MEMORANDUM

FCSIC
FARM CREDIT SYSTEM INSURANCE CORPORATION

June 10, 2010

To: Chairman, Board of Directors
Chief Executive Officer
Each Farm Credit System Institution

From: Kenneth A. Spearman
Chairman

Subject: Reduced Premiums for 2010

Based on preliminary results reported by the Federal Farm Credit Banks Funding Corporation through May 31, 2010, the principal amount of outstanding insured obligations was $173.7 billion, down $2.4 billion from year-end 2009. Using the most recent Call Report data, the Farm Credit System Insurance Corporation (Corporation or FCSIC) projects a decline in adjusted insured debt[1] of $4.7 billion for the first five months of 2010. The other factor causing this drop in adjusted insured debt is the continuing increase in government-guaranteed deductions (i.e., government-guaranteed loans and investments), which expanded by $2.3 billion during the most recent reporting period. In our June survey of System banks, they forecast slower growth in insured obligations in 2010 (2 to 4 percent) than they estimated in December 2009.

As a result of these factors, the Board of Directors is reducing the insurance premium assessment rate on adjusted insured debt from 10 basis points to 5 basis points for 2010. Depending on projected growth, some banks may not need to accrue additional premiums for adjusted insured debt. The Board has decided to continue assessing 10 basis points on nonaccrual loans and other-than-temporarily impaired investments.

The Board considered the following factors in setting premiums:

- Current level of the Insurance Fund and projections for growth in insured obligations;
- Likelihood and probable amount of any losses to the Insurance Fund;
- Financial condition of the Farm Credit System banks and associations;

[1] Adjusted insured debt is equal to outstanding insured obligations less eligible government-guaranteed deductions and is multiplied by 2 percent to compute the secure base amount; premiums will be calculated as set out in the Certified Statement instructions in December. Generally, premiums will be calculated as follows: (average daily balance of adjusted insured debt multiplied by 5 basis points) plus (the average daily balance of nonaccrual loans plus other-than-temporarily impaired investments multiplied by 10 basis points).

- Health and prospects for the agricultural economy; and,
- Risks in the financial environment that could cause problems, including volatility of interest rates, increased competition, and use of sophisticated investment securities and derivatives.

Deductions from the secure base amount (SBA) increased significantly since the passage of the Food, Conservation, and Energy Act of 2008 which permits the deduction of a portion of performing Federal government-guaranteed and state government-guaranteed investments made by the bank that are backed by the full faith and credit of the United States or one of the states. Prior to passage, at March 31, 2008, full faith and credit loan deductions totaled $3.4 billion compared to full faith and credit loan and investment deductions of $25.5 billion at the end of the most recent reporting period. These deductions have lowered the SBA by $510 million. Using preliminary results, at May 31, 2010 the Insurance Fund level relative to the SBA was 2.13 percent of insured debt outstanding or $193 million above the SBA.

Based on our analysis and the survey results, we believe the current excess Insurance Fund balance above the 2 percent SBA will likely be sufficient to capitalize the anticipated growth of adjusted insured debt for the balance of 2010. Since growth has slowed recently, assessing 5 basis points on adjusted insured debt for the year is somewhat conservative; however, we feel it is appropriate given the current uncertainty in the financial environment and the increased level of stress in the System.

The Corporation's most recent allowance for loss review of all banks and associations concluded that no allowances are recommended at this time. The Farm Credit Administration's Office of Examination reports that the System's overall financial condition and performance remain fundamentally sound although it continues to operate in a heightened risk environment.

The current troubled financial environment in agriculture is posing challenges for the System and its borrowers. These include: volatile farm commodity and farm input prices; stress to specific agricultural sectors, including ethanol, dairy, hogs, poultry, and timber; and reduced debt servicing ability by many farm families and rural residents due to the rising level of unemployment and diminished non-farm income. As a result, System asset quality has deteriorated and capital levels are stressed at a number of institutions.

The Board will meet again in September to review premium rates for 2010 and to provide guidance for 2011 premium assessments.