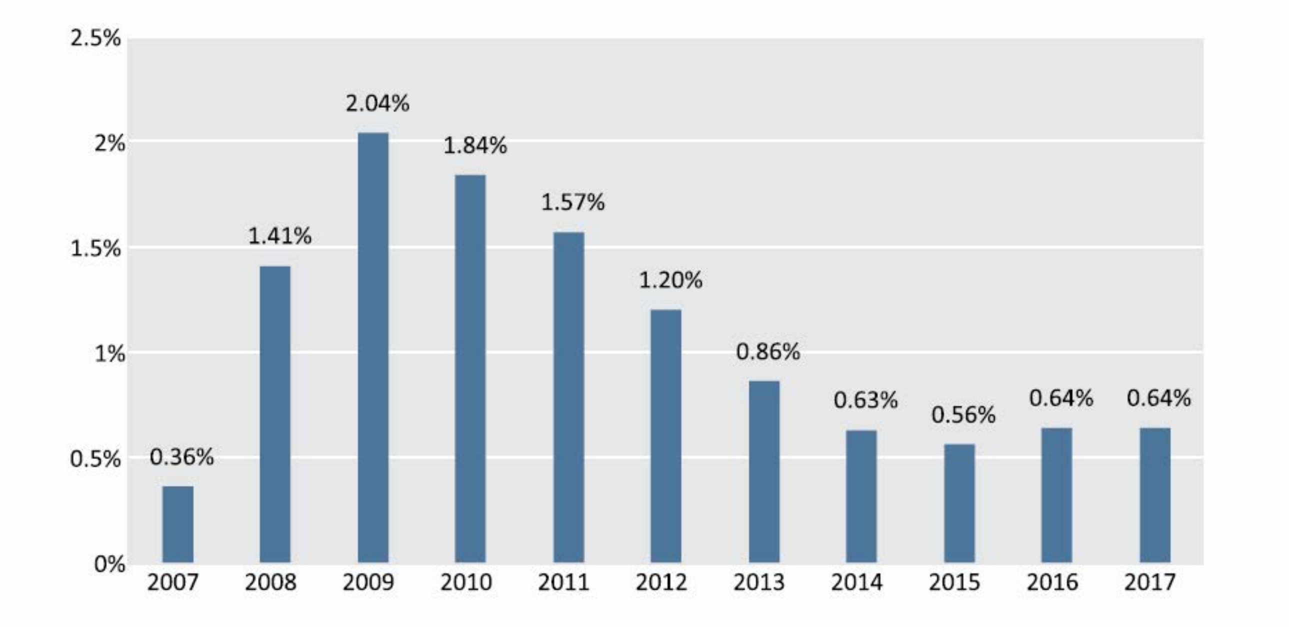
The System reported net income of $5.189 billion for 2017, up 7 percent from $4.848 billion in 2016. Net interest margin was 2.48 percent compared with 2.49 percent for 2016. The net interest rate spread was 2.25 percent compared with 2.31 percent in 2016. The decrease in net interest rate spread was largely attributable to an increase in debt costs and lower lending spreads due to competitive pressures.

The System's loan volume increased $10.0 billion or 4 percent to $258.8 billion at year-end 2017 compared with $248.8 billion at the end of 2016. The growth was primarily due to increased real estate mortgages, agribusiness, production, and intermediate-term loans.

System credit quality declined slightly in 2017. Nonaccrual loans increased $69 million, or 4.3 percent, to $1.660 billion at December 31, 2017. The increase was primarily due to the impact of reduced net farm income on certain agricultural production sectors and deterioration in the credit quality of a limited number of agribusiness borrowers. Nonaccrual loans as a percentage of total loans outstanding was 0.64 percent at December 31, 2017, unchanged from December 31, 2016 (see figure 14).

Figure 14

Nonaccrual Loans as a Percentage of Total Loans Outstanding



The allowance for loan losses was $1.596 billion at December 31, 2017, an increase of $90 million, or 6 percent, above the $1.506 billion at December 31, 2016. The allowance for loan losses represents the aggregate of each System entity's individual evaluation of its allowance for loan losses requirements based on management's evaluation of factors including loan loss experience, portfolio quality and composition, collateral values, current agricultural production, and economic conditions. Although aggregated for the System's combined financial statements, the allowance of each entity is specific to that institution and is not available to absorb losses at other System entities.

The System continued to have reliable access to the debt markets to support its mission. Investor demand for Systemwide insured debt securities remained favorable across all products. The System is a government-sponsored enterprise that continues to benefit from broad access to domestic and global capital markets providing a dependable source of competitively priced debt.

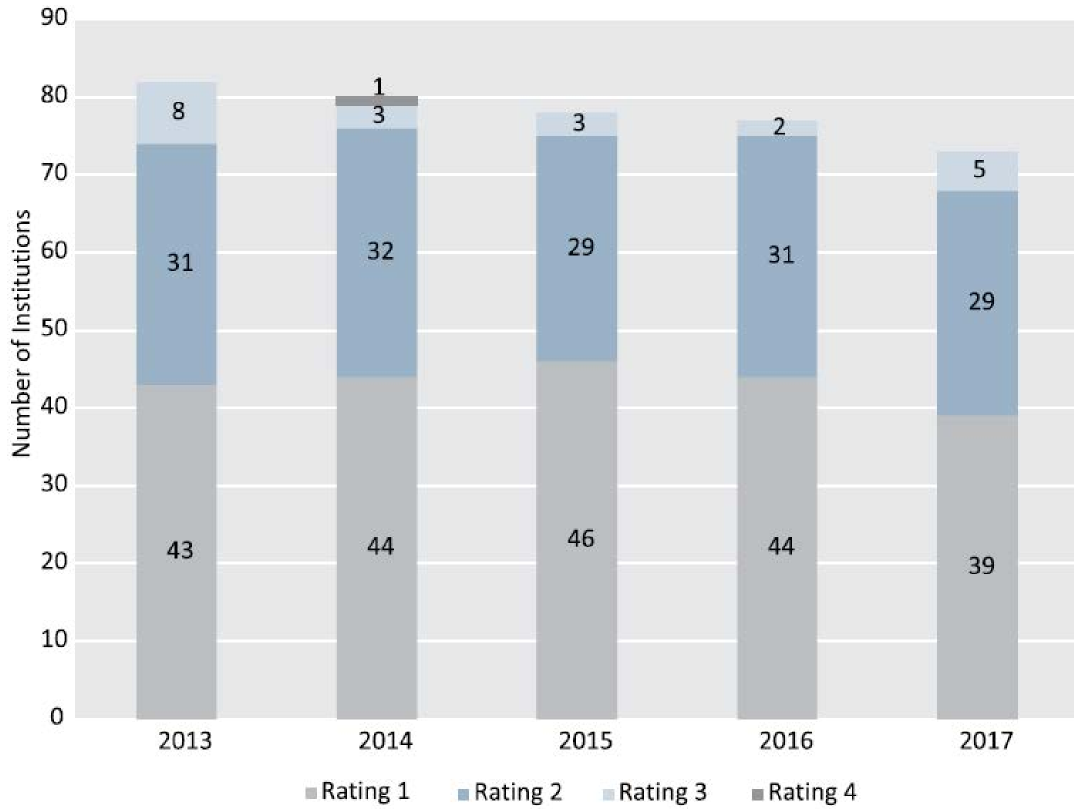
The System banks have established contingency funding plans to provide for events that could impede access to the debt markets. The System banks also regularly perform credit and liquidity stress testing to determine their ability to withstand severe market events while continuing to fulfill their mission.

In 2017 FCSIC completed a project to enhance its model for assessing Insurance Fund solvency. The improved model allows us to include bank investment assets as a component in the simulation of risks to the solvency of the Insurance Fund. In addition, we updated the historic data used to estimate the probability and severity of modeled insurance obligations. We expect the improved model will enhance our ability to forecast the Insurance Fund's capacity to withstand insurance losses if they occur.

Figure 15 shows a summary of composite year-end Financial Institution Rating System ratings for System banks and associations. Institutions with performance-related issues continued to receive greater examination scrutiny and supervisory attention from FCA.

Figure 15

FIRS Composite Year-End Ratings for Banks and Associations of the Farm Credit System



Source: FCA

Note: Figure reflects ratings only for the System's banks and direct-lending associations; it does not include ratings for the System's service corporations, the Federal Agricultural Mortgage Corporation, or the Federal Farm Credit Banks Funding Corporation.

Financial Assistance and Receivership

FCSIC is authorized to provide assistance to troubled System banks and associations to prevent default, restore normal operations, and facilitate mergers or consolidations. At present, no assistance agreements are outstanding. If a System institution needed financial assistance, FCSIC would ensure that the proposed assistance was the least costly means for resolving the institution's problems. By law, FCSIC cannot provide financial assistance if the cost of liquidation is lower than the cost of providing assistance.

Procedures are in place in the event a System bank requires liquidity assistance. The procedures implement the FCSIC board's Policy Statement Concerning Assistance. Along with the procedure, we developed a model assistance agreement and drafted necessary forms related to valuation of collateral and liquidity reserves. We review the procedures annually to evaluate if changes are needed.

When appointed by FCA, FCSIC has the statutory responsibility to serve as receiver or conservator for System banks and associations. As conservator, we will operate the institution as a going concern. Upon appointment as receiver, we will take possession of a System institution to settle its business operations, collect the debts owed to it, liquidate its property and assets, pay its creditors, and distribute any remaining proceeds to stockholders. There are no active receiverships or conservatorships in the System.

We use contractors on an as-needed basis so that we can continue to operate with a small core staff while also maintaining our readiness to act as receiver or conservator. These contractors provide knowledgeable and readily available staff resources while allowing us to contain costs during periods of limited or no activity.

Our staff also maintains contact with the resolution staff of the Federal Deposit Insurance Corporation and the National Credit Union Administration to stay informed about best practices and exchange information concerning receivership management.

As part of our strategic plan, we continue to pursue a legislative initiative to modernize and strengthen our resolution authorities, including our conservatorship and receivership powers. These changes would ensure that we have express statutory authority comparable to that of other federal receivers and conservators, improve our ability to protect investors, and reduce the cost of resolving a troubled System institution. Since 1987, there have been no substantive amendments to the Farm Credit Act relating to FCSIC's resolution authorities.

We have several board-approved policy statements that provide guidance related to resolution activities, including appraisal of real estate securing nonperforming assets, insurance of assets that come under our control, and environmental hazards assessments of real estate securing nonperforming assets. The FCSIC board must review and approve policy statements every five years.

FARM CREDIT SYSTEM INSURANCE CORPORATION

McLean, VA

FINANCIAL STATEMENTS

Including Independent Auditors' Report

As of and for the Years Ended December 31, 2017 and 2016

TABLE OF CONTENTS

BAKER TILLY

Independent Auditors' Report

The Board of Directors
Farm Credit System Insurance Corporation
McLean, Virginia

We have audited the accompanying financial statements of the Farm Credit System Insurance Corporation ("FCSIC"), which comprise the statement of financial condition as of December 31, 2017 and 2016, and the related statements of income and expenses and changes in insurance fund and cash flows for the years then ended, and the related notes to the financial statements. We also have audited FCSIC's internal control over financial reporting as of December 31, 2017, based on the criteria established in *Internal Control-Integrated Framework (2013)* promulgated by the Committee of Sponsoring Organizations of the Treadway Commission.

Management's Responsibility for the Financial Statements and Internal Control over Financial Reporting

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, which is included in the accompanying *Management's Report on Internal Control Over Financial Reporting*.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on the entity's internal control over financial reporting based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in U.S. Government Auditing Standards issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also involves obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Farm Credit System Insurance Corporation as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the Farm Credit System Insurance Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017 based on the criteria established in *Internal Control-Integrated Framework (2013)* promulgated by the Committee of Sponsoring Organizations of the Treadway Commission.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Farm Credit System Insurance Corporation's financial statements are free from material misstatement, we also performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported herein under U.S. Government Auditing Standards.

Milwaukee, Wisconsin
February 9, 2018

Baker Tilly Virchow Krause, LLP

FARM CREDIT SYSTEM INSURANCE CORPORATION

STATEMENTS OF FINANCIAL CONDITION
As of December 31, 2017 and 2016
(Dollars in thousands)

Assets	**2017**	**2016**
Cash and cash equivalents	$ 1,613	$ 241
Investments in U.S. Treasury obligations	4,454,235	4,016,813
Premiums receivable	340,565	372,721
Accrued interest receivable	21,894	17,334
Other receivables	30,012	46,356
General property, plant, equipment, and software, net	78	-
Total Assets	**$ 4,848,397**	**$ 4,453,465**
Liabilities and Insurance Fund		
Accounts payable and accrued expenses	$ 679	$ 561
Total Liabilities	**679**	**561**
Farm Credit Insurance Fund		
Allocated Insurance Reserves Accounts	175,832	-
Unallocated Insurance Fund	4,671,886	4,452,904
Total Insurance Fund	**4,847,718**	**4,452,904**
Total Liabilities and Insurance Fund	**$ 4,848,397**	**$ 4,453,465**

FARM CREDIT SYSTEM INSURANCE CORPORATION

STATEMENTS OF INCOME AND EXPENSES AND CHANGES IN INSURANCE FUND
For the Years Ended December 31, 2017 and 2016
(Dollars in thousands)

	2017	2016
Income		
Premiums	$ 340,762	$ 372,626
Interest income	57,720	45,751
Total Income	**398,482**	**418,377**
Expenses		
Administrative operating expenses	3,668	3,714
Total Expenses	**3,668**	**3,714**
Net Income	**394,814**	**414,663**
Farm Credit Insurance Fund — Beginning of Year	**4,452,904**	**4,038,241**
Payments to AIRAs Accountholders	-	-
Farm Credit Insurance Fund — End of Year	**$ 4,847,718**	**$ 4,452,904**

FARM CREDIT SYSTEM INSURANCE CORPORATION

STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016
(Dollars in thousands)

	2017	2016
Cash Flows from Operating Activities		
Net income	$ 394,814	$ 414,663
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	13	-
(Increase) decrease in premiums receivable	32,156	(112,087)
(Increase) decrease in accrued interest receivable	(4,560)	(3,289)
(Increase) decrease in other receivables	16,344	(46,356)
Net amortization and accretion of investments	11,849	17,463
(Increase) decrease in accounts payable and accrued expenses	118	30
Net Cash Provided by Operating Activities	**450,734**	**270,424**
Cash Flows from Investing Activities		
Payments for purchase of U.S. Treasury obligations	(1,246,440)	(1,387,970)
Proceeds from maturity of U.S. Treasury obligations	797,169	968,999
Payment for purchase of depreciable assets	(91)	-
Net Cash Provided by Investing Activities	**(449,362)**	**(418,971)**
Cash Flows from Financing Activities		
Payment to AIRAs Accountholders	-	-
Net Cash Used in Financing Activities	**-**	**-**
Net change in cash and cash equivalents	1,372	(148,547)
Cash and cash equivalents, beginning of year	241	148,788
Cash and Cash Equivalents, End of Year	**$ 1,613**	**$ 241**

FARM CREDIT SYSTEM INSURANCE CORPORATION

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended December 31, 2017 and 2016

NOTE 1 – Farm Credit Insurance Fund (Insurance Fund): Statutory Framework

The Agricultural Credit Act of 1987 established the Farm Credit System Insurance Corporation (the Corporation or FCSIC) for the purpose of ensuring the timely payment of principal and interest on notes, bonds, debentures, and other obligations issued under subsection (c) or (d) of section 4.2 of the Farm Credit Act of 1971, as amended (the Farm Credit Act), (insured obligations). Each bank in the Farm Credit System (System) participating in insured obligations is an insured System bank. At December 31, 2017, there were four insured System banks and 69 direct lender associations, down from December 31, 2016 when there were four insured System banks and 74 direct lender associations.

The Corporation is managed by a Board of Directors consisting of the same individuals as the Farm Credit Administration (FCA) Board except that the Chairman of the FCA Board may not serve as the Chairman of the Corporation's Board of Directors.

The Corporation must spend amounts in the Insurance Fund necessary to:

1. Ensure the timely payment of interest and principal on insured obligations; and

2. Ensure the retirement of eligible borrower stock at par value under section 4.9A of the Farm Credit Act.

The Corporation, in its sole discretion, is authorized to expend amounts to provide financial assistance to System banks and direct lender associations.

As of December 31, 2017, there were $266.0 billion of insured obligations compared to $258.4 billion as of December 31, 2016, and less than $1 million of eligible borrower stock outstanding as of December 31, 2017 and 2016.

If the Corporation does not have sufficient funds to ensure payment on insured obligations, System banks will be required to make payments under joint and several liability, as required by section 4.4 (a)(2) of the Farm Credit Act.

Under section 5.63 of the Farm Credit Act, the Corporation is exempt from all Federal, state, and local taxes with the exception of real property taxes.

NOTE 2 – Summary of Significant Accounting Policies

Basis of Accounting — The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America (GAAP) and, as such, the financial statements have been prepared using the accrual basis of accounting.

Cash and Cash Equivalents — Cash and cash equivalents include investments in U.S. Treasury obligations with original maturities of 90 days or less. At December 31, 2017, the Corporation held $1,413 thousand in overnight Treasury Certificates maturing on January 2, 2018, with an investment rate of 1.18 percent, and $200 thousand in cash. At December 31, 2016, the Corporation held $140 thousand in overnight Treasury Certificates maturing on January 3, 2017, with an investment rate of 0.39 percent, and $101 thousand in cash.

NOTE 2 – Summary of Significant Accounting Policies (cont.)

Investments in U.S. Treasury Obligations — Section 5.62 of the Farm Credit Act requires that funds of the Corporation, not otherwise employed, shall be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. The Corporation has classified its investments as held to maturity in accordance with Financial Accounting Standards Board Accounting Standards Codification 320, *Investments - Debt and Equity Securities* and carries them at amortized cost. Amortization of premium and accretion of discount on investments has been computed under the interest method since 2002. Fair value of investments is estimated based on quoted market prices for those or similar instruments.

Other Receivables — The Corporation reports receivables for securities when investments mature at the end of an accounting period and proceeds are received in the following month.

Liability for Estimated Insurance Obligations — The liability for estimated insurance obligations is the present value of estimated probable insurance payments to be made in the future based on the Corporation's analysis of economic conditions of insured System banks.

The insured System banks' primary lending markets are borrowers engaged in farming, ranching, and producing or harvesting of aquatic products, and their cooperatives. Financial weaknesses in these market segments and the effect of general market conditions on the System's borrowers could adversely affect the banks' financial condition and profitability. Insured System banks also face risks from changing interest rate environments and the need to maintain ongoing access to financial markets. Adverse changes in the financial condition and profitability of insured System banks resulting from increased levels of credit, financial, or other risks could occur in the future which would require a liability for estimated insurance obligations to be recorded.

The Corporation actively monitors the creditworthiness and financial position of the insured System banks. Management is not aware of any events or circumstances at this time which would require a liability for estimated insurance obligations to be recorded at December 31, 2017 or 2016.

Premiums — Annual premiums are recorded as revenue during the period on which the premiums are based. All premiums are due on or before January 31st of the year subsequent to the year in which they are earned.

Use of Estimates — The preparation of financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3 – Investments in U.S. Treasury Obligations

In addition to the amounts referenced in Note 2, Cash and Cash Equivalents, at December 31, 2017 and 2016, investments in U.S. Treasury obligations which are carried at amortized cost consisted of the following:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2017				
U.S. Treasury obligations	$ 4,454,235	$ 304	$ (35,858)	$ 4,418,681
December 31, 2016				
U.S. Treasury obligations	$ 4,016,813	$ 6,947	$ (16,584)	$ 4,007,176

The amortized cost and estimated fair value of U.S. Treasury obligations at December 31, 2017, by contractual maturity, are shown below.

(Dollars in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 1,188,463	$ 1,185,688
Due after one year through five years	3,216,264	3,183,566
Due after five years through ten years	49,508	49,427
	$ 4,454,235	$ 4,418,681

The Corporation follows GAAP for measuring, reporting, and disclosing fair value. These standards apply to all assets and liabilities that are measured, reported, and/or disclosed on a fair value basis.

As defined in the accounting standards, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Assets and liabilities measured, reported and/or disclosed at fair value will be classified and disclosed in one of the following three categories:

Level 1 - Inputs to the valuation methodology are unadjusted quoted market prices for identical assets in active markets that the plan has the ability to access.

NOTE 3 – Investments in U.S. Treasury Obligations (cont.)

Level 2 - Observable market based inputs or unobservable inputs that are corroborated by market data. Inputs to the valuation methodology include

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Unobservable inputs that are unobservable and not corroborated by market data.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The fair values of FCSIC's investments in U.S. Treasury obligations are estimated based on quoted market prices for those instruments; accordingly, these are classified as Level 1 assets.

NOTE 4 – Premiums, the Secure Base Amount and Excess Insurance Fund Balances

Each System bank which issues insured obligations under subsection (c) or (d) of section 4.2 of the Farm Credit Act is an insured System bank and may be required to pay premiums to the Corporation.

The Food, Conservation, and Energy Act of 2008 amended the Farm Credit Act of 1971 (12 U.S.C. § 2001 et seq.) to generally assess premiums based on each bank's pro rata share of insured debt (rather than on loans), aligning premiums with what FCSIC insures. The changes were implemented beginning July 1, 2008. Now FCSIC may collect from 0 to 20 basis points annually on adjusted insured debt outstanding. The amendments also authorize a risk surcharge of up to 10 basis points on non-accrual loans and on other-than-temporarily impaired investments. The amendments reduce the total insured debt on which premiums are assessed by 90 percent of Federal government-guaranteed loans and investments and 80 percent of state government-guaranteed loans and investments, and deduct similar percentages of such guaranteed loans and investments when calculating the secure base amount (SBA). The amendments clarify that FCSIC may collect premiums more frequently than annually.

In addition, the Farm Credit Act no longer specifies how the System banks pass premiums to associations and other financing institutions, although it requires that the banks do so in an equitable manner. This change allows the banks flexibility in allocating premium costs to associations. The amendments clarify that, in addition to FCSIC's regulatory authority under Title V of the Farm Credit Act, FCSIC has the authority to adopt rules and regulations concerning provisions in Title I of the Farm Credit Act related to banks passing along the cost of insurance premiums. Finally, the amendments change the Farm Credit Act provisions regarding certified statements and simplify the formula for payments from the Farm Credit Insurance Fund Allocated Insurance Reserves Accounts (AIRAs) to allow more immediate distribution of excess Insurance Fund balances to insured banks and the System Financial Assistance Corporation (the FAC) stockholders.

NOTE 4 – Premiums, the Secure Base Amount and Excess Insurance Fund Balances (cont.)

The Farm Credit Act sets a base amount for the Insurance Fund to achieve. The statutory SBA is equivalent to 2.0 percent of the aggregate outstanding insured obligations of all insured System banks (adjusted downward by a percentage of the guaranteed portions of principal outstanding on certain government-guaranteed loans and investments) or such other percentage as determined by the Corporation in its sole discretion to be actuarially sound to maintain in the Insurance Fund taking into account the risk of insuring outstanding insured obligations. When the assets in the Insurance Fund for which no specific use has been designated exceed the SBA, the Corporation is required to reduce the premiums, but it still must ensure that reduced premiums are sufficient to maintain at the SBA the assets in the Insurance Fund for which no specific use has been designated (the unallocated Insurance Fund).

Insurance premium rates are reviewed semiannually. For 2017, the Board of Directors set premium rates at its January 26, 2017 meeting at 15 basis points on average adjusted insured debt and continued the assessment of the 10 basis point surcharge on the average principal balance outstanding for nonaccrual loans and other-than-temporarily impaired investments. The Board of Directors again reviewed premiums at its June 8, 2017 meeting. The Board of Directors voted to maintain the premium accrual rate on average adjusted insured debt at 15 basis points and continued the assessment of the 10 basis point surcharge on the average principal balance outstanding for nonaccrual loans and other-than-temporarily impaired investments for the remainder of 2017. In 2017, outstanding insured obligations increased by $7.6 billion (3 percent). At December 31, 2017, the unallocated Insurance Fund and the total Insurance Fund were 2.00 percent and 2.08 percent of adjusted insured obligations, respectively.

For 2016, the Board of Directors set premium rates at its February 19, 2016 meeting at 16 basis points for the first 6 months, and 18 basis points for the second 6 months, on average adjusted insured debt and continued the assessment of the 10 basis point surcharge on the average principal balance outstanding for nonaccrual loans and other-than-temporarily impaired investments. The Board of Directors again reviewed premiums at its June 9, 2016 meeting. The Board of Directors voted to maintain the premium accrual rate on average adjusted insured debt at 16 basis points for the first 6 months and 18 basis points for the second 6 months and continued the assessment of the 10 basis point surcharge on the average principal balance outstanding for nonaccrual loans and other-than-temporarily impaired investments for the remainder of 2016. In 2016, outstanding insured obligations increased by $15 billion (6 percent). At December 31, 2016, both the unallocated Insurance Fund and the total Insurance Fund were 1.96 percent of adjusted insured obligations.

A 1996 amendment to the Farm Credit Act requires the Corporation to establish AIRAs for each System bank and an account for the stockholders of the FAC. If, at the end of any calendar year, the aggregate of the amounts in the Insurance Fund exceed the SBA, the Corporation is to allocate to the AIRAs any excess balances less the amount that the Corporation, in its sole discretion, determines to be the sum of the estimated operating expenses and estimated insurance obligations of the Corporation for the immediately succeeding calendar year.

As the total Insurance Fund exceeded the 2 percent SBA at December 31, 2017, there was an allocation of $175.8 million to the AIRAs as follows:

FAC Shareholders	$ 13.1 million
Farm Credit System banks	$162.7 million

NOTE 4 – Premiums, the Secure Base Amount and Excess Insurance Fund Balances (cont.)

The AIRAs' balances are recorded as part of the Insurance Fund until approved for payment by the Corporation's Board of Directors. AIRAs' balances may be used to absorb any insurance losses and claims. Furthermore, the Board of Directors has discretion to limit or restrict the AIRAs' payments. In accordance with the Corporation's policy, any AIRAs' balances do not count in measuring the Insurance Fund's compliance with the SBA.

NOTE 5 – Operating Lease

On October 8, 2015, the Corporation executed a ten-year lease with the FCS Building Association for office space. The terms of the lease provide for an annual minimum base rent for office space of $143 thousand for 2018. The Corporation recorded lease expense (including operating cost assessments) of $144 thousand and $139 thousand for 2017 and 2016, respectively.

NOTE 6 – Line of Credit

On September 24, 2013, the Corporation entered into an agreement with the Federal Financing Bank (the FFB), a United States government corporation subject to the supervision and direction of the U.S. Treasury. Pursuant to this agreement, the FFB may advance funds to the Corporation when exigent market circumstances make it extremely doubtful that insured System banks will be able to pay maturing debt obligations. The Corporation will in turn use the funds advanced by the FFB to provide assistance to the System banks until market conditions improve. The agreement provides for a short-term revolving credit facility of up to $10 billion, is renewable annually and terminates on September 30, 2018, unless otherwise further extended.

Under the agreement, each provision of funds by the FFB is subject to certain terms and conditions. The interest rate for each advance will be established by the FFB at the time the respective advance is made. Each advance cannot have a maturity date longer than twelve months and the maturity date cannot be later than the final termination date of the agreement.

The Corporation paid no commitment fee to secure this line of credit. There were no amounts drawn on this line of credit during 2017 and 2016.

NOTE 7 – Retirement Plan

All permanent Corporation employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The Corporation's contribution to the CSRS plan during 2017 and 2016 was 7 percent of base pay. For those employees covered by FERS, the Corporation's contribution was 13.7 percent of base pay for 2017 and 2016. In addition, for FERS-covered employees, the Corporation automatically contributes 1 percent of base pay to the employee's Thrift Savings Plan account, matches the first 3 percent contributed by the employee, and matches one-half of the next 2 percent contributed by the employee. In 2015, the Corporation began a 401K plan for both CSRS and FERS employees. The Corporation automatically contributes 1 percent of base pay to the employee's 401K account and matches the first 2 percent contributed by the employee. Retirement plan expenses amounted to $385 thousand in 2017 and $370 thousand in 2016.

NOTE 8 – Related Parties

The Corporation purchases services from the FCA under an Interagency Agreement. These include examination and administrative support services. The intention of the parties as stated in the agreement is that specified rates and fees will reimburse the party providing services for all reasonable costs associated with provision of the services. The Corporation purchased services for 2017 which totaled $322 thousand, compared with $343 thousand for 2016.

The Corporation may also provide services to the FCA under an Interagency Agreement; however, the Corporation provided no services and recognized no revenue for 2017 and 2016. At December 31, 2017, and 2016, the Corporation did not have any receivables from the FCA.

NOTE 9 – Subsequent Events

Management evaluated subsequent events through February 9, 2018, the date the financial statements were available to be issued. Events or transactions occurring after the balance sheet date but prior to the date the financial statements were available to be issued, that provide additional evidence about conditions that existed at the balance sheet date, are recognized in the financial statements. Events or transactions that provide evidence about conditions that did not exist at the balance sheet date but arose before the financial statements were available to be issued are not recognized in the financial statements.

The financial statements for the year ended December 31, 2017 have not been adjusted for any events or transactions occurring after the balance sheet date.

Farm Credit System Insurance Corporation

Management's Report on Internal Control Over Financial Reporting

The Farm Credit System Insurance Corporation's (FCSIC) internal control over financial reporting is a process designed by those charged with governance and management to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and that receipts and expenditures are being made only in accordance with authorizations of FCSIC management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of FCSIC's assets that could have a material effect on our financial statements.

Management of FCSIC is responsible for designing, implementing, and maintaining effective internal control over financial reporting. Management assessed the effectiveness of FCSIC's internal control over financial reporting as of December 31, 2017 using the framework in *Internal Control – Integrated Framework (2013)* promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO criteria". Management concluded that as of December 31, 2017, FCSIC's internal control over financial reporting is effective, based on the COSO criteria.

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgement and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Dorothy L. Nichols
Chief Operating Officer

Emily W.F. Dean
Chief Financial Officer

C. Richard Pfitzinger
Director, Risk Management

Howard I. Rubin
General Counsel

February 9, 2018

1501 Farm Credit Drive
McLean, Virginia 22102
(703) 883-4380

Management Assurances

March 14, 2018

The management of the Farm Credit System Insurance Corporation is responsible for managing risk and maintaining effective internal control to meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA).

FCSIC is an independent U.S. government-controlled corporation. Our primary purpose is to ensure the timely payment of principal and interest on insured debt obligations issued on behalf of System banks.

The System is a nationwide government-sponsored enterprise of cooperative lending institutions owned by the agricultural and rural customers it serves. By protecting investors, we help maintain a dependable source of funds for the farmers, ranchers, and other borrowers of the System.

FCSIC actively monitors and manages insurance risk to minimize the Farm Credit Insurance Fund's exposure to potential losses. When appointed by the Farm Credit Administration, we also serve as receiver or conservator of any System bank or association.

Our management has completed an assessment of the effectiveness of the corporation's enterprise risk management and internal control systems in effect during 2017 in accordance with guidelines provided by the Office of Management and Budget (OMB) in consultation with the Comptroller General (OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control). The objective of these controls and systems is to provide reasonable assurance that

- obligations and costs comply with applicable laws;
- all assets are safeguarded against waste, fraud, unauthorized use, and mismanagement;
- revenues and expenditures applicable to our operations are recorded and accounted for properly; and
- financial and statistical reports are reliable, complete, and timely.

On the basis of established guidelines and the assessment performed, we concluded that as of December 31, 2017, the internal control over financial reporting was effective and meets the objectives of FMFIA.

In addition, as stated in the accompanying report, FCSIC's independent auditor, Baker Tilly Virchow Krause, LLP, indicated that the financial statements of the Farm Credit Insurance Fund as of December 31, 2017, of which we are stewards, are fairly and accurately presented. In 2017, we expanded our audit and Baker Tilly Virchow Krause, LLP conducted testing on the effectiveness of FCSIC's internal control over financial reporting and issued an opinion that it was effective.

Dorothy L Nichols

Dorothy L. Nichols
Chief Operating Officer

Emily W. F. Dean
Chief Financial Officer

C. Richard Pfitzinger
Director of Risk Management

Compliance with the Federal Civil Penalty Inflation Adjustment Act Improvements Act of 2015

FCSIC has authority under section 5.65(c) of the Farm Credit Act (12 U.S.C. § 2277a-14) to impose civil money penalties against a Farm Credit System bank that willfully fails or refuses to file any certified statement or pay any required premium.

In addition, section 5.65(d) of the Farm Credit Act provides that, except with the prior written consent of the Farm Credit Administration, it shall be unlawful for any person convicted of any criminal offense involving dishonesty or a breach of trust to serve as a director, officer, or employee of any System institution and authorizes FCSIC to recover penalties for a willful violation of this prohibition. Sections 5.65(c) and (d) provide for a penalty of not more than $100 for each day during which the violation continues.

The Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 (the 2015 Act) amended the Federal Civil Penalties Inflation Adjustment Act of 1990 to provide for regular evaluation of civil penalties and required every applicable federal agency to adopt, through an interim final rule, a one-time "catch up adjustment" to be effective no later than August 1, 2016, and annual adjustments thereafter.

FCSIC published a final rule on January 30, 2017 — making the annual adjustment required by the 2015 Act — that increased our civil money penalties to not more than $201 for each day during which a violation continues. On January 26, 2018, we published a final rule — making the required annual adjustment — that increased our civil money penalties to not more than $205 for each day during which a violation continues.

Performance Management Program

FCSIC's mandate is to ensure the timely payment of principal and interest on insured Farm Credit System debt securities and to serve as receiver or conservator when appointed by the Farm Credit Administration board. To fulfill our mandate, we have three fundamental program goals:

- Build and manage the Insurance Fund to protect investors
- Monitor, evaluate, and report insurance risk
- Maintain the capability to manage assistance requests, receiverships, and conservatorships

Performance Measures

1. Build and manage the Insurance Fund to protect investors

We adjust insurance premium assessments when appropriate and manage assets to optimize investment returns to build and maintain the Insurance Fund at the statutory 2 percent secure base amount. At the same time, we must maintain appropriate liquidity to carry out our mission.

We assess the effectiveness of our performance in achieving this goal through the following:

- Reviewing semiannually the need for adjustments to insurance premium assessments
- Measuring investment performance by comparing the portfolio's average yield with peer investment funds that have similar investment parameters for quality and maturity
- Comparing the level of the Insurance Fund every month with the secure base amount and reporting the results to the board of directors

Our ability to maintain the Insurance Fund at the secure base amount may be affected by events beyond our control, such as insurance losses.

2. Monitor, evaluate, and report insurance risk

We measure progress toward this program goal by how promptly we detect emerging problems and how effectively we minimize insurance losses. We use financial indicators to monitor conditions and trends, and we analyze and report data before losses become likely. In periods when there are insurance claims or the probability of claims, the ratio of estimated losses to actual losses helps measure our ability to assess prospective loss exposure.

As guidance, our management uses criteria specified in our policy for allowance for losses and in the Financial Accounting Standards Board's Accounting Standards Topic 450, Contingencies. Timely evaluation of the Insurance Fund's risk exposure is critical to preserving the Insurance Fund's solvency. We use FCA reports of examination to evaluate risks to the Insurance Fund. When necessary, we independently examine and require information from System institutions.

3. Maintain the capability to manage assistance requests, receiverships, and conservatorships

FCSIC has statutory authority to provide financial assistance to System institutions, including loans. Any assistance agreement is subject to our board of directors' approval. We have a policy statement on assistance and we have adopted procedures for providing assistance in a liquidity crisis. We measure effectiveness by periodically testing our procedures and updating our policy statement so we remain ready to provide financial assistance in a timely and cost-effective manner.

FCSIC is required to serve as receiver or conservator of System banks and associations when appointed by FCA. This program goal requires us to maintain readiness through periodic staff training and evaluation of contractors' capabilities. We must ensure that we have the resources we need to manage receiverships or conservatorships in case the need arises.

We use the following measures to determine the effectiveness of our receivership operations:

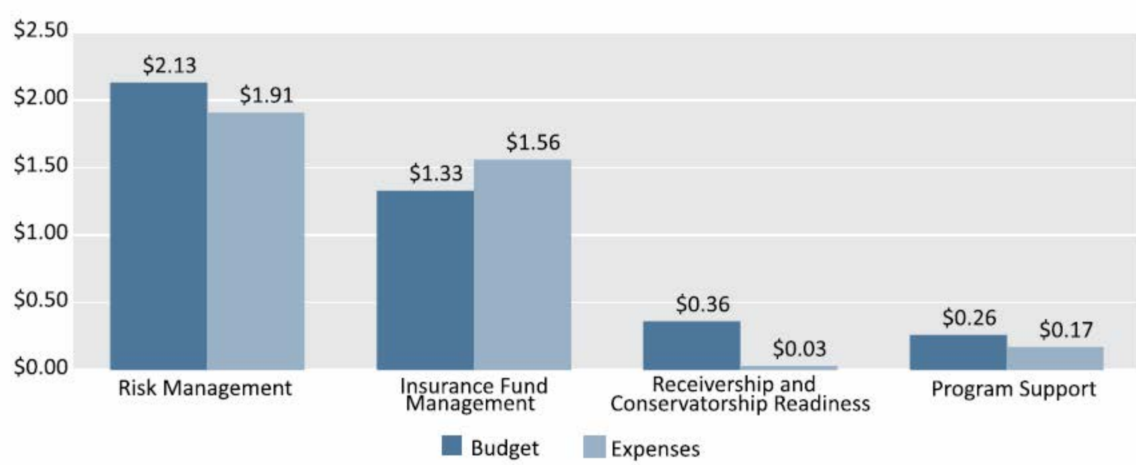
- Timeliness of initial processing of all claims (Processing should occur within a period of time warranted by the size and complexity of each case.)
- The ratio of operating costs to total assets
- The ratio of actual asset recovery returns to net realizable asset values

FCSIC has three major program areas with corresponding strategic goals and objectives. We have implemented performance measures to help us evaluate the effectiveness of these goals and objectives. It is important to note that some of these measures use management estimates that may be affected by the performance and condition of System institutions. Also, unforeseen events may have a material effect on performance measures over time. Figure 16 illustrates each program's 2017 budget and expenditures, including program support.

Figure 16

2017 Budget and Expenditure by Program

(Dollars in Millions)



The Government Performance and Results Act of 1993 requires all federal government organizations to report on the results of program performance. Performance results are included in regular reports to the board of directors and our annual report. Information for each of the three major program areas is presented in table 6.

Table 6

Strategic Goals and Objectives by Program Area

FCSIC's Mission	Program Areas	Strategic Goals	Strategic Objectives	For More Information
Protect investors in insured Farm Credit System obligations and taxpayers through sound administration of the Farm Credit Insurance Fund (Insurance Fund), Exercise its authorities to minimize Insurance Fund loss, and Help ensure the future of a permanent system for delivery of credit to agricultural borrowers.	Insurance Fund management	Manage the Farm Credit Insurance Fund to maintain the secure base amount to provide protection for investors and taxpayers against identified risks.	1. Manage the Insurance Fund to ensure adequate liquidity while optimizing investment returns and ensuring premium collections and refunds reflect anticipated changes in adjusted insured debt levels and potential insurance claims. 2. Use actuarial tools to evaluate the adequacy of investor protections and risk exposures to the Insurance Fund. 3. Ensure that System banks have adequate temporary liquidity in situations where external market factors make normal debt market access extremely doubtful. 4. Communicate accurate and easily understood information about the insurance program to the public, insured investors, and System institutions.	See pages 21-28 for 2017 results
	Risk management	Monitor, evaluate and report risks that could generate losses to the Insurance Fund.	1. Use analytical models and other risk management tools and processes to identify and respond to potential risks to the Insurance Fund. Conduct trend analysis on the System's growth, funding needs, condition and performance. Regularly report to the board of directors on identified risk exposures. 2. Monitor conditions in the agricultural and financial sectors that may affect insurance risk and integrate the results into the process for setting annual insurance premium rates.	See pages 29-33 for 2017 results
	Receivership and conservatorship readiness	Maintain the capability to manage assistance requests, receiverships and conservatorships.	1. Subject to the provisions of the Farm Credit Act, including the least-cost test, provide assistance when appropriate to a troubled System bank or association. 2. Ensure receiverships and conservatorships are managed to fulfill the purposes of the Farm Credit Act, protect creditors, and are terminated in an orderly and timely manner.	See page 34 for 2017 results

Glossary

Farm Credit Act — The Farm Credit Act of 1971, as amended, (12 U.S.C. § 2001 et seq.) is the statute under which the Farm Credit System, FCSIC, and the Farm Credit Administration operate.

Farm Credit Administration — FCA was established in 1933 to regulate the System. It is governed by a three-member presidentially appointed board. To ensure the safety and soundness of the System, FCA examines and supervises System institutions and develops regulations to govern them.

Federal Farm Credit Banks Funding Corporation — Based in Jersey City, New Jersey, the Funding Corporation manages the sale of Systemwide debt securities to finance the loans made by System institutions. It uses a network of bond dealers to market the System's securities.

Federal Open Market Committee — This committee of the Federal Reserve Board determines the direction of monetary policy. The committee is composed of the board of governors, which has seven members, and five Federal Reserve Bank presidents. The president of the Federal Reserve Bank of New York serves continuously, while the presidents of the other reserve banks rotate their service of one-year terms.

Financial Institution Rating System (FIRS) — The FIRS is similar to the Uniform Financial Institutions Rating System used by other federal banking regulators except that the FIRS reflects the nondepository nature of System 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. Because 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, these institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if weaknesses are not corrected. Institutions that are in significant noncompliance with laws and regulations may also be given this rating. Risk management practices are less than satisfactory for the size, complexity, and risk profile of each institution in this group. Institutions in this category generally give cause for regulatory concern and require more than normal supervision to address deficiencies. Overall strength and financial capacity, however, still make failure only a remote possibility if corrective actions are taken.

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 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.

Government-sponsored enterprise (GSE) — A GSE is typically a federally chartered corporation created by Congress 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. The System is the oldest financial GSE.

Acronyms and Abbreviations

AIRAs	allocated insurance reserves accounts
CIPA	Contractual Interbank Performance Agreement
FAC	Financial Assistance Corporation
Farm Credit Act	Farm Credit Act of 1971, as amended
FCA	Farm Credit Administration
FCSIC	Farm Credit System Insurance Corporation
FIRS	Financial Institution Rating System
FMFIA	Federal Managers Financial Integrity Act
Funding Corporation	Federal Farm Credit Banks Funding Corporation
GAAP	generally accepted accounting principles
GDP	gross domestic product
GSE	government-sponsored enterprise
OMB	Office of Management and Budget
System	Farm Credit System
TIPS	Treasury inflation protected securities
URE	unallocated retained earnings
USDA	United States Department of Agriculture

Corporate Staff

Dorothy L. Nichols	Chief Operating Officer
C. Richard Pfitzinger	Director of Risk Management
Emily W. F. Dean*	Chief Financial Officer
Howard I. Rubin	General Counsel
Wade Wynn	Chief Investment Officer and Senior Risk Analyst
Gregory Smith	Senior Resolution Specialist
Tanya Renica	Accountant
Mark Bowen	Accountant
Matthew Morgan	Financial Analyst
Barbara Loggins	Senior Administrative Specialist
Molly Sproles	Administrative Management Assistant

*In April 2018, Emily W. F. Dean, who had served with distinction as the Chief Financial Officer from April 2013 until March 2018, retired. Andrew Grimaldi became the Chief Financial Officer effective March 2018.

Contact Information

To obtain Farm Credit System quarterly and annual information statements, contact the Federal Farm Credit Banks Funding Corporation at the following address:

Federal Farm Credit Banks Funding Corporation
101 Hudson Street
Suite 3505
Jersey City, NJ 07302
(201) 200-8000

These documents are also available on the Funding Corporation's website at www.farmcreditfunding.com.

To obtain copies of the Farm Credit Administration's Annual Report on the Farm Credit System and the FCA Annual Performance and Accountability Report, contact FCA at the following address:

Office of Congressional and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102
(703) 883-4056

These documents are also available on the FCA website at www.fca.gov.

Banks Insured by FCSIC as of January 1, 2018

To obtain copies of quarterly and annual reports of a Farm Credit System bank and its affiliated associations, please contact the bank directly. The mailing addresses, website addresses, and telephone numbers of all four System banks are provided below.

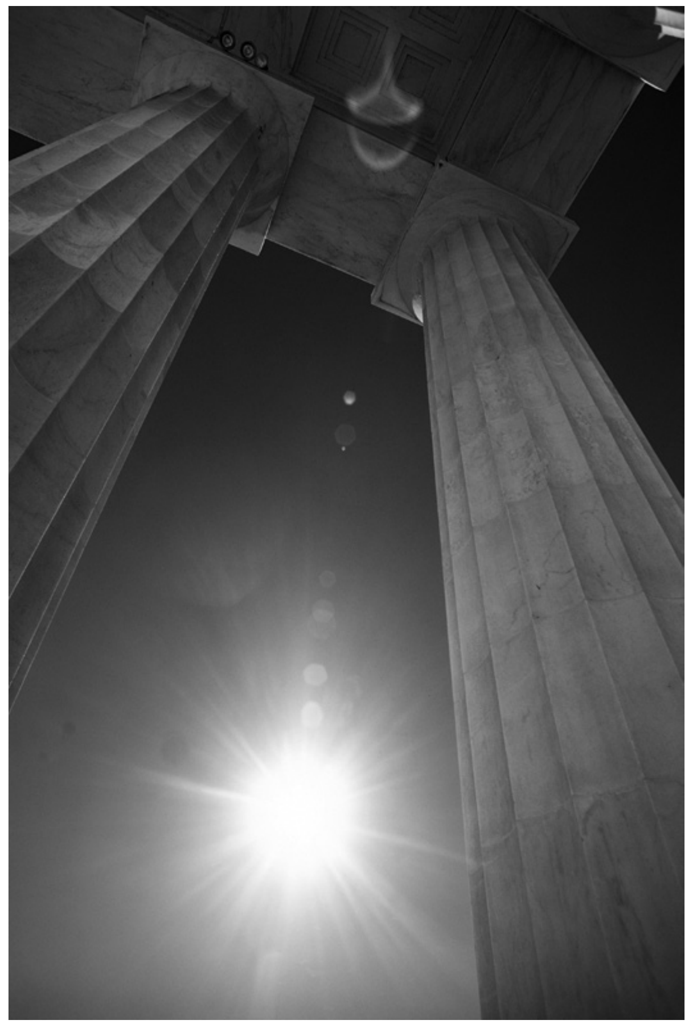
AgFirst Farm Credit Bank
P.O. Box 1499
Columbia, SC 29202-1499
(803) 799-5000
www.agfirst.com

AgriBank
30 E. 7th Street, Suite 1600
St. Paul, MN 55101-4914
(651) 282-8800
www.agribank.com

CoBank
P.O. Box 5110
Denver, CO 80217-5110
(303) 740-4000
www.cobank.com

Farm Credit Bank of Texas
P.O. Box 202590
Austin, TX 78720-2590
(512) 465-0400
www.farmcreditbank.com

Note: Information contained on these websites is not incorporated by reference into this annual report, and you should not consider information contained on these websites to be part of this annual report.



Farm Credit System Insurance Corporation
1501 Farm Credit Drive
McLean, VA 22102

Voice: 703-883-4380
Fax: 703-790-9088
www.fcsic.gov