

# *Farm Credit System*



Federal Farm Credit Banks  
Funding Corporation  
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(201) 200-8000

*February 27, 2009*

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This annual information statement provides important information for investors in the debt securities jointly issued by the five Farm Credit System Banks — AgFirst Farm Credit Bank, AgriBank, FCB, CoBank, ACB, Farm Credit Bank of Texas, and U.S. AgBank, FCB (collectively, the Banks). These debt securities, which we refer to as Systemwide Debt Securities, include:

- Federal Farm Credit Banks Consolidated Systemwide Bonds,
- Federal Farm Credit Banks Consolidated Systemwide Discount Notes,
- Federal Farm Credit Banks Consolidated Systemwide Master Notes,
- Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes, and
- any other debt securities that the Farm Credit System Banks may jointly issue from time to time.

This annual information statement does not constitute an offer to sell or a solicitation of an offer to buy Systemwide Debt Securities. Systemwide Debt Securities are offered by the Federal Farm Credit Banks Funding Corporation on behalf of the Banks pursuant to offering circulars for each type of debt offering. The relevant offering circulars as of this date are:

- Federal Farm Credit Banks Consolidated Systemwide Bonds and Discount Notes Offering Circular dated June 18, 1999, as amended by supplements dated August 20, 2001, November 26, 2003, March 8, 2007, and September 30, 2008, and
- Federal Farm Credit Banks Consolidated Systemwide Master Notes Offering Circular dated December 21, 1999, as amended by the supplement dated August 20, 2001.

Each of the offering circulars may be amended or supplemented from time to time and new offering circulars may be issued. Before purchasing Systemwide Debt Securities, you should carefully read the relevant offering circular, this annual information statement and other current information released by the Funding Corporation regarding the Banks and/or Systemwide Debt Securities. At this time, no Systemwide Debt Securities are being offered under the Federal Farm Credit Banks Global Debt Program Offering Circular dated October 10, 1996 or the Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes Offering Circular dated July 19, 1993, as amended by supplements dated February 26, 1997 and June 11, 1999. No securities previously offered under the Global Debt Offering Circular or the Master Notes Offering Circular are currently outstanding.

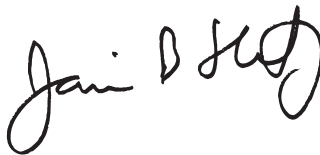
**Systemwide Debt Securities are the joint and several obligations of the Banks and are not obligations of and are not guaranteed by the United States government.** Systemwide Debt Securities are not required to be registered and have not been registered under the Securities Act of 1933. In addition, the Banks are not required to file and do not file periodic reports under the Securities Exchange Act of 1934. Systemwide Debt Securities have not been recommended by any federal or state securities commission or regulatory authority. Furthermore, these authorities have not confirmed the accuracy or determined the adequacy of any offering material.

*Certification*

**The undersigned certify that (1) we have reviewed this annual information statement, (2) this annual information statement has been prepared in accordance with all applicable statutory or regulatory requirements, and (3) the information contained in this annual information statement is true, accurate, and complete to the best of the signatories' knowledge and belief.**



J. Less Guthrie  
Chairman of the Board



Jamie B. Stewart, Jr.  
President and CEO



H. John Marsh, Jr.  
Managing Director — Financial  
Management Division

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### WHERE YOU CAN FIND ADDITIONAL INFORMATION

Farm Credit System quarterly and annual information statements and press releases relating to financial results or other developments affecting the System issued by the Federal Farm Credit Banks Funding Corporation for the current fiscal year and the two preceding fiscal years, as well as offering circulars relating to Systemwide Debt Securities, are available for inspection at, or will be furnished without charge upon request to, the Federal Farm Credit Banks Funding Corporation, 10 Exchange Place, Suite 1401, Jersey City, New Jersey 07302; telephone (201) 200-8000. These documents are also available on the Funding Corporation’s website located at [www.farmcredit-ffcb.com](http://www.farmcredit-ffcb.com).

In addition, copies of quarterly and annual reports of each Bank and, as applicable, each Bank combined with its affiliated Associations (collectively referred to as a District) may be obtained from the individual Bank. Bank addresses and telephone numbers where copies of these documents may be obtained are listed on page S-28 of this annual information statement. These documents and further information on each Bank and/or District and links to a Bank’s affiliated Associations’ websites are also available on each Bank’s website as follows:

- AgFirst Farm Credit Bank — [www.agfirst.com](http://www.agfirst.com)
- AgriBank, FCB — [www.agribank.com](http://www.agribank.com)
- CoBank, ACB — [www.cobank.com](http://www.cobank.com)
- Farm Credit Bank of Texas — [www.farmcreditbank.com](http://www.farmcreditbank.com)
- U.S. AgBank, FCB — [www.usagbank.com](http://www.usagbank.com)

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

**FIVE-YEAR SUMMARY OF SELECTED COMBINED  
FINANCIAL DATA AND KEY FINANCIAL RATIOS**

The following selected combined financial data for each of the five years in the period ended December 31, 2008 has been derived from the combined financial statements of the Farm Credit System that were audited by PricewaterhouseCoopers LLP, independent auditors. The selected combined financial data and combined financial statements of the Farm Credit System combine the financial condition and operating results of each of the Banks, their affiliated Associations, the Farm Credit System Financial Assistance Corporation, the Federal Farm Credit Banks Funding Corporation, and the Farm Credit Insurance Fund, and reflect the investments in, and allocated earnings of, certain service organizations owned by the Banks and/or Associations. All significant intra-System transactions and balances have been eliminated in combination. Because System entities are financially and operationally interdependent, we believe providing the combined financial information is more meaningful to investors in Systemwide Debt Securities than financial information relating to the Banks on a stand-

alone basis (i.e., without the Associations). While this annual information statement reports on the combined financial position and results of operations of the Banks, Associations, and other System entities specified above, only the Banks are jointly and severally liable for payments on Systemwide Debt Securities. As an important component of the System combined financial statements, Note 21 to the accompanying combined financial statements provides combining Bank-only financial condition and results of operations information. Copies of quarterly and annual reports of each Bank are available on its website; see page 2 for a listing of the websites.

The combined statement of condition at December 31, 2008 and 2007 and the related combined statements of income, of changes in capital, and of cash flows for each of the three years in the period ended December 31, 2008 and related notes appear elsewhere in this annual information statement.

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(in millions)				
<b>Combined Statement of Condition Data</b>					
Loans	\$161,423	\$142,906	\$123,436	\$106,272	\$ 96,367
Allowance for loan losses	(936)	(781)	(734)	(755)	(792)
Net loans	160,487	142,125	122,702	105,517	95,575
Cash, Federal funds sold and investments	43,807	36,460	33,117	28,427	24,164
Accrued interest receivable	1,970	2,013	1,839	1,405	1,116
Other property owned	46	32	21	16	24
Total assets	214,353	186,451	162,864	139,886	124,850
Systemwide bonds, medium-term notes and master notes	162,260	134,783	115,862	100,868	88,839
Systemwide discount notes	16,105	19,660	17,768	11,851	10,268
Subordinated debt	1,050	500			
Other bonds	1,404	852	836	857	898
Financial Assistance Corporation bonds					325
Mandatorily redeemable preferred stock	225	225	225	225	225
Protected borrower stock	10	11	13	17	23
Total liabilities	187,229	160,032	138,434	117,112	103,461
Capital	27,124	26,419	24,430	22,774	21,389
<b>Combined Statement of Income Data</b>					
Net interest income	\$ 4,702	\$ 4,060	\$ 3,584	\$ 3,246	\$ 2,994
(Provision for loan losses) loan loss reversal	(408)	(81)	(35)	1	1,208
Net noninterest expense	(1,225)	(1,135)	(1,087)	(1,056)	(1,014)
Income before income taxes	3,069	2,844	2,462	2,191	3,188
Provision for income taxes	(153)	(141)	(83)	(95)	(195)
Net income	<u>\$ 2,916</u>	<u>\$ 2,703</u>	<u>\$ 2,379</u>	<u>\$ 2,096</u>	<u>\$ 2,993*</u>

\* Included in net income for 2004 were reversals of the allowance for loan losses of \$1.167 billion, net of the related \$95 million deferred tax expense.

## Combined Key Financial Ratios

Certain combined key financial ratios of the System are set forth below.

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Return on average assets . . . . .	1.44%	1.56%	1.59%	1.61%	2.48%*
Return on average capital . . . . .	10.63	10.44	10.03	9.43	15.10*
Net interest income as a percentage of average earning assets . . . . .	2.41	2.43	2.48	2.58	2.56
Operating expense as a percentage of net interest income and noninterest income . . . . .	33.0	35.3	37.6	39.2	39.9
Net loan charge-offs as a percentage of average loans . . . . .	0.06	0.03	0.04	0.04	0.08
Allowance for loan losses as a percentage of loans outstanding at year end . . . . .	0.58	0.55	0.59	0.71	0.82
Capital as a percentage of total assets at year end . . . . .	12.7	14.2	15.0	16.3	17.1
Risks funds (capital plus allowance for loan losses) as a percentage of loans outstanding at year end . . . . .	17.4	19.0	20.4	22.1	23.0
Debt to capital at year end . . . . .	6.90:1	6.06:1	5.67:1	5.14:1	4.84:1

\* Includes reversals of the allowance for loan losses of \$1.167 billion, net of the related \$95 million deferred tax expense. Excluding the reversals of the allowance for loan losses, net of the related tax effect, the return on average assets would have been 1.52% and the return on average capital would have been 9.21%.

## BUSINESS

### Overview of the Farm Credit System

The Farm Credit System is a federally chartered network of borrower-owned lending institutions comprised of cooperatives and related service organizations. Cooperatives are organizations that are owned and controlled by their members who use the cooperatives' products or services. The U.S. Congress authorized the creation of the first System institutions in 1916. Our mission is to provide sound and dependable credit to American farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, and farm-related businesses. We do this by making appropriately structured loans to qualified individuals and businesses at competitive rates and providing

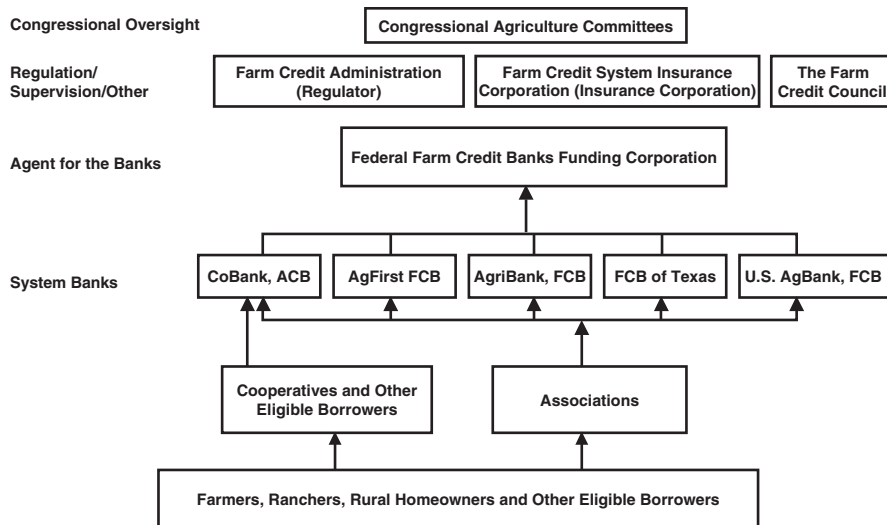
financial services and advice to those persons and businesses.

Consistent with our mission of serving rural America, we also make rural residential real estate loans, finance rural communication, energy and water infrastructures and make loans to support agricultural exports and to finance other eligible entities.

Congress established the Farm Credit Administration as the System's independent federal regulator to examine and regulate System institutions, including their safety and soundness. System institutions are federal instrumentalities.

### Structure/Ownership of the Farm Credit System

The following chart depicts the overall structure and ownership of the System.



The Associations are cooperatives owned by their borrowers, and the Farm Credit Banks (AgFirst, AgriBank, Texas and U.S. AgBank) are cooperatives primarily owned by their affiliated Associations. The Agricultural Credit Bank (CoBank) is a cooperative principally owned by cooperatives, other eligible borrowers and its affiliated Associations. The Banks and Associations each have their own board of directors and are not commonly owned. Each Bank and Association manages and controls its own business activities, operations and financial performance. The Banks jointly own the Federal Farm Credit Banks Funding Corporation. The Funding Corporation, as agent for the Banks, issues and markets Systemwide Debt Securities in order to raise funds for the lending activities and operations of the Banks and Associations. The

Funding Corporation also provides the Banks with certain consulting, accounting and financial reporting services, including the preparation of the System's quarterly and annual information statements and the System's combined financial statements contained in those information statements. As the System's financial spokesperson, the Funding Corporation is primarily responsible for financial disclosure and the release of public information concerning the financial condition and performance of the System.

**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 United States government. In addition, Systemwide Debt**

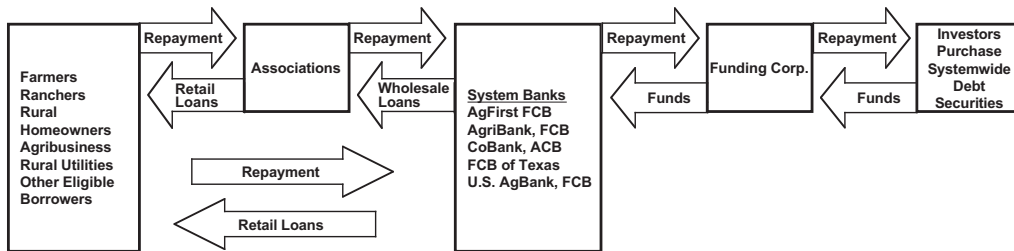
**Securities are not the direct obligations of the Associations and, as a result, the capital of the Associations may not be available to support principal or interest payments on Systemwide Debt Securities.**

**Our Business Model**

A Bank and its affiliated Associations are financially and operationally interdependent as the Bank is statutorily required to serve as an intermediary between the financial markets and the retail lending activities of its affiliated Associations. The Banks are the primary source of funds for the Associations. Associations are not legally authorized to accept deposits and may not borrow from other financial institutions without the approval of their affiliated Bank. The Banks are not authorized to accept deposits

and they principally obtain their funds through the issuance of Systemwide Debt Securities. Other less significant sources of funding for the Banks include internally generated earnings, the issuance of common and preferred equities and the issuance of subordinated debt. As a result, the loans made by the Associations are primarily funded by the issuance of Systemwide Debt Securities by the Banks. The repayment of Systemwide Debt Securities is dependent upon the ability of borrowers to repay their loans from the Associations. In addition, CoBank makes retail loans and leases directly to cooperatives, rural utilities, and other eligible borrowers. The Banks also purchase retail loan participations from Associations, other Banks and non-System lenders. Therefore, the repayment of Systemwide Debt Securities is also dependent upon the ability of these borrowers to repay their loans.

The chart below illustrates the flow of funds from investors in Systemwide Debt Securities to the System’s borrowers and the ultimate repayment of the investors resulting from borrower loan repayments.



**Overview of Our Business**

As required by the Farm Credit Act, we specialize in providing financing and related services to eligible, creditworthy borrowers in the agricultural and rural sectors, to certain related entities, and to domestic or foreign parties in connection with international agricultural trade transactions. We make credit available in all 50 states, the Commonwealth of Puerto Rico, and, under conditions set forth in the Farm Credit Act, U.S. territories.

System institutions may also provide a variety of services to their borrowers, including credit and mortgage-life insurance, disability insurance, various types of crop insurance, estate planning, record keeping services, tax planning and preparation, cash management products and services, and consulting. In addition, some System institutions provide leasing and related services to their customers.

**Government-Sponsored Enterprise Status**

Our mission is to provide sound and dependable credit to American farmers, ranchers, farm-related

businesses, rural homeowners, and producers or harvesters of aquatic products by making loans and providing financially related services. In order to better accomplish our mission, Congress has granted the System certain attributes that result in government-sponsored enterprise status for the System. As a government-sponsored enterprise, we have traditionally been able to raise funds at competitive rates and terms, in varying economic environments. This ability to raise funds has historically allowed us to make competitively priced loans to eligible borrowers and thus accomplish our mission. (See “Business — Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Management — Liquidity Risk Management” for a discussion of the impact of the current global credit crisis on our ability to issue Systemwide Debt Securities at competitive rates and terms.)

**Agricultural Industry Overview**

The agricultural sector has been a key economic force in the U.S. economy and is strongly affected by domestic and world economic conditions. The System



was created to provide support for this sector because of its significance to the well-being of the U.S. economy and the U.S. consumer. The receipt of government payments by the agricultural sector enhances farm income. These payments are typically made to producers of certain commodities. Profitability in our business is dependent on the health of the U.S. agricultural sector and government support is very important for producers of some commodities. Further, in view of the importance of off-farm income to the repayment ability of many agricultural producers, our business is also dependent upon the health of the general economy.

### System Lending Institutions

The two types of entities through which we conduct our lending business are the Banks and the Associations.

#### *Banks*

At December 31, 2008, the System had five Banks (four Farm Credit Banks and one Agricultural Credit Bank). The Banks and their affiliated Associations are referred to as Districts. The Banks' lending operations include wholesale loans to their affiliated Associations and loan participations in eligible loans purchased from Associations, other Banks and non-System lenders. In addition, CoBank, as the Agricultural Credit Bank, has additional nationwide authority to make retail loans directly to cooperatives and other eligible entities.

The Banks obtain a substantial majority of funds for their lending operations through the issuance of Systemwide Debt Securities, but also obtain some of their funds from internally generated earnings, from the issuance of common and preferred equities and from the issuance of subordinated debt.

#### *Associations*

As of January 1, 2009, the System had 90 Associations throughout the nation. There were 83 Agricultural Credit Associations with Production Credit Association subsidiaries and Federal Land Credit Association subsidiaries, and seven Federal Land Credit Associations. The Federal Land Credit Associations make real estate mortgage loans, including rural residential real estate loans. Agricultural Credit Associations may, directly or through their subsidiaries, make real estate mortgage loans, and production and intermediate-term loans, agribusiness loans (processing and marketing loans, and farm-related

business loans) and rural residential real estate loans. These retail loans are made to farmers, ranchers, producers or harvesters of aquatic products, farm-related businesses and rural homeowners. Associations may also purchase loan participations from other System entities and other lending institutions.

Although the Associations obtain some of the funds for their lending operations from internally generated earnings and from the issuance of equities, the substantial majority of their funding is obtained through borrowings from their affiliated Bank.

#### *Districts*

The following table lists the five Districts and provides information about the asset size and the loan portfolio size of each District as of December 31, 2008.

<u>District</u>	<u>Assets</u>	<u>Loans</u>
	(in millions)	
AgFirst . . . . .	\$32,412	\$23,078
AgriBank . . . . .	70,468	57,152
Texas . . . . .	20,171	16,590
U.S. AgBank . . . . .	29,816	23,125
CoBank . . . . .	62,784	46,072

There is substantial variation among the Districts with respect to size, number and mix of Associations. The 10 largest Associations accounted for 31.3% of the System's assets at December 31, 2008. A summary of the 10 largest Associations by asset size can be found in the Supplemental Financial Information on page F-54.

### Products And Services

#### *Loans by Banks*

The Banks lend to the Associations in their District and, to a much lesser extent, other eligible financing institutions relating to their agricultural loan portfolios (e.g., national or state banks, trust companies, savings institutions or credit unions). They also purchase participations in loans made by the Associations, other Banks and non-System lenders to eligible borrowers or certain entities whose operations are functionally similar to those of an eligible borrower.

CoBank also may make the following types of loans:

- Agribusiness loans — primarily to finance the operations of farmer-owned cooperatives,

- Communication loans — primarily to finance rural communication companies,
- Energy loans — primarily to finance electric generation, transmission and distribution systems serving rural areas,
- Water and waste disposal loans — primarily to finance water and waste disposal systems serving rural areas, and
- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a majority of these loans.

These lending authorities are subject to certain limitations and criteria. The other Banks and the Associations may also participate in any loan originated or purchased by CoBank. CoBank may participate with other System institutions in loans that the originating System institution is authorized to make and with non-System institutions in eligible loans.

### *Loans by Associations*

The Associations offer the following types of loans to their borrowers:

- Real estate mortgage loans — generally to purchase farm real estate, refinance existing mortgages, construct various facilities used in agricultural operations, or purchase other rural residential/lifestyle real estate for both full-time and part-time farmers. In addition, credit for other agricultural purposes and family needs is available to full-time and part-time farmers. Real estate mortgage loans have maturities ranging from five to 40 years and must be secured by first liens on the real estate. These loans may be made only in amounts up to 85% of the appraised value of the property taken as security or up to 97% of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage.
- Production and intermediate-term loans — for operating funds, equipment and other purposes. Eligible financing includes operating inputs (such as labor, feed, fertilizer, and repairs), livestock, family living expenses, income taxes, debt payments on machinery or equipment, and other business-related expenses. Production loans are most often made for a period

of time that matches the borrower's normal production and marketing cycle, on a short-term basis, typically less than 12 months. Intermediate-term loans typically finance depreciable capital assets of a farm or ranch. Examples of the uses of intermediate-term loans are to purchase or refinance farm machinery, vehicles, equipment, breeding livestock, or farm buildings, to make improvements, or to provide working capital. Intermediate-term loans are made for a specific term, generally 10 years or less. These loans may be made on a secured or unsecured basis, but are normally secured.

- Agribusiness loans —
  - Processing and marketing loans — for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.
  - Farm-related business loans — loans to eligible borrowers that furnish farm-related business services to farmers or ranchers that are directly related to their agricultural production.
- Rural residential real estate loans — to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans shall be secured by a first lien on the property, except that it may be secured by a second lien if the institution also holds the first lien on the property.

Associations may also purchase participations in loans made by other Associations, System Banks and non-System lenders to eligible borrowers or certain entities whose operations are functionally similar to those of an eligible borrower.

### *Loan Interest Rate and Prepayment Features*

Depending on the purpose of the loan, its repayment terms and the creditworthiness of the borrower, several interest rate (fixed or floating) and prepayment features may be available for a loan. Indexed floating-rate loans are tied solely to an external index such as the London InterBank Offered Rate (LIBOR) or the prime rates charged by certain commercial banks (Prime). The interest rate on an adjustable-rate loan may be fixed for a period of time and adjusted

periodically by predetermined amounts and may have an adjustment rate cap for each period as well as for the life of the loan. The interest rate on an administered-rate loan may be adjusted periodically on a basis internally determined by the lending institution. The interest rate on a fixed-rate loan will not change for the term of the loan.

A range of prepayment options exists on fixed- and floating-rate loans. These options range from the loans being fully prepayable with the option cost being reflected in the interest rate paid by the borrower, to loans with “make-whole” prepayment provisions, i.e., the borrower pays an additional amount when the loan is prepaid to cover the loss from the residual higher-cost funding that can occur as a result of the prepayment.

### ***Investments in Rural America***

In addition to making loans to accomplish the System’s congressionally mandated mission to finance agriculture and rural America, the Banks and Associations may make investments in rural America to address the diverse needs of agriculture and rural communities across America. The Farm Credit Administration approves these investments on a program or a case-by-case basis. Examples of investment programs that the Farm Credit Administration will consider include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

### ***Financially Related Services***

System institutions also provide a variety of products and services to their borrowers designed to enhance their business. Products and services provided by certain System institutions include:

- credit and mortgage life or disability insurance developed specifically for System borrowers to protect the repayment of loan obligations,
- acting in an agent capacity, various types of crop insurance covering specific risks (e.g., hail, fire, or lightning) and multi-peril crop insurance to protect against unpredictable weather and volatile markets in a combination of yield and revenue based products,

- livestock risk protection that provides revenue protection during unpredictable declines in the livestock industry,
- estate planning, record keeping, and tax planning and preparation,
- fee appraisal services, and
- cash management products and services and other related services to allow borrowers to more effectively manage their financial positions.

The Banks and Associations make the above insurance available through private insurers.

In addition, a subsidiary of one Bank and certain other System institutions provide leasing services to their customers that include a broad spectrum of lease options tailored to the borrower’s unique financial needs. These leasing services include the leasing of equipment, vehicles and facilities used by our borrowers in their businesses.

### **Customers**

Our borrowers consist of farmers, ranchers, producers and harvesters of aquatic products, agricultural cooperatives, eligible rural communications, energy and water companies, rural homeowners and other eligible entities, including other financing institutions (e.g., national or state banks, trust companies, savings institutions or credit unions).

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio at the System level is diversified by commodity and geographic location. On a combined basis, loans to borrowers raising livestock, which does not include poultry and dairy, represented 10.1% of the System’s total assets at December 31, 2008 and 10.6% at December 31, 2007. No other commodity exceeded 10% of total assets. However, due to the geographic territories served by individual Banks and Associations, most System institutions have higher concentrations of certain types of loans or commodities than does the System as a whole.

As part of our mission, we have established policies and programs for furnishing sound and constructive credit and related services to young, beginning, and small farmers and ranchers. A summary of these activities can be found in the Supplemental Financial Information on pages F-55 and F-56.

In accordance with the Farm Credit Act, each borrower, as a condition of borrowing, is generally required to invest in capital stock or participation certificates (non-voting equity investment) of the Association or Bank that originates the loan. The initial investment requirement may vary by Association or Bank with the minimum being the statutory minimum amount of 2% of the loan amount or one thousand dollars, whichever is less. The different classes of capital stock and participation certificates and the manner in which capital stock and participation certificates are issued, retired and transferred are set forth in the respective Bank's or Association's bylaws. The Bank or Association generally has a first lien on the capital stock and participation certificates as collateral for the repayment of the borrower/stockholder loan. For a more detailed discussion of these requirements, see Note 12 to the System's combined financial statements contained in this annual information statement.

### **Loan Underwriting Standards**

Credit risk arises from the potential inability of a borrower to meet a repayment obligation. This credit risk is managed at both the Association and Bank levels. Farm Credit Administration regulations establish loan-to-value limits for real estate mortgage loans and require that collateral be posted for real estate mortgage loans and some production loans in order to provide security on these loans. System institutions are required to adopt written standards for prudent lending and effective collateral evaluation.

#### *Underwriting by Associations*

The Associations manage credit risk through the use of underwriting standards, borrower assessments and portfolio management techniques. When making a loan, the Associations consider many factors about the borrower and apply certain underwriting standards to the lending process. The factors considered in the underwriting process include borrower integrity, credit history, cash flows, equity, and collateral, as well as other sources of loan repayment, loan pricing and an evaluation of management and the board of directors, if applicable. Additionally, many borrowers have off-farm sources of income that enhance their debt repayment capacity. Other factors that may influence the risk profiles of the lending businesses of Associations include the impact of urban and recreational influences on real estate values and the benefit of vertical integration (control over all stages of production of a commodity), which tend to reduce farm income volatility at the producer level.

To mitigate credit risk, each Association establishes "lending limits," which represent the maximum amount of credit that can be extended to any one borrower or industry. Further, in some instances, portfolio risk is managed through the purchase and sale of loan participations with other lenders in order to diversify the portfolio by borrower, commodity and geography.

#### *Underwriting by Banks*

The Banks also employ risk management practices when making wholesale loans to their affiliated Associations and loans to their retail borrowers. With respect to retail lending, the Banks manage credit risk through the use of underwriting standards, borrower assessments and portfolio management techniques. Similar to the Associations, when making a loan, they consider many factors about the borrower and apply underwriting standards to the lending process. The factors considered, and underwriting standards utilized, include borrower earnings, cash flows, equity, and collateral, as well as loan pricing and an evaluation of management and the board of directors, if applicable.

In the case of wholesale loans to Associations, the assets of the Association secure the Bank's loan to the Association and the lending terms are specified in a general financing agreement between each Association and its affiliated Bank. These financing agreements typically include:

- measurable, risk-based covenants,
- collateralization of the loan by substantially all Association assets,
- the Bank's prior approval of certain loans made by an Association,
- a defined borrowing base calculation or maximum loan amount,
- a prohibition against other borrowings without the Bank's approval, and
- loan rates tied to financial performance.

### **Competition**

The System competes with other lenders, including local, regional, national and international commercial banks, insurance companies, manufacturers and suppliers, captive finance companies of manufacturers and suppliers and, increasingly, non-traditional lenders, e.g., fixed-income mutual funds. Competition varies throughout the nation. System charters and

regulations impose geographic and authority limitations on System institutions that may not be imposed on their competitors. Through their ability to accept deposits and their access to capital markets, commercial banks may also have access to competitively priced funds for their lending activities. In addition, many banks and other financial institutions have been able to access funds for their lending operations through the various programs created or recently expanded by the U.S. government, including the Federal Reserve, the Department of the Treasury and the Federal Deposit Insurance Corporation, in response to the current credit crisis. Such programs include direct borrowings from the Federal Reserve to a broader variety of financial institutions (previously only commercial banks could borrow directly from the Federal Reserve) and equity investments by the Treasury in banks pursuant to the Treasury's Capital Purchase Program. These programs may put us at a competitive disadvantage to those entities participating in such programs. To date, we have not requested access to these programs.

Competition is also a consideration in connection with the issuance of Systemwide Debt Securities. In addition to securities issued by the United States Treasury, we compete with Fannie Mae, Freddie Mac, the Federal Home Loan Banks, other federal government-sponsored enterprises, foreign governments and other highly rated issuers for funds raised through the issuance of unsecured debt in the debt markets. Moreover, the U.S. government has taken a number of measures over the last several months that have increased the competition among issuers of debt securities, including the System. For example, the FDIC approved and has recently extended a program that guarantees newly issued senior unsecured debt of banks, thrifts, and certain holding companies and the Federal Reserve began purchasing short-term debt obligations issued by Fannie Mae, Freddie Mac and the Federal Home Loan Banks in the secondary market. In addition, at the time Fannie Mae and Freddie Mac were put into conservatorship by their regulator, the U.S. Treasury undertook certain initiatives, including the creation of a line of credit at Treasury for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Increases in the issuance of debt by these other issuers could cause us to issue our debt at higher interest rates and different maturities than would otherwise be the case. (See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Risk Management - Liquidity Risk Management" for further discussion.)

## **Federal Farm Credit Banks Funding Corporation**

As agent for the Banks, the Funding Corporation issues, markets, and handles Systemwide Debt Securities. The Funding Corporation, which was established by the Farm Credit Act, is owned by the Banks and is located in the metropolitan New York City area. The board of directors of the Funding Corporation is defined by statute and is comprised of nine voting members: four current or former Bank directors and three Bank chief executive officers or presidents elected by the Banks, and two additional voting members appointed by the other members of the board of directors after receiving recommendations from and consulting with the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve System. The additional members cannot be affiliated with the System or our regulator and cannot be actively engaged with a member of the group of investment banks and dealer banks involved in selling Systemwide Debt Securities. The president of the Funding Corporation serves as a non-voting member of the Funding Corporation's board of directors.

At December 31, 2008, the Funding Corporation utilized a selling group of 29 banks and securities dealers to sell Systemwide Debt Securities. The Funding Corporation's selling group distributes Systemwide Debt Securities on a worldwide basis to investors, including commercial banks, states, municipalities, pension and money-market funds, insurance companies, investment companies, corporations and foreign banks and governments. In addition, the Funding Corporation assists the Banks with respect to a variety of asset/liability management and certain specialized funding activities. For a discussion of the current financial markets and funding environment, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Overview — Funding" below.

The Funding Corporation, subject to Farm Credit Administration approval, is responsible for determining the amounts, maturities, rates of interest, and terms of each issuance of Systemwide Debt Securities and for establishing conditions of participation in the issuances of Systemwide Debt Securities by the Banks. In this regard, the Funding Corporation and all of the Banks have entered into the Amended and Restated Market Access Agreement. For a detailed discussion of the Market Access Agreement, see "Description of Systemwide Debt Securities — Agreements Among Certain System Institutions — Market Access Agreement" below.

The Funding Corporation also provides the Banks with certain consulting, accounting, and financial reporting services, including the preparation of the System's quarterly and annual information statements and the System's combined financial statements contained in the quarterly and annual information statements. As the System's financial spokesperson, the Funding Corporation is primarily responsible for financial disclosure and the release of public information concerning the financial condition and performance of the System as a whole.

### **Federal Agricultural Mortgage Corporation (Farmer Mac)**

Farmer Mac, which is statutorily defined as an institution of the System and is examined and regulated by the Farm Credit Administration, provides secondary marketing arrangements, certifies marketing facilities in order to promote a secondary market for agricultural and rural home mortgage loans that meet certain underwriting standards, and is authorized to be a direct pooler of farm mortgage loans. The common stock of Farmer Mac is owned by both System and non-System entities and its board of directors has both System and non-System representation. The System Banks also own \$60 million of Farmer Mac's senior cumulative perpetual preferred stock. Other than the contractual obligations arising from business transactions between Farmer Mac and certain System institutions, Farmer Mac is not liable for any debt or obligation of any other System institution and no System institution other than Farmer Mac is liable for any debt or obligation of Farmer Mac. Further, the assets of the Farm Credit Insurance Fund do not support any debt issuances or obligations of Farmer Mac nor do the System's independent credit ratings apply to Farmer Mac. Accordingly, the financial information of Farmer Mac is not included in the combined financial statements of the System.

Some System institutions have entered into guarantee agreements with Farmer Mac that are intended to reduce their credit risk and/or manage their capital positions. These agreements are commonly referred to as long-term standby commitment to purchase agreements. System institutions may also securitize mortgage loans by exchanging the loans for Farmer Mac mortgage-backed securities. At December 31, 2008, Farmer Mac guaranteed \$2.165 billion of loans issued by System institutions and System institutions had exchanged \$1.447 billion of loans for mortgage-backed securities issued by Farmer Mac.

### **The Farm Credit Council**

The Farm Credit Council is a federated trade association representing the System before Congress, the Executive Branch and others. The Council provides the mechanism for member "grassroots" involvement in the development of System positions and policies with respect to federal legislation and government actions that impact the System.

### **Governance**

#### *Boards of Directors*

Each Bank and Association has its own board of directors, which is primarily comprised of directors elected by the stockholders, that oversees the management of the Bank or the Association. Farm Credit Administration regulations require each Bank and Association to have a nominating committee that is responsible for identifying, evaluating and nominating candidates for director positions. Each committee should nominate at least two candidates for each director position. Stockholder-elected directors must constitute at least 60 percent of the members of the board. Therefore, each board may include additional directors appointed by the stockholder-elected directors. In addition, each Bank and each Association with assets exceeding \$500 million is required to have at least two outside directors. All other Associations must have at least one outside director. Each Bank and Association board must have a member who is a financial expert, except for those Associations with assets of \$500 million or less, who may retain a financial advisor. The boards of directors represent the interests of the stockholders of their particular institution. Each board of directors performs the following functions, among others:

- selects, compensates and evaluates the chief executive officer,
- approves the strategic plan and annual operating plans and budget,
- advises management on significant issues facing the institution, and
- oversees the financial reporting process, communications with stockholders and the institution's legal and regulatory compliance.

Each Bank and Association has an audit committee and a compensation committee but may also have additional committees as determined by the board of the Bank or Association. The audit committee members must be members of the board and the board members

designated as financial experts must serve on the audit committee. The audit committee is responsible for the oversight of the financial reporting process and the internal controls related to the preparation of the financial reports, and the appointment, compensation and retention of the independent auditors. The compensation committee is responsible for reviewing compensation policies and plans for senior officers and employees, and must approve the overall compensation program for senior officers. In addition, the Funding Corporation has a board of directors, an audit committee and a compensation committee that perform the same functions for the Funding Corporation as discussed above.

### *Presidents' Planning Committee*

The Presidents' Planning Committee is comprised of the chief executive officer or president of each Bank, one Association from each District, the Funding Corporation, The Farm Credit Council and certain large Associations. The Presidents' Planning Committee serves in a management coordination capacity for the System and provides a key advisory role in the System's decision-making process.

The Presidents' Planning Committee has certain broad responsibilities including:

- establishing and advancing strategic direction,
- identifying and analyzing business opportunities,
- providing advice and recommendations on legislative and regulatory issues, and
- improving communications within the System and with the System's various stakeholders and external entities.

The Presidents' Planning Committee carries out these responsibilities with the objective of promoting and protecting the System's core values and strengths. Subcommittees of the Presidents' Planning Committee include: the Executive Committee, the Risk Management Committee, the Finance Committee, and the Regulatory, Legislative and Public Relations Committee. These committees aid System communication and promote the sharing of best practices. The committees actively engage in discussions about topics where common action is needed by the System.

### *System Audit Committee*

As required by regulation, the board of directors of the Funding Corporation has established a System Audit Committee and adopted a written charter for the Committee. The System Audit Committee is comprised of five members — one of the Funding

Corporation's outside directors, two Bank or Association directors, one outside person who has no current affiliation with the System and is a financial expert, and either the second Funding Corporation outside director or a second outside person at the Funding Corporation board's discretion (the second outside person must have no current affiliation with the System and be a financial expert). Under the charter, the Funding Corporation's board of directors selects all members of the System Audit Committee and appoints the chairman and vice chairman. The chairman of the System Audit Committee must be a financial expert. A copy of the charter is available on the Funding Corporation's website at [www.farmcredit-ffcb.com](http://www.farmcredit-ffcb.com).

The System Audit Committee reports to the board of directors of the Funding Corporation. The responsibilities of the System Audit Committee include, among other things:

- the oversight of the Funding Corporation's system of internal controls related to the preparation of the System's quarterly and annual information statements,
- the integrity of the System's quarterly and annual information statements,
- the review and assessment of the impact of accounting and auditing developments on the System's combined financial statements,
- the review and assessment of the impact of accounting policy changes related to the preparation of the System's combined financial statements,
- the appointment, compensation, retention and oversight of the System's independent auditors,
- the pre-approval of allowable non-audit services at the System level,
- the establishment and maintenance of procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters at the System level and for the confidential, anonymous submission of concerns regarding questionable System accounting, internal accounting controls or auditing matters,
- the receipt of various reports from Funding Corporation management on internal controls, off-balance sheet arrangements, critical accounting policies, and material alternative accounting treatments,

- the review and approval of the scope and planning of the annual audit by the System's independent auditors,
- the approval of policies and procedures for the preparation of the System's quarterly and annual information statements, and
- the review and approval of the System's quarterly and annual information statements and annual financial press releases, after discussions with management and the independent auditors.

### ***Internal Control Over Financial Reporting***

To enhance our governance and internal controls, the System voluntarily implemented policies and procedures to assess the System's internal control over financial reporting beginning with the year ended December 31, 2005. As of January 2008, this assessment is now required by regulation. The System's management is responsible for establishing and maintaining internal control over financial reporting and the Funding Corporation's management has assessed the effectiveness of the System's internal control over financial reporting as of December 31, 2008. The Funding Corporation's management has used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework* to assess the effectiveness of internal control over financial reporting and has included this report on the assessment on page F-2 of this annual information statement.

The System has also engaged PricewaterhouseCoopers LLP, the System's independent auditors, to opine on the effectiveness of the System's internal control over financial reporting based on their audit. Their report can be found on page F-3.

### ***Code of Ethics***

Each Bank and the Funding Corporation have adopted codes of ethics that apply to their chief executive officers, certain other executives, and senior professionals in the finance and accounting areas who are involved with the preparation of the System's financial statements and the maintenance of the financial records supporting the financial statements.

A copy of the Funding Corporation's code of ethics related to the preparation of the System's quarterly and annual information statements can be accessed on the Funding Corporation's website at [www.farmcredit-ffcb.com](http://www.farmcredit-ffcb.com). The Funding Corporation will disclose material amendments to or any waivers

from a required provision of the codes of ethics for any individual covered by the Banks' or the Funding Corporation's codes of ethics by including that information in future information statements. No such amendments or waivers were made in 2008. Each Bank's code of ethics includes similar content and can be accessed through its website listed on page 2.

### ***Complaints Regarding Accounting, Internal Accounting Controls and Auditing Matters***

Each Bank and the Funding Corporation have adopted employee complaint procedures for accounting, financial reporting, internal accounting controls, or auditing matters. These procedures allow employees to submit confidential, anonymous concerns regarding accounting, financial reporting, internal accounting controls, or auditing matters without the fear of reprisal, retaliation or adverse action being taken against any employee who, in good faith, reports or assists in the investigation of a violation or suspected violation, or who makes an inquiry about the appropriateness of an anticipated or actual course of action. No concerns or inquiries were submitted for 2008.

### **Employees**

The number of personnel employed by the System on a full-time equivalent basis was 11,814 at December 31, 2008, up from 11,173 at December 31, 2007, and 10,883 at December 31, 2006.

### **Properties**

As of December 31, 2008, AgFirst owned its corporate office in Columbia, South Carolina and U.S. AgBank owned its corporate office in Wichita, Kansas. The other three Banks each leased their respective corporate offices. In addition, AgFirst owned additional buildings in Columbia, South Carolina. Certain Banks leased other offices throughout the country and, in the case of CoBank, internationally. The Associations owned or leased various offices in locations throughout the United States and Puerto Rico. The Funding Corporation leased office space in Jersey City, New Jersey.

As authorized by the Farm Credit Act, the Farm Credit Administration occupies buildings and uses land owned and leased by the Farm Credit System Building Association, an entity jointly owned by the Banks. The headquarters for the Farm Credit Administration is located in McLean, Virginia.



## FEDERAL REGULATION AND SUPERVISION OF THE FARM CREDIT SYSTEM

The following summaries of certain provisions of the Farm Credit Act, the Farm Credit Administration regulations and the Farm Credit System Insurance Corporation regulations should not be viewed as complete and are qualified in their entirety by reference to the provisions of the Farm Credit Act and these regulations.

### Farm Credit Administration

As a federally chartered network of lending institutions and related service organizations that performs a public policy function, the System is subject to Congressional legislation and oversight. The Farm Credit Administration, an independent federal regulatory agency, has jurisdiction over System institutions. A three-member full-time board appointed by the President of the United States with the advice and consent of the Senate manages the Farm Credit Administration.

The Farm Credit Administration examines each System institution not less than once during each 18-month period. The examinations may include analyses of credit and collateral quality, capitalization, earnings, interest rate risk, the effectiveness of management, and the application of policies in carrying out the Farm Credit Act, in adhering to the Farm Credit Administration regulations, and in serving eligible borrowers.

Further, the Farm Credit Act authorizes the Farm Credit Administration to take specified enforcement actions to ensure the safe and sound operations of System institutions and their compliance with the Farm Credit Act and Farm Credit Administration regulations. These enforcement powers include the power to:

- issue cease and desist orders,
- suspend or remove a director or an officer of a System institution, and
- impose specified civil money penalties for certain violations of the Farm Credit Act, Farm Credit Administration regulations or certain orders of the Farm Credit Administration.

In addition, Farm Credit Administration regulations provide that if the Farm Credit Administration determines, after consultation with the Funding Corporation, that a financial, economic, agricultural or national defense crisis exists that could impede the normal access of the Banks to the capital markets, the

Farm Credit Administration Board shall, in its sole discretion, adopt a resolution that:

- increases the amount of eligible investments that a Bank is authorized to hold, and/or,
- modifies or waives the liquidity reserve requirement.

The Farm Credit Administration did not take any enforcement actions against any of the Banks or Associations during 2008 and no enforcement actions were outstanding at December 31, 2008.

### Farm Credit Administration Regulations

The Farm Credit Act authorizes, and in some instances requires, the Farm Credit Administration to issue regulations governing various operations of System institutions and subjects certain actions by System institutions to the approval of the Farm Credit Administration. These regulations and approval requirements include the following:

#### *Issuances of Systemwide Debt Securities*

Under the Farm Credit Act, determinations by the Funding Corporation as to the amounts, maturities, rates of interest, terms, and conditions of participation by the Banks in each issuance of Systemwide Debt Securities are subject to Farm Credit Administration approval.

#### *Lending Objective*

In accordance with the Farm Credit Administration regulations, the lending objective of the System institutions is to provide full credit, to the extent of creditworthiness, to borrowers whose primary business is farming, ranching, or producing or harvesting aquatic products; conservative credit to part-time farmers and to rural homeowners; and more restricted credit for other credit requirements as needed to ensure a sound credit package or to accommodate a borrower's needs as long as the total credit results in being primarily an agricultural loan. System institutions are specifically prohibited from extending credit where investment in agricultural assets is primarily for speculative purposes.

### ***Borrower Protections***

The Farm Credit Act and/or the Farm Credit Administration regulations provide the following protections to most System institution borrowers:

- prior to loan closing, System institutions must provide borrowers with extensive disclosure-related information and copies of appraisals, if any,
- System institutions must provide borrowers with access to a Credit Review Committee hearing on an adverse action taken on a loan application or a request for loan restructuring, if requested,
- borrowers have the right of first refusal to lease or repurchase any real estate acquired from them by a System lender, and
- System institutions must protect the nonpublic personal information of their borrowers.

### ***Bank Collateral Requirements***

As a condition of a Bank's participation in the issuance of Systemwide Debt Securities, the Bank must have, and at all times thereafter maintain, free from any lien or other pledge, specified eligible assets (referred to in the Farm Credit Act as "collateral") at least equal in value to the total amount of outstanding debt securities of the Bank that are subject to the collateral requirement. These securities include Systemwide Debt Securities for which the Bank is primarily liable and investment bonds or other debt securities that the Bank has issued individually. The collateral must consist of notes and other obligations representing loans or real or personal property acquired in connection with loans made under the authority of the Farm Credit Act (valued in accordance with Farm Credit Administration regulations and directives), obligations of the United States or any agency thereof direct or fully guaranteed, other Farm Credit Administration-approved Bank assets, including eligible marketable securities, or cash. These collateral requirements do not provide holders of Systemwide Debt Securities with a security interest in any assets of the Banks. The Banks may in the future issue Systemwide Debt Securities that are secured by specific assets.

Farm Credit Administration regulations require the Banks to maintain a net collateral ratio of at least 103% (as discussed in "Capital Adequacy" below). The Banks, however, manage their operations to

achieve a higher net collateral ratio percentage. The net collateral ratio is net collateral (primarily loans and investments) divided by total liabilities less subordinated debt, subject to certain limits. The net collateral ratio is much more restrictive than the debt issuance collateral requirement. Therefore, if a minimum net collateral ratio of 103% is met, the debt issuance collateral requirement is automatically met. In connection with preferred stock and subordinated debt offerings, certain Banks are required by the Farm Credit Administration to maintain a minimum net collateral ratio of 104%.

### ***Capital Adequacy***

Farm Credit Administration regulations require that the Banks and Associations achieve and maintain a permanent capital level of at least 7% of risk-adjusted assets. Risk-adjusted assets mean the total dollar amount of the System institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. In addition, these regulations require that:

- all Banks and Associations achieve and maintain a total surplus ratio of at least 7% of risk-adjusted assets and a core surplus ratio of at least 3.5% of risk-adjusted assets, and
- all Banks achieve and maintain a net collateral ratio of at least 103%.

Also, each System institution is required to adopt a written capital adequacy plan. The plan must include capital targets that are necessary to achieve the institution's capital adequacy goals as well as maintain the minimum permanent capital and surplus standards.

### ***Accounting Requirements***

Farm Credit Administration regulations require that each System institution prepare all financial statements in accordance with accounting principles generally accepted in the United States. The financial statements must be audited by qualified independent auditors on an annual basis.

### ***Internal Controls***

Farm Credit Administration regulations require that each System institution adopt an internal control policy that provides adequate direction to the institution in establishing effective control over and accountability for operations, programs, and resources.

### ***Disclosure Obligations***

The Banks, the Associations and the Funding Corporation must prepare and file with the Farm Credit Administration quarterly and annual reports that comply with Farm Credit Administration regulations:

- Each Bank and Association must prepare and publish its annual report on its website and submit a copy to the Farm Credit Administration within 75 days of the end of its fiscal year. In addition, each Bank and Association must prepare and provide to its shareholders an annual report within 90 days of the end of its fiscal year. The annual report must include, among other things, a description of the System institution's business, properties, capital structure, risk exposures, loan portfolio and financial performance. Each Bank and Association must prepare a quarterly report within 40 days after the end of each fiscal quarter. The quarterly reports update and supplement the last annual report, as necessary.
- The Funding Corporation must prepare and disseminate a System annual information statement for holders of Systemwide Debt Securities and other users of the annual information statement within 75 days of the end of each fiscal year and file a copy with the Farm Credit Administration. The annual information statement must include, among other things, a description of the System's business, properties, capital structure, risk exposures, loan portfolio and financial performance. The Funding Corporation must also prepare a quarterly information statement within 45 days after the end of each fiscal quarter. The quarterly information statements update and supplement the System's latest annual information statement, as necessary.
- The Banks and the Funding Corporation are responsible for disclosure of information concerning the System to investors in Systemwide Debt Securities. The Banks are required to provide specified information to the Funding Corporation so that it can prepare the System information statements. Further, the Funding Corporation is required to establish a system of internal controls sufficient to reasonably ensure that any information it releases to investors or the general public is true, and that there are no omissions of material information.

- The appropriate officers and board members from each Bank, Association and the Funding Corporation must certify that the information contained in the quarterly and annual reports or information statements they prepare and file with the Farm Credit Administration is true, accurate and complete to the best of their knowledge and belief.

### ***Withdrawal from the System***

The Farm Credit Act permits a Bank or an Association to withdraw from the System to become chartered by a federal or state authority as a bank, savings association or other financial institution if certain restrictive requirements are met, including:

- adequate provision for the payment of all of the institution's obligations to other System entities,
- if a Bank, adequate provision for the repayment of its Systemwide Debt Securities and related interest,
- approval of the Farm Credit Administration Board,
- approval by the institution's stockholders, and
- payment by the institution to the Insurance Fund of an amount by which its total capital exceeds 6% of its assets.

### ***Appointment of Conservator or Receiver***

The Farm Credit Administration also has the exclusive authority to appoint a conservator or receiver for any System institution under circumstances specified in the Farm Credit Act and has promulgated regulations governing receiverships and conservatorships. The Farm Credit Act provides that the Insurance Corporation will serve as receiver or conservator of any System institution placed in receivership or conservatorship by the Farm Credit Administration and authorizes the Insurance Corporation to issue certain rules and regulations relating to its statutory authorities.

### ***Farm Credit System Insurance Corporation***

The Insurance Corporation is an independent U.S. government-controlled corporation and is not under the control of any System institution. The Insurance Corporation's primary purpose is to insure the timely payment of principal and interest on Systemwide Debt Securities. It also carries out various other

responsibilities. A board of directors consisting of the Farm Credit Administration Board directs the Insurance Corporation. The chairman of the Insurance Corporation's board of directors must be someone other than the current chairman of the Farm Credit Administration Board.

### ***Uses of the Farm Credit Insurance Fund***

The Insurance Corporation is required to expend funds in the Insurance Fund, which can only be used for the benefit of the System, to:

- insure the timely payment of principal and interest on Systemwide Debt Securities, and
- ensure the retirement of protected borrower stock at par value (\$10 million as of December 31, 2008).

Further, subject to the provisions of the Farm Credit Act, the Insurance Corporation, in its sole discretion, is also authorized to expend funds in the Insurance Fund to pay its operating expenses, to assist a financially stressed Bank or Association, and to assist qualified merging institutions. The Insurance Corporation cannot provide this discretionary assistance to an institution unless the means of providing this assistance is the least costly of all possible alternatives to the Insurance Corporation.

The Insurance Corporation may also, in its sole discretion, make loans on the security of, or may purchase, and liquidate or sell, any part of the assets of any Bank or Association that is placed in receivership because of the inability of the institution to pay the principal or interest on any of its notes, bonds, debentures, or other obligations in a timely manner.

### ***Funding for the Farm Credit Insurance Fund***

The Insurance Corporation's primary asset is the Insurance Fund and the primary sources of funds for the Insurance Fund are:

- the premiums paid by the Banks, and
- earnings on assets in the Insurance Fund.

The premiums are based on each Bank's pro rata share of adjusted outstanding insured debt, as reduced by loans and investments guaranteed by the U.S. or state governments, with 20 basis points being the

statutory maximum the Banks may be assessed. Up to an additional 10 basis points may be assessed on nonaccrual loans or investments that are other-than-temporarily impaired. The Insurance Corporation conducts a semi-annual review of insurance premium levels and adjusts the premium levels based on certain criteria. Furthermore, the Insurance Corporation, in its sole discretion, may reduce the annual premiums due from each Bank. Each Bank is authorized to assess its affiliated Associations and other financing institutions in order to pay the premiums.

Premiums are collected to maintain the Insurance Fund at the "secure base amount," which is defined in the Farm Credit Act as 2% of the aggregate outstanding insured obligations (adjusted to reflect the System's reduced risk on loans and investments guaranteed by federal or state governments) or another percentage of the aggregate outstanding insured obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. The Insurance Corporation has adopted a Policy Statement addressing the periodic determination of the secure base amount that is currently set at the 2% level.

When the Insurance Fund is at or above the 2% secure base amount, the Insurance Corporation is required to reduce premiums, as necessary, to maintain the Insurance Fund at the 2% level. In addition, the Insurance Corporation is required to establish allocated insurance reserve accounts for each Bank and an allocated insurance reserve account for former Farm Credit System Financial Assistance Corporation stockholders under certain circumstances. The Financial Assistance Corporation's charter was cancelled by the Farm Credit Administration Board as of December 31, 2006. For a discussion about the Financial Assistance Corporation, see Note 1 to the accompanying combined financial statements. The Insurance Corporation has established a policy to allocate excess Insurance Fund balances above the secure base amount into these accounts. However, these reserve accounts remain part of the Insurance Fund, and, therefore, may be used for statutorily authorized Insurance Corporation purposes.

For additional information with respect to the Insurance Fund, see "Description of Systemwide Debt Securities — Repayment Protections" and Note 7 to the accompanying combined financial statements.

## DESCRIPTION OF SYSTEMWIDE DEBT SECURITIES

### General

The System obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities. Each issuance of Systemwide Debt Securities must be approved by the Farm Credit Administration and each Bank's participation is subject to: (1) the availability of specified eligible assets (referred to in the Farm Credit Act as "collateral" as previously described), (2) compliance with the conditions of participation as prescribed in the Amended and Restated Market Access Agreement, and (3) determinations by the Funding Corporation of the amounts, maturities, rates of interest, and terms of each issuance. Systemwide Debt Securities are issued pursuant to authorizing resolutions adopted by the boards of directors of each Bank and under the authority of the Farm Credit Act and the Farm Credit Administration regulations. The following summary descriptions of Systemwide Debt Securities should not be viewed as complete and are qualified in their entirety by reference to the offering circulars pertaining to the particular types of debt securities, the provisions of the Farm Credit Act and the Farm Credit Administration regulations.

**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 United States government. In addition, Systemwide Debt Securities are not the direct obligations of the Associations and, as a result, the capital of the Associations may not be available to support principal or interest payments on Systemwide Debt Securities.** For additional financial information with respect to the Banks, see Note 21 to the accompanying combined financial statements.

Each issuance of Systemwide Debt Securities ranks equally, in accordance with the Farm Credit Administration regulations, with the System's other unsecured Systemwide Debt Securities. Systemwide Debt Securities are not issued under an indenture and no trustee is provided with respect to these securities. Systemwide Debt Securities are not subject to acceleration prior to maturity upon the occurrence of any default or similar event.

The System may issue the types of Systemwide Debt Securities listed on page 1 of this annual information statement. For a discussion of the various risks, tax and other considerations, and terms and conditions

related to each of these types of securities, see the discussions in the offering circulars listed on page 1 of this annual information statement, each of which may be amended or supplemented from time to time.

### Use of Proceeds

Net proceeds from sales of Systemwide Debt Securities are used by the Banks to fund their loan and investment portfolios (which primarily include loans to their affiliated Associations and liquidity investments), to meet maturing debt obligations, and for other corporate purposes. The Banks anticipate that additional financing, including financing through various types of debt securities, will be required from time to time. The amount and nature of the financings depend on a number of factors, including the volume of the Banks' maturing debt obligations, the volume of loans made by and repaid to System institutions, and general market conditions.

### Repayment Protections

#### *General*

While the repayment of Systemwide Debt Securities is the direct joint and several obligation of the Banks, there are several sources of funds in the System for the payment of interest and principal due on the securities. The underlying source of funds for the repayment of Systemwide Debt Securities is the System's borrowers, with each borrower having certain minimum levels of net worth and, in most cases, collateral posted in connection with loans made to the borrower. These borrowers make payments on their loans to the lending Bank or Association. The lending Associations in turn make payments on their wholesale loans to their affiliated lending Bank. Both the Banks, which ultimately repay Systemwide Debt Securities, and the Associations have substantial amounts of capital as further protection and sources of support for the repayment of the outstanding debt. Each Bank's ability to participate in a particular issue of Systemwide Debt Securities is regulated and monitored by the Farm Credit Administration. Furthermore, the Banks and the Funding Corporation have entered into the Amended and Restated Market Access Agreement that sets forth certain conditions of participation for the Banks, as described below.

Under each Bank's bylaws, the Bank is authorized under certain circumstances to require its affiliated Associations and certain other equity holders to

purchase additional Bank equities. In most cases, the Banks are limited as to the amounts of these purchases that may be required, generally with reference to a percentage of the Association's or other equity holder's direct loan from the Bank. However, the Banks also generally possess indirect access to certain financial resources of their affiliated Associations through loan-pricing provisions and through Bank-influenced District operating and financing policies.

If a Bank participating in an issue of Systemwide Debt Securities were unable to repay its portion of that security, the Insurance Fund would be required to make that payment. In the event the assets in the Insurance Fund were exhausted, the provisions of joint and several liability of all the Banks would be triggered, which means the financial resources of the other Banks would be called upon to repay the defaulting Bank's portion of the debt issuance.

#### ***Net Collateral Ratio***

Farm Credit Administration regulations require each Bank to maintain a minimum net collateral ratio of 103%, although the Banks manage their operations to achieve a higher net collateral ratio percentage, as required under the Amended and Restated Market Access Agreement discussed below. In connection with preferred stock and subordinated debt offerings, certain Banks are required by the Farm Credit Administration to maintain a minimum net collateral ratio of 104%. The net collateral ratio is net collateral (primarily loans and investments) divided by total liabilities less subordinated debt, subject to certain limits. Also see "Federal Regulation and Supervision of the Farm Credit System — Farm Credit Administration Regulations — Bank Collateral Requirements" above.

#### ***Capital Adequacy***

Farm Credit Administration regulations require that each Bank and Association achieve and maintain permanent capital and certain surplus to assets ratios. In addition, the Banks are required to maintain a minimum net collateral to liabilities ratio, as well as develop a capital adequacy plan, each as described above in "Federal Regulation and Supervision of the Farm Credit System — Farm Credit Administration Regulations — Capital Adequacy."

#### ***Agreements Among Certain System Institutions***

In order to provide for mutual protection among the Banks with respect to their debt obligations, the Banks have voluntarily entered into integrated

agreements that contain certain financial covenants. These integrated agreements are the Amended and Restated Market Access Agreement and the Amended and Restated Contractual Interbank Performance Agreement. A copy of the Amended and Restated Market Access Agreement and a summary of the Amended and Restated Contractual Interbank Performance Agreement are available on the Funding Corporation's website located at [www.farmcredit-fccb.com](http://www.farmcredit-fccb.com).

Amended and Restated Market Access Agreement (MAA) — The Funding Corporation and the Banks have entered into the MAA. The MAA establishes criteria and procedures for the Banks that provide operational oversight and control over a Bank's access to System funding if the creditworthiness of the Bank declines below certain agreed-upon levels. If the criteria are not met, the MAA may require the Bank to provide certain additional information and, under specified circumstances, restrict or prohibit an individual Bank's participation in issuances of Systemwide Debt Securities. The MAA is designed to provide for the identification and resolution of individual Bank financial problems in a timely manner. The MAA also discharges the Funding Corporation's statutory responsibility for determining conditions for each Bank's participation in each issuance of Systemwide Debt Securities. For additional discussion of the criteria and standards under the MAA, and the resulting categories and restrictions if the standards are not met, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Risk Management — Structural Risk Management."

Amended and Restated Contractual Interbank Performance Agreement (CIPA) — The Banks and the Funding Corporation have also entered into the CIPA. Under provisions of the CIPA, a CIPA score is calculated that measures the financial condition and performance of each District using various ratios that take into account the District's capital, asset quality, earnings, interest-rate risk and liquidity. This CIPA score is then compared against the agreed-upon standard of financial condition and performance in the CIPA that each District must achieve and maintain. The CIPA also establishes economic incentives whereby monetary penalties are applied if the performance standard is not met.

#### ***Farm Credit Insurance Fund***

The Insurance Corporation insures the timely payment of principal and interest on Systemwide Debt

Securities. The Insurance Corporation maintains the Insurance Fund for this purpose and for certain other purposes. In the event a Bank is unable to timely pay principal or interest on any insured debt obligation for which that Bank is primarily liable, the Insurance Corporation must expend amounts in the Insurance Fund to the extent available to insure the timely payment of principal and interest on the debt obligation. The provisions of the Farm Credit Act providing for joint and several liability of the Banks on the debt obligation cannot be invoked until all amounts in the Insurance Fund have been exhausted. However, because of other mandatory and discretionary uses of the Insurance Fund, there is no assurance that there will be sufficient funds to pay the principal or interest on the insured debt obligation. The insurance provided through use of the Insurance Fund is not an obligation of and is not a guarantee by the U.S. government.

#### ***Joint and Several Liability***

The Banks are jointly and severally liable for the payment of principal and interest on Systemwide Debt Securities. If a Bank is unable to pay the principal or interest on a Systemwide Debt Security and if the amounts in the Insurance Fund have been exhausted, the Farm Credit Administration is required to make calls on all non-defaulting Banks to satisfy the liability. These calls would be in the proportion that each non-defaulting Bank's "available collateral" ("available collateral" is collateral in excess of the aggregate of the Bank's "collateralized" obligations) bears to the aggregate available collateral of all non-defaulting Banks. If these calls were not sufficient to satisfy the liability, then a further call would be made in proportion to each non-defaulting Bank's remaining assets. On making a call on non-defaulting Banks with respect to a Systemwide Debt Security issued on behalf of a defaulting Bank, the Farm Credit Administration is required to appoint the Insurance Corporation as the receiver for the defaulting Bank. The receiver would be required to expeditiously liquidate the Bank.

#### ***Status in Liquidation***

Farm Credit Administration regulations provide that in the event a Bank is placed in liquidation, holders of Systemwide Debt Securities have claims against the Bank's assets, whether or not the holders file individual claims. The claims of these holders are junior to claims related to costs incurred by the receiver in connection with the administration of the receivership, claims for taxes, claims of secured creditors, and claims of holders of bonds, including investment bonds, issued by the Bank individually, to the extent the bonds are collateralized in accordance with the requirements of the Farm Credit Act. Further, claims of holders of Systemwide Debt Securities are senior to all claims of general creditors. If particular Systemwide Debt Securities were offered on a secured basis, the holders of these obligations would have the priority accorded secured creditors of the liquidating Bank. To date, the Banks have not issued secured Systemwide Debt Securities.

#### ***Amended Contingency Funding Program***

The Banks have established a Contingency Funding Program to provide for contingency financing mechanisms and procedures to address potential disruptions in the System's communications, operations and payments systems. Effective January 5, 2009, the Banks amended the Contingency Funding Program to broaden its scope to cover events that threaten continuous market access by the Banks or the Funding Corporation's normal operations. Under this Program, the Funding Corporation has the option to finance all Systemwide Debt Securities through the issuance of Systemwide discount notes either directly to institutional investors or through the selling group. The Funding Corporation, on behalf of the Banks, may also incur other obligations, such as Federal funds purchased, that would be the joint and several obligations of the Banks and would be insured by the Insurance Corporation to the extent funds are available in the Insurance Fund.

## RISK FACTORS

The following discussion summarizes some of the more important risk factors that the System faces. This discussion is not exhaustive and there may be other risk factors that the System faces that are not described below. The risk factors described below, if realized, could negatively affect the System's business, financial condition, and future results of operations, and, among other things, could result in the Banks' inability to pay principal and interest on a timely basis on Systemwide Debt Securities.

### **The System's business is directly affected by agricultural and other economies.**

The System's financial condition is directly impacted by factors affecting the agricultural, rural and other economies, since these factors impact the demand for loans and financial services offered by the System and the ability of System borrowers to make payments on loans. These factors may include:

- weather-related, disease, and other adverse climatic or biological conditions that impact the agricultural productivity and income of System borrowers,
- changes in production expenses, particularly fuel and fertilizer,
- changes in land values,
- irrigation water availability and cost, and environmental standards,
- availability and cost of agricultural workers,
- changes in United States government support of the agricultural sector, including expenditures on agricultural programs, that may affect the level of income of some System borrowers,
- political, legal, regulatory, financial markets and economic conditions and developments in the United States and abroad that can affect such things as the price of commodities or products used or sold by System borrowers, including the volatility thereof, as well as changes in the relative value of the U.S. dollar,
- changes in the general economy that can affect the availability of off-farm sources of income and prices of real estate, and
- the development of alternative uses and markets for agricultural commodities, including ethanol and other biofuel production, and the resulting impact on the prices of commodities sold or used by System borrowers.

### **The System's funding costs and our flexibility in accessing the debt markets are directly affected by factors impacting the U.S. and global financial and capital markets.**

The U.S. and global financial markets are currently in the midst of severe dislocation and volatility. At the present time, these conditions, and the condition of the U.S. and global economy in general, show little evidence of improving in the short term. These conditions have had the direct effect of reducing the System's ability to issue debt in varying economic environments at competitive prices and terms. In particular, the current negative events surrounding the U.S. financial system, including the events surrounding the housing-related government sponsored enterprises (GSEs), have resulted in an extraordinary level of U.S. government intervention and assistance to these GSEs and many U.S. financial institutions. The Federal government's response to this turmoil has had, and may continue to have, an unintended consequence of increasing our funding costs and reducing our ability to issue debt with preferred maturities and structures, and may negatively impact the System's financial condition and results of operations.

While the System has continued to have regular and flexible access to the short-term debt markets, issuance of securities with maturities greater than one year has been reduced and the cost of such term issuances has increased. In addition, certain traditional buyers of the System's long-term securities have significantly reduced their purchases, with the corresponding negative impact on the market and cost of these securities. The System has begun to adjust to these conditions with changes in issuance strategies and in the structure and pricing of loans to borrowers.

In addition, over the past few years the System has grown at a relatively high rate in order to serve its customers and fulfill its mission. System institutions have accessed third party capital to supplement member-supplied equity and support adequate regulatory capital levels. Issuances include both preferred stock and subordinated debt. These third party capital issuances have supplemented traditional capital sources. Current conditions in the U.S. and global capital markets have substantially reduced, if not eliminated, the System's ability to issue third party capital at a cost acceptable to the issuing institution, at least in the near term. To the extent that third party capital alternatives remain difficult to access, overall System growth may be reduced.



**Uncertainty about the future of government-sponsored enterprises has had, and may continue to have, an adverse impact on the System's ability to issue debt at the favorable rates and terms it has historically been able to obtain, and may negatively affect its business prospects, earnings or capital.**

The System's GSE status has been an important factor in its ability to continually access the debt capital markets. In addition, the System's funding costs have historically been substantially below that of similar non-GSE entities. However, as a direct result of the financial difficulties experienced by the housing-related GSEs, with both Fannie Mae and Freddie Mac having been placed into conservatorship by the U.S. government, GSE status has been and may continue to be a topic of debate and concern to various stakeholders. A changing perception of GSE status has had and may continue to have an adverse impact on the System's ability to issue debt at the favorable rates and terms it has historically been able to obtain.

**The increased volatility in the agricultural commodity market and the cost of farm inputs has resulted in, and may continue to result in, higher risk profiles for certain System borrowers.**

Over the past 18 months, there has been considerable volatility in both the agricultural commodities market and the cost of farm inputs. Although many of the System's borrowers have been positively impacted by the current agricultural market, the increased volatility in commodities prices, coupled with substantial fluctuations in production expenses, has had, and may continue to have, an adverse impact on the cash flow and profitability of certain System borrowers, which, in turn, may negatively affect their ability to repay their loans. In particular, this increased volatility has resulted in higher risk profiles for livestock producers, producers and marketers of grains and oilseeds, and borrowers that use corn or other grains in their products. Continued volatility in the agricultural commodities market and the cost of farm inputs may further adversely impact the credit quality of our loan portfolio and, as a result, negatively affect our operating results.

**Agriculture has experienced a sustained period of favorable economic conditions. However, in an environment of less favorable economic conditions in agriculture, and without sufficient government support programs, the System's financial performance and credit quality measures would likely be negatively impacted.**

The overall U.S. farm economy has experienced a prolonged period of favorable economic conditions due, in part, to stronger commodity prices. This has led to increased farmland values and debt levels as farmers borrowed money to buy more land, financed the higher costs of inputs such as fertilizer, fuel and seed, and upgraded their equipment. Over the last several years, the System's financial results have been favorably impacted by these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. Among factors that could affect demand for commodities would be a change in the government's support programs for agriculture and the ethanol industry, deteriorating economic conditions internationally or an increase in the U.S. dollar's value, any of which would reduce agricultural exports. In an environment of less favorable economic conditions in agriculture, and without sufficient government support programs, the System's financial performance and credit quality measures would likely be negatively impacted.

**Changes in the laws or regulations that govern the System could have a material impact on the System or its operations.**

System institutions are created and extensively governed by federal statutes and regulated by the Farm Credit Administration. Any change in the laws or regulations that govern the System's business could have a material impact on the System and its operations. In addition, changes in the laws or regulations that govern government-sponsored enterprises or agricultural or other rural industries may significantly affect the System's business. Laws and regulations may change from time to time, and the interpretations of the relevant laws and regulations also are subject to change.

**An unfavorable change in U.S. tax laws or an adverse interpretation of existing tax laws could negatively impact the System's financial results.**

Certain System institutions are statutorily exempt from Federal taxes. Other System institutions operate as non-exempt cooperatives. As such, they are eligible, under Subchapter T of the Internal Revenue Code, to deduct or exclude from taxable income amounts determined to be qualified patronage dividends. A change in U.S. tax law or an adverse interpretation of existing tax laws in a manner that reduces or eliminates these tax benefits or that is different from the System's application of such laws would negatively impact the System's results of operations.

**The Banks and Associations are subject to credit risk.**

The Banks and Associations are subject to credit risk in the course of their lending, investing and hedging activities. Credit risk is the risk that arises from the inability of borrowers, debt issuers or counterparties, including bond insurers such as MBIA Inc. and Ambac Financial Group Inc., to meet their repayment obligations. The Banks and Associations have underwriting standards and lending policies to manage credit risk.

**The Banks and Associations are subject to liquidity risk with respect to their investments.**

The Banks and Associations are subject to liquidity risk in the course of their investing activities, particularly with respect to their investments in mortgage-backed securities and asset-backed securities. While the vast majority of these securities are agency mortgage-backed securities, over the past year, the non-agency mortgage-backed securities and asset-backed securities markets have experienced significantly reduced liquidity and credit deterioration and investments in these securities have been subject to impairment losses. In this regard, the Banks have recorded impairment losses on certain of these investments. Moreover, if the market for the Banks' and Associations' investments continues to become less liquid, the underlying credit fundamentals continue to deteriorate and the investments further decline in value, it may make it difficult for such investments to be sold if the need arises. In addition, because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of the Banks' and Associations' investments may differ significantly from the values that would have been used had a ready market existed for the investments. Ultimately, these factors could lead to further write-downs in the value of investments and impairment of assets that, if significant, could have adverse effects on our business, financial condition and liquidity.

**The earnings of the Banks and Associations are significantly affected by the monetary policies of the Board of Governors of the Federal Reserve System.**

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its policies influence the Banks' and Associations' cost of funds for lending and investing and the return they earn on their loans and investments, both of which impact their net interest margins, and can materially affect the value of the loans and

investments they hold. Federal Reserve Board policies also can affect System borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in Federal Reserve Board policies are beyond the System's control and are difficult to predict or anticipate, especially in light of the current extraordinary conditions in the overall economy.

**The agricultural financial services industry is highly competitive.**

The System operates in a competitive marketplace in which there is competition from banks and non-bank lenders. The competitive market has resulted in, and may further result in, reduced interest rate spreads and, in some cases, less favorable loan structures and terms for the System. In order to remain a viable competitor in the U.S. farm debt market, System institutions must provide effective loan products, undertake significant marketing efforts, use competitive pricing programs and maintain operating efficiency. Further, System institutions also must maintain a viable business model in order to deliver value to their borrowers/stockholders.

**The Banks and Associations are subject to interest rate risk.**

The Banks and Associations, in the course of their borrowing, lending and investment activities, are subject to interest rate risk. Interest rate risk is the risk that changes in interest rates may adversely affect the institution's operating results and financial condition. This risk arises from differences in the timing between the contractual maturity and the repricing characteristics of the institution's assets and the financing obtained to fund those assets. The Banks are generally responsible for developing institution-specific asset/liability management policies and strategies to manage interest rate risk and monitoring them on a regular basis.

**Each Bank, to varying degrees, relies on derivative financial instruments to hedge against interest rate and liquidity risks and to lower the overall cost of funds. The financial condition of derivatives and other counterparties may adversely affect the Banks.**

Each Bank uses derivative financial instruments and must determine the nature and quantity of hedging transactions. The effectiveness of the hedging transactions depends upon management's ability to determine the appropriate hedging position, taking into consideration the Bank's assets, liabilities and

prevailing and anticipated market conditions. In addition, the usefulness of the Bank's hedging strategy depends on the ability to enter into hedging transactions with high quality counterparties. If a Bank is unable to manage its hedging position properly or is unable to attract high quality counterparties, the Bank may be unable to manage interest rate and liquidity risks and thus negatively impact the Bank's financial condition and results of operations.

As a result of recent market events, some of the derivative and other financial instrument counterparties of the Banks have experienced various degrees of financial distress, including liquidity constraints, credit downgrades and bankruptcy. The Banks have responded with enhanced counterparty credit reviews, reduced collateral posting thresholds and increased frequency of collateral postings by counterparties. The financial condition of these counterparties may have an adverse effect on the Banks in the event that these counterparties default or otherwise fail to meet their obligations to the Banks. In addition, defaults by one or more financial institutions could lead to market-wide disruptions, which could lead to further defaults that could adversely affect the Banks. It may be difficult for the Banks to find counterparties for derivative financial instruments in such a market.

**Prepayment risks in mortgage assets could affect the System's earnings.**

The System funds real estate mortgage loans and purchases mortgage-backed securities that are impacted by interest rates. Changes in interest rates can significantly impact the prepayment patterns of these assets and thus affect the System's earnings. The System strives to manage or reduce this risk by "match-funding" the assets to the Systemwide Debt Securities issued to fund these loans and investments and entering into interest-rate derivative transactions, and through the rebalancing of cash-flow mismatches of assets and liabilities. The "match-funding" of Systemwide Debt Securities to longer-term assets has become more difficult recently as a result of the turmoil in the U.S. and global markets and the financial difficulties of the housing-related GSEs described above. The System's inability to "match-fund" Systemwide Debt Securities to longer-term assets may increase the repayment risks described herein for the System.

**Each Bank and Association depends on the accuracy and completeness of information about its customers and counterparties.**

In deciding whether to extend credit or enter into transactions with customers and counterparties, the

Banks and Associations may rely on information furnished to them by or on behalf of customers and counterparties, including financial statements and other financial information. The Banks and Associations also may rely on representations of customers and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. If the financial or other information provided to them is incorrect, the Banks and Associations could suffer adverse credit or other consequences.

**The Banks and Associations may lend only to qualified borrowers in the agricultural and rural sectors and certain related entities and are subject to geographic lending restrictions.**

Unlike commercial banks and other financial institutions that lend to both the agricultural sector and other sectors of the economy, the Banks and Associations are restricted solely to making loans and providing financial services to qualified, eligible borrowers in the agricultural and rural sectors and to certain related entities. In addition, the Banks and Associations are subject to certain geographic lending restrictions. As a result, the Banks and Associations do not have as much flexibility in attempting to diversify their loan portfolios as compared to commercial banks and other financial institutions. This concentration may limit their ability to offset adverse performance in one sector against positive performance in another sector like most diversified financial institutions.

**The System's accounting policies and methods are key to how it reports its financial condition and results of operations, and they may require System institutions' managements to make estimates about matters that are inherently uncertain.**

The System's accounting policies, methods and estimates are fundamental to how it records and reports its financial condition and results of operations. System institutions' managements must exercise judgment in selecting and applying many of these accounting policies, methodologies, and estimates so that they not only comply with generally accepted accounting principles and reflect best practices but also reflect managements' judgments as to the most appropriate manner in which to record and report our financial condition and results of operations. Inappropriate policies, methods and estimates, or the misapplication of accounting policies, methods or estimates could adversely affect the financial condition or results of operations of the System.

## **OTHER BUSINESS MATTERS**

### **Related Party Transactions**

In the ordinary course of business, the Banks and Associations may enter into loan transactions with their officers and directors and non-System organizations with which such persons may be associated. These loans are subject to special approval requirements contained in Farm Credit Administration regulations and are, in the view of the System institutions' management, made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers. Total loans outstanding to such persons were \$1.9 billion at both December 31, 2008 and December 31, 2007. During 2008 and 2007, \$6.8 billion and \$4.9 billion of new loans were made to such persons and repayments totaled \$6.8 billion and \$4.7 billion. In the opinions of Bank and Association managements, substantially all such loans outstanding at December 31, 2008 and 2007 did not involve more than a normal risk of collectibility.

### **Legal Proceedings**

At December 31, 2008, various lawsuits were pending or threatened against System institutions. In the opinion of management, based on information currently available and taking into account the advice of legal counsel, the ultimate liability, if any, of pending legal actions will not have a material adverse impact on the System's combined results of operations or financial position.

### **Changes in and Disagreements with Auditors of the Combined Financial Statements of the Farm Credit System**

During the fiscal year ended December 31, 2008 and through the date of this annual information statement, there have been no changes in or disagreements with the independent auditors of the combined financial statements of the System.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis provides a narrative on the System's financial performance and condition that should be read in conjunction with the accompanying financial statements. It includes the following sections:

- Basis of Presentation
- Forward-Looking Information
- Critical Accounting Policies
- 2008 Overview
- Fourth Quarter Results
- Agricultural Outlook
- System Organizational and Structural Matters
- Results of Operations
- Risk Management
- Other Matters
- Regulatory Matters
- Recently Adopted or Issued Accounting Pronouncements

### **Basis of Presentation**

The System is a federally chartered network of interdependent, borrower-owned lending institutions (Banks and Associations) and affiliated service organizations. Through our four Farm Credit Banks, one Agricultural Credit Bank and 90 Associations, we provide credit and related services nationwide to farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, and farm-related businesses. We also make loans to finance the processing and marketing activities of these borrowers and to foreign purchasers of American agricultural products. In addition, we make loans to rural homeowners, rural utilities and other eligible borrowers.

The combined financial statements and related financial information contained in this annual information statement present the combined assets, liabilities, capital, income and expenses of the Banks, the Associations, the Federal Farm Credit Banks Funding Corporation and the Farm Credit Insurance Fund and reflect the investments in and allocated earnings of the service organizations owned by the Banks and/or Associations. All significant intra-System transactions and balances have been eliminated in combination.

(See Note 1 to the accompanying combined financial statements for additional information on organization, operations and principles of combination and the Supplemental Combining Information on pages F-44 through F-51.) This annual information statement has been prepared under the oversight of the System Audit Committee.

Our financial statements are presented on a combined basis due to the financial and operational interdependence of the System entities as discussed in the "Business" section of this annual information statement.

While this annual information statement reports on the combined financial position and results of operations of the Banks, Associations and other System entities specified above, only the Banks are jointly and severally liable for the payments on Systemwide Debt Securities. Each Bank is primarily liable for the payment of principal and interest on Systemwide Debt Securities issued to fund its operations. (See Notes 12 and 21 to the accompanying combined financial statements for information about the capital of the Banks and the Supplemental Combining Information on pages F-44 through F-46 for information related to the financial condition of the combined Banks.) Because the Associations are not directly liable for the payment of principal and interest on Systemwide Debt Securities, their capital may not be available to support those payments. Under the Farm Credit Act, the timely payment of principal and interest on Systemwide Debt Securities is insured by the Farm Credit System Insurance Corporation to the extent funds are available in the Insurance Fund. (See Note 7 to the accompanying combined financial statements.)

### **Forward-Looking Information**

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number

of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory, financial markets and economic conditions and developments in the United States and abroad,
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors,
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income,
- changes in U.S. government support of the agricultural industry and the System as a government-sponsored enterprise, as well as investor and rating agency reactions to events involving other government-sponsored enterprises and other financial institutions, and
- actions taken by the Federal Reserve System in implementing monetary policy.

### **Critical Accounting Policies**

The System's financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the reported amounts of certain assets or liabilities. We consider these policies as critical because managements of System institutions have to make judgments about matters that are inherently uncertain. For a complete discussion of the System's significant accounting policies, see Note 2 of the accompanying combined financial statements. The following is a summary of certain of our most significant critical accounting policies.

- Allowance for loan losses — The allowance for loan losses is each Bank and Association management's best estimate of the amount of probable losses existing in and inherent in its loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. Each Bank and Association determines its allowance for loan losses based on periodic evaluation of

its loan portfolio, which generally considers recent historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, collateral value, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record; the prospects for support from any financially responsible guarantor; and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

Changes in the factors considered by each Bank's and Association's management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- Valuation methodologies — Managements of the Banks and Associations use market prices when estimating fair values for certain assets and liabilities for which an observable liquid market exists. However, they apply various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Examples of these items include impaired loans and investments, pension and other post-retirement benefit obligations, and certain derivative and other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the System's results of operations.

- Pensions — The Banks and substantially all Associations sponsor defined benefit retirement plans, although most plans are closed to new participants. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Banks and Associations sponsor defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense is determined by using Hewitt Associates LLC actuarial valuations based on certain assumptions, including expected long-term rates of return on plan assets and discount rates. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. In prior periods, we selected the discount rate by reference to Hewitt's Yield Curve, actuarial analyses and industry norms. However, in light of the current financial environment, the Banks and Associations evaluated the assumed rates that would be derived using our existing methodology and determined that the rates would not be reflective of high-quality fixed income investments given the current financial environment. As a result, we refined our methodology for selecting the discount rate by reference to Hewitt's Above-Median Yield Curve so to better represent the Banks' and Associations' current pension/other postretirement benefit liabilities. This refinement in methodology may not be permanent but reflects our reaction to the current financial environment.

## 2008 Overview

### *Funding*

The second half of 2008 saw unprecedented instability in the U.S. and global financial markets. However, to date, the System has been able to meet its mission and continues to be a reliable source of debt capital for farmers, ranchers and other rural businesses that we serve. Over the past year and, in particular, during the third and fourth quarters of 2008, negative economic developments in the U.S. and global financial markets have created a high level of uncertainty about the ongoing repayment capacity among financial institutions. As a result, the level of credit

availability and investor willingness to purchase debt securities issued by financial institutions has been greatly reduced. This has reduced our ability to issue debt with preferred maturities and structures, particularly longer-term maturities. Responses by the Federal government, including actions to protect the housing government-sponsored enterprises and to capitalize and guarantee the liabilities of commercial banks, have and may continue to have an unintended consequence of increasing our funding costs and reducing our ability to issue debt with preferred maturities and structures.

We continue to expect to be able to issue short-term debt securities as necessary, even though the issuance of longer-term debt has become, and may continue to be, more restrictive. System institutions are responding to these funding challenges with appropriate actions, including adjusting loan structures and payment terms, and in some cases increased pricing to customers.

### *General*

The System's loan portfolio grew 13.0% during 2008, as compared with 15.8% in 2007 and 16.2% in 2006. As discussed in the "Agricultural Outlook" section below, conditions impacting U.S. agriculture and other rural borrowers continued to drive loan demand by System borrowers. Loan growth has been the principal reason for the System's increased profitability over the past few years. Net interest income has increased, operating efficiency ratios have improved, and credit quality indicators, while reflecting additional credit stress during 2008, have remained generally favorable. The increased volatility of market conditions has resulted in challenges for certain System borrowers, increasing the System's credit risk. In addition, this growth continues to place pressure on System institutions' capital ratios. System institutions continue to evaluate capital and asset management strategies in order to balance growth with capital adequacy. Nevertheless, due to U.S. and global financial market conditions, System institutions' ability to efficiently access additional sources of capital has been significantly reduced. While the System's capital grew \$705 million in 2008 to \$27.124 billion and remained at a favorable level, the System's capital-to-assets ratio declined from 14.2% at December 31, 2007 to 12.7% at December 31, 2008.

The System's combined net income was \$2.916 billion for 2008, \$2.703 billion for 2007 and \$2.379 billion for 2006. System earnings improved

year-over-year primarily due to increases in net interest income. Net interest income was \$4.702 billion for 2008, \$4.060 billion for 2007 and \$3.584 billion for 2006. The increase in net interest income in each of these periods resulted from higher levels of average earning assets due to the continued growth in the System's loan portfolio and, to a much lesser extent, the growth in the investment portfolio. Partially offsetting the increase in net interest income for 2008 were increases in the provision for loan losses and noninterest expense. Net interest income in excess of operating expenses was \$2.987 billion, \$2.463 billion and \$2.079 billion for 2008, 2007 and 2006.

The System's total amount of nonperforming loans increased \$1.795 billion to \$2.416 billion at December 31, 2008, as compared with \$621 million at December 31, 2007, representing 1.50% and 0.43% of total loans outstanding for the corresponding periods. While nonperforming loans increased during 2008, these loans were at very low levels at December 31, 2007 and the December 31, 2008 level was more in line with historical levels.

#### **Fourth Quarter 2008 Results of Operations**

Combined net income declined to \$546 million for the fourth quarter of 2008, as compared with \$682 million for the fourth quarter of 2007. The decline in earnings primarily resulted from increases in the provision for loan losses and noninterest expense and a decrease in noninterest income as a result of losses on impaired investments, partially offset by an increase in net interest income. Net interest income increased \$145 million to \$1.197 billion in the fourth quarter of 2008, as compared with the prior year period. The increase in net interest income resulted from higher levels of average earning assets, primarily loans, which grew \$23.447 billion to \$199.122 billion for the quarter ended December 31, 2008, as compared with \$175.675 billion for the same period in 2007.

The System recognized provisions for loan losses of \$284 million and \$17 million for the fourth quarters of 2008 and 2007. The provision for loan losses recorded for the fourth quarter of 2008 primarily resulted from credit deterioration due to exceptional volatility in commodity prices, which adversely impacted the livestock/poultry and ethanol sectors, and, to a lesser extent, to a decline in the condition of the overall economy. The provision for loan losses for the fourth quarter of 2007 was due to the credit deterioration in a limited number of loans.

Noninterest income decreased \$6 million to \$130 million for the fourth quarter of 2008, as compared with the same period in 2007. This decrease was due primarily to an increase in losses on other-than-temporarily impaired investments and a decrease in income earned on Insurance Fund investments, offset, in part, by increases in fees for financially related services and other noninterest income. Losses on other-than-temporarily impaired investments of \$67 million were recognized in the fourth quarter of 2008, as compared with a \$5 million impairment loss for the same period of the prior year.

Noninterest expense increased \$37 million to \$485 million for the fourth quarter of 2008, as compared with the fourth quarter of 2007. This increase was largely due to increases in salaries and employee benefits and other operating expenses.

#### **Agricultural Outlook**

We utilized the following United States Department of Agriculture (USDA) analysis to provide a general understanding of the U.S. agricultural economic outlook; however, this outlook does not take into account all aspects of our business. References to USDA information in this section refers to the U.S. agricultural market data and not System data.

The February 2009 USDA forecast estimates that 2009 farmers' net cash income (a measure of the cash income after payment of business expenses) will decrease to \$77.3 billion, down \$16.1 billion from 2008 and \$5.5 billion higher than the 10-year average. Contributing to this decrease in farmers' net cash income are decreases in cash receipts for crops of \$18.7 billion and livestock of \$10.9 billion and a decrease in direct government payments of \$1.0 billion, offset, in part, by a decrease in cash expenses of \$14.1 billion and an increase in farm-related income of \$400 million.

In general, 2008 was an excellent year for U.S. crop producers, particularly for feed crops, oilseeds and food grains. The high level of farmers' net cash income was primarily the result of high commodity prices during the first half of the year. Prices for corn, soybeans and wheat peaked at levels close to \$8.00, \$16.50 and \$12.50 per bushel during 2008 before significantly declining in the latter half of 2008. These higher prices were principally due to strong demand from foreign buyers and the domestic biofuels industry. Corn producers were the primary beneficiaries of the increased demand. Other crop prices, in general, increased due to increased acreage



devoted to corn, which decreased the acreage available for other crops, and to consumers seeking lower cost alternatives to corn. Inadequate rainfall in competitor countries and increased international consumption (from growth in population and rising incomes) reduced world supplies of corn and soybeans, which translated into rising demand for farm commodities. In addition, the U.S. dollar depreciated against major foreign currencies in recent years resulting in greater demand for U.S. agricultural exports. However, during the latter half of 2008, many of these factors shifted. Oil prices dropped, which dampened the demand for ethanol. Crop production improved in certain regions of the world. Further, the dollar strengthened in the latter half of 2008. The combination of these events resulted in a dramatic drop in commodity prices in late 2008 to levels more in line with commodity prices at December 31, 2007. The following table sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2005 to December 31, 2008:

<u>Commodity</u>	<u>12/31/08</u>	<u>12/31/07</u>	<u>12/31/06</u>	<u>12/31/05</u>
Corn . . . . .	\$ 4.10	\$ 3.76	\$ 3.01	\$ 1.92
Soybeans . . . .	\$ 9.24	\$10.00	\$ 6.18	\$ 5.77
Wheat . . . . .	\$ 5.97	\$ 7.74	\$ 4.52	\$ 3.54
Beef Cattle . . .	\$79.80	\$88.90	\$83.10	\$93.30

Elevated crop prices during 2008 and the resulting volatility from a dramatic drop in crop prices in the latter half of 2008 had both positive and negative impacts on the System, as a lender to the agricultural and rural sectors. Elevated commodity prices and increased prices and demand for farm inputs resulted in an increase in average agribusiness loans outstanding during 2008, as compared with 2007. While higher commodity prices positively impacted grain farmers through the first nine months of 2008, a continuation of recent declines in grain prices could have an unfavorable impact in the near future. Livestock producers, particularly poultry, pork, and fed beef, generally experienced reduced profitability due to the elevated grain prices. The volatility of commodity prices has resulted in higher risk profiles for System borrowers, particularly borrowers who purchased at elevated prices crops for future production purposes.

The USDA's February 2009 income outlook varies depending on farm size and commodity specialties. The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11% of U.S. farms by number and represent 75% of total U.S. farm production. Intermediate farms

(where the primary occupation is farming and gross sales are below \$250,000) represent 26% of U.S. farms by number and account for 16% of total production. The remaining 63% of U.S. farms are classified as rural residential farms where the primary occupation is not farming and the farms produce less than \$250,000 in products and only account for 9% of total production.

In addition to farmers' net cash income, off-farm income is an important source of income for the repayment of farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100% of farm household income for operators of rural residential farms and more than 80% of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that approximately 25% of farm household income for commercial farms is generated from off-farm income. The USDA forecasts 2009 farm household income to decrease 15% for commercial farms and 19% for intermediate farms.

According to the USDA February 2009 forecast, farm business balance sheets continued to strengthen in the last few years, as measured by debt relative to assets and equity levels. U.S. farm debt to U.S. farm assets is forecasted to remain relatively unchanged from 9.2% for 2008 to 9.1% for 2009. Farmers' equity (farm business assets less farm business debt) is expected to continue to rise by 1.7% in 2009, after increasing 6.8% in 2008.

One measure of the financial health of the agricultural sector used by the USDA is farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk; however, these estimates do not take into account off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8% in 1973 to a high of 104.1% in 1981, and has remained relatively stable since 1987, averaging about 50%. USDA predictions suggest an increase in the use of repayment capacity from 44.1% in 2008 to 50.2% in 2009.

As estimated by the USDA in September 2007, the System's market share of farm business debt (defined as debt incurred by those involved in on-farm agricultural production) grew to 36.7% at December 31, 2007, as compared with 28.3% at December 31,

2000. Farm business debt is forecasted to grow by 0.9% in 2009. The USDA predicts the moderation in debt growth due to decreases in agricultural production costs and to high levels of earnings during the past two years that may enable certain producers to self finance crop production.

In general, agriculture has experienced a sustained period of favorable economic conditions due to stronger commodity prices, higher land values, and, to a lesser extent, government support programs. To date, the System's financial results have remained favorable as a result of these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In an environment of less favorable economic conditions in agriculture and without sufficient government support programs, the System's financial performance and credit quality measures would likely be negatively impacted. Conditions in the general and agricultural economies have become more volatile with the recent instability in the global financial markets and declines in commodity prices. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification across the System and the influence of off-farm income sources

supporting agricultural-related debt. Agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy. However, due to the geographic territories served by Banks and Associations, most institutions have higher geographic, borrower and commodity concentrations than does the System as a whole.

### System Organizational and Structural Matters

Over the past several years, the number of System Banks and Associations has declined through mergers. The following table summarizes the structural changes over the past five years:

	<u>Banks</u>	<u>Associations</u>	<u>Total</u>
Entities at January 1, 2004. . .	5	97	102
Net changes through January 1, 2008. . . . .	—	(3)	(3)
Entities at January 1, 2008. . .	5	94	99
Net changes through January 1, 2009. . . . .	—	(4)	(4)
Entities at January 1, 2009. . .	<u>5</u>	<u>90</u>	<u>95</u>

### Results of Operations

#### *Earnings Analysis*

Changes in the key components impacting the System's results of operations over the past three years are summarized below:

	<u>2008 vs. 2007</u>	<u>2007 vs. 2006</u>
	(in millions)	
Increase (decrease) in net income due to:		
Interest income . . . . .	\$ (600)	\$ 1,812
Interest expense . . . . .	<u>1,242</u>	<u>(1,336)</u>
Net interest income . . . . .	642	476
Provision for loan losses . . . . .	(327)	(46)
Noninterest income . . . . .	40	45
Noninterest expense . . . . .	(130)	(93)
Provision for income taxes . . . . .	<u>(12)</u>	<u>(58)</u>
Net change in net income. . . . .	<u>\$ 213</u>	<u>\$ 324</u>

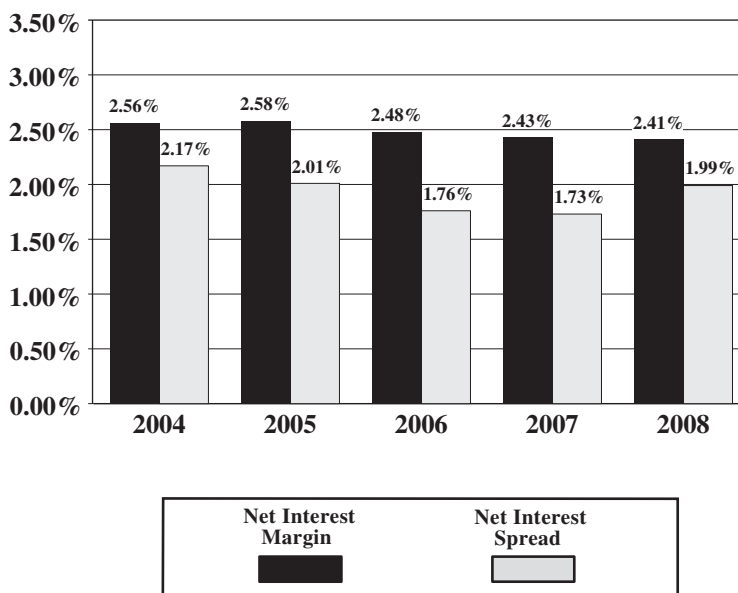
#### *Net Interest Income*

Net interest income was \$4.702 billion in 2008, \$4.060 billion in 2007 and \$3.584 billion in 2006. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the System and is

impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

	2008 vs. 2007			2007 vs. 2006		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(in millions)					
Interest income						
Loans . . . . .	\$1,644	\$(1,887)	\$ (243)	\$1,311	\$179	\$1,490
Investments . . . . .	150	(507)	(357)	227	95	322
Total interest income . . . . .	1,794	(2,394)	(600)	1,538	274	1,812
Interest expense . . . . .	1,250	(2,492)	(1,242)	1,063	273	1,336
Changes in net interest income . . . . .	<u>\$ 544</u>	<u>\$ 98</u>	<u>\$ 642</u>	<u>\$ 475</u>	<u>\$ 1</u>	<u>\$ 476</u>

The following chart illustrates the components underlying the System's net interest income for the past five years:



The following table presents interest rate spreads, components of interest rate spreads, the details of the changes in interest rates earned and paid, and the impact of those changes on interest rate spreads for the past three years:

	2008			2007			2006		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
	(\$ in millions)								
<b>Assets</b>									
Real estate mortgage loans . . . . .	\$ 67,569	\$ 4,317	6.39%	\$ 59,802	\$ 4,312	7.21%	\$ 53,530	\$3,771	7.04%
Production and intermediate-term loans . . . . .	34,120	1,985	5.82	29,686	2,260	7.61	25,893	1,932	7.46
Agribusiness loans . . . . .	31,595	1,714	5.42	23,565	1,730	7.34	17,085	1,243	7.28
Rural home loans . . . . .	4,349	273	6.28	3,643	233	6.40	3,141	196	6.24
Energy, water and waste disposal loans . . . . .	8,438	469	5.56	6,654	437	6.57	5,834	379	6.50
Communication loans . . . . .	4,032	227	5.63	3,106	233	7.50	2,922	218	7.46
International loans . . . . .	2,716	106	3.90	2,077	120	5.78	2,207	118	5.35
Lease receivables . . . . .	1,794	114	6.35	1,548	103	6.65	1,364	92	6.74
Loans to other financial institutions . . . . .	524	18	3.44	445	25	5.62	421	23	5.46
Nonaccrual loans . . . . .	839	45	5.36	483	58	12.01	500	49	9.80
Total loans . . . . .	155,976	9,268	5.94	131,009	9,511	7.26	112,897	8,021	7.10
Federal funds sold, investments and other . . . . .	38,856	1,554	4.00	35,858	1,911	5.33	31,539	1,589	5.04
Total earning assets . . . . .	194,832	10,822	5.55	166,867	11,422	6.84	144,436	9,610	6.65
Allowance for loan losses . . . . .	(819)			(753)			(748)		
Other noninterest-earning assets . . . . .	8,546			6,951			6,168		
Total assets . . . . .	<u>\$202,559</u>			<u>\$173,065</u>			<u>\$149,856</u>		
<b>Liabilities and Capital</b>									
Systemwide bonds and medium-term notes . . . . .	\$152,592	\$ 5,598	3.67%	\$124,590	\$ 6,370	5.11%	\$108,341	\$5,291	4.88%
Systemwide discount notes . . . . .	16,419	421	2.56	17,830	895	5.02	13,526	666	4.92
Subordinated debt and other interest-bearing liabilities . . . . .	2,851	101	3.54	1,690	97	5.74	1,252	69	5.51
Total interest-bearing liabilities . . . . .	171,862	6,120	3.56	144,110	7,362	5.11	123,119	6,026	4.89
Noninterest-bearing liabilities . . . . .	3,256			3,054			3,027		
Capital . . . . .	27,441			25,901			23,710		
Total liabilities and capital . . . . .	<u>\$202,559</u>			<u>\$173,065</u>			<u>\$149,856</u>		
Net interest spread(1) . . . . .			1.99			1.73			1.76
Impact of noninterest-bearing sources . . . . .			0.42			0.70			0.72
Net interest income and margin(2) . . . . .		<u>\$ 4,702</u>	2.41%		<u>\$ 4,060</u>	2.43%		<u>\$3,584</u>	2.48%

(1) Net interest spread is the difference between the rate earned on total earning assets and the rate paid on total interest-bearing liabilities.

(2) Net interest margin is net interest income divided by average earning assets.

Earning assets consisted of loans (accrual and nonaccrual), Federal funds sold and investments. Systemwide Debt Securities generally financed earning assets. In addition to these interest-bearing funds, earning assets also were funded by capital. Variations in average volume and the spreads earned on interest-bearing funds and capital determine changes in net interest income.

As illustrated in the preceding tables, net interest income increased in 2008, as compared to 2007. This increase resulted from higher levels of average earning

assets which grew \$27.965 billion or 16.8% to \$194.832 billion due to the continued growth in the System's loan portfolio and, to a much lesser extent, growth in the investment portfolio. The net interest margin declined two basis points to 2.41% for 2008, as compared with 2.43% for 2007. The decrease in the net interest margin was primarily due to the decline in income earned on earning assets funded by noninterest-bearing sources (principally capital), as yields on average earning assets declined in this lower interest rate environment, and to a decline in capital as a

percentage of average earning assets. These declines were mostly offset by an increase in the net interest spread of 26 basis points to 1.99% for 2008, as compared with 1.73% for 2007. The increase in the net interest spread was primarily attributable to continued favorable agricultural lending conditions and the lower interest rate environment in 2008, as compared with 2007. The Banks took advantage of this lower interest rate environment and called debt totaling \$49 billion. As a result, the Banks were able to lower their cost of funds relative to the interest rate earned on their assets, which did not change as quickly. In addition, net interest spread was positively impacted by the change in asset mix, which resulted from an increased percentage of assets with higher yielding loan spreads, and from a decreased percentage of lower-rate investments.

Interest income recognized on cash-basis nonaccrual loans was \$45 million for 2008, \$58 million for 2007 and \$49 million for 2006. Interest income is recognized on cash-basis nonaccrual loans only as interest payments are received and certain other conditions are met. Nonaccrual loans are returned to accrual status after a period of sustained payment performance provided they are current as to principal and interest, any previously charged off amounts have been collected and the collectibility of the remaining amounts of principal and interest is no longer in doubt.

Net interest income increased in 2007, as compared to 2006. This increase resulted from higher levels of average earning assets due to the continued growth in the System's loan and investment portfolios, which grew \$22.431 billion or 15.5% to \$166.867 billion. Partially offsetting the impact of the increase in average earning assets was the decrease in the net interest spread of three basis points for 2007 to 1.73%, as compared with 1.76% for the prior year. The net interest spread for most of the portfolio was pressured by continued competition for loans. However, the net interest spread was positively impacted by the favorable change in the asset mix, which resulted from an increase in higher spread loan products, particularly as a result of the growth in the agribusiness loan portfolio. The net interest margin decreased five basis points to 2.43% for 2007, as compared with 2006, due to the decrease in net interest spread and a lower percentage of average capital as a percentage of average earning assets.

### *Provision for Loan Losses*

Each Bank and Association makes its own determination whether an increase in its allowance for loan losses through a provision for loan losses or a decrease in its allowance for loan losses through a loan loss reversal is warranted based on its assessment of the credit risk in its loan portfolio.

The System recognized a provision for loan losses of \$408 million in 2008, \$81 million in 2007 and \$35 million in 2006. The 2008 provision for loan losses consisted of \$416 million of provisions for loan losses recorded by certain System institutions, partially offset by \$8 million of loan loss reversals recorded by other System institutions. The significant increase in the 2008 provision for loan losses primarily resulted from credit deterioration due to exceptional volatility in commodity prices, which adversely impacted the livestock/poultry and ethanol sectors and, to a lesser extent, a decline in the condition of the overall economy.

The 2007 provision for loan losses consisted of \$100 million of provisions for loan losses recorded by certain System institutions, partially offset by \$19 million of loan loss reversals recorded by other System institutions. The 2007 provisions for loan losses were primarily due to credit deterioration in a limited number of loans.

The 2006 provision for loan losses consisted of \$64 million of provisions for loan losses recorded by certain System institutions, partially offset by \$29 million of loan loss reversals recorded by other System institutions. The 2006 provisions for loan losses were due to the credit deterioration in a limited number of agribusiness loans and lease receivables and to increases in the credit risk at certain System institutions during the year, while the loan loss reversals reflected the continued improvement in credit quality at other System institutions.

### Noninterest Income

Noninterest income for each of the three years in the period ended December 31, 2008 is summarized in the following table:

	For the year ended December 31,		
	2008	2007	2006
	(in millions)		
Fees for financially related services . . . . .	\$265	\$180	\$120
Loan-related fee income . . . . .	148	115	110
Income earned on Insurance Fund assets . . . . .	76	98	89
Mineral income . . . . .	46	23	25
Operating lease income . . . . .	44	42	42
(Losses) gains on other transactions . . . . .	(11)	(4)	16
Losses on impairment of investments available-for-sale . . . . .	(82)	(5)	
Gains on sales of investments, net and other assets . . . . .	11	1	3
Gains on derivatives not designated as hedges . . . . .	12	7	11
(Losses) gains on discontinuance of fair value hedges . . . . .	(1)	2	5
Losses on discontinuance of cash flow hedges . . . . .	(2)	(5)	(13)
Losses on extinguishment of debt . . . . .	(57)	(21)	(16)
Other noninterest income . . . . .	53	29	25
Total noninterest income . . . . .	<u>\$502</u>	<u>\$462</u>	<u>\$417</u>

Noninterest income increased \$40 million or 8.7% in 2008 to \$502 million, as compared with 2007. The increase was primarily due to an increase in earnings from financially related services of \$85 million, a \$33 million increase in loan-related fee income, and a \$23 million increase in mineral income offset, in part, by an increase in losses on impairment of investments available-for-sale of \$77 million and an increase in losses on extinguishment of debt of \$36 million. The increase in fees for financially related services primarily resulted from an increase in multi-peril crop insurance commissions due to a combination of additional emphasis on marketing and sales of related services, higher commodity prices and additional loan volume. The increase in loan-related fee income was primarily due to greater fees on uncommitted lines of credit and on loan syndication/participation transactions. Mineral income increased due to increased royalties and bonus payments on mineral rights.

The losses of \$82 million on impaired investments related to 14 securities that were negatively impacted by deterioration in the U.S. housing market and overall economy, reduced liquidity and increased volatility in the financial markets, as compared with a loss of \$5 million on one investment that was impaired at December 31, 2007. The other-than-temporarily impaired investments were small in comparison with the available-for-sale investment portfolio of \$34.6 billion at December 31, 2008. Losses on extinguishment

of debt increased in 2008 as the Banks' losses related to early extinguishment of higher cost debt and the write-off of unamortized debt issuance costs on \$49 billion of debt called in a lower interest rate environment.

Noninterest income increased \$45 million or 10.8% in 2007 to \$462 million, as compared with 2006. The increase was primarily due to an increase in earnings from financially related services of \$60 million, a \$9 million increase in income earned on Insurance Fund assets and a \$5 million increase in loan-related fee income offset, in part, by losses on other transactions of \$4 million, as compared with a gain of \$16 million in 2006. The increase in fees for financially related services primarily resulted from an increase in the sale of multi-peril crop insurance due to a combination of additional emphasis on marketing and sales of related services, higher commodity prices and additional loan volume.

### Noninterest Expense

Noninterest expense for each of the three years in the period ended December 31, 2008 is summarized below:

	For the year ended December 31,		
	2008	2007	2006
	(in millions)		
Salaries and employee benefits . . . . .	\$1,068	\$1,009	\$ 956
Other operating expense . . . . .	379	344	325
Occupancy and equipment expense . . . . .	151	139	132
Purchased services . . . . .	117	105	92
Total operating expense . . . . .	<u>1,715</u>	<u>1,597</u>	<u>1,505</u>
Losses(gains) on other property owned . . . . .	5	(1)	(2)
Other noninterest expense . . . . .	7	1	1
Total noninterest expense . . . . .	<u>\$1,727</u>	<u>\$1,597</u>	<u>\$1,504</u>

Noninterest expense increased \$130 million to \$1.727 billion for 2008, primarily due to increases in salaries and employee benefits, other operating expense and purchased services. Salaries and employee benefits increased \$59 million or 5.8% in 2008, as compared with 2007, as a result of higher staffing levels at certain System institutions, resulting from overall higher asset growth, and annual merit and performance-based incentive compensation increases. The System employed 11,814 full-time equivalents at December 31, 2008, as compared with 11,173 full-time equivalents at December 31, 2007, a 5.7% increase over the prior year end. A decrease in pensions and other post-retirement benefit cost partially offset the increases in salaries. Pension and other post-retirement benefit costs are expected to increase substantially in 2009 primarily as a result of the decline in the fair value of the pension

assets. The remaining operating expenses increased 10.0% due, in part, to increases in purchased services, occupancy and equipment and other general expenses.

Noninterest expense increased \$93 million to \$1.597 billion for 2007, as compared with 2006, primarily due to increases in salaries and employee benefits, other operating expense and purchased services. Salaries and employee benefits increased \$53 million or 5.5% in 2007, as compared with 2006, as a result of annual merit and performance-based incentive compensation increases and, to a lesser extent, higher staffing levels at certain System institutions. The System employed 11,173 full-time equivalents at December 31, 2007, a 2.7% increase over the prior year end. A decrease in pensions and other post-retirement benefits partially offset the increases in salaries. Other operating expense increased due, in part, to an increase in information technology costs.

Operating expense (salaries and employee benefits, occupancy and equipment expense, purchased services and other operating expense) statistics for each of the three years in the period ended December 31, 2008 are set forth below:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(\$ in millions)		
Excess of net interest income over operating expense . . . .	\$2,987	\$2,463	\$2,079
Operating expense as a percentage of net interest income . . . . .	36.5%	39.3%	42.0%
Operating expense as a percentage of net interest income and noninterest income . . . . .	33.0	35.3	37.6
Operating expense as a percentage of average loans . . . . .	1.10	1.22	1.33
Operating expense as a percentage of average earning assets . . . . .	0.88	0.96	1.04

The growth in net interest income in excess of operating expense during 2008 of 21.3% and 2007 of 18.5% resulted from the increase in net interest income due to the System's growth in loans and investments that exceeded the 7.4% and 6.1% growth in operating expense.

**Provision for Income Taxes**

As discussed in Note 2 to the accompanying combined financial statements, the System is comprised of both taxable and non-taxable entities. Taxable entities are eligible to operate as cooperatives for

tax purposes and thus may elect to deduct from taxable income certain amounts allocated to borrowers as patronage refunds in the form of cash, stock or allocated surplus.

The System recorded provisions for income taxes of \$153 million in 2008, \$141 million in 2007 and \$83 million in 2006. The effective tax rate was relatively unchanged at 5.0% for 2008 and 2007.

The effective tax rate increased from 3.4% for 2006 to 5.0% for 2007 primarily due to increased earnings at taxable System institutions and the favorable impact in 2006 of an \$11 million resolution of certain tax contingencies.

**Risk Management**

*Overview*

The System is in the business of making agricultural and other loans that requires us to take certain risks in exchange for compensation for the risks undertaken. Management of risks inherent in our business is essential for our current and long-term financial performance. Our goal is to mitigate risk, where appropriate, and to properly and effectively identify, measure, price, monitor and report risks in our business activities.

The major types of risk to which we have exposure are:

- structural risk — risk inherent in our business and related to our structure (an interdependent network of lending institutions),
- credit risk — risk of loss arising from an obligor's failure to meet the terms of its contract or failure to perform as agreed,
- interest rate risk — risk that changes in interest rates may adversely affect our operating results and financial condition,
- liquidity risk — risk arising from our inability to meet obligations when they come due without incurring unacceptable losses,
- operational risk — risk resulting from inadequate or failed internal processes or systems, errors by employees or external events, and
- political risk — risk of loss of support for the System and agriculture by the federal and state governments.

**Structural Risk Management**

Structural risk results from the fact that the System is comprised of Banks and Associations that are cooperatively owned, directly or indirectly, by their borrowers. While System institutions are financially and operationally interdependent, they are not commonly owned. This structure at times requires action by consensus or contractual agreement. Further, there is structural risk in that only the Banks are jointly and severally liable for the payment of principal and interest on Systemwide Debt Securities. Although capital at the Association level reduces a Bank’s credit exposure with respect to its wholesale loans to its affiliated Associations, this capital may not be available to support the payment of principal and interest on Systemwide Debt Securities.

In order to mitigate this risk, we utilize two integrated agreements — the Amended and Restated Contractual Interbank Performance Agreement, or CIPA, and the Amended and Restated Market Access Agreement, or MAA. Under provisions of the CIPA, a score is calculated that measures the financial condition and performance of each District using various ratios that take into account the District’s and Bank’s capital, asset quality, earnings, interest-rate risk and liquidity. The CIPA score is then compared against the agreed-upon standard of financial condition and performance that each District must achieve and maintain.

Periodically, the ratios in the CIPA model are reviewed to take into consideration current performance standards in the financial services industry. The CIPA also establishes economic incentives whereby monetary penalties are applied if the performance standard is not met. These penalties will occur at the same point at which a Bank would be required to provide additional monitoring information under the MAA.

The MAA establishes criteria and procedures for the Banks, which are jointly and severally liable for the payment of principal and interest on Systemwide Debt Securities, that provide operational oversight and control over a Bank’s access to System funding if the creditworthiness of the Bank declines below certain agreed-upon levels. The MAA promotes the identification and resolution of individual Bank financial problems in a timely manner and discharges the Funding Corporation’s statutory responsibility for determining conditions of participation for each Bank’s participation in each issuance of Systemwide Debt Securities.

Under the MAA, if certain financial criteria are not met, a Bank may be placed in one of three categories, each of which imposes certain requirements and/or restrictions on the affected Bank. The criteria under the MAA are the CIPA scores, the net collateral ratio, and the permanent capital ratio of a Bank. The Bank’s net collateral ratio is net collateral (primarily loans and investments) divided by total liabilities less subordinated debt, subject to certain limits, and the Bank’s permanent capital ratio is primarily the Bank’s common stock, preferred stock and subordinated debt, subject to certain limits, and surplus divided by risk-adjusted assets. The criteria for the net collateral ratio and the permanent capital ratio are:

	<u>Net Collateral Ratio</u>	<u>Permanent Capital Ratio</u>
Category I . . . . .	<104%	<8.0%
Category II. . . . .	<103%	<7.0%
Category III . . . . .	<102%	<5.0%

The categories are progressively more restrictive: a “Category I” Bank is subject to additional monitoring and reporting requirements; a “Category II” Bank’s ability to participate in issuances of Systemwide Debt Securities may be limited to refinancing maturing debt obligations; and a “Category III” Bank may not be permitted to participate in issuances of Systemwide Debt Securities. (See Note 21 for each Bank’s net collateral and permanent capital ratios.)

During the three years ended and as of December 31, 2008, all Banks met the agreed-upon standard of financial condition and performance required by the CIPA and none of the Banks was placed in any of the three categories designated for Banks failing to meet the MAA’s specified financial criteria.

**Credit Risk Management**

Credit risk arises from the potential inability of an obligor to meet its payment obligation and exists in our outstanding loans, letters of credit, unfunded loan commitments, investment portfolios and derivative counterparty credit exposures. We manage credit risk associated with our retail lending activities through an assessment of the credit risk profile of an individual borrower. Each Bank and Association has its own set of underwriting standards and lending policies, approved by its board of directors, that provides



direction to its loan officers. Underwriting standards include, among other things, an evaluation of:

- character — borrower integrity and credit history,
- capacity — repayment capacity of the borrower based on cash flows from operations or other sources of income,
- collateral — protects the lender in the event of default and represents a potential secondary source of loan repayment,
- capital — ability of the operation to survive unanticipated risks, and
- conditions — intended use of the loan funds.

The retail credit risk management process begins with an analysis of the borrower's credit history, repayment capacity and financial position, which includes an analysis of credit scores for smaller loans. Repayment capacity focuses on the borrower's ability to repay the loan based on cash flows from operations or other sources of income, including off-farm income. Real estate mortgage loans must be secured by first liens on the real estate (collateral). As required by Farm Credit Administration regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85% of the original appraised value of the property taken as security or up to 97% of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than \$250,000. In addition, each loan is assigned a credit risk rating based on the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths and weaknesses and risks in a particular relationship.

This credit risk ratings process uses a two-dimensional loan rating structure, incorporating a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default. This 14-point scale provides for nine acceptable categories, one other assets especially mentioned category, two substandard categories, one doubtful category and one loss category. These categories are defined as follows:

- acceptable — assets are expected to be fully collectible and represent the highest quality,

- other assets especially mentioned — assets are currently collectible but exhibit some potential weakness,
- substandard — assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan,
- doubtful — assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable, and
- loss — assets are considered uncollectible.

In addition, borrower and commodity concentration lending limits have been established by each individual System institution to manage credit exposure. The regulatory lending limit to any one borrower is 25% of the institution's capital but System institutions' boards of directors have generally established more restrictive lending limits.

The Banks manage credit risk arising from their wholesale loans (revolving lines of credit) to their affiliated Associations as well as credit risk arising from the Banks' retail loans to borrowers. An Association's ability to repay its loan from its affiliated Bank is dependent on repayment of loans made to the Association's borrowers. Monitoring of the credit risk of an Association's loan portfolio, together with appropriate credit administration and servicing, reduces credit risk on the wholesale loans. Monitoring may include various mechanisms, including testing the reliability of an Association's credit classifications, periodic meetings with the Association's management and board of directors, formalized risk assessments, and prior approval by the Bank of transactions that exceed the Association's delegated lending authority (which is determined by the Bank). In addition, some Banks utilize risk-based pricing programs that price funds differentially to Associations based on risk profiles. Each Bank utilizes a "General Financing Agreement" setting forth the terms and conditions of each loan to its affiliated Associations to achieve this goal. This agreement generally includes:

- typical commercial lending provisions, including advance rates based on quality of pledged assets and financial performance covenants,
- a pledge of substantially all Association assets as collateral for the loan,
- a risk-based score that is based on the Association's profitability, credit quality, risk

coverage, capital adequacy and quality of credit administration,

- a requirement that retail loans originated by the Association over an established dollar amount be approved by the Bank and all loans to Association board members receive prior approval by the Bank, and
- a requirement that the Association adopt underwriting standards consistent with the Bank's underwriting guidelines and maintain an internal audit function, which reviews its lending operations.

By selling loans or interests in loans to other institutions within the System or outside the System, a

#### Loan Portfolio

The System's loan portfolio consists only of retail loans. Bank loans to affiliated Associations have been eliminated in the combined financial statements. Loans outstanding for each of the past five years consisted of:

	December 31,				
	2008	2007	2006	2005	2004
			(in millions)		
Real estate mortgage loans . . . . .	\$ 71,892	\$ 63,458	\$ 56,489	\$ 51,690	\$47,695
Production and intermediate-term loans . . . . .	37,468	32,267	28,731	24,935	22,789
Agribusiness loans:					
Loans to cooperatives . . . . .	12,213	15,855	12,222	8,778	7,627
Processing and marketing loans . . . . .	12,160	9,772	6,781	4,083	2,678
Farm-related business loans . . . . .	2,528	2,464	2,138	1,812	1,748
Energy and water/waste disposal loans . . . . .	9,387	7,496	6,279	5,458	4,811
Rural residential real estate loans . . . . .	4,611	3,965	3,408	2,950	2,482
Communication loans . . . . .	4,544	3,350	3,290	2,605	2,389
International loans . . . . .	4,077	2,135	2,183	2,277	2,624
Lease receivables . . . . .	1,952	1,708	1,489	1,290	1,168
Loans to other financing institutions . . . . .	591	436	426	394	356
Total loans . . . . .	<u>\$161,423</u>	<u>\$142,906</u>	<u>\$123,436</u>	<u>\$106,272</u>	<u>\$96,367</u>

Bank or Association can manage its growth and capital, and limit its exposure to either a borrower or geographic, industry or commodity concentration. By buying loans or interests in loans from another System institution or from outside the System, a Bank or Association can improve diversification.

Portfolio credit risk is also evaluated with the goal of managing the concentration of credit risk. Concentration risk is reviewed and measured by each institution by industry, product, geography and customer limits. The concentrations at the System level are illustrated in the "Loan Portfolio Diversification" section that follows.

Loans by type as a percentage of total loans for each of the past five years were:

	December 31,				
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Real estate mortgage loans . . . . .	44.5%	44.4%	45.8%	48.6%	49.5%
Production and intermediate-term loans . . . . .	23.2	22.6	23.3	23.5	23.6
Agribusiness loans:					
Loans to cooperatives . . . . .	7.6	11.1	9.9	8.3	7.9
Processing and marketing loans . . . . .	7.5	6.8	5.5	3.8	2.8
Farm-related business loans . . . . .	1.6	1.7	1.7	1.7	1.8
Energy and water/waste disposal loans . . . . .	5.8	5.3	5.1	5.1	5.0
Rural residential real estate loans . . . . .	2.9	2.8	2.8	2.8	2.6
Communication loans . . . . .	2.8	2.3	2.6	2.5	2.5
International loans . . . . .	2.5	1.5	1.8	2.1	2.7
Lease receivables . . . . .	1.2	1.2	1.2	1.2	1.2
Loans to other financing institutions . . . . .	<u>0.4</u>	<u>0.3</u>	<u>0.3</u>	<u>0.4</u>	<u>0.4</u>
Total loans . . . . .	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

The year-to-year increase in loan volume was 13.0% in 2008, 15.8% in 2007, 16.2% in 2006 and 10.3% in 2005 and represents an increase in our aggregate market share of farm debt (principally defined as real estate mortgage loans and production and intermediate-term loans). These increases are largely attributable to competitively priced credit offered to borrowers and to historically high commodity prices, which contributed to the increased cost of land, inputs and customer inventories. We continue to implement a number of measures, including new products and competitive loan programs, designed to retain creditworthy borrowers and to attract new loan volume.

At December 31, 2008, real estate mortgage loans increased \$8.434 billion or 13.3% from the December 31, 2007 level. In addition, production and intermediate-term loans increased \$5.201 billion or 16.1%, as compared with December 31, 2007. Both types of loans increased due to continued demand for these loans, marketing efforts by System institutions, competitive rates and products, and continued loan participations purchased from non-System lenders.

Loans to cooperatives decreased \$3.642 billion or 23.0% from year-end 2007, in part, due to the decline in commodity prices in late 2008. In late 2007 and continuing into the first three quarters in 2008, loan demand increased significantly from cooperative customers, which was primarily the result of exceptionally high prices and associated volatility for grain commodities, including corn, soybeans and wheat. These higher and

more volatile commodity prices contributed to the increased cost of customer inventories and resulted in increased customer financing requirements and significant growth in average agribusiness loan volume during 2008. However, in the last few months of 2008, as a result of the turmoil in the financial markets and reduced demand in connection with the U.S. and global economic downturn, commodity prices declined driving down loan demand. Processing and marketing loans increased \$2.388 billion or 24.4% during 2008 primarily due to increased marketing efforts and increased loan participations with non-System lenders.

Energy and water/waste disposal loans increased \$1.891 billion or 25.2% from the December 31, 2007 level. In addition, communication loans increased \$1.194 billion or 35.6% from the year-end 2007 level. The increase in both of these types of loans was driven by increased customer capital expenditures in early 2008 and the overall tighter credit market conditions.

At December 31, 2008, loans made in connection with international transactions increased \$1.942 billion to \$4.077 billion, as compared with December 31, 2007, as tighter world credit markets led to greater lending opportunities in the latter part of 2008. The international portfolio continued to reflect a major concentration in federal government-sponsored trade financing programs. Overall, 81% and 61% of the loans made in connection with international transactions at December 31, 2008 and 2007 were guaranteed through the USDA's Commodity Credit Corporation.

The following table presents the contractual maturity distribution of loans, excluding real estate mortgage and rural residential real estate loans, at December 31, 2008:

	<u>Due in 1 year or less</u>	<u>Due after 1 year through 5 years</u>	<u>Due after 5 years</u>	<u>Total</u>
	(in millions)			
Production and intermediate-term loans . . . . .	\$15,364	\$16,081	\$ 6,023	\$37,468
Loans to cooperatives . . . . .	5,191	4,170	2,852	12,213
Processing and marketing loans . . . . .	5,176	3,604	3,380	12,160
Farm-related business loans . . . . .	1,007	755	766	2,528
Energy and water/waste disposal loans . . . . .	2,154	1,959	5,274	9,387
Communication loans . . . . .	937	1,832	1,775	4,544
International loans . . . . .	1,236	2,841		4,077
Lease receivables . . . . .	193	847	912	1,952
Loans to other financing institutions . . . . .	190	345	56	591
Total . . . . .	<u>\$31,448</u>	<u>\$32,434</u>	<u>\$21,038</u>	<u>\$84,920</u>

*Loan Portfolio Diversification*

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio at the System level is diversified by commodities financed and geographic locations served, as illustrated in the following two tables. However, due to the geographic territories served by Banks and Associations, most institutions have higher geographic, borrower and commodity concentrations than does the System as a whole.

Commodity and industry categories are based on the Standard Industrial Classification System published by the federal government. This system is used to assign commodity or industry categories based on the primary business of the customer. Primary business is assigned if the commodity or industry accounts for 50% or more of the total value of sales for its products; however, generally a large percentage of agricultural operations include more than one commodity. Otherwise, the category assigned will be considered as other.

	<u>December 31, 2008</u>		<u>December 31, 2007</u>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
	(\$ in millions)			
Cash grains (includes corn, wheat and soybeans) . . . . .	\$ 19,554	12.11%	\$ 16,496	11.54%
Cattle . . . . .	15,492	9.60	14,318	10.02
Dairy farms . . . . .	11,819	7.32	10,116	7.08
Forestry . . . . .	10,955	6.79	9,722	6.80
Tree fruits, nuts and grapes . . . . .	10,656	6.60	9,068	6.35
Rural home loans, farm landlords and part-time farms . . . . .	10,247	6.35	9,046	6.33
Food products (includes meat, dairy and bakery products) . . . . .	9,634	5.97	8,455	5.92
Energy and water/waste disposal . . . . .	9,387	5.82	7,496	5.25
Field crops (includes sugar beets, potatoes and vegetables) . . . . .	9,098	5.64	8,200	5.74
Farm supplies and marketing . . . . .	7,448	4.61	10,058	7.04
General farms, primarily crop . . . . .	6,442	3.99	6,870	4.81
Poultry and eggs . . . . .	5,547	3.44	4,871	3.41
Agricultural services and fishing . . . . .	5,314	3.29	4,560	3.19
Communication . . . . .	4,544	2.81	3,350	2.34
Hogs . . . . .	4,444	2.75	3,743	2.62
General farms, primarily livestock . . . . .	4,150	2.57	3,667	2.57
International loans . . . . .	4,077	2.53	2,135	1.49
Biofuels (primarily ethanol) . . . . .	2,975	1.84	2,277	1.59
Cotton . . . . .	1,923	1.19	1,928	1.35
Other livestock . . . . .	1,624	1.01	1,782	1.25
Other . . . . .	6,093	3.77	4,748	3.31
	<u>\$161,423</u>	<u>100.00%</u>	<u>\$142,906</u>	<u>100.00%</u>

Two industries that experienced significant credit stress during 2008 were the poultry industry and the ethanol industry. As set forth in the above table, total loans outstanding to the poultry industry were \$5.547 billion or 3.44% of the System's loan portfolio at December 31, 2008. One loan to a poultry processor in the amount of \$680 million was placed into

nonaccrual status during the fourth quarter of 2008. In addition, the System had \$780 million in loans outstanding to poultry producers who are or had been under contract with this processor. As a result of production cutbacks by this poultry processor, financial stress increased significantly for certain of these producers.

The following table provides additional information on biofuel (primarily ethanol) plants, which represented 1.84% of the System's loan portfolio as of December 31, 2008:

	<u>Loans Outstanding</u>	<u>Unfunded Commitments</u>	<u>Total Exposure</u>
	(\$ in millions)		
Plants in operation longer than one year . . . . .	\$1,350	\$ 812	\$2,162
Plants in operation less than one year . . . . .	978	145	1,123
Plants under construction . . . . .	282	457	739
Plants completed but not placed into production . . . . .	<u>365</u>	<u>21</u>	<u>386</u>
Total . . . . .	<u>\$2,975</u>	<u>\$1,435</u>	<u>\$4,410</u>

Consistent with the decline in oil prices, ethanol producers have experienced considerable financial pressure in recent months. Generally, plants in operation longer than one year have had the ability to generate and retain profits to support the operation in times of financial stress. Plants that have been operating for less than a year are generally experiencing more financial stress under current conditions. Further, under these current conditions, it is difficult to bring plants into operation.

The System makes credit available in all 50 states, the Commonwealth of Puerto Rico, and U.S. territories under conditions set forth in the Farm Credit Act. The following table presents the geographic distribution of the System's loan portfolio for states that represented 1% or more of the System's total loan volume during one or more of the past three years:

<u>State</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
California . . . . .	8.76%	9.23%	8.81%
Texas . . . . .	8.12	8.45	8.11
Iowa . . . . .	5.31	5.89	5.57
Minnesota . . . . .	4.58	4.49	4.47
Illinois . . . . .	4.06	4.18	3.89
Nebraska . . . . .	3.88	4.37	3.93
Ohio . . . . .	3.33	3.53	3.40
Florida . . . . .	3.21	3.29	3.46
Indiana . . . . .	2.88	2.88	2.88
Oregon . . . . .	2.83	2.31	1.99
Missouri . . . . .	2.70	2.54	2.68
Wisconsin . . . . .	2.70	2.91	2.85
Tennessee . . . . .	2.63	2.39	2.35
Georgia . . . . .	2.60	2.49	2.62
North Carolina . . . . .	2.48	2.54	2.59
Kansas . . . . .	2.38	2.87	2.66
Michigan . . . . .	2.38	2.42	2.42
Washington . . . . .	2.31	1.83	2.05
New York . . . . .	2.28	2.25	2.37
South Dakota . . . . .	2.02	2.04	1.97
Colorado . . . . .	1.93	2.04	2.09
Arkansas . . . . .	1.92	1.89	1.83
Kentucky . . . . .	1.81	1.75	1.79
North Dakota . . . . .	1.78	1.59	1.72
Idaho . . . . .	1.74	1.63	1.63
Pennsylvania . . . . .	1.71	1.72	1.83
Virginia . . . . .	1.70	1.83	2.07
Alabama . . . . .	1.36	1.36	1.45
Oklahoma . . . . .	1.21	1.24	1.20
Mississippi . . . . .	1.15	1.13	1.17
Maryland . . . . .	1.04	1.03	1.08
South Carolina . . . . .	0.95	0.98	1.14
All other states . . . . .	<u>10.26</u>	<u>8.91</u>	<u>9.93</u>
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

The table below sets forth the loans by dollar size:

Range (\$ in thousands)	December 31, 2008		December 31, 2007	
	Amount Outstanding	Number of Loans	Amount Outstanding	Number of Loans
	(\$ in millions)			
\$1 – \$250 . . . . .	\$ 40,248	710,247	\$ 40,826	710,858
\$251 – \$500 . . . . .	17,789	50,301	16,440	48,432
\$501 – \$1,000 . . . . .	17,205	23,438	14,793	21,850
\$1,001 – \$5,000 . . . . .	36,525	17,868	32,548	16,415
\$5,001 – \$25,000 . . . . .	27,936	3,070	21,363	2,543
\$25,001 – \$100,000 . . . . .	8,302	192	6,262	167
\$100,001 – \$250,000 . . . . .	8,551	50	6,352	43
Over \$250,000 . . . . .	4,867	14	4,322	13
Total . . . . .	<u>\$161,423</u>	<u>805,180</u>	<u>\$142,906</u>	<u>800,321</u>

Note: Loans greater than \$100 million are aggregated by borrower.

Small loans (less than \$250 thousand) accounted for 88% of System customers and 25% of System loan volume at December 31, 2008, as compared with 89% and 29% at December 31, 2007. Credit risk on small loans, in many instances, is reduced by off-farm income sources. Generally, loans up to \$250 thousand are evaluated using validated automated credit scorecards (which are mathematical models that provide a quantitative measurement of a borrower's creditworthiness). Credit scorecards are widely used by the System for smaller loans, including production and intermediate-term, real estate mortgage and rural residential real estate loans.

The table sets forth scored loans for the past two years:

	December 31,	
	2008	2007
	(\$ in millions)	
Number of credit-scored loans . . . . .	424,403	382,241
Amount of credit-scored loans . . . . .	\$ 20,600	\$ 18,864
Delinquent (30 days or more past due) credit scored loans as a % of credit scored loans. . . . .	1.11%	0.78%
Delinquent loans for overall portfolio as a % of accruing loans . . . . .	0.53%	0.41%

The largest 10 borrowers accounted for \$3.799 billion or 2.35% of the System's total outstanding loans at

December 31, 2008, as compared with \$3.547 billion or 2.48% at December 31, 2007. The concentration of large loans to relatively few borrowers continued to be a significant factor in assessing the credit risk associated with loans. Although not a formal limit, we have established a quarterly process to identify and monitor System large loan exposures (outstanding loan amounts plus any unfunded loan commitments) to existing individual customers that may reach \$750 million. Since it is possible that one or more System institutions may simultaneously make credit available to a customer that may, in the aggregate, exceed \$750 million, the process provides for quarterly data to be compiled on existing large loan exposures with notice provided to the Banks and Associations of the largest ten loan exposures, including all loan exposures to a borrower greater than 75% of the \$750 million level or \$563 million. At December 31, 2008, nine exposures (including unfunded commitments) exceeded \$563 million but were below the \$750 million level, while at December 31, 2007 seven loan exposures exceeded \$563 million but were below the \$750 million level.

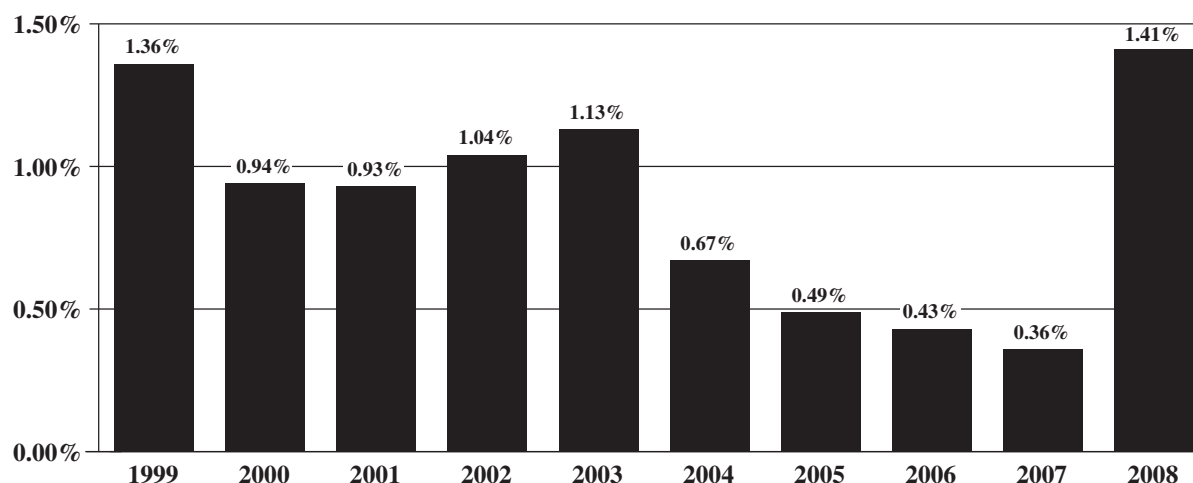
Credit risk on loans made in connection with international transactions remained relatively low, because approximately 81% and 61% of these loans were guaranteed under federal government programs as of December 31, 2008 and 2007. Additionally, we have reduced, to some extent, the credit risk of some real estate mortgage loans by entering into agreements that provide long-term standby commitments to purchase System loans and other credit guarantees. The amount of loans under credit guarantees was \$4.607 billion at December 31, 2008, of which \$2.165 billion was provided by Farmer Mac, as compared with total credit guarantees of \$4.262 billion at December 31, 2007, of which \$1.912 billion was provided by Farmer Mac. Fees paid for credit guarantees totaled \$18 million in 2008, \$14 million in 2007, and \$15 million in 2006, and are included in other operating expenses.

*Nonperforming Assets*

Nonperforming assets for each of the past five years consisted of the following:

	December 31,				
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(in millions)				
Nonaccrual loans:					
Real estate mortgage . . . . .	\$ 526	\$245	\$210	\$228	\$254
Production and intermediate-term . . . . .	659	156	137	123	141
Agribusiness . . . . .	986	78	96	132	109
Energy . . . . .	10		67	7	57
Communication . . . . .	30			17	60
Rural residential real estate . . . . .	38	23	17	14	12
Lease receivables . . . . .	28	10	6	3	5
International . . . . .	5				8
Total nonaccrual loans . . . . .	<u>2,282</u>	<u>512</u>	<u>533</u>	<u>524</u>	<u>646</u>
Accruing restructured loans:					
Real estate mortgage . . . . .	30	41	50	54	58
Production and intermediate-term . . . . .	5	11	6	5	16
Agribusiness . . . . .	1	1	1	2	2
Total accruing restructured loans . . . . .	<u>36</u>	<u>53</u>	<u>57</u>	<u>61</u>	<u>76</u>
Accruing loans 90 days or more past due:					
Real estate mortgage . . . . .	26	31	12	9	9
Production and intermediate-term . . . . .	34	19	8	5	5
Agribusiness . . . . .	30	3	3		5
Energy . . . . .					2
Rural residential real estate . . . . .	7	3	1	1	
Lease receivables . . . . .	1		1		
Total accruing loans 90 days or more past due . . . . .	<u>98</u>	<u>56</u>	<u>25</u>	<u>15</u>	<u>21</u>
Total nonperforming loans . . . . .	2,416	621	615	600	743
Other property owned . . . . .	46	32	21	16	24
Total nonperforming assets . . . . .	<u>\$2,462</u>	<u>\$653</u>	<u>\$636</u>	<u>\$616</u>	<u>\$767</u>

**Nonaccrual Loans As a %  
of Total Loans  
Outstanding  
as of December 31,**



Nonaccrual loans increased \$1.770 billion to \$2.282 billion at December 31, 2008, as compared with the December 31, 2007 level. This increase was primarily due to the movement of an agribusiness loan to a poultry processor in the amount of \$680 million and a loan to an ethanol producer in the amount of \$385 million into nonaccrual status. As a result of higher feed costs and reduced demand for poultry, the poultry processor filed for bankruptcy protection in the fourth quarter of 2008. Consistent with System institutions' allowance for loan losses methodologies (as discussed on page 48), the System did not record a specific provision for loan losses on this loan. More than half the entities in the System hold participation interests in varying amounts in this loan. This large ethanol producer and its wholly-owned subsidiaries filed for bankruptcy protection. Approximately, one-third of System institutions have separate lines of credit with several of the subsidiaries. The ethanol producer was adversely impacted by higher corn prices and falling energy prices.

The remainder of the increase in nonaccrual loans was primarily due to the overall deterioration in credit quality of loans to other borrowers, including other livestock/poultry producers and ethanol producers, adversely impacted by commodity price volatility and higher farm input costs in the current agricultural environment and loans to borrowers who were adversely impacted due to the deterioration in the general economy.

Nonaccrual loans as a percentage of total loans outstanding have been at historically low levels over the

past four years. Nonaccrual loans as a percentage of total loans outstanding increased from 0.36% at December 31, 2007 to 1.41% at December 31, 2008, and moved more in line with long-term historical norms, which averaged 2.45% during the 1990s. Nonaccrual loans that were current as to principal and interest were 74.7% of total nonaccrual loans at December 31, 2008, as compared with 52.1% at December 31, 2007. Nonaccrual loans contractually past due with respect to either principal or interest were \$577 million and \$245 million at December 31, 2008 and 2007.

At December 31, 2008, the ten largest nonaccrual loans totaled \$1.363 billion, while at December 31, 2007 only six nonaccrual loans exceeded \$5 million and totaled \$89.9 million.

Accruing restructured loans, including related accrued interest, were \$36 million and \$53 million at December 31, 2008 and 2007. The restructured loans include only the year-end balances of loans (and related accrued interest) on which monetary concessions have been granted to borrowers and that are in accrual status. Restructured loans do not include loans on which extensions or other nonmonetary concessions have been granted, or restructured loans on which monetary concessions have been granted but which remain in nonaccrual status. Upon restructuring, our accounting policies generally require a period of loan performance during which the borrower complies with the restructured terms before a loan is transferred to accruing restructured status.



The following table is a reconciliation of non-accrual loan activity during the past three years:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(in millions)		
Balance at beginning of period . . . . .	\$ 512	\$ 533	\$ 524
Additions:			
Gross amounts transferred into nonaccrual . . . . .	2,390	442	423
Recoveries . . . . .	17	24	30
Advances . . . . .	232	471	544
Other, net . . . . .	24	4	
Reductions:			
Charge-offs . . . . .	(127)	(52)	(78)
Transfers to other property owned . . . . .	(37)	(29)	(14)
Returned to accrual status . . . . .	(69)	(52)	(56)
Repayments . . . . .	(660)	(829)	(840)
Balance at end of period . . . . .	<u>\$2,282</u>	<u>\$ 512</u>	<u>\$ 533</u>

The increased volatility in the agricultural commodity market and the increased cost of farm inputs during the past year have resulted in higher risk profiles for certain of our borrowers, including livestock producers, producers and marketers of grains and oilseeds, and borrowers that use corn or other grains in their products. In line with these higher risk profiles and the impact of the volatile economic environment, we anticipate credit quality of the loan portfolio will continue to decline in 2009.

While certain credit quality indicators declined, these indicators remained at generally favorable levels. Loan delinquencies (accruing loans 30 days or more past due) as a percentage of accruing loans increased but remained at a low level of 0.53% at December 31, 2008, as compared with 0.41% at December 31, 2007. Loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" as a percentage of total loans and accrued interest receivable declined to 97.1% at December 31, 2008, as compared with 98.5% at December 31, 2007. The credit quality of our loan portfolio was impacted by commodity price volatility and higher farm input costs in the current agricultural environment due to pressures brought on by higher corn prices that adversely impacted borrowers in the livestock/poultry and ethanol industries. This had a larger impact on our production and intermediate-term loans and agribusiness loans, which experienced increases in the substandard/doubtful accounts.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Real estate mortgage			
Acceptable . . . . .	96.0%	97.4%	97.1%
OAEM . . . . .	2.2	1.5	1.6
Substandard/doubtful . . . . .	1.8	1.1	1.3
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Production and intermediate-term			
Acceptable . . . . .	92.9	95.5	95.5
OAEM . . . . .	3.1	2.5	2.6
Substandard/doubtful . . . . .	4.0	2.0	1.9
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Agribusiness			
Acceptable . . . . .	90.6	94.5	94.3
OAEM . . . . .	3.5	3.0	2.7
Substandard/doubtful . . . . .	5.9	2.5	3.0
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Energy and water/waste disposal			
Acceptable . . . . .	99.8	99.7	97.8
OAEM . . . . .	0.1	0.3	1.0
Substandard/doubtful . . . . .	0.1	0.0	1.2
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Communication			
Acceptable . . . . .	96.8	96.7	94.2
OAEM . . . . .	1.5	1.9	3.4
Substandard/doubtful . . . . .	1.7	1.4	2.4
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Rural residential real estate			
Acceptable . . . . .	97.4	98.1	98.1
OAEM . . . . .	1.3	0.9	0.9
Substandard/doubtful . . . . .	1.3	1.0	1.0
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
International			
Acceptable . . . . .	99.8	100.0	100.0
OAEM . . . . .	0.1	0.0	0.0
Substandard/doubtful . . . . .	0.1	0.0	0.0
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Lease receivables			
Acceptable . . . . .	94.1	96.1	96.4
OAEM . . . . .	2.2	2.1	1.4
Substandard/doubtful . . . . .	3.7	1.8	2.2
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Loans to other financing institutions			
Acceptable . . . . .	100.0	100.0	100.0
OAEM . . . . .	0.0	0.0	0.0
Substandard/doubtful . . . . .	0.0	0.0	0.0
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Total Loans			
Acceptable . . . . .	94.7	96.6	96.3
OAEM . . . . .	2.4	1.9	2.0
Substandard/doubtful . . . . .	2.9	1.5	1.7
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

### Allowance for Loan Losses

The allowance for loan losses at each period end was considered by the managements of System institutions to be adequate to absorb probable losses existing in and inherent to their loan portfolios. The allowance for loan losses represents the aggregate of each System entity's individual evaluation of its allowance for loan losses requirements. Although aggregated in the combined financial statements, the allowance for loan losses of each System entity is particular to that institution and is not available to absorb losses realized by other System entities.

Managements' evaluations consider factors that include, among other things, loan loss experience, portfolio quality, loan portfolio composition, collateral value, current agricultural production conditions and economic conditions. The allowance for loan losses was \$936 million, \$781 million and \$734 million at December 31, 2008, 2007 and 2006.

Net loan charge-offs of \$99 million, \$34 million and \$50 million were recorded in 2008, 2007 and 2006. Net loan charge-offs as a percentage of average loans remained at low levels of 0.06%, 0.03% and 0.04% for 2008, 2007 and 2006.

The following table presents the activity in the allowance for loan losses for the most recent five years:

	<b>For the Year Ended December 31,</b>				
	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
	(\$ in millions)				
Balance at beginning of year . . . . .	\$ 781	\$ 734	\$ 755	\$ 792	\$ 2,075
Charge-offs:					
Real estate mortgage . . . . .	(33)	(35)	(12)	(3)	(21)
Production and intermediate-term . . . . .	(29)	(18)	(19)	(18)	(21)
Agribusiness . . . . .	(27)	(5)	(36)	(16)	(22)
Communication . . . . .	(8)			(5)	(18)
Energy . . . . .	(19)		(1)	(23)	(53)
Rural residential real estate . . . . .	(2)	(1)	(1)		(1)
International . . . . .	(9)			(4)	(4)
Lease receivables . . . . .	(1)	(3)	(12)	(1)	(2)
Total charge-offs . . . . .	<u>(128)</u>	<u>(62)</u>	<u>(81)</u>	<u>(70)</u>	<u>(142)</u>
Recoveries:					
Real estate mortgage . . . . .	2	6	1	4	15
Production and intermediate-term . . . . .	4	7	6	9	11
Agribusiness . . . . .	18	6	8	8	13
Communication . . . . .	1	8	2	6	10
Energy . . . . .	2		11	5	13
International . . . . .		1	1	1	
Lease receivables . . . . .	2		2	1	5
Total recoveries . . . . .	<u>29</u>	<u>28</u>	<u>31</u>	<u>34</u>	<u>67</u>
Net loan charge-offs . . . . .	(99)	(34)	(50)	(36)	(75)
Provision for loan losses (loan loss reversal) . . . . .	408	81	35	(1)	(1,208)**
Other . . . . .	(154)*		(6)		
Balance at end of year . . . . .	<u>\$ 936</u>	<u>\$ 781</u>	<u>\$ 734</u>	<u>\$ 755</u>	<u>\$ 792</u>
Ratio of net loan charge-offs during the period to average loans outstanding during the period . . . . .	<u>0.06%</u>	<u>0.03%</u>	<u>0.04%</u>	<u>0.04%</u>	<u>0.08%</u>

\* The \$154 million decrease to the allowance for loan losses in 2008 resulted from one Bank's change in its allowance methodology that resulted in the reclassification to other liabilities as a reserve for unfunded commitments.

\*\* The allowance for loan losses decreased significantly in 2004 as a result of loan loss reversals, the majority of which were related to the real estate mortgage and production and intermediate-term loan portfolios that generally experienced minimal losses in the several years preceding 2004.

The allowance for loan losses by loan type for the most recent five years is as follows:

	December 31,									
	2008	%	2007	%	2006	%	2005	%	2004	%
	(\$ in millions)									
Real estate mortgage . . . . .	\$214	22.9%	\$131	16.8%	\$110	15.0%	\$138	18.3%	\$158	19.9%
Production and intermediate-term . . . . .	219	23.4	140	17.9	133	18.1	127	16.8	145	18.3
Agribusiness . . . . .	357	38.1	323	41.4	289	39.4	291	38.6	261	33.0
Communication . . . . .	47	5.0	72	9.2	64	8.7	65	8.6	82	10.3
Energy and water/waste disposal . . . . .	60	6.4	75	9.6	97	13.2	92	12.2	95	12.0
Rural residential real estate . . . . .	6	0.7	4	0.5	4	0.6	4	0.5	6	0.7
International . . . . .	12	1.3	21	2.7	20	2.7	18	2.4	21	2.7
Lease receivables . . . . .	20	2.1	15	1.9	17	2.3	20	2.6	22	2.8
Loans to other financing institutions . . . . .	<u>1</u>	<u>0.1</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>2</u>	<u>0.3</u>
Total . . . . .	<u>\$936</u>	<u>100.0%</u>	<u>\$781</u>	<u>100.0%</u>	<u>\$734</u>	<u>100.0%</u>	<u>\$755</u>	<u>100.0%</u>	<u>\$792</u>	<u>100.0%</u>

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

	December 31,				
	2008	2007	2006	2005	2004
Total loans . . . . .	0.58%	0.55%	0.59%	0.71%	0.82%
Nonperforming loans . . . . .	39	126	119	126	107
Nonaccrual loans . . . . .	41	153	138	144	123

Even though System borrowers faced increased challenges due to the volatile market environment, their financial positions remain generally strong given the past decade of extremely favorable U.S. farm economic conditions. As a result, the allowance for loan losses has been less impacted than it would have been in light of the volatile market environment.

Further, while nonaccrual loans increased significantly during 2008, nonaccrual loans not current as to principal and interest increased at a slower rate. Nonaccrual loans not current as to principal and interest increased from \$245 million at December 31, 2007 to \$577 million at December 31, 2008.

#### Credit Commitments

The following table summarizes the maturity distribution (expiration) of unfunded credit commitments at December 31, 2008:

	Less than 1 year	1-3 years	3-5 years (in millions)	Over 5 years	Total
Commitments to extend credit . . . . .	\$26,233	\$24,520	\$10,524	\$6,352	\$67,629
Standby letters of credit . . . . .	1,530	1,124	434	230	3,318
Commercial and other letters of credit . . . . .	339	—	—	—	339
Total commitments . . . . .	<u>\$28,102</u>	<u>\$25,644</u>	<u>\$10,958</u>	<u>\$6,582</u>	<u>\$71,286</u>

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. These credit-related financial instruments, other than standby letters of credit, have off-balance-sheet credit risk because their contractual amounts are not reflected on the balance sheet until funded or drawn upon. However, standby letters of credit are reflected on the balance sheet at the fair value of the liability of \$15 million. The fair value of

these letters of credit is estimated based on the cost to terminate the agreement or fees currently charged for similar agreements. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security are of

no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The System has established a reserve for unfunded commitments of \$161 million at December 31, 2008, as compared with a \$6 million reserve at December 31, 2007. During 2008, one Bank refined its allowance for loan losses methodology and reclassified \$154 million from the allowance for loan losses to the reserve for unfunded commitments. The reserve for unfunded commitments is reported as other liabilities in the System Combined Statement of Condition.

### *Interest Rate Risk Management*

Interest rate risk is the risk of loss of future earnings or long-term market value of equity that may result from changes in interest rates. This risk can produce variability in System earnings (net interest spread achieved and net interest income earned) and, ultimately, the long-term capital position of the System. The System actively manages the following risks:

- Yield curve risk — results from changes in the level, shape, and implied volatility of the yield curve. Changes in the yield curve often arise due to the market's expectation of future interest rates at different points along the yield curve.
- Repricing risk — caused by the timing differences (mismatches) between financial assets and related funding that limit the ability to alter or adjust the rates earned on assets or paid on liabilities in response to changes in market interest rates.
- Option risk — results from "embedded options" that are present in many financial instruments, including the right to prepay loans before the contractual maturity date. Lending practices or loan features that provide the borrower with flexibility frequently introduce a risk exposure for the lender. For example, a fixed-rate loan product may provide a potential borrower with a rate guarantee, an option to lock-in the loan rate for a period of time prior to closing, which protects the borrower from an increase in interest rates between the time loan terms are negotiated and the loan settles. If interest rates increase while the rate guarantee is in effect and if we do not take measures to hedge the rate guarantee, we might realize a

lower spread than expected when the loan is funded.

After the loan settles, the borrower may also have the option to repay the loan's principal ahead of schedule. If interest rates have fallen, System institutions may be forced to reinvest principal returned from higher rate loans at a lower rate, which may reduce the interest rate spread unless the underlying debt can be similarly refinanced.

Interest rate caps are another form of embedded options that may be present in certain investments and floating and adjustable rate loans. Interest rate caps typically prevent the borrower's loan rate from increasing above a defined limit. In a rising interest rate environment, the lender's spread may be reduced if caps limit upward adjustments to floating loan rates while debt costs continue to increase.

- Basis risk — results from unexpected changes in the relationships among interest rates and interest rate indexes. Basis risk can produce volatility in the spread earned on a loan or an investment relative to its cost of funds. This risk arises when the floating-rate index tied to a loan or investment differs from the index on the Systemwide Debt Security issued to fund the loan or investment.

The goal of the Banks in managing interest rate risk is to maintain long-term value and stable earnings over both the short- and long-term time horizons. In most cases, the wholesale funding provided by a Bank to an Association matches the terms of and embedded options in the Association's retail loans. This funding approach shifts the majority of the interest rate risk connected with our retail loans from the Association to its funding Bank. The Banks are responsible for developing asset/liability management policies and strategies to manage interest rate risk and for monitoring them on a regular basis. These policies include guidelines for measuring and evaluating exposures to interest rate risk. In addition, the policies establish limits for interest rate risk management and define the role of the board of directors in delegating day-to-day responsibility for interest rate risk management to Bank management. That authority is delegated to an asset/liability management committee, or ALCO, made up of senior Bank managers. The policies define the composition of the committee and its responsibilities. Interest rate risk management is also subject to certain intra-System agreements, including the Contractual

Interbank Performance Agreement and the Market Access Agreement, and regulatory oversight by the Farm Credit Administration.

Historically, one of the primary benefits of our status as a government-sponsored enterprise debt issuer has been that, through the Funding Corporation and its selling group, the System has had daily access to the debt markets and a great deal of flexibility in structuring the maturity and types of debt securities we issued. The ability to quickly access the debt markets helped us minimize the risk that interest rates might change between the time a loan commitment is made and the time it is funded.

Flexibility in structuring debt enabled us to issue Systemwide Debt Securities that offset some of the primary interest rate risk exposures embedded in our loans. For example, by issuing LIBOR-indexed, floating-rate Systemwide Debt Securities we are able to minimize the basis risk exposure presented by our LIBOR-indexed, floating-rate loans. As we discussed above, some of our fixed-rate loans may provide borrowers with the option to prepay their loans. In most interest rate environments we were able to significantly offset the risk created by an embedded prepayment option by funding prepayable fixed-rate loans with callable debt. Callable debt provides us with the option to retire debt early in order to maintain a better match between the duration of our assets and our liabilities. See “Business — Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Management — Liquidity Risk Management” for a discussion of the impact of the current U.S. and global credit crisis on our ability to issue Systemwide Debt Securities at competitive rates and terms.

Approximately two-thirds of our fixed-rate loans provide the borrowers with the option to prepay their loan at any time, and the remainder of the System’s fixed-rate loans contain provisions requiring prepayment fees to partially or fully compensate the Banks for the cost of retiring the debt, some of which may be non-callable, that is funding fixed-rate loans.

The Banks actively participate in the derivatives markets, which provides additional tools to manage risk. Our use of derivatives is detailed later in this section.

## Interest Rate Risk Measurements

The Banks measure interest rate risk using:

- interest rate gap analysis — compares the amount of interest sensitive assets to interest sensitive liabilities in defined time periods,
- duration gap analysis — measures the difference between the estimated durations of assets and liabilities,
- net interest income sensitivity analysis — projects the impact of changes in the level of interest rates and the shape of the yield curve on net interest income for the next year, and
- market value of equity sensitivity analysis — projects the impact of changes in the level of interest rates and the shape of the yield curve on the market value of assets, liabilities and equity.

These measures are calculated on a monthly basis and the assumptions used in these analyses are monitored routinely and adjusted as necessary. The Banks use sophisticated simulation models to develop interest rate sensitivity estimates and periodically back test those models to ensure reasonable performance.

## Interest Rate Risk Management Results

### *Interest Rate Gap Analysis*

The interest rate gap analysis shown below presents a comparison of interest-sensitive assets and liabilities in defined time segments as of December 31, 2008. The interest rate gap analysis is a static indicator, which does not reflect the dynamics of balance sheet, rate and spread changes and may not necessarily indicate the sensitivity of net interest margin in a changing rate environment. Within the gap analysis, gaps are also created when an institution uses its capital to fund assets. Capital reduces the amount of debt that otherwise would be required to fund a certain level of assets. The quantity of assets will exceed the quantity of interest-bearing liabilities in any repricing interval where capital is assumed to provide part of the funding. The gap table below includes anticipated cash flows on assets and liabilities given the current level of interest rates:

	Repricing Intervals				
	0-6 Months	6 Months to 1 Year	1-5 Years (\$ in millions)	Over 5 Years	Total
Floating-rate loans:					
Indexed/adjustable loans . . . . .	\$ 36,874	\$ 1,103	\$ 1,687	\$ 828	\$ 40,492
Administered-rate loans . . . . .	28,797	66			28,863
Fixed-rate loans:					
Fixed-rate with prepayment or conversion fees . .	7,035	2,128	10,389	9,225	28,777
Fixed-rate without prepayment or conversion fees . . . . .	22,652	9,622	19,825	8,910	61,009
Nonaccrual loans . . . . .			579	1,703	2,282
Total gross loans . . . . .	95,358	12,919	32,480	20,666	161,423
Federal funds sold, investments and other . . . . .	28,087	3,883	6,958	1,885	40,813
Total earning assets . . . . .	123,445	16,802	39,438	22,551	202,236
Interest-bearing liabilities:					
Callable bonds . . . . .	15,269	6,066	7,373	13,255	41,963
Noncallable bonds and notes . . . . .	68,908	13,143	37,369	16,982	136,402
Subordinated debt . . . . .	500			550	1,050
Other interest-bearing liabilities . . . . .	1,838	1		274	2,113
Total interest-bearing liabilities . . . . .	86,515	19,210	44,742	31,061	181,528
Effect of interest rate swaps and other derivatives . . . . .	27,709	(5,531)	(18,418)	(3,760)	
Total interest-bearing liabilities adjusted for swaps and other derivatives . . . . .	114,224	13,679	26,324	27,301	181,528
Interest rate sensitivity gap (total earning assets less total interest-bearing liabilities adjusted for swaps and other derivatives) . . . . .	\$ 9,221	\$ 3,123	\$ 13,114	\$ (4,750)	\$ 20,708
Cumulative gap . . . . .	\$ 9,221	\$12,344	\$ 25,458	\$20,708	
Cumulative gap as a percentage of total earning assets . . . . .	4.56%	6.10%	12.59%	10.24%	

Consistent with the positive gap between the System's earning assets and interest-bearing liabilities as reflected in the table above, the System's interest rate sensitivity position at December 31, 2008 for repricing intervals in the first six months of 2009 may generally be characterized as "asset sensitive," i.e., interest rates earned by the System on earning assets may change or be changed more quickly than interest rates on the interest-bearing liabilities used to fund these assets.

Typically, the net interest margin of an institution that is "asset sensitive" will be unfavorably impacted in a declining interest-rate environment and favorably impacted in a rising short- and long-term interest-rate environment. The System's capital is invested in loans and investment securities that reprice to lower yields

when interest rates are falling and to higher yields when interest rates increase. However, the net interest spread, a component of net interest margin, may react in a different manner due to competitive conditions at the time of repricing. Further, a significant portion of the System's floating-rate loans are management administered-rate loans that, unlike indexed loans, require definitive action at the discretion of the lending Bank or Association to change the interest rates charged and may reflect managements' assessments of whether rate changes are warranted or feasible in view of competitive market conditions. The actual interest rates charged on the administered-rate loans may not mirror the movement of some market interest rates, thereby moderating the overall net interest income impact of market fluctuations that would otherwise exist for asset-sensitive institutions.

Additionally, the Banks issue callable debt to accelerate the repricing of debt in a declining interest rate environment and thereby moderate the impact of falling interest rates on net interest income of institutions in an asset-sensitive position. During 2008, \$49.3 billion of debt was called and at December 31, 2008, \$42.0 billion of callable debt obligations were outstanding. The System's cumulative gap position in the 0-6 months repricing interval decreased from 6.41% at December 31, 2007 to 4.56% at December 31, 2008.

#### *Duration Gap Analysis*

Another risk measurement is duration, which we calculate using a simulation model. Duration is the weighted average maturity (typically measured in months or years) of an instrument's cash flows, weighted by the present value of those cash flows. As such, duration provides an estimate of an instrument's sensitivity to small changes in market interest rates. The duration gap is the difference between the estimated durations of assets and liabilities. All else being equal, an institution with a small duration gap has less exposure to interest rate risk than an institution with a large duration gap.

A positive duration gap means there is a greater exposure to rising interest rates because it indicates that the duration of our assets exceeds the duration of our liabilities. A negative duration gap means that there is a greater exposure to declining interest rates because the duration of our assets is less than the duration of our liabilities. At December 31, 2008, the System's aggregate duration gap was a positive 0.2 months, as compared with a positive 1.4 month at December 31, 2007. A duration gap within the range of a positive three months to a negative three months generally indicates a small exposure to changes in interest rates.

Duration gap provides a relatively concise and simple measure of the interest rate risk inherent in the balance sheet, but it is not directly linked to expected future earnings performance. An institution's overall exposure to interest rate risk is a function not only of the duration gap, but also of the financial leverage inherent in the institution's capital structure. For the same duration gap, an institution with more equity or capital will have a lower overall percentage exposure to interest rate risk, stated in terms of the percentage change in the market value of equity, than one with less capital and more leverage.

There are some limitations to duration analysis as balance sheets are dynamic. Durations change over time and as the composition of a portfolio changes.

#### *Sensitivity Analysis*

In addition to the static view of interest rate sensitivity shown by the gap analysis and the simple duration gap, each Bank conducts simulations of net interest income and market value of equity. The market value of equity sensitivity analysis incorporates the effects of leverage. The two primary scenarios used for the analysis reflect the impact of interest rate shocks upward and downward (i.e., immediate, parallel changes upward and downward in the yield curve) on projected net interest income and on market value of equity. The Banks also use other types of measures to model exposures to interest rate changes, such as rate ramps (gradual change in rates) and yield curve slope changes.

The upward and downward shocks are generally based on movements of 100 and 200 basis points in interest rates, which are considered significant enough to capture the effects of embedded options and convexity within the assets and liabilities so that underlying risk may be revealed. However, in the current, relatively low interest rate environment, the downward shock is based on one-half of the three-month Treasury bill rate, which was 6 basis points and 169 basis points at December 31, 2008 and 2007. Under these simulations, the System's sensitivity to interest rate changes was:

	December 31, 2008			December 31, 2007			
	-6	+100	+200	-169	-100	+100	+200
Change in net interest income . . . . .	-0.06%	1.97%	5.47%	-1.13%	-1.02%	2.28%	3.69%
Change in market value of equity . . . . .	0.07%	-1.65%	-3.31%	2.96%	1.69%	-2.13%	-4.93%

Each Bank's interest rate risk management policy establishes limits for changes in net interest income sensitivity and market value of equity sensitivity. These limits are measured monthly and reported to each Bank's board of directors at least quarterly. The limits set by the Banks' boards of directors for net interest income and market value of equity sensitivity ranged up to a negative 20% for a 200 basis point shock. During 2008 and 2007, no Bank exceeded its policy limits.

Further, each Bank has established a District limit not to exceed a 15% negative movement for changes in net interest income sensitivity and market value of equity sensitivity as measured using the combined results of each Bank and its affiliated Associations. This limit is measured and reported on a quarterly

basis. None of the Banks exceeded the District limit during 2008 and 2007. District measurements are presented in Supplemental Financial Information on page F-52.

In addition to the interest rate scenarios required for reporting and regulatory purposes, the Banks also periodically perform additional scenario analyses to study the effects of changes in critical modeling assumptions — for example, the impact of increased/decreased prepayments, changes in the relationship of the System’s funding cost to other benchmark interest rates, additional non-parallel shifts in the yield curve, and changes in market volatility.

One of the primary modeling assumptions affecting the measurement of market value of equity is the prepayment function. The cash flows on some of our fixed-rate agricultural loans and most of our mortgage-related investment securities are sensitive to changes in interest rates because borrowers may have the flexibility to partially or completely repay the loan ahead of schedule. When interest rates decrease, borrowers can often reduce their interest costs by refinancing their fixed-rate loans. The financial incentive for the borrowers to refinance their loans increases as interest rates decline and the potential savings increase.

When interest rates rise, borrowers with fixed-rate loans lack the incentive to prepay their loans. However, prepayments can occur in any rate environment due to real estate sales transactions or early repayment of loans for reasons unrelated to interest rate conditions.

Lenders closely study the relationship between interest rates, the potential savings available from refinancing, and actual loan prepayment activity in order to gain a better understanding of prepayment behavior and more accurately forecast cash flows for prepayable loans and mortgage-related investments.

We gather and maintain loan information, including prepayment data, for use in developing prepayment models for agricultural loans. These models typically specify a minimum or “baseline” level of expected

prepayments that is not affected by the general level of interest rates, along with an interest-sensitive component that projects faster prepayments as the potential refinancing advantage increases. The refinancing advantage is defined as the difference between the loan rate on an outstanding fixed-rate loan and the current loan rate offered for a new fixed-rate loan with a similar maturity. Further, model refinements may reflect differences due to the loan product type and age or “seasoning” of the loan. The Banks’ agricultural loan prepayment models are based on proprietary data and may differ from Bank to Bank and from prepayment models developed for use with residential mortgages.

We also maintain investment portfolios that contain mortgage- and asset-backed investments that may also be subject to prepayment risk. Detailed prepayment data for these assets are readily available and a number of banks and fixed-income consulting firms market product-specific prepayment models for use in asset/liability risk management. The Banks typically subscribe to a commercially available prepayment model appropriate for these securities and integrate the analysis within their regular asset/liability analysis.

#### Derivative Products

Derivative products are an integral part of our interest rate risk management activities and supplement our issuance of debt securities in the capital markets. We use derivative financial instruments as hedges against interest rate and liquidity risks and to lower the overall cost of funds. We do not hold or enter into derivative transactions for trading purposes. Our ability to modify the debt securities by using derivative instruments provides us with greater flexibility to manage our interest rate risk.

The primary types of derivative products used and hedging strategies employed are summarized in the following table. For additional information, see Note 17 to the accompanying combined financial statements.



Derivative Products/Hedged Item	Purpose of the Hedge Transaction	Strategic Impact
Receive-fixed, pay-floating interest rate swap hedging callable or non-callable fixed rate debt	To protect against the decline in interest rates on assets by exchanging the debt's fixed-rate payment for a floating-rate payment that better reflects the amounts received on the assets.	A common use is to create a substitute for conventional floating-rate funding. The fixed-rate received on the swap largely offsets the fixed-rate paid on the associated debt leaving a net floating payment. The strategy frequently provides cost savings or promotes liquidity by permitting access to longer maturity floating-rate funding than may otherwise be available.
Pay-fixed, receive-floating interest rate swap hedging floating rate debt	To protect against an increase in interest rates by exchanging the debt's floating-rate payment for a fixed-rate payment that matches the cash flows of assets.	The combination of the pay-fixed, receive-floating swap with floating-rate funding results in a net fixed-rate payment. This strategy may provide lower cost fixed-rate funding than outright issuance of fixed-rate debt.
Floating-for-floating swap hedging floating-rate assets and liabilities	Used to manage the basis risk that can result when assets and liabilities are based on different floating-rate indexes or reprice at different times or on different frequencies.	The System's floating-rate loans and floating-rate investments are tied to a number of floating-rate indexes including Farm Credit's short-term debt cost, the prime rate, Federal funds and LIBOR. Ideally, floating-rate loans would be funded by issuing floating-rate funding tied to the same floating-rate index with identical reset terms. However, floating-rate funding is not consistently available to exactly meet these requirements. Floating-for-floating or 'basis' swaps are used to bridge this gap.
Interest rate caps hedging floating-rate assets and debt	To replace income lost from floating-rate assets that have reached cap levels or to put a ceiling on interest cost on floating-rate debt.	Some floating-rate loans and investments may specify a maximum interest rate to limit the borrower's exposure to rising interest rates. Interest rate caps are purchased to provide offsetting protection against rising interest rates.
Interest rate floors hedging floating-rate loans	To protect against falling interest rates on floating-rate assets.	A purchased floor option will produce a cash flow when the index rate falls below the strike rate. Cash flow from the floor can be used to offset income lost on floating-rate assets when interest rates decline. Floor options may also be used in combination with interest rate caps to create interest rate collars or otherwise limit or modify floating-rate cash flows.

The aggregate notional amount of the System's derivative products, most of which consisted of interest rate swaps, increased \$4.074 billion to \$45.806 billion at December 31, 2008, as compared with \$41.732 billion at December 31, 2007. The aggregate notional amount of these instruments, which is not included in the Combined Statement of Condition, is indicative of the System's activities in derivative financial instruments, but is not an indicator of the level of credit risk associated with these instruments.

The exposure to credit risk is a small fraction of the aggregate notional amount as more fully discussed on page 57. The majority of the swaps used by the Banks were receive-fixed swaps, which are used to improve liquidity and/or lower their cost of debt by issuing fixed-rate debt and swapping the debt to floating to create synthetic floating-rate debt.

The following table presents notional amounts and weighted average interest rates by expected (contractual) maturity dates for the System's derivative financial instruments. The fair values of these

derivatives were recognized in the Combined Statement of Condition. The table was prepared using the implied forward yield curve at December 31, 2008.

	Maturities of 2008 Derivative Products						Total	Fair Value at December 31, 2008
	2009	2010	2011	2012	2013	2014 and thereafter		
	(\$ in millions)							
Receive-fixed swaps								
Notional value. . . . .	\$ 8,651	\$ 7,921	\$ 11,139	\$ 1,960	\$ 2,838	\$ 4,200	\$ 36,709	\$ 2,174
Weighted average receive rate . . . .	4.05%	3.99%	3.81%	4.67%	3.21%	5.12%	4.05%	
Weighted average pay rate . . . . .	1.06%	1.38%	1.83%	2.25%	2.39%	2.52%	1.70%	
Pay-fixed and amortizing-pay fixed swaps								
Notional value. . . . .	\$ 743	\$ 274	\$ 295	\$ 167	\$ 127	\$ 856	\$ 2,462	\$ (159)
Weighted average receive rate . . . .	1.59%	1.40%	1.81%	1.90%	2.32%	2.57%	2.00%	
Weighted average pay rate . . . . .	4.19%	3.63%	4.24%	4.01%	3.49%	4.21%	4.09%	
Floating-for-floating and amortizing floating-for-floating swaps								
Notional value. . . . .	\$ 700	\$ 250	\$ 100	\$ 500	\$ 100		\$ 1,650	\$ 14
Weighted average receive rate . . . .	2.17%	3.51%	4.00%	2.68%	2.71%		2.67%	
Weighted average pay rate . . . . .	1.48%	2.14%	2.43%	2.83%	2.85%		2.13%	
Interest rate caps								
Notional value. . . . .	\$ 480	\$ 215	\$ 193	\$ 1,052	\$ 590	\$ 270	\$ 2,800	\$ 6
Foreign exchange contracts								
Notional value. . . . .	\$ 288	\$ 18	\$ 12	\$ 10	\$ 10	\$ 32	\$ 370	\$ (2)
Other derivative products								
Notional value. . . . .	\$ 404	\$ 275	\$ 263	\$ 401	\$ 88	\$ 384	\$ 1,815	\$ 112
Total notional value. . . . .	<u>\$11,266</u>	<u>\$8,953</u>	<u>\$12,002</u>	<u>\$4,090</u>	<u>\$3,753</u>	<u>\$5,742</u>	<u>\$45,806</u>	<u>\$2,145</u>
Total weighted average rates on swaps:								
Receive rate . . . . .	3.77%	3.88%	3.77%	4.10%	3.17%	4.68%	3.89%	
Pay rate . . . . .	1.31%	1.47%	1.89%	2.42%	2.44%	2.78%	1.85%	

Approximately 78% of the notional amounts of derivative products outstanding at December 31, 2008 were entered into to create synthetic floating-rate debt for the purpose of reducing the cost of directly issuing floating-rate debt or managing liquidity risk. Most of the remaining derivative products outstanding at December 31, 2008 were entered into for other asset/liability management purposes.

By using derivative instruments, we are exposed to counterparty credit risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the Bank's credit risk (exposure) will equal the fair value gain in a derivative. When the fair value of a derivative is positive, the counterparty would owe the Bank on early termination of the derivative, thus

creating a credit risk for the Bank. When the fair value of the derivative is negative, the Bank would owe the counterparty on early termination of the derivative, and, therefore, assumes no credit risk.

To minimize the risk of credit losses from derivatives, we deal with counterparties that have an investment grade or better long-term credit rating from a Nationally Recognized Statistical Rating Organization such as Moody's Investors Service or Standard & Poor's, and also monitor the credit standing of and levels of exposure to individual counterparties. We typically enter into master agreements that govern all derivative transactions with a counterparty and contain netting provisions. These provisions allow us to use the net value of affected transactions with the same

counterparty in the event of a default by the counterparty or early termination of the agreement. The counterparty credit ratings for the exposure on

derivatives that would be owed to us due to a default or early termination by our counterparties at December 31, 2008 were:

### Derivative Credit Exposure

	Number of Counterparties	Notional Principal	Years to Maturity(1)			Maturity Distribution Netting(2)	Exposure	Collateral Held	Exposure, Net of Collateral
			Less than 1 Year	1 to 5 Years	Over 5 Years				
(\$ in millions)									
Current Moody's Credit Rating									
Aaa	4	\$13,674	\$ 66	\$ 229	\$373	\$(13)	\$ 655	\$ 521	\$134
Aa1	7	15,085	9	707	1	(19)	698	479	219
Aa2	3	10,352	75	214	288	(23)	554	367	187
A2	3	5,248	11	157	133	(5)	296	197	99
Total	17	\$44,359	\$161	\$1,307	\$795	\$(60)	\$2,203	\$1,564	\$639

(1) Represents gain positions on derivative instruments with individual counterparties. Net gains represent the exposure to credit loss estimated by calculating the cost, on a present value basis, to replace all outstanding derivative contracts within a maturity category. Within each maturity category, contracts in a loss position are netted against contracts in a gain position with the same counterparty. If the net position within a maturity category with a particular counterparty is a loss, no amount is reported.

(2) Represents impact of netting of derivatives in a gain position and derivatives in a loss position with the same counterparty across different maturity categories.

Note: The remaining notional amount of derivative financial instruments of \$1.447 billion at December 31, 2008 was related to interest rate swaps that one Bank and one Association entered into with certain of their customers. The risk from these transactions is offset by concurrently entering into offsetting derivative transactions with some of the above counterparties.

At December 31, 2008, the credit exposure, net of collateral, increased to \$639 million from \$398 million at December 31, 2007. Substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of exposure of one party to the other one are reached, which thresholds may vary depending on a counterparty's credit rating. At December 31, 2008, the Banks' counterparties posted \$1.424 billion in cash and \$140 million in securities as collateral with us, as compared with \$88 million of cash collateral and \$13 million in securities at December 31, 2007. At December 31, 2008, none of the Banks posted collateral, as compared with one Bank that posted collateral with respect to its obligations under these agreements totaling \$2 million in 2007.

### Liquidity Risk Management

#### General

Liquidity risk management is necessary to ensure our ability to meet our financial obligations. These obligations include the repayment of Systemwide Debt Securities as they mature, the ability to fund new and existing loan and other funding commitments, and the ability to fund operations in a cost-effective manner. A primary objective of liquidity risk management is to plan for unanticipated changes in the capital

markets. The Banks have established a Contingency Funding Program to provide for contingency financing mechanisms and procedures to address potential disruptions in the System's communications, operations and payments systems. Effective January 5, 2009, the Banks amended the Contingency Funding Program to broaden its scope to cover events that threatens continuous market access by the Banks or the Funding Corporation's normal operations. Under this Program, the Funding Corporation has the option to finance all Systemwide Debt Securities through the issuance of Systemwide discount notes either directly to institutional investors or through the selling group. The Funding Corporation, on behalf of the Banks, may also incur other obligations, such as Federal funds purchased, that would be the joint and several obligations of the Banks and would be insured by the Farm Credit System Insurance Corporation to the extent funds are available in the Insurance Fund.

#### Funding Sources

Our primary source of liquidity is the ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the Banks. We continually raise funds to support our mission to provide credit and related services to the agricultural and rural sectors, repay maturing Systemwide Debt Securities, and meet other obligations. As a government-sponsored enterprise, we have had access to both the nation's and

world's capital markets. This access has traditionally provided us with a dependable source of competitively priced debt that is critical to support our mission of providing funding to the agricultural and rural sectors.

Moody's Investors Service, Standard & Poor's and Fitch Ratings rate our long-term debt as Aaa, AAA and AAA, and our short-term debt as P-1, A-1+ and F1. These are the highest ratings available from these rating agencies. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's status as a government-sponsored enterprise. Material changes to the factors considered could result in a different debt rating. A rating issued by these rating agencies is not a recommendation to buy, sell, or hold securities. You should evaluate the rating of each rating agency independently. The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities.

Cumulative Systemwide Debt Securities maturities for the past two years were:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(in millions)</b>	
Debt maturing within:		
one day . . . . .	\$ 745	\$ 2,630
one week . . . . .	2,845	5,865
one quarter . . . . .	19,702	24,527
six months . . . . .	34,807	35,328
one year . . . . .	65,722	57,034

Cash provided by the System's operating activities was \$3.015 billion for 2008, \$2.559 billion for 2007 and \$2.265 billion for 2006 (primarily generated from net

interest income in excess of operating expenses) and provided an additional source of liquidity for the System that is not reflected in the individual Bank's calculation of days of liquidity. Further, investments in the Insurance Fund would be used to repay maturing Systemwide Debt Securities to the extent available if no other sources existed to repay the debt. At December 31, 2008 and 2007, the assets in the Insurance Fund totaled \$2.915 billion and \$2.599 billion. (See "Insurance Fund" for additional information.)

#### Eligible Investments

As permitted under Farm Credit Administration regulations, a Bank is authorized to hold eligible investments (including Federal funds), in an amount not to exceed 35% of average loans outstanding for the quarter. We utilize investments for the purposes of maintaining a diverse source of liquidity and managing short-term surplus funds and interest rate risk, and in so doing may enhance profitability. Farm Credit Administration regulations also permit an Association to hold eligible investments with the approval of its affiliated Bank.

Farm Credit Administration regulations define eligible investments by specifying credit rating criteria, final maturity limit, and percentage of investment portfolio limit for each investment type. The Banks' investments must be highly rated by at least one Nationally Recognized Statistical Rating Organization, such as Moody's Investors Service, Standard & Poor's or Fitch Ratings.

#### Credit Rating Criteria by Investment Type

	<u>Moody's</u>	<u>Standard &amp; Poor's</u>	<u>Fitch</u>
Overnight Federal funds . . . . .	P-1, P-2	A-1+, A-1, A2	F1, F2
Term Federal funds . . . . .	P-1, P-2	A-1+, A-1, A2	F1, F2
Commercial paper . . . . .	P-1	A-1+, A-1	F1
Corporate securities . . . . .	Aaa, Aa1, Aa2, Aa3	AAA, AA+, AA, AA-	AAA, AA
Mortgage-backed securities . . . . .	Aaa	AAA	AAA
Asset-backed securities . . . . .	Aaa	AAA	AAA

Investments by type and credit rating were:

<u>December 31, 2008</u>	<u>Eligible</u>			<u>Ineligible</u>							<u>Total</u>	
	<u>AAA/Aaa</u>	<u>A1/P1/F1</u>	<u>Split Rated(1)</u>	<u>AA/Aa(2)</u>	<u>A(2)</u>	<u>BBB(2)</u>	<u>BB(2)</u>	<u>B(2)</u>	<u>CCC/Caa(2)</u>	<u>CC/Ca(2)</u>		
	(in millions)											
Federal funds . . . . .		\$ 729	\$ 300									\$ 1,029
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$ 282	3,288	1,043									4,613
U.S. agency securities . . . . .	3,033											3,033
Mortgage-backed securities:												
Agency collateralized . . . . .	22,079											22,079
Agency whole-loan pass through . . . . .	1,078											1,078
Non-Agency . . . . .	1,916		328	44	20	25	22	32				2,387
Asset-backed securities . . . . .	<u>757</u>	<u>      </u>	<u>223</u>	<u>230</u>	<u>78</u>	<u>19</u>	<u>30</u>	<u>16</u>	<u>\$10</u>	<u>\$3</u>		<u>1,366</u>
Total . . . . .	<u>\$29,145</u>	<u>\$4,017</u>	<u>\$1,894</u>	<u>\$274</u>	<u>\$98</u>	<u>\$44</u>	<u>\$52</u>	<u>\$48</u>	<u>\$10</u>	<u>\$3</u>		<u>\$35,585</u>

<u>December 31, 2007</u>	<u>Eligible</u>			<u>Ineligible</u>		<u>Total</u>
	<u>AAA/Aaa</u>	<u>A1/P1/F1</u>	<u>Split Rated(1)</u>	<u>AA/Aa(2)</u>		
	(in millions)					
Federal funds . . . . .			\$1,907			\$ 1,907
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$ 203	1,342	\$333			1,878
U.S. agency securities . . . . .	1,337					1,337
Mortgage-backed securities:						
Agency collateralized . . . . .			19,765			19,765
Agency whole-loan pass through . . . . .			1,371			1,371
Non-agency . . . . .			3,790			3,790
Asset-backed securities . . . . .	<u>2,203</u>	<u>      </u>	<u>      </u>	<u>8</u>	<u>\$26</u>	<u>2,237</u>
Total . . . . .	<u>\$28,669</u>	<u>\$3,249</u>	<u>\$341</u>	<u>\$26</u>		<u>\$32,285</u>

(1) Investments that received the highest credit rating from at least one rating organization.

(2) Investments that received the indicated rating as the highest rating from at least one rating organization.

As required by Farm Credit Administration regulations, mortgage-backed and asset-backed securities must be rated AAA/Aaa by at least one rating organization and must meet certain other requirements set forth in the regulations in order to be defined as an eligible investment. Eligible Federal funds and investments increased \$2.797 billion during the 2008 to \$35.056 billion and declined to 22.5% of average loans outstanding during the year ended December 31, 2008, as compared with 24.6% at December 31, 2007. At December 31, 2008, the Banks held mortgage-backed and asset-backed securities with a fair value of \$529 million and amortized cost of \$739 million that were considered ineligible, as compared with asset-backed securities with a fair value of \$26 million

and amortized cost of \$38 million at December 31, 2007.

If an investment no longer meets the credit rating criteria set forth above, the investment becomes ineligible. A Bank must dispose of an investment that becomes ineligible within six months, unless the Farm Credit Administration approves, in writing, a plan that authorizes the Bank to divest the instrument over a longer period of time. The Farm Credit Administration has approved with conditions the majority of the securities for which the Banks' plans were submitted and are in the process of reviewing the other plans that have been submitted. To date, the Farm Credit Administration has not required disposition of any of these securities.

The types of asset-backed securities that were included in the System's investment portfolio at December 31, 2008 and 2007 were:

	December 31, 2008		December 31, 2007	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Home equity loans . . . . .	\$1,271	\$1,034	\$1,925	\$1,804
Credit card receivables . . . . .	146	135	242	241
Equipment loans . . . . .	74	72		
Student loans . . . . .	54	52	82	82
Auto loans . . . . .	49	45	97	96
Small business loans . . . . .	28	28	14	14
Total asset-backed securities . . . . .	<u>\$1,622</u>	<u>\$1,366</u>	<u>\$2,360</u>	<u>\$2,237</u>

The fair values for floating-rate and fixed-rate mortgage-backed and asset-backed securities were:

	December 31,	
	2008	2007
	(in millions)	
Floating-rate mortgage-backed securities . . . . .	\$10,052	\$15,692
Fixed-rate mortgage-backed securities . . . . .	15,492	9,234
Total mortgage-backed securities . . . . .	<u>\$25,544</u>	<u>\$24,926</u>
Floating-rate asset-backed securities . . . . .	\$ 255	\$ 2,017
Fixed-rate asset-backed securities . . . . .	1,111	220
Total asset-backed securities . . . . .	<u>\$ 1,366</u>	<u>\$ 2,237</u>

Each Bank's investment securities are rated in the highest category required by regulation at the time of purchase and substantially all securities (98.5% and 99.9% at fair value) at December 31, 2008 and 2007 retained these highest ratings by at least one rating agency. Of the \$25.544 billion of mortgaged-backed securities at December 31, 2008, \$23.157 billion were issued and guaranteed by a government-agency or issued by triple-A rated government-sponsored enterprises, as compared with \$24.926 billion of mortgaged-backed securities, of which \$21.136 billion were issued and guaranteed by a government-agency or issued by triple-A rated government-sponsored enterprises at December 31, 2007.

The remaining \$2.387 billion at December 31, 2008 and \$3.790 billion at December 31, 2007 of mortgage-backed securities held were triple-A rated non-agency mortgage-backed securities, except for 13 securities with a fair value of \$143 million and amortized cost of \$237 million that were downgraded during 2008.

The market liquidity for agency and non-agency mortgage-backed securities has deteriorated due to overall market conditions and resulted in a \$825 million decline in the fair value of these securities during 2008. A continued deterioration in the U.S. economy and increasing levels of defaults and foreclosures on home mortgages may result in further downward adjustments to the fair value of our non-agency securities and the need to record additional other-than-temporary impairment losses.

At December 31, 2008 and 2007, \$1.034 billion and \$1.804 billion of our investment portfolio were asset-backed securities collateralized by first or second lien home equity mortgage loans. These asset-backed securities are supported by various forms of credit enhancements, including insurance guarantees from bond insurers, overcollateralization and favorable priority of payments. Just over half of the asset-backed securities held by the Banks are supported by insurance guarantees. The bond insurers, over the past year or so have faced significant challenges and uncertainties surrounding the asset-backed securities market and the potential for significant losses. As a result, the rating agencies downgraded the large insurers, which resulted in many of the securities with the guarantees also being downgraded and/or placed on negative watch. To the extent these insurers' credit ratings are further downgraded to a level at which we believe their ability to meet their obligations is reduced or if there is further deterioration in the U.S. economy, we would be required to adjust the values of these securities and consider whether an other-than-temporary impairment loss has occurred.

Current credit and market conditions have continued to reduce the liquidity of these asset-backed securities reducing the fair value of this portion of our investment portfolio by \$116 million during 2008. In

view of the continuing economic conditions and volatility related to these types of securities and the associated reduced liquidity in these markets, the Banks are actively monitoring these securities, which were all rated either Aaa by Moody's Investors Service or AAA by Standard & Poor's. The remaining 42 securities that had been downgraded below triple-A at December 31, 2008 had a fair value of \$386 million and an amortized cost of \$502 million, as compared with three securities with a fair value of \$26 million and an amortized cost of \$38 million at December 31, 2007.

At December 31, 2008, the Banks determined that they have the ability and intent to hold downgraded securities for a period of time to collect all contractual principal and interest, except for 14 securities that were determined to be other-than-temporarily impaired and a \$82 million loss was recognized during 2008. At year-end 2007, one security was determined to be other-than-temporarily impaired and a \$5 million loss was recognized. The Banks perform other-than-temporary impairment assessments of the investments that are based on an evaluation of both current and future market and credit conditions at each quarter-end. Subsequent changes in market or credit conditions could change those evaluations.

Mission-Related and Other Investments

The Farm Credit Act states that the mission of the System is "to provide for an adequate and flexible flow of money into rural areas." Congress also recognized the "growing need for credit in rural areas" and declared that the System be designed to accomplish the objective of improving the income and well being of America's farmers and ranchers. To further the System's mission to serve rural America, the System has initiated mission-related programs and other mission-related investments approved by the Farm Credit Administration. These investments are not included in the Banks' liquidity calculations and are not covered by the eligible investment limitation discussed above. However, limitations on mission-related investments are determined by the Farm Credit Administration.

Mortgage-backed securities issued by Farmer Mac are also considered other investments and are excluded from the eligible investment limitation and the Banks' liquidity calculations. These Farmer Mac securities are backed by loans originated by Associations and previously held by the Associations under Farmer Mac standby purchase commitments. Mission-

related and other investments outstanding are as follows:

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
	(in millions)	
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$ 234	\$ 162
Mortgage-backed securities . . . . .	3,016	2,963
Asset-backed securities . . . . .	<u>1,214</u>	<u>332</u>
Total . . . . .	<u>\$4,464</u>	<u>\$3,457</u>

At December 31, 2008 and 2007, there were \$1.545 billion and \$1.125 billion of rural housing mortgage-backed securities held under approved programs that were classified as held-to-maturity and had a Aaa credit rating from Moody's Investors Service and a AAA rating from Standard & Poor's. At December 31, 2008 and 2007, the Banks and Associations held mortgage-backed securities of \$889 million and \$1.177 billion issued by Farmer Mac that were classified as held-to-maturity. Certain Banks and Associations held mortgage-backed securities of \$558 million at December 31, 2008 and \$646 million at December 31, 2007 issued by Farmer Mac that were classified as available-for-sale. Asset-backed securities increased \$882 million to \$1.214 billion at December 31, 2008. The increase was primarily due to increased purchases of Small Business Administration government-guaranteed pooled investments.

Liquidity Standard

The Banks have jointly developed and adopted a Common Minimum Liquidity Standard. This Standard is designed to maintain and assure adequate liquidity to meet the business and financial needs of each Bank and the System. The Standard requires each Bank to maintain a minimum of 90 days of liquidity on a continuous basis, assuming no access to the capital markets. The number of days of liquidity is calculated by comparing maturing Systemwide Debt Securities and other bonds with the total amount of cash, investments, and other liquid assets maintained by that Bank. For purposes of calculating liquidity, liquid assets are subject to discounts that reflect potential exposure to adverse market value changes that might be recognized upon liquidation or sale. The liquid assets include only the eligible investments of the Banks and are valued as follows:

- multiply cash and overnight investments by 100%,

- multiply the market value of money market instruments and floating rate debt securities, whose current coupon rates are below their contractual rate, by 95%,
- multiply the market value of fixed rate debt securities and floating rate debt securities, whose coupon rates are at their contractual cap rate, by 90%,
- multiply individual securities in diversified investment funds by the discounts that would apply to the securities if held separately, and
- multiply new debt issued but not settled by 100%.

At December 31, 2008, all Banks exceeded the minimum 90 days of liquidity. The System's liquidity position was 177 days at December 31, 2008, as compared with 122 days at December 31, 2007. Overall, as compared with December 31, 2007, the System's liquidity position widened as the Banks took deliberate actions to increase the days liquidity by extending the maturities of Systemwide Debt Securities. This extension of maturities and the additional liquidity provides each Bank with a cushion in view of

significant negative events occurring in the U.S. and global markets over the latter half of 2008, including the severe limitations accessing the debt capital markets. (See Note 21 for each Bank's liquidity position at December 31, 2008 and 2007.)

#### Contractual Obligations

We enter into contractual obligations in the ordinary course of business, including debt issuances for the funding of our business operations. Systemwide Debt Securities are the joint and several obligations of the Banks. Payments of principal and interest to the holders of Systemwide Debt Securities are insured by amounts held in the Insurance Fund as described in Note 7 to the accompanying combined financial statements. Certain other bonds issued directly by individual Banks are the obligations solely of the issuing Bank. In addition, we enter into derivative transactions with counterparties that create contractual obligations. See "Derivative Products" for additional information. Substantially all proceeds of debt issuances were used to repay maturing debt, as well as to fund growth in loans and investment securities. Issuance, maturity, and retirement activity of Systemwide Debt Securities for the past two years was:

	Systemwide Bonds		Systemwide Medium-Term Notes		Systemwide Discount Notes		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
	(in millions)							
Balance, beginning of year . . . . .	\$133,147	\$113,833	\$1,636	\$2,029	\$ 19,660	\$ 17,768	\$ 154,443	\$ 133,630
Issuances . . . . .	110,976	65,830			407,874	418,646	518,850	484,476
Maturities/retirements . . . . .	(82,687)	(46,516)	(812)	(393)	(411,429)	(416,754)	(494,928)	(463,663)
Balance, end of year . . . . .	<u>\$161,436</u>	<u>\$133,147</u>	<u>\$ 824</u>	<u>\$1,636</u>	<u>\$ 16,105</u>	<u>\$ 19,660</u>	<u>\$ 178,365</u>	<u>\$ 154,443</u>

Weighted average interest rates and weighted average maturities for 2008 and 2007 were:

	Systemwide Bonds		Systemwide Medium-Term Notes		Systemwide Discount Notes		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
At December 31:								
Average interest rate . . . . .	2.87%	4.78%	6.22%	6.36%	1.34%	4.34%	2.75%	4.74%
Average remaining maturity . . . . .	3.6 years	4.1 years	5.5 years	3.8 years	4.4 months	1.3 months	3.3 years	3.6 years
Issuances during the year:								
Average interest rate . . . . .	3.48%	5.03%			1.91%	4.83%	2.25%	4.86%
Average maturity at issuance . . . . .	3.5 years	4.1 years			18 days	15 days	9.3 months	7.2 months



The following table presents principal cash flows and related weighted average interest rates by contractual maturity dates for Systemwide Debt Securities.

	<u>Fixed Rate</u>	<u>Average Interest Rate</u>	<u>Floating Rate</u>	<u>Average Interest Rate</u>	<u>Total</u>
	(\$ in millions)				
2009 . . . . .	\$ 31,579	2.58%	\$34,143	1.02%	\$ 65,722
2010 . . . . .	14,614	3.54	18,372	1.15	32,986
2011 . . . . .	13,737	3.74	8,373	1.05	22,110
2012 . . . . .	7,006	4.33	2,217	0.78	9,223
2013 . . . . .	12,719	4.20	2,245	1.60	14,964
2014 and thereafter . . . . .	<u>29,308</u>	5.13	<u>4,052</u>	0.63	<u>33,360</u>
Total . . . . .	<u>\$108,963</u>	3.84	<u>\$69,402</u>	1.05	<u>\$178,365</u>
Fair value at December 31, 2008 . . . . .	<u>\$111,026</u>		<u>\$69,680</u>		<u>\$180,706</u>

The Farm Credit Act and Farm Credit Administration regulations require, as a condition for a Bank's participation in the issuance of Systemwide Debt Securities, that the Bank maintain specified eligible assets, referred to in the Farm Credit Act as "collateral," at least equal in value to the total amount of the debt securities outstanding for which it is primarily liable. (See "Federal Regulation and Supervision of the Farm Credit System — Bank Collateral Requirements" for a description of eligible assets.) The collateral requirement does not provide holders of Systemwide Debt Securities with a security interest in any assets of the Banks. At December 31, 2008, all Banks reported compliance with the collateral requirement. (See "FCA Capital Requirements" and Note 9 to the accompanying combined financial statements.)

Each Bank determines its participation in each issue of Systemwide Debt Securities based on its funding and operating requirements, subject to: (1) the

availability of eligible collateral (as described above), (2) compliance with the conditions of participation as prescribed in the Market Access Agreement, (3) determination by the Funding Corporation of the amounts, maturities, rates of interest and terms of each issuance, and (4) Farm Credit Administration approval. As of December 31, 2008, no Bank was limited or precluded from participation in issuances of Systemwide Debt Securities. As required by the Farm Credit Act, Systemwide Debt Securities are issued pursuant to authorizing resolutions adopted by the board of directors of each Bank. Under the Market Access Agreement, each Bank's ability to withdraw its authorizing resolution is restricted and, in certain circumstances, eliminated.

Issuance, maturity, and retirement activity of other bonds for the past two years was:

	<u>Other Bonds</u>	
	<u>2008</u>	<u>2007</u>
	(in millions)	
Balance, beginning of year . . . . .	\$ 852	\$ 836
Issuances . . . . .	72,242	62,176
Maturities/retirements . . . . .	<u>(71,690)</u>	<u>(62,160)</u>
Balance, end of year . . . . .	<u>\$ 1,404</u>	<u>\$ 852</u>

Weighted average interest rates and weighted average maturities of other bonds for 2008 and 2007 were:

	<u>Other Bonds</u>	
	<u>2008</u>	<u>2007</u>
At December 31:		
Average interest rate . . . . .	0.57%	4.00%
Average remaining maturity . . . . .	1 day	3 days
Issuances during the year:		
Average interest rate . . . . .	1.03%	4.53%
Average maturity at issuance . . . . .	1 day	2 days

## Capital Adequacy and the Ability to Repay Systemwide Debt Securities

### System Capitalization

The changes in capital for the year ended December 31, 2008 were:

	Capital				
	Combined Banks	Combined Associations	Insurance Fund	Combination Entries	System Combined
	(in millions)				
Balance at December 31, 2007 . . . . .	\$9,095	\$17,727	\$2,599	\$(3,002)	\$26,419
Adjustment to beginning balance due to the change in accounting for pensions and other benefits . . . . .	(1)			(14)	(15)
Balance at January 1, 2008 . . . . .	9,094	17,727	2,599	(3,016)	26,404
Net income . . . . .	1,175	1,924	316	(499)	2,916
Change in accumulated other comprehensive loss . . . . .	(918)	(61)		(611)	(1,590)
Preferred stock issued, net . . . . .	198	432			630
Preferred stock retired . . . . .		(386)			(386)
Capital stock and participation certificates issued . . . . .	871	79		(868)	82
Capital stock and participation certificates and surplus retired . . . . .	(201)	(75)		166	(110)
Protected borrower stock retired . . . . .		(1)		1	
Patronage and dividends . . . . .	(649)	(560)		499	(710)
Preferred stock dividends . . . . .	(104)	(8)			(112)
Balance at December 31, 2008 . . . . .	<u>\$9,466</u>	<u>\$19,071</u>	<u>\$2,915</u>	<u>\$(4,328)</u>	<u>\$27,124</u>

**Note:** System combined capital reflected eliminations of approximately \$3.3 billion and \$2.6 billion of Bank equities held by Associations as of December 31, 2008 and 2007. System combined capital also reflected net eliminations of transactions between System entities. The combination entry for change in accumulated other comprehensive loss substantially resulted from the application of the Statement of Financial Accounting Standards No. 158 — Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, which for multi-employer plans was recorded at a District level. (See Notes 12 and 21 to the accompanying combined financial statements.)

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services. We believe a sound capital position is critical to providing protection to investors in Systemwide Debt Securities and our long-term financial success.

Over the past several years, we have built capital through net income earned and retained. Capital accumulated through earnings has been partially offset by cash distributions to shareholders. Surplus of \$23.148 billion is the most significant component of capital. Surplus as a percentage of capital was 85.3% and 81.3% at December 31, 2008 and 2007. Capital as a percentage of assets declined to 12.7% at December 31, 2008 from 14.2% at December 31, 2007 due principally to the growth in loans and investments and increases in accumulated other comprehensive losses. Accumulated other comprehensive loss,

net of tax, at December 31, 2008 and 2007 was comprised of the following components:

	<u>2008</u>	<u>2007</u>
Unrealized losses on investments available-for-sale, net . . . . .	\$(1,028)	\$(190)
Unrealized losses on cash flow hedges, net . . . . .	(64)	(27)
Pension and other benefit plans . . . . .	(1,041)	(326)
	<u>\$(2,133)</u>	<u>\$(543)</u>

While System institutions have built strong capital levels and are generally favorably positioned to meet demands of future asset growth, sustained loan and investment growth could further reduce System capital as a percentage of assets and could place pressure on certain System institutions' capital positions. The Banks and Associations continue to evaluate capital management strategies, including raising additional third party capital through the issuance of preferred stock or subordinated debt, to provide additional capacity and ensure the demands for future asset growth will be met. However, during the latter half of 2008, as a result of negative events in the U.S. and

global markets, the System's ability to raise third party capital was severely limited.

During the third quarter of 2008, the Farm Credit Bank of Texas issued \$50 million of 8.406% subordinated debt due in 2018, as a capital management strategy. In addition, in the second quarter of 2008, CoBank issued \$500 million of 7.875% unsecured subordinated debt due in 2018. The proceeds from these issuances were used to increase each of the Bank's regulatory permanent capital and total surplus, with certain limitations, and for general corporate and liquidity purposes. (See Note 10 of the accompanying condensed combined financial statements for additional information on subordinated debt.)

*Interdependency of the Banks and the Associations*

Understanding the System's structure and the interdependent nature of the Banks and the Associations is critical in understanding our capital adequacy.

As previously discussed, each Bank is primarily liable for the repayment of Systemwide Debt Securities issued on its behalf, as well as being liable for Systemwide Debt Securities issued on behalf of the other Banks. The Farm Credit Banks, through the issuance of Systemwide Debt Securities, generally finance the wholesale loans to their affiliated Associations who lend the proceeds to their customers. CoBank, as an Agricultural Credit Bank, makes loans to cooperatives, rural utilities, and other eligible borrowers, as well as Associations. Each Bank's ability to repay Systemwide Debt Securities is due, in large part, to each of its Association's ability to repay its loan from the Bank. As a result, the Banks continually monitor the risk-bearing capabilities of each affiliated Association through various mechanisms, including testing the reliability of each Association's credit classifications and prior-approval of certain Association loan transactions. Capital at the Association level also reduces the credit exposure that the Banks have with respect to the loans between the Bank and its affiliated Associations.

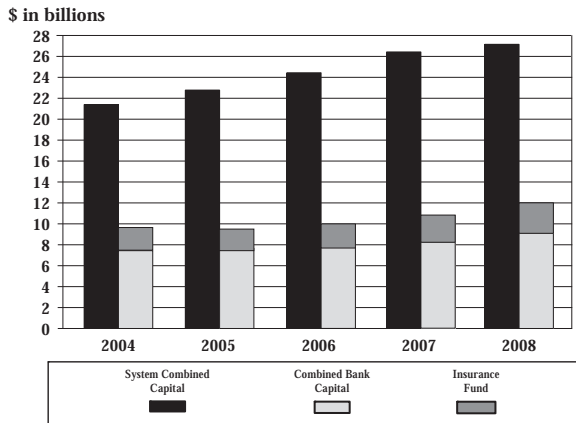
Since an Association's ability to obtain funds from sources other than its affiliated Bank is significantly limited, the financial well-being of the Bank and its ability to continue to provide funds is very important to the Association. In addition to the equity the Associations are required to purchase in connection with their direct loans from their affiliated Bank, under each Bank's bylaws, the Bank is authorized, under certain circumstances, to require its affiliated Associations and certain other equity holders to purchase additional Bank

equity subject to certain limits or conditions. Further, the Banks generally possess indirect access to certain financial resources of their affiliated Associations through loan-pricing provisions and through Bank-influenced operating and financing policies for its District. (See Notes 12 and 21 to the accompanying combined financial statements for further discussion of Bank and Association capital.)

Notwithstanding the foregoing, only the Banks, and not the Associations, are jointly and severally liable for the repayment of Systemwide Debt Securities. Other than as described above, and subject to various regulatory and contractual conditions and limitations, the Banks do not have direct access to the capital of their affiliated Associations. Moreover, capital in one Association is not available to address capital needs of another Association or of a non-affiliated Bank.

*Bank Capital and Insurance Fund*

**System Combined Capital,  
Combined Bank Capital and Insurance Fund  
as of December 31,**



Combined Bank-only information is considered meaningful because only the Banks are jointly and severally liable for payment of principal and interest on Systemwide Debt Securities. Amounts in the Insurance Fund are included in the System's combined financial statements because, under the Farm Credit Act, before joint and several liability can be invoked, available amounts in the Insurance Fund would be used to make principal and interest payments on Systemwide Debt Securities. Combined Bank capital and the Insurance Fund increased \$687 million since December 31, 2007 to \$12.381 billion at December 31, 2008. Combined Bank capital as a percentage of combined Bank assets declined to 4.9% at December 31, 2008 from 5.4% at December 31, 2007. This decline resulted from the

significant growth in retail loans made by the Banks and in loans to Associations, which the Banks fund through the issuance of Systemwide Debt Securities, and from a significant increase in other comprehensive losses, substantially all of which was a result of decreased market value in investment securities. The Banks' capital as a percentage of assets ranged from 4.1% to 5.9% at December 31, 2008. (See Note 21 to the accompanying combined financial statements.) The Banks have implemented and continue to evaluate capital and asset management strategies, to provide additional capacity and ensure the demands for future asset growth will be met. As previously mentioned, turmoil in the U.S. and global markets in the latter half of 2008 severely limited the Banks' ability to raise third party capital.

In July 2008, CoBank issued \$200 million of Series C non-cumulative subordinated perpetual preferred stock, representing four million shares at \$50 per share par value. Dividends are payable quarterly and will accrue at an annual rate equal to 11% of par value per share up to, but excluding July 1, 2013. Thereafter, dividends will accrue at an annual rate equal to the 3-Month USD LIBOR plus 6.79%. This preferred stock is not mandatorily redeemable at any time. However, it will be redeemable at par value, in whole or in part, at CoBank's option on July 1, 2013, and each July 1 thereafter. The net proceeds from the sale of this preferred stock were used to increase capital and for general corporate purposes.

Combined Bank-only net income was \$1.175 billion and \$959 million for 2008 and 2007. The combined Bank-only net income reflects the earnings from Banks' wholesale loans to Associations, retail loans, principally consisting of CoBank's domestic loans to cooperatives and other eligible borrowers and loans to finance international transactions, and investments. The Banks' wholesale loans to Associations represent a majority of the assets on the combined Bank-only balance sheet. These loans carry less risk than retail loans because the Associations operate under General Financing Agreements with their affiliated Banks and a regulatory regime that requires maintaining certain minimum capital standards, adequate reserves, and prudent underwriting standards. Based on the lower risk of loans to the Associations, the Banks typically operate with more leverage and lower earnings than would be expected from a retail bank.

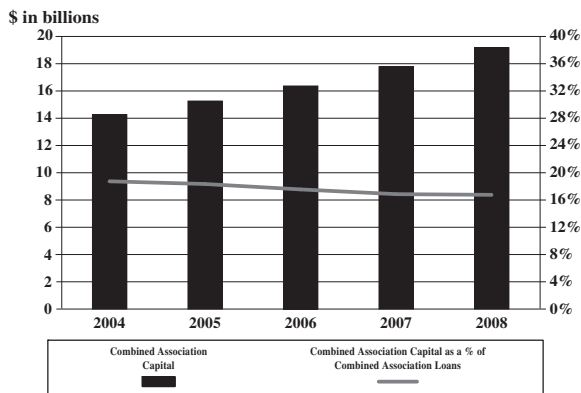
Accumulated other comprehensive loss at the combined Bank-only level grew \$918 million to \$1.153 billion for 2008, as a result of an increase of \$897 million in net unrealized losses on available-for-sale investments

held by the Banks. As previously discussed, the market value of available-for-sale investments securities was negatively impacted by reduced liquidity and increased credit risk in the financial markets during 2008.

Over the past five years, a substantial portion of income earned at the Bank level has been passed on to the Associations through patronage distributions. Bank capital increased \$2.030 billion since December 31, 2004 and \$371 million since December 31, 2007 to \$9.466 billion at December 31, 2008. The Banks recorded net income of \$1.175 billion in 2008, retaining \$422 million after patronage distributions and preferred stock dividends were paid.

For combining Bank-only information, see Note 21 to the accompanying combined financial statements.

*Association Capital*  
**Combined Association Capital and  
Combined Association Capital as a Percentage  
of Combined Association Loans  
as of December 31,**



Combined Association capital increased \$4.897 billion since December 31, 2004 and \$1.344 billion since December 31, 2007 to \$19.071 billion at December 31, 2008. The growth in Association capital during 2008 resulted primarily from income earned and retained. Combined Associations recorded \$1.924 billion of net income in 2008, retaining \$1.364 billion after patronage distributions, as compared with \$1.929 billion of net income in 2007 with \$1.329 billion retained after patronage distributions.

Combined Association capital as a percentage of combined Association loans decreased slightly to 16.7% at December 31, 2008 from 16.8% at December 31, 2007. Individual Association capital as a

percentage of risk-adjusted assets ranged from 10.1% to 27.5% at December 31, 2008, as compared with 10.7% to 30.9% at December 31, 2007. (See “FCA Capital Requirements” for additional information.)

### *Economic Capital*

The System’s capital management framework is intended to ensure there is sufficient capital to support the underlying risks of its business activities, exceed all regulatory capital requirements, and achieve certain capital adequacy objectives. The Banks have implemented economic capital software, methodologies, and assumptions to quantify the capital requirements related to the Bank’s primary areas of risk. Each Bank periodically quantifies its economic capital requirements, based on the credit risk, interest rate risk, operational risk, and market risk inherent in its operations. Due to the evolving nature of economic capital, we anticipate the methodologies and assumptions will continue to be refined.

Economic capital is a measure of risk and is defined as the amount of capital required to absorb potential unexpected losses resulting from extremely severe events over a one-year time period.

- “Unexpected losses” are the difference between potential extremely severe losses and the expected (average) loss over a one-year time period.
- The amount of economic capital required is based on each Bank’s risk profile and a targeted solvency standard. For economic capital modeling purposes, each Bank has targeted an “AA” solvency standard, which equates to a 99.97% confidence level. This means the likelihood of incurring losses in excess of the required economic capital amount is estimated to be similar to the likelihood of an “AA” rated bond defaulting (0.03% probability).

Below is a brief description of the four types of risk to which the Banks attribute economic capital:

- **Credit Risk** — The risk that borrowers or counterparties default on their financial obligations.
- **Interest Rate Risk** — The risk generated from changes in interest rates.
- **Operational Risk** — The risk of loss resulting from inadequate or failed internal processes or systems, human factors, or changes in the competitive environment.

- **Market and Other Risk** — Exposures related to asset residual values affiliated with leasing activity and other areas of risk.

These risks are measured and aggregated by each Bank to estimate the exposure to potential extremely severe events and any impact to its level or composition of capital.

The Banks utilize economic capital software, including similar conceptual designs and modeling methodologies. Methodologies and assumptions used in measuring economic capital were jointly developed by Bank risk management and financial management personnel, in consultation with industry experts. The Bank modeling considers the economic capital requirements of its affiliated Associations, through the evaluation of the Associations’ retail credit risk, operational risk, and interest rate risk. An economic capital shortfall (which is the difference between available capital and required economic capital) at any Association is included in the related Bank’s economic capital requirements. The Bank models are calibrated to achieve a standard of default protection equivalent to an “AA” rated institution. At December 31, 2008 and 2007, each Bank’s capital position exceeded its calculated economic capital requirements.

### *Credit Risk Capital*

The primary component of the economic capital requirement is credit risk capital. Credit risk arises from the potential inability of an obligor to meet its repayment obligation and exists in our outstanding loans, letters of credit, unfunded loan commitments, investment portfolios, and derivative counterparty credit exposures.

Credit risk capital requirements are based on the risk profile of the borrower or counterparty, repayment sources (including non-farm income), the nature of underlying collateral, and other support, given current events and conditions. Our credit risk ratings process uses a two-dimensional loan rating structure, incorporating a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default, as described in the “Risk Management — Credit Risk Management” section of Management’s Discussion and Analysis.

In assigning credit risk capital, the Bank’s economic capital models consider retail borrower probability of default, loss given default, and portfolio concentrations. Other principal drivers of credit risk that differentiate capital allocation include exposure at

default, asset maturity, and asset and inter-commodity correlations. The Banks have developed standards for probability of borrower default and loss given default, based on Moody's Investor Service's external benchmarks. Historical USDA data was used to determine asset and inter-commodity correlations.

#### Interest Rate Risk Capital

Another significant component of the economic capital requirement is interest rate risk capital. Interest rate risk is the risk of loss of future earnings or long-term value that may result from changes in interest rates. The adverse change in interest rates may be in the form of yield curve risk, repricing risk, option risk or basis risk, as described in the "Risk Management — Interest Rate Risk Management" section of Management's Discussion and Analysis.

The amount of capital attributed by the Banks for interest rate risk is based on potential changes in Bank market value of equity, calculated under randomly generated interest rate scenarios. All Banks utilize widely accepted, third party models to quantify their interest rate risk and related risk capital requirements.

#### Operational Risk Capital

Another component of the economic capital requirement is operational risk capital. Operational risk for the Banks results primarily from event risk and/or business risk. Event risk is the risk of loss resulting from inadequate or failed internal processes or systems, human factors, and external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and the risk of fraud by employees or persons outside the System. Business risk is the risk of loss due to changes in the competitive environment or events that damage the franchise or operating economics of the business.

Each Bank's approach to quantifying operational risk capital is based on the capital of non-financial companies with similar business risks. These non-financial companies hold capital primarily for operational risk. Their level of capital and credit rating yields an inferred estimate of the level of capital to be held for operational risk. Capital as a percentage of non-interest expense is the primary methodology used in determining operational risk capital.

#### Market and Other Risk Capital

For certain Banks, market risk is a component of the economic capital requirement and arises primarily

from the volatility in the residual value of leased assets at the maturity of lease contracts. Other areas of risk in which the Banks may have exposure are structural, liquidity, and political risk. Capital is not specifically attributed for these risks. Some of the excess capital of the Banks is held for "Other Risks."

#### *Capital Adequacy Plans*

Each System institution also maintains a capital adequacy plan that addresses its capital targets in relation to its risks. The capital adequacy plan assesses the capital level and composition necessary to assure financial viability and to provide for growth. The plans are updated at least annually and are approved by the institution's board of directors. At a minimum, the plans consider the following factors in determining optimal capital levels:

- asset quality and the adequacy of the allowance for loan losses to absorb potential loss within the loan portfolio,
- quality and quantity of earnings,
- sufficiency of liquid funds,
- capability of management and the quality of operating policies, procedures, and internal controls,
- needs of an institution's customer base, and
- other risk-oriented activities, such as funding and interest rate risks, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities and other conditions warranting additional capital.

In addition, as discussed below, each Bank has a regulatory minimum for the net collateral ratio of 103%. Under the Market Access Agreement, the minimum established is 104%. Because the minimum net collateral ratio generally would be breached before any of the other minimum capital requirements, the Banks closely monitor the level of the net collateral ratio.

#### *FCA Capital Requirements*

The Farm Credit Administration sets minimum regulatory capital requirements for Banks and Associations. The Farm Credit Administration's capital regulations require that the Banks and Associations achieve and maintain permanent capital of at least seven percent of risk-adjusted assets. In addition, Farm Credit Administration regulations require that: (1) all

System institutions achieve and maintain a total surplus ratio of at least seven percent of risk-adjusted assets and a core surplus ratio of at least three and one-half percent of risk-adjusted assets and (2) all Banks

achieve and maintain a net collateral ratio of at least 103%. At December 31, 2008, all System institutions maintained ratios in excess of these standards as follows:

<u>System Institutions</u>	<u>Permanent Capital Ratio</u>	<u>Total Surplus Ratio</u>	<u>Core Surplus Ratio**</u>	<u>Net Collateral Ratio</u>
Banks*	14.0% — 18.9%	11.3% — 17.1%	6.4% — 11.0%	104.6% — 107.7%
Associations	10.1% — 27.5%	9.6% — 27.1%	8.2% — 25.6%	Not Applicable
Regulatory minimum required	7.0%	7.0%	3.5%	103%***

\* See Note 21 for each Bank's permanent capital ratio and net collateral ratio at December 31, 2008 and 2007.

\*\* The Farm Credit Administration determined that one Bank may include a significant portion of its capital stock and participation certificates in its core surplus, subject to certain conditions, on a temporary basis that would likely continue until the earlier of December 31, 2012 or when the Farm Credit Administration promulgates a final capital rule that would be inconsistent with this treatment. As part of this determination, the Farm Credit Administration also imposed a requirement that the core surplus ratio be calculated excluding capital stock and participation certificates and established a 3.0% minimum for this ratio.

\*\*\* In connection with preferred stock and subordinated debt offerings, certain Banks are required by the Farm Credit Administration to maintain a minimum net collateral ratio of 104%.

### *Insurance Fund*

An additional layer of protection for Systemwide Debt Security holders is the Insurance Fund that insures the timely payment of principal and interest on these securities. The primary sources of funds for the Insurance Fund are:

- premiums paid by the Banks, the cost of which may be passed on to the Associations, and
- earnings on assets in the Insurance Fund.

The Insurance Corporation's primary purpose is to insure the timely payment of principal and interest on Systemwide Debt Securities. In the event a Bank is unable to timely pay Systemwide Debt Securities for which the Bank is primarily liable, the Insurance Corporation must expend amounts in the Insurance Fund to the extent necessary to insure the timely payment of principal and interest on the debt obligations. However, the Insurance Corporation also has certain discretionary authorities to assist System institutions under specified circumstances, and as a result, there is no assurance that amounts in the Insurance Fund will be available and sufficient to fund the timely payment of principal and interest on Systemwide Debt Securities in the event a Bank is unable to make timely payment.

Due to the restricted use of funds in the Insurance Fund, it has been included as a restricted asset and as restricted capital in the System's combined financial statements. As of December 31, 2008, the assets in the Insurance Fund totaled \$2.915 billion. The aggregate amounts of additions to the Insurance Fund and the related transfers from surplus to restricted capital were

\$316 million in 2008, \$287 million in 2007 and \$250 million in 2006. (See Note 7 to the accompanying combined financial statements and the Supplemental Combining Information on pages F-44 through F-46 for combining statements of condition and income that illustrate the impact of including the Insurance Fund in the System's combined financial statements.)

Premiums are due until the assets in the Insurance Fund for which no specific use has been identified or designated reach the "secure base amount." The Farm Credit Act, as amended by the 2008 Farm Bill, requires the secure base amount to be maintained at 2% of aggregate outstanding insured debt (adjusted to reflect the reduced risk on loans or investments guaranteed by the U.S. or state governments) or such other percentage of aggregate outstanding insured debt as the Insurance Corporation in its sole discretion determines to be actuarially sound. Insurance premiums are established by the Insurance Corporation with the objective of maintaining the secure base amount at the level required by the Farm Credit Act. In accordance with the 2008 Farm Bill, at December 31, 2008, when calculating the secure base amount as a percentage of adjusted outstanding insured debt, insured debt was adjusted for the reduced risk of loans and investments guaranteed by the U.S. or state governments, which has the effect of increasing the Insurance Fund as a percentage of adjusted outstanding insured debt. Prior to the 2008 Farm Bill, U.S. guaranteed loans were deducted but not U.S. guaranteed investments. At December 31, 2008, 2007 and 2006, as determined by the Insurance Corporation, the assets in the Insurance Fund for which no specific use has been identified or

designated were 1.77%, 1.68%, and 1.72% of aggregate insured obligations. With the Allocated Insurance Reserve Accounts, the Insurance Fund was 1.80%, 1.71% and 1.75% of aggregate insured obligations at December 31, 2008, 2007 and 2006.

The 2008 Farm Bill increased the statutory maximum premium level to 20 basis points and changed the basis for the assessment of premiums from loan volume to adjusted insured debt. An additional 10 basis points can be charged on average nonaccrual loan volume and other-than-temporarily impaired investments. In January 2009, the Insurance Corporation reviewed the level of the secure base amount and determined that it would assess the statutory maximum premiums of 20 basis points on adjusted insured debt and an additional 10 basis points on the average principal outstanding for nonaccrual loans and on the average amount outstanding for any other-than-temporarily impaired investments. For an additional discussion on the Insurance Fund and the Allocated Insurance Reserve Accounts, see Note 7 to the accompanying combined financial statements.

#### *Joint and Several Liability*

The provisions of joint and several liability of the Banks with respect to Systemwide Debt Securities would be invoked if the available amounts in the Insurance Fund were exhausted. Once joint and several liability is triggered, the Farm Credit Administration is required to make "calls" to satisfy the liability first on all non-defaulting Banks in the proportion that each non-defaulting Bank's available collateral (collateral in excess of the aggregate of the Bank's collateralized obligations) bears to the aggregate available collateral of all non-defaulting Banks. If these calls do not satisfy the liability, then a further call would be made in proportion to each non-defaulting Bank's remaining assets. On making a call on non-defaulting Banks with respect to a Systemwide Debt Security issued on behalf of a defaulting Bank, the Farm Credit Administration is required to appoint the Insurance Corporation as the receiver for the defaulting Bank, and the receiver must expeditiously liquidate the Bank.

#### *Operational Risk Management*

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches

of the internal control system and the risk of fraud by employees or persons outside the System. Each Bank's and Association's board of directors is required, by regulation, to adopt an internal control policy that provides adequate direction to the institution in establishing effective control over and accountability for operations, programs and resources. The policy must include, at a minimum, the following items:

- direction to management that assigns responsibility for the internal control function to an officer of the institution,
- adoption of internal audit and control procedures,
- direction for the operation of a program to review and assess its assets,
- adoption of loan, loan-related assets and appraisal review standards, including standards for scope of review selection and standards for work papers and supporting documentation,
- adoption of asset quality classification standards,
- adoption of standards for assessing credit administration, including the appraisal of collateral, and
- adoption of standards for the training required to initiate a program.

In general, System institutions address operational risk through the organization's internal framework under the supervision of the internal auditors. Exposure to operational risk is typically identified with the assistance of senior management and internal audit plans developed with higher risk areas receiving more review.

#### *Political Risk Management*

System institutions are instrumentalities of the federal government and are intended to further governmental policy concerning the extension of credit to or for the benefit of agricultural and rural America. The System and its borrowers may be significantly affected by federal legislation that affects the System directly, such as changes to the Farm Credit Act, or indirectly, such as agricultural appropriations bills. Political risk to the System is the risk of loss of support for the System or agriculture by the U.S. government.

We manage political risk by actively supporting The Farm Credit Council, which is a full-service, federated trade association located in



Washington, D.C. representing the System before Congress, the Executive Branch, and others. The Council provides the mechanism for “grassroots” involvement in the development of System positions and policies with respect to federal legislation and government actions that impact the System. In addition, each District has a District Farm Credit Council that is a regional trade association dedicated to promoting the interests of cooperative farm lending institutions and their borrowers in the District.

### **Other Matters**

On September 30, 2008, the five System Banks invested \$60 million in aggregate in senior cumulative perpetual preferred stock of Farmer Mac. Dividends on the preferred stock are cumulative and are payable quarterly, in cash, at an annual interest rate of 10%, increasing by 2% in each of the first three years, up to a maximum of 16%. The preferred stock is callable at par value after nine months, and on any quarterly dividend date thereafter, and accounted for under the cost method. Additionally, the stock is redeemable in whole by Farmer Mac beginning nine months after the date of issuance with cash or certain qualifying assets. Farmer Mac used the net proceeds from the preferred stock sale to strengthen its capital position and comply with its minimum regulatory capital requirements, thereby promoting the steady and dependable flow of capital to rural America. (For additional information regarding Farmer Mac, see page 12 in the *Annual Information Statement — 2008*.)

### **Regulatory Matters**

During 2008, the Farm Credit Administration took no enforcement actions against System institutions. There were no enforcement actions in effect for the Banks or Associations at December 31, 2008.

On October 31, 2007, the Farm Credit Administration published an advance notice of proposed rulemaking in the Federal Register with respect to the consideration of possible modifications to the Farm Credit Administration’s risk-based capital rules for Farm Credit System institutions that are similar to the standardized approach delineated in the Basel II Framework. The Farm Credit Administration sought comments to facilitate the development of a proposed rule that would enhance its regulatory capital framework and more closely align minimum capital requirements with risks taken by System institutions. Comments on the advance notice of proposed rulemaking were due no later than December 31, 2008.

The System submitted a comment letter to the Farm Credit Administration on this proposed rulemaking.

On June 16, 2008, the Farm Credit Administration published a proposed rule in the Federal Register that would authorize Banks, Associations or service corporations to invest in rural communities, i.e., communities that have fewer than 50,000 residents and are outside of an urbanized area, under certain conditions. The proposed rule would authorize two types of rural community investments: (1) investment in debt securities that would involve projects or programs that benefit the public in rural communities, and (2) equity investment in venture capital funds, which funds create economic opportunities and jobs in rural communities by providing capital to small or start-up businesses. Under the proposed rule, these investments would be limited to 150% of the institution’s total surplus. The comment period closed August 15, 2008.

In November 2008, the Farm Credit Administration adopted the Market Emergency Standby Resolution. The resolution authorizes a waiver of the liquidity reserve requirement whenever a financial, economic, agricultural, or national defense emergency is deemed to exist. After certain conditions are met and the resolution goes into effect, the resolution temporarily allows the Banks to fund their assets with discount notes even if doing so would cause the liquidity reserve of one or more of the Banks to drop below the regulatory minimum. The resolution grants the Banks a temporary waiver, subject to certain conditions, of the liquidity reserve requirement for no more than 14 calendar days. It also contemplates that any affected Bank would develop a plan for quickly restoring its liquidity reserve to the minimum regulatory level.

### **Recently Adopted or Issued Accounting Pronouncements**

In October 2008, the Financial Accounting Standards Board (FASB) issued Staff Interpretation (FSP) No. 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active.” This FSP clarifies the application of FASB Statement No. 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. It became effective upon issuance, and included prior periods for which financial statements have not been issued. Revisions resulting from a change in valuation techniques or their application shall be

accounted for as a change in accounting estimate. The System has considered the interpretation in determining the fair value of its financial assets at December 31, 2008.

In February 2008, the FASB issued FSP No. 157-2, "Effective Date of FASB Statement No. 157." This FSP delayed the effective date of the Statement for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008. The System is currently evaluating the impact of adoption on the System's financial condition and results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, "Disclosures about Derivative Instruments and Hedging Activities," which amends and expands the

disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under this Statement and related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The adoption of this Statement will result in additional disclosures and not have an impact on our financial condition or results of operations.

**INDEX TO COMBINED FINANCIAL STATEMENTS AND  
SUPPLEMENTAL COMBINING AND FINANCIAL INFORMATION**

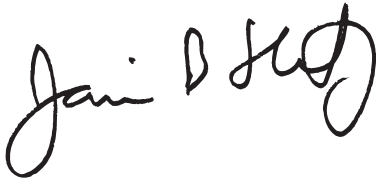
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## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The System's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the System's combined financial statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the System's principal executives and principal financial officers, or persons performing similar functions, and effected by the System's boards of directors, managements and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the System's combined financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and 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 System, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the System are being made only in accordance with authorizations of managements and directors of the System, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the System's assets that could have a material effect on the System's combined financial statements.

The Funding Corporation's management has completed an assessment of the effectiveness of the System's internal control over financial reporting as of December 31, 2008. In making the assessment, Funding Corporation's management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Funding Corporation concluded that as of December 31, 2008, the System's internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Funding Corporation determined that there were no material weaknesses in the System's internal control over financial reporting as of December 31, 2008.



Jamie B. Stewart, Jr.  
President and CEO  
Funding Corporation



H. John Marsh, Jr.  
Managing Director — Financial  
Management Division  
Funding Corporation

## REPORT OF INDEPENDENT AUDITORS

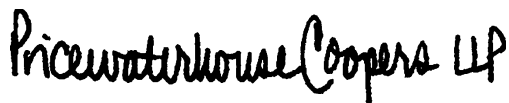
TO THE BOARDS OF DIRECTORS  
OF THE FARM CREDIT SYSTEM:

In our opinion, the accompanying combined statements of condition and the related combined statements of income, of changes in capital and of cash flows appearing on pages F-4 through F-43 of this Annual Information Statement present fairly, in all material respects, the financial position of the Farm Credit System (the System) at December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the System maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The System's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Report on Internal Control over Financial Reporting appearing on page F-2 of this Annual Information Statement. Our responsibility is to express opinions on these financial statements and on the System's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with generally accepted auditing standards established by the Auditing Standards Board (United States) and in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Our audits were conducted for the purpose of forming an opinion on the basic combined financial statements taken as a whole. The supplemental combining information on pages F-44 through F-51 of this Annual Information Statement is presented for purposes of additional analysis and is not a required part of the basic combined financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company'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 misstatements. Also, projections of any evaluation 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.



PRICEWATERHOUSECOOPERS LLP

New York, NY  
February 27, 2009

**FARM CREDIT SYSTEM**  
**COMBINED STATEMENT OF CONDITION**  
(in millions)

	December 31,	
	2008	2007
<b>ASSETS</b>		
Cash . . . . .	\$ 3,758	\$ 718
Federal funds sold and securities purchased under resale agreements . . . . .	1,029	1,907
Investments (Note 3)		
Available-for-sale (amortized cost of \$35,660 and \$30,588, respectively) . . . . .	34,556	30,378
Mission-related and other held-to-maturity (fair value of \$3,890 and \$2,773, respectively) . . . . .	3,876	2,774
Mission-related and other available-for-sale (amortized cost of \$576 and \$675, respectively) . . . . .	588	683
Loans (Note 4) . . . . .	161,423	142,906
Less: allowance for loan losses (Note 4) . . . . .	(936)	(781)
Net loans . . . . .	160,487	142,125
Accrued interest receivable . . . . .	1,970	2,013
Premises and equipment (Note 5) . . . . .	605	552
Other assets (Notes 6, 13, 14 and 15) . . . . .	4,569	2,702
Restricted assets (Note 7) . . . . .	2,915	2,599
Total assets . . . . .	\$214,353	\$186,451
 <b>LIABILITIES AND CAPITAL</b>		
Systemwide Debt Securities		
Due within one year:		
Systemwide discount notes . . . . .	\$ 16,105	\$ 19,660
Systemwide bonds and medium-term notes . . . . .	49,617	37,374
	65,722	57,034
Due after one year:		
Systemwide bonds and medium-term notes . . . . .	112,643	97,409
Total Systemwide Debt Securities (Notes 8 and 9) . . . . .	178,365	154,443
Subordinated debt (Note 10) . . . . .	1,050	500
Other bonds (Note 9) . . . . .	1,404	852
Notes payable and other interest-bearing liabilities . . . . .	484	469
Accrued interest payable . . . . .	1,322	1,448
Other liabilities (Notes 6, 13, 14 and 15) . . . . .	4,379	2,095
Mandatorily redeemable preferred stock (Note 11) . . . . .	225	225
Total liabilities . . . . .	187,229	160,032
Commitments and contingencies (Notes 4, 15 and 19)		
Capital		
Preferred stock (Note 12) . . . . .	1,771	1,525
Capital stock and participation certificates (Note 12) . . . . .	1,423	1,357
Restricted capital (Notes 7 and 12) . . . . .	2,915	2,599
Accumulated other comprehensive loss, net of tax (Notes 3, 12, 13 and 17) . . . . .	(2,133)	(543)
Allocated surplus (Note 12) . . . . .	1,591	1,437
Unallocated surplus (Note 12) . . . . .	21,557	20,044
Total capital . . . . .	27,124	26,419
Total liabilities and capital . . . . .	\$214,353	\$186,451

The accompanying notes are an integral part of these combined financial statements.

**FARM CREDIT SYSTEM**  
**COMBINED STATEMENT OF INCOME**  
(in millions)

	<u>For Year Ended December 31,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest income			
Investments, Federal funds sold and securities purchased under resale agreements . . . . .	\$ 1,554	\$ 1,911	\$1,589
Loans . . . . .	<u>9,268</u>	<u>9,511</u>	<u>8,021</u>
Total interest income . . . . .	<u>10,822</u>	<u>11,422</u>	<u>9,610</u>
Interest expense			
Systemwide bonds and medium-term notes . . . . .	5,598	6,370	5,291
Systemwide discount notes . . . . .	421	895	666
Subordinated debt . . . . .	48	17	
Other interest-bearing liabilities . . . . .	<u>53</u>	<u>80</u>	<u>69</u>
Total interest expense . . . . .	<u>6,120</u>	<u>7,362</u>	<u>6,026</u>
Net interest income . . . . .	4,702	4,060	3,584
Provision for loan losses . . . . .	<u>(408)</u>	<u>(81)</u>	<u>(35)</u>
Net interest income after provision for loan losses . . . . .	<u>4,294</u>	<u>3,979</u>	<u>3,549</u>
Noninterest income			
Fees for financially related services . . . . .	265	180	120
Loan-related fee income . . . . .	148	115	110
Income earned on Insurance Fund assets (Note 7) . . . . .	76	98	89
Losses on impairment of investments available-for-sale . . . . .	(82)	(5)	
Operating lease income . . . . .	44	42	42
Mineral income . . . . .	46	23	25
Gains on sales of investments and other assets, net . . . . .	11	1	3
Losses on extinguishment of debt . . . . .	(57)	(21)	(16)
Net (losses) gains on derivative and other transactions . . . . .	(2)		19
Other noninterest income . . . . .	<u>53</u>	<u>29</u>	<u>25</u>
Total noninterest income . . . . .	<u>502</u>	<u>462</u>	<u>417</u>
Noninterest expense			
Salaries and employee benefits (Note 13) . . . . .	1,068	1,009	956
Occupancy and equipment expense . . . . .	151	139	132
Purchased services . . . . .	117	105	92
Other operating expense . . . . .	379	344	325
Losses (gains) on other property owned . . . . .	5	(1)	(2)
Other noninterest expense . . . . .	<u>7</u>	<u>1</u>	<u>1</u>
Total noninterest expense . . . . .	<u>1,727</u>	<u>1,597</u>	<u>1,504</u>
Income before income taxes . . . . .	3,069	2,844	2,462
Provision for income taxes (Note 14) . . . . .	<u>(153)</u>	<u>(141)</u>	<u>(83)</u>
Net income . . . . .	<u>\$ 2,916</u>	<u>\$ 2,703</u>	<u>\$2,379</u>

The accompanying notes are an integral part of these combined financial statements.

**FARM CREDIT SYSTEM**  
**COMBINED STATEMENT OF CHANGES IN CAPITAL**  
(in millions)

	Preferred Stock	Capital Stock and Participation Certificates	Restricted Capital Farm Credit Insurance Fund	Accumulated Other Comprehensive Income (Loss)	Allocated Surplus	Unallocated Surplus	Total Capital
Balance at December 31, 2005 . . . . .	\$1,017	\$1,333	\$2,062	\$ (242)	\$1,280	\$17,324	\$22,774
Comprehensive income							
Net income . . . . .						2,379	2,379
Change in unrealized losses on investments available-for-sale, including reclassification adjustments of \$1 . . . . .				36			36
Change in unrealized losses on cash flow hedges, including reclassification adjustments of \$23 . . . . .				8			8
Minimum pension liability adjustment . . . . .				44			44
Income tax related to other comprehensive income . . . . .				(9)			(9)
Total comprehensive income . . . . .				<u>79</u>		<u>2,379</u>	<u>2,458</u>
Transfer of Insurance Fund premiums and other income from surplus to restricted capital — Farm Credit Insurance Fund . . . . .			250			(250)	
Preferred stock retired, net by Associations . . . . .	(14)						(14)
Preferred stock dividends . . . . .						(72)	(72)
Capital stock and participation certificates issued . . . . .		99					99
Capital stock and participation certificates retired . . . . .		(171)					(171)
Patronage:							
Cash . . . . .					(142)	(502)	(644)
Capital stock, participation certificates and surplus allocations . . . . .		63			153	(216)	
Balance at December 31, 2006 . . . . .	<u>1,003</u>	<u>1,324</u>	<u>2,312</u>	<u>(163)</u>	<u>1,291</u>	<u>18,663</u>	<u>24,430</u>
Comprehensive income							
Net income . . . . .						2,703	2,703
Change in unrealized losses on investments available-for-sale, including reclassification adjustments of \$3 . . . . .				(69)			(69)
Change in unrealized losses on cash flow hedges, including reclassification adjustments of \$18 . . . . .				2			2
Minimum pension liability adjustment . . . . .				8			8
Income tax related to other comprehensive income . . . . .				(9)			(9)
Total comprehensive income . . . . .				<u>(68)</u>		<u>2,703</u>	<u>2,635</u>
Adjustment to initially apply FASB Statement No. 158, net of tax . . . . .				(312)			(312)
Transfer of Insurance Fund premiums and other income from surplus to restricted capital — Farm Credit Insurance Fund . . . . .			287			(287)	
Preferred stock issued by Banks . . . . .	475					(7)	468
Preferred stock issued, net by Associations . . . . .	47						47
Preferred stock dividends . . . . .						(94)	(94)
Capital stock and participation certificates issued . . . . .		74					74
Capital stock and participation certificates retired . . . . .		(122)					(122)
Patronage:							
Cash . . . . .					(136)	(571)	(707)
Capital stock, participation certificates and surplus allocations . . . . .		81			282	(363)	
Balance at December 31, 2007 . . . . .	<u>1,525</u>	<u>1,357</u>	<u>2,599</u>	<u>(543)</u>	<u>1,437</u>	<u>20,044</u>	<u>26,419</u>
Adjustment to beginning balance due to the SFAS No. 158 accounting change . . . . .						(15)	(15)
Balance at January 1, 2008 . . . . .	<u>1,525</u>	<u>1,357</u>	<u>2,599</u>	<u>(543)</u>	<u>1,437</u>	<u>20,029</u>	<u>26,404</u>
Comprehensive income							
Net income . . . . .						2,916	2,916
Change in unrealized losses on investments available-for-sale, including reclassification adjustments of \$79 . . . . .				(889)			(889)
Change in unrealized losses on cash flow hedges, including reclassification adjustments of \$12 . . . . .				(38)			(38)
Change in pension and postretirement benefit plans, including reclassification adjustments of \$7 . . . . .				(738)			(738)
Income tax related to other comprehensive income . . . . .				75			75
Total comprehensive income (loss) . . . . .				<u>(1,590)</u>		<u>2,916</u>	<u>1,326</u>
Transfer of Insurance Fund premiums and other income from surplus to restricted capital — Farm Credit Insurance Fund . . . . .			316			(316)	
Preferred stock issued by Banks . . . . .	200					(2)	198
Preferred stock issued, net by Associations . . . . .	46						46
Preferred stock dividends . . . . .						(112)	(112)
Capital stock and participation certificates issued . . . . .		82					82
Capital stock and participation certificates retired . . . . .		(110)					(110)
Patronage:							
Cash . . . . .					(121)	(589)	(710)
Capital stock, participation certificates and surplus allocations . . . . .		94			275	(369)	
Balance at December 31, 2008 . . . . .	<u>\$1,771</u>	<u>\$1,423</u>	<u>\$2,915</u>	<u>\$(2,133)</u>	<u>\$1,591</u>	<u>\$21,557</u>	<u>\$27,124</u>

The accompanying notes are an integral part of these combined financial statements.



**FARM CREDIT SYSTEM**  
**COMBINED STATEMENT OF CASH FLOWS**  
(in millions)

	<b>For the Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities</b>			
Net income	\$ 2,916	\$ 2,703	\$ 2,379
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	408	81	35
Depreciation and amortization on premises and equipment	77	74	70
Gains on sales of investments, net and other assets	(11)	(1)	(3)
Losses on impairment of investments available-for-sale	82	5	
Accretion on mission-related and other investments held-to-maturity	2	2	(1)
Income on Insurance Fund assets, net of operating expenses	(73)	(96)	(86)
Decrease (increase) in accrued interest receivable	43	(174)	(434)
(Decrease) increase in other assets	(76)	188	(12)
Change in amortized discount on Systemwide discount notes	(34)		33
(Decrease) increase in accrued interest payable	(126)	133	372
Decrease in other liabilities	(193)	(356)	(88)
Net cash provided by operating activities	<u>3,015</u>	<u>2,559</u>	<u>2,265</u>
<b>Cash flows from investing activities</b>			
Increase in loans, net	(18,552)	(20,214)	(18,254)
Decrease in Federal funds sold and securities purchased under resale agreements, net	878	45	431
Investments available-for-sale:			
Purchases	(17,026)	(14,963)	(16,666)
Proceeds from maturities and payments	11,688	11,106	12,403
Proceeds from sales	189	1,138	163
Mission-related and other investments held-to-maturity:			
Purchases	(1,471)	(275)	(1,192)
Proceeds from maturities and payments	252	246	1,214
Mission-related and other investments available-for-sale:			
Purchases	(4)	(32)	
Proceeds from maturities and payments	99	131	82
Proceeds from sale		8	
Decrease (increase) in tobacco contract receivables, net	43	(3)	(341)
Premiums paid to the Insurance Fund	(191)	(164)	(49)
Purchases of premises and equipment, net of disposals	(130)	(100)	(98)
Proceeds from sales of other assets	32	23	14
Net cash used in investing activities	<u>(24,193)</u>	<u>(23,054)</u>	<u>(22,293)</u>
<b>Cash flows from financing activities</b>			
Systemwide bonds issued	110,976	65,830	47,168
Systemwide bonds and medium-term notes retired	(85,216)	(47,736)	(32,434)
Systemwide discount notes issued	407,874	418,646	339,803
Systemwide discount notes retired	(411,395)	(416,754)	(333,919)
Subordinated debt issued, net	547	497	
Other bonds issued (retired), net	552	16	(21)
Increase in notes payable and other interest-bearing liabilities, net	15	177	103
Increase in collateral held from derivative counterparties	1,336	88	
Protected borrower stock retired	(1)	(2)	(4)
Preferred stock issued by Banks	198	468	
Preferred stock issued by Associations	432	382	377
Preferred stock retired by Associations	(386)	(335)	(391)
Capital stock and participation certificates issued	82	74	99
Capital stock, participation certificates and surplus retired	(110)	(122)	(171)
Preferred stock dividends paid	(96)	(70)	(69)
Cash patronage paid	(590)	(514)	(445)
Net cash provided by financing activities	<u>24,218</u>	<u>20,645</u>	<u>20,096</u>
Net increase in cash	3,040	150	68
Cash at beginning of year	718	568	500
Cash at end of year	<u>\$ 3,758</u>	<u>\$ 718</u>	<u>\$ 568</u>
<b>Supplemental schedule of non-cash investing and financing activities:</b>			
Loans transferred to other assets	\$ 52	\$ 34	\$ 20
Property disposals through financed sales	(6)		(1)
Conversion of mission-related and other investments held-to-maturity to loans guaranteed by Farmer Mac	(115)		
Loans securitized and retained as mission-related and other held-to-maturity investments		676	470
Loans securitized and retained as mission-related and other available-for-sale investments			550
Transfer of mission-related and other held-to-maturity investments to mission-related and other available-for-sale investments		12	
Adjustments for minimum pension liability and FASB Statement No. 158		(304)	
Transfer of allowance for loan losses to other liabilities	154		6
<b>Supplemental non-cash fair value changes related to hedging activities:</b>			
Increase in Systemwide bonds and medium-term notes	1,717	827	260
Increase in other assets	(1,794)	(507)	(25)
Increase (decrease) in other liabilities	71	(320)	(235)
Increase in loans, net	(1)		
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid during the year for:			
Interest	6,281	7,229	5,621
Taxes	60	141	121

The accompanying notes are an integral part of these combined financial statements.

**FARM CREDIT SYSTEM**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**(dollars in millions, except as noted)**

**NOTE 1 — ORGANIZATION, OPERATIONS  
AND PRINCIPLES OF COMBINATION**

**Organization and Operations**

The Farm Credit System is a federally chartered network of borrower-owned lending institutions comprised of cooperatives and related service organizations. The System was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The Farm Credit Act provides authority for changes in the organizational structure and operations of the System and its entities.

At December 31, 2008, the System consisted of: (i) four Farm Credit Banks (AgFirst FCB; AgriBank, FCB; FCB of Texas; and U.S. AgBank, FCB) and their affiliated Associations, (ii) one Agricultural Credit Bank (CoBank, ACB) and its affiliated Associations, (iii) the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and (iv) various service and other organizations.

The Associations are cooperatives owned by their borrowers and the Farm Credit Banks are cooperatives primarily owned by their affiliated Associations. CoBank is a cooperative principally owned by cooperatives, other eligible borrowers and its affiliated Associations. Each Bank and Association manages and controls its own business activities, operations and financial performance. Each Bank and Association has its own board of directors and is not commonly owned or controlled.

A Bank and its affiliated Associations are financially and operationally interdependent as the Bank is statutorily required to serve as an intermediary between the financial markets and the retail lending activities of its affiliated Associations. The Banks are the primary source of funds for the Associations. Associations are not legally authorized to accept deposits and they may not borrow from other financial institutions without the approval of their affiliated Bank. The Banks are not authorized to accept deposits and they principally obtain their funds through the issuance of Systemwide Debt Securities. As a result, the loans made by the Associations are substantially funded by the issuance of Systemwide Debt Securities by the Banks. The repayment of Systemwide Debt Securities is dependent upon the ability of borrowers

to repay their loans from the Associations. In addition, CoBank makes retail loans and leases directly to cooperatives, rural utilities, and other eligible borrowers, and the Banks purchase retail loan participations from Associations and other lenders, including other System Banks. Therefore, the repayment of Systemwide Debt Securities is also dependent upon the ability of these retail borrowers to repay their loans.

As required by the Farm Credit Act, the System specializes in providing financing and related services to qualified borrowers in the agricultural and rural sectors and to certain related entities. The System makes credit available in all 50 states, the Commonwealth of Puerto Rico, and U.S. territories under conditions set forth in the Farm Credit Act, which provides both geographic and agricultural sector diversification.

The Banks and/or Associations jointly own several organizations that were created to provide a variety of services for the System. The Funding Corporation provides for the issuance, marketing and handling of Systemwide Debt Securities, using a network of investment banks and dealer banks, and prepares and distributes the Farm Credit System Quarterly and Annual Information Statements. The Farm Credit System Building Association is a partnership of the Banks that owns premises and other fixed assets that are leased to the Farm Credit Administration, the System's regulator.

The Farm Credit Leasing Services Corporation (Leasing Services Corporation), a wholly-owned subsidiary of CoBank, ACB, provides a variety of leasing programs primarily for agriculture-related equipment and facilities. Other leasing programs exist in the System through Associations and through alliances with non-System leasing companies.

Most System institutions provide financially related services to their customers, including credit, appraisal and mortgage life or disability insurance, crop insurance, estate planning, record keeping services, tax planning and preparation, and consulting.

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 pursuant to the Farm Credit Act to provide capital and other assistance to System institutions experiencing severe financial difficulty at that

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

time. The capital assistance was provided for through the issuance by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005. The Farm Credit Administration Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

The Farm Credit Act provided for the establishment of the Farm Credit System Insurance Corporation (Insurance Corporation). As more fully described in Note 7, the Farm Credit Insurance Fund (Insurance Fund) is under the direct control of the Insurance Corporation.

The Farm Credit Administration is delegated authority by Congress to regulate and examine the activities of the Banks, Associations and certain other System institutions. Accordingly, certain actions of System institutions are subject to the Farm Credit Administration's prior approval or regulations. The Farm Credit Administration has statutory enforcement and related authorities with respect to System institutions.

#### Principles of Combination

The accompanying System combined financial statements include the accounts of the Banks, the affiliated Associations, the Funding Corporation and the Insurance Fund and reflect the investments in, and allocated earnings of, the service organizations owned jointly by the Banks and/or Associations. The System combined financial statements include the equity investments of the Farm Credit System Building Association. All significant intra-System transactions and balances have been eliminated in combination. Combined financial statements of the System are presented because of the financial and operational interdependence of the Banks and Associations. Notwithstanding the presentation in the accompanying combined financial statements, the joint and several liability for Systemwide Debt Securities is limited to the Banks, as more fully described in Notes 9, 12 and 21.

#### NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Accounting Principles and Reporting Practices

The accounting and reporting policies of the System conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of combined financial statements in conformity with GAAP requires the managements of System institutions to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates are discussed in these footnotes, where applicable. Actual results could differ from those estimates. Certain amounts in prior years' combined financial statements have been reclassified to conform to the current year presentation.

##### Recently Issued or Adopted Accounting Pronouncements

In October 2008, the Financial Accounting Standards Board (FASB) issued Staff Interpretation (FSP) No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active." This FSP clarifies the application of FASB Statement No. 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. It became effective upon issuance, and included prior periods for which financial statements have not been issued. Revisions resulting from a change in valuation techniques or their application shall be accounted for as a change in accounting estimate. The System has considered the interpretation in determining the fair value of its financial assets at December 31, 2008.

In February 2008, the FASB issued FSP No. 157-2, "Effective Date of FASB Statement No. 157." This FSP delayed the effective date of the Statement for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008. The System is

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

currently evaluating the impact of adoption on the System's financial condition and results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, "Disclosures about Derivative Instruments and Hedging Activities," which amends and expands the disclosure requirements for derivative instruments and for hedging activities previously required by SFAS No. 133. It states that an entity with derivative instruments shall disclose information to enable users of the financial statements to understand: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under this Statement and related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The adoption of this Statement will result in additional disclosures and not have an impact on our financial condition or results of operations.

#### Cash

Cash, as included in the financial statements, represents cash on hand and deposits at banks.

#### Investments and Federal Funds

The Banks and Associations, as permitted under Farm Credit Administration regulations, hold eligible investments for the purposes of maintaining a liquidity reserve, managing short-term surplus funds, and managing interest rate risk. These investments are generally classified as available-for-sale and carried at fair value, and unrealized holding gains and losses are netted and reported as a separate component of capital. Changes in the fair value of these investments are reflected as direct charges or credits to other comprehensive income, unless the investment is deemed to be other than temporarily impaired. If impaired, the impairment loss is taken through earnings in the period of impairment and the amortized cost of the investment is written down to its fair value. Subsequent changes in the value of those securities that were

impaired would be recorded as unrealized gains or losses unless such losses are deemed to be other than temporarily impaired. All or a portion of the unrealized holding gain or loss of an available-for-sale security that is designated as a hedged item in a fair value hedge must be recognized in earnings during the period of the hedge. Gains and losses on the sales of investments available-for-sale are determined using the specific identification method. Neither the Banks nor the Associations hold investments for trading purposes.

Premiums and discounts are amortized or accreted into interest income over the term of the respective issues.

Banks and Associations may also hold additional investments in accordance with mission-related and other investment programs approved by the Farm Credit Administration. These programs allow Banks and Associations to make investments that further the System's mission to serve rural America. These investments are not included in the Banks' liquidity calculations and are not covered by the eligible investment limitations specified by the Farm Credit Administration regulations. Mortgage-backed securities issued by Farmer Mac are considered other investments and are also excluded from the limitation and the Banks' liquidity calculations. Mission-related and other investments for which the System institution has the intent and ability to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for the amortization of premiums and accretion of discounts. Farmer Mac investments are classified either as held-to-maturity or available-for-sale depending on the institution's ability and intent to hold the investment to maturity.

#### Loans and Allowance for Loan Losses

Loans are generally carried at their principal amount outstanding adjusted for charge-offs, deferred loan fees or costs, and valuation adjustments relating to hedging activities. Loan origination fees and direct loan origination costs are capitalized, on a combined System basis, and the net fee or cost is amortized over the life of the related loan as an adjustment to interest income. Loan prepayment fees are reported in interest income. Interest on loans is accrued and credited to

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

interest income based on the daily principal amount outstanding.

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the original contractual terms. Impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the fair value of the collateral, if the loan is collateral dependent. Impaired loans also include those restructured loans whose terms have been modified and on which concessions have been granted because of borrower financial difficulties.

Impaired loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or when circumstances indicate that collection of principal and interest is in doubt. Additionally, all loans over 180 days past due are placed in nonaccrual status. When a loan is placed in nonaccrual status, accrued interest that is considered uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

When loans are in nonaccrual status, interest payments received in cash are generally recognized as interest income if the collectibility of the loan principal is fully expected and certain other criteria are met. Otherwise, payments received on nonaccrual loans are applied against the recorded investment in the loan asset. Nonaccrual loans may be transferred to accrual status when principal and interest are current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs and collection of future payments is no longer in doubt.

The allowance for loan losses is maintained at a level considered adequate by managements to provide for probable and estimable losses inherent in the loan portfolios. The allowance for loan losses represents the aggregate of each System entity's individual evaluation of its allowance for loan losses requirements. Although aggregated in the combined financial statements, the allowance for loan losses of each System entity is particular to that institution and is not available to absorb losses realized by other System entities. The allowance is increased through provisions for loan

losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. The allowance is based on a periodic evaluation of the loan portfolio in which numerous factors are considered, including economic conditions, collateral values, borrowers' financial conditions, loan portfolio composition and prior loan loss experience.

The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the System's loans and their underlying security that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from System institutions' expectations and predictions of those circumstances. Managements consider the following factors in determining and supporting the levels of System institutions' allowances for loan losses: the System's concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences.

#### Premises and Equipment

Premises and equipment are carried at cost, less accumulated depreciation and amortization, which is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expenses and improvements are capitalized.

#### Other Assets

In connection with past foreclosure and sale proceedings, some Banks and Associations continue to retain certain mineral interests and equity positions in land from which revenues are received in the form of lease bonuses, rentals and leasing and production royalties. These intangible assets are recorded at nominal or no value in the Combined Statement of Condition. The Farm Credit Act requires that mineral rights acquired through foreclosure in 1986 and later years be sold to the buyer of the land surface rights.

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

Other property owned, which is held for sale, consists of real and personal property acquired through collection actions and is recorded at fair value at acquisition less estimated selling costs. Revised estimates of the fair value less estimated selling costs are reported as adjustments to the carrying amount of the asset, provided that the adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations, adjustments to carrying amount and realized gains and losses from dispositions of the properties are included in other noninterest expense.

#### Employee Benefit Plans

Substantially all employees of System institutions participate in various retirement plans. System institutions generally provide defined benefit and/or defined contribution retirement plans for their employees. For financial reporting purposes, System institutions use the projected unit credit actuarial method for defined benefit retirement plans.

The Banks and Associations provide certain healthcare and life insurance benefits to eligible retired employees. Employees of System institutions may become eligible for those benefits if they reach normal retirement age while working for the institution. Statement of Financial Accounting Standard No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires the accrual of the expected cost of providing postretirement benefits other than pensions (primarily healthcare benefits) to an employee and an employee's beneficiaries and covered dependents during the years that the employee renders service necessary to become eligible for these benefits.

#### Income Taxes

The Farm Credit Banks, certain Associations, and the income related to the Insurance Fund are exempt from federal and other income taxes as provided in the Farm Credit Act. CoBank, certain other Associations and service organizations are not exempt from federal and certain other income taxes. Taxable institutions are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Under specified conditions, these cooperatives can exclude from taxable income amounts

distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. System institutions whose patronage distributions are based on book income recognize the tax effect of all temporary differences based on the assumption that these temporary differences are retained by the institution and will therefore impact future tax payments. Certain taxable System institutions have provided a valuation allowance for deferred tax assets to the extent that it is more likely than not that the deferred tax assets will not be realized.

Deferred income taxes have not been provided by the taxable Associations on pre-1993 earnings from their related Bank when management's intent is to permanently invest these undistributed earnings in the Bank and to indefinitely postpone their conversion to cash, or if distributed by the related Bank, to pass these earnings through to Association borrowers through qualified patronage allocations.

Deferred income taxes have not been provided for the Banks' post-1992 earnings allocated to taxable Associations to the extent that the earnings will be passed through to Association borrowers through qualified patronage allocations. No deferred income taxes have been provided for the Banks' post-1992 unallocated earnings. The Banks currently have no plans to distribute unallocated Bank earnings and do not contemplate circumstances that, if distributions were made, would result in taxes being paid at the Association level.

#### Derivative Products and Hedging Activity

The Banks are party to derivative financial products, primarily interest rate swaps, which are principally used to manage interest rate risk on assets, liabilities, anticipated transactions and firm commitments. Derivatives are recorded on the combined statement of condition as assets or liabilities, measured at fair value.

Changes in the fair value of a derivative are recorded in current period earnings or accumulated other comprehensive income (loss) depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions, which

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

hedge changes in the fair value of assets, liabilities, or firm commitments, changes in the fair value of the derivative are reflected in current period earnings and are generally offset by changes in the hedged item's fair value. For cash-flow hedge transactions, which hedge the variability of future cash flows related to a floating-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative are deferred and reported in accumulated other comprehensive income (loss). The gains and losses on the derivative that are deferred and reported in accumulated other comprehensive income (loss) are reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recorded in current period earnings. For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings.

Each Bank formally documents all relationships between hedging instruments and hedged items, as well as the risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (i) specific assets or liabilities on the balance sheet or (ii) firm commitments or forecasted transactions. Each Bank also formally assesses (both at the hedge's inception and on an ongoing basis, at least quarterly) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. Each Bank typically uses regression analyses or other statistical analyses to assess the effectiveness of its hedges. Each Bank discontinues hedge accounting prospectively when the Bank determines that a hedge has not been or is not expected to be effective as a hedge. For discontinued cash flow hedges, any remaining accumulated other comprehensive income (loss) is amortized into earnings over the remaining life of the original hedged item. For discontinued fair value hedges, changes in the fair value of the derivative are recorded in current period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank carries the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

#### Fair Value Measurement

Effective January 1, 2008, the System adopted SFAS No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets. Assets held in trust funds relate to deferred compensation and our supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates and (d) inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, and derivative contracts. The market value of collateral assets and liabilities is their face value, plus accrued interest, as these

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

instruments are cash balances; therefore, fair value approximates face value.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar

techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities and certain mortgage-backed securities, and highly structured or long-term derivative contracts.

The fair value disclosures have been expanded in accordance with SFAS No. 157, as disclosed in Note 15.

**NOTE 3 — INVESTMENTS**

**Available-for-Sale**

The following is a summary of investments held by the Banks for maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk and classified as available-for-sale:

	<b>December 31, 2008</b>				
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Weighted Average Yield</u>
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$ 4,612	\$ 4	\$ (3)	\$ 4,613	1.67%
U.S. agency securities . . . . .	2,970	63		3,033	3.79
Mortgage-backed securities . . . . .	26,456	171	(1,083)	25,544	2.95
Asset-backed securities . . . . .	<u>1,622</u>	<u>4</u>	<u>(260)</u>	<u>1,366</u>	2.13
Total . . . . .	<u>\$35,660</u>	<u>\$242</u>	<u>\$(1,346)</u>	<u>\$34,556</u>	2.82

	<b>December 31, 2007</b>				
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Weighted Average Yield</u>
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$ 1,879		\$ (1)	\$ 1,878	5.07%
U.S. agency securities . . . . .	1,336	\$ 1		1,337	4.72
Mortgage-backed securities . . . . .	25,013	81	(168)	24,926	5.05
Asset-backed securities . . . . .	<u>2,360</u>	<u>1</u>	<u>(124)</u>	<u>2,237</u>	5.10
Total . . . . .	<u>\$30,588</u>	<u>\$83</u>	<u>\$(293)</u>	<u>\$30,378</u>	5.04

The System realized gross gains of \$3 million in 2008 and gross losses of \$3 million in 2007 from sales of investment securities.



**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

A summary of the fair value and amortized cost of investments available-for-sale at December 31, 2008 by contractual maturity is as follows:

	Due in 1 Year or Less		Due After 1 Year Through 5 Years		Due After 5 Years Through 10 Years		Due After 10 Years		Total	
	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$4,480		\$133						\$ 4,613	1.67%
U.S. agency securities . . . . .	2,151		233		\$ 649				3,033	3.79
Mortgage-backed securities . . . . .	2		202		1,848		\$23,492		25,544	2.95
Asset-backed securities . . . . .			263		24		1,079		1,366	2.13
Total fair value . . . . .	<u>\$6,633</u>	2.18%	<u>\$831</u>	3.47%	<u>\$2,521</u>	2.91%	<u>\$24,571</u>	2.97%	<u>\$34,556</u>	2.82
Total amortized cost . . . . .	<u>\$6,629</u>		<u>\$833</u>		<u>\$2,485</u>		<u>\$25,713</u>		<u>\$35,660</u>	

Substantially all mortgage-backed securities and most asset-backed securities have contractual maturities in excess of ten years. However, expected and actual maturities for these securities will typically be shorter than contractual maturities because borrowers generally have the right to prepay the underlying obligations with or without prepayment penalties.

The ratings of the eligible investments held for maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk must meet the applicable regulatory guidelines, which require these securities to be high quality, senior class, and rated triple-A at the time of purchase. To achieve the ratings, these securities have a guarantee of timely payment of principal and interest or credit enhancement achieved through over collateralization and the

priority of payments of senior classes over junior classes. System institutions perform analysis based on expected behavior of the loans, whereby these loan performance scenarios are applied against each security's credit-support structure to monitor credit-enhancement sufficiency to protect the investment. The model output includes projected cash flows, including any shortfalls in the capacity of the underlying collateral to fully return the original investment, plus accrued interest.

If an investment no longer meets the credit rating criteria, the investment becomes ineligible. A Bank must dispose of an investment that becomes ineligible within six months, unless the Farm Credit Administration approves, in writing, a plan that authorizes the Bank to divest over a longer period of time.

**Mission-Related and Other Investments**

The Banks and Associations may hold mission-related and other investments. Mission-related programs and other mission-related investments are approved by the Farm Credit Administration. The following is a summary of mission-related and other investments, which are held-to-maturity:

	December 31, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$ 234	\$ 7	\$(19)	\$ 222	6.16%
Mortgage-backed securities . . . . .	2,447	60	(23)	2,484	5.39
Asset-backed securities . . . . .	<u>1,195</u>	<u>14</u>	<u>(25)</u>	<u>1,184</u>	4.26
Total . . . . .	<u>\$3,876</u>	<u>\$81</u>	<u>\$(67)</u>	<u>\$3,890</u>	5.09

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

	December 31, 2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .	\$ 162	\$ 2	\$ (3)	\$ 161	6.43%
Mortgage-backed securities . . . . .	2,302	21	(20)	2,303	5.71
Asset-backed securities . . . . .	<u>310</u>	<u>—</u>	<u>(1)</u>	<u>309</u>	6.54
Total . . . . .	<u>\$2,774</u>	<u>\$23</u>	<u>\$(24)</u>	<u>\$2,773</u>	5.84

A summary of the fair value and amortized cost of mission-related and other investments that are held-to-maturity at December 31, 2008 by contractual maturity is as follows:

	Due in 1 Year or Less		Due After 1 Year Through 5 Years		Due After 5 Years Through 10 Years		Due After 10 Years		Total	
	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
Commercial paper, bankers' acceptances, certificates of deposit and other securities . . . . .			\$ 66		\$ 76		\$ 92		\$ 234	6.16%
Mortgage-backed securities . . . . .	\$1		37		105		2,304		2,447	5.39
Asset-backed securities . . . . .	<u>—</u>		<u>40</u>		<u>45</u>		<u>1,110</u>		<u>1,195</u>	4.26
Total amortized cost . . . . .	<u>\$1</u>	5.60%	<u>\$143</u>	5.14%	<u>\$226</u>	5.35%	<u>\$3,506</u>	5.07%	<u>\$3,876</u>	5.09
Total fair value . . . . .	<u>\$1</u>		<u>\$142</u>		<u>\$223</u>		<u>\$3,524</u>		<u>\$3,890</u>	

The following is a summary of mission-related and other investments that are available-for-sale:

	December 31, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Mortgage-backed securities . . . . .	\$557	\$15	\$(3)	\$569	3.87%
Asset-backed securities . . . . .	<u>19</u>	<u>—</u>	<u>—</u>	<u>19</u>	3.13
Total . . . . .	<u>\$576</u>	<u>\$15</u>	<u>\$(3)</u>	<u>\$588</u>	3.85

	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Fair Value	Weighted Average Yield
Mortgage-backed securities . . . . .	\$653	\$8	\$661	5.16%
Asset-backed securities . . . . .	<u>22</u>	<u>—</u>	<u>22</u>	6.07
Total . . . . .	<u>\$675</u>	<u>\$8</u>	<u>\$683</u>	5.19

There were no gross unrealized losses at December 31, 2007.

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

A summary of the fair value and amortized cost of mission-related and other investments that are available-for-sale at December 31, 2008 by contractual maturity is as follows:

	Due After 1 Year Through 5 Years		Due After 5 Years Through 10 Years		Due After 10 Years		Total	
	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
Mortgage-backed securities . . . . .					\$569		\$569	3.87%
Asset-backed securities . . . . .	\$3		\$11		5		19	3.13
Total fair value . . . . .	\$3	6.57%	\$11	2.49%	\$574	3.86%	\$588	3.85
Total amortized cost . . . . .	\$3		\$11		\$562		\$576	

**Other-Than-Temporarily Impaired Investments Evaluation**

The following table shows the gross unrealized losses and fair value of the System’s available-for-sale, and mission-related and other investment securities that have been in a continuous unrealized loss position

at December 31, 2008. An investment is considered impaired if its fair value is less than its cost. The continuous loss position is based on the date the impairment was first identified.

	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Commercial paper, bankers’ acceptances, certificates of deposit and other securities . . . . .	\$ 749	\$ 14	\$ 101	\$ 8
Mortgage-backed securities . . . . .	8,676	446	7,456	663
Asset-backed securities . . . . .	1,256	29	1,047	256
Total . . . . .	\$10,681	\$489	\$8,604	\$927

The fair value of the System’s investment portfolio has been declining as a result of recent turmoil in the credit markets. The evaluation of unrealized losses for other-than-temporary impairment contemplates numerous factors. System institutions perform the evaluation quarterly on a security-by-security basis considering all available information. Important factors considered in determining whether an impairment is other-than-temporary include: (1) the length of time and the extent to which the fair value is less than cost, (2) the financial condition and near-term prospects of the issuer, (3) the estimated cash flow projections compared to contractual cash flows, (4) significant rating agency changes on the issuer (5) the ability of the bond insurer, if any, to pay if required to, and (6) our ability and intent to hold these investments for a period of time sufficient to collect all amounts due according to the contractual terms of the investments. In addition, System institutions qualitatively consider all available information when assessing whether impairment is other-than-temporary. Based on the

results of these evaluations, if it is determined that the impairment is other-than-temporary, the carrying value of the security is written down to fair value, and a loss is recognized through earnings.

At December 31, 2008, the Banks owned mortgage-backed securities and asset-backed securities primarily for liquidity purposes with an amortized cost of \$28.078 billion, as compared with a fair value of \$26.910 billion. These investments consisted predominantly of agency mortgage-backed securities classified as available for sale. The current unrealized loss positions principally resulted from a decrease in liquidity in the marketplace and, to a lesser extent, from deterioration in credit quality. Except for those securities that have been determined to be other-than-temporarily impaired, we expect to collect all principal and interest payments on our investment securities given the continued performance of these securities, the creditworthiness of the bond insurers and our ability and intent to hold these securities until such

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

time as the value recovers or the securities mature. There are currently no plans to sell these securities and thus the majority of these securities are not considered to be other-than-temporarily impaired. To date, the Farm Credit Administration has not required the disposition of any of these securities.

At December 31, 2008, 14 non-agency mortgage-backed and asset-backed securities with an amortized cost of \$68 million were determined to be other-than-temporarily impaired resulting in a \$82 million loss being recognized in 2008. At December 31, 2007, one security with an amortized cost of \$12 million was determined to be other-than-temporarily impaired resulting in a \$5 million loss being recognized in 2007.

**NOTE 4 — LOANS AND ALLOWANCE FOR LOAN LOSSES**

The System is limited by statute to providing credit and related services nationwide to farmers, ranchers, producers and harvesters of aquatic products, rural homeowners, certain farm-related businesses, agricultural and aquatic cooperatives (or to other entities for the benefit of the cooperatives) and their customers, rural utilities, and other eligible entities engaging in certain international transactions related to agriculture as described below. Accordingly, the borrowers' abilities to perform in accordance with their loan contracts are generally dependent upon the performance of the agricultural economic sector. While the amounts in the following table represent the maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the System's lending activities is collateralized, which reduces the exposure to credit risk associated with the activities.

Loans outstanding consisted of the following:

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Real estate mortgage loans . . . . .	\$ 71,892	\$ 63,458
Production and intermediate-term loans . .	37,468	32,267
Agribusiness loans:		
Loans to cooperatives . . .	12,213	15,855
Processing and marketing loans . . . . .	12,160	9,772
Farm-related business loans . . . . .	2,528	2,464
Energy and water/waste disposal loans . . . . .	9,387	7,496
Rural residential real estate loans . . . . .	4,611	3,965
Communication loans . . . . .	4,544	3,350
International loans . . . . .	4,077	2,135
Lease receivables . . . . .	1,952	1,708
Loans to other financing institutions . . . . .	<u>591</u>	<u>436</u>
Total loans . . . . .	<u>\$161,423</u>	<u>\$142,906</u>

Approximately 45% of the loan volume at December 31, 2008 and 2007 contained terms under which the interest rate on the outstanding balance may be adjusted from time-to-time during the term of the loan. These floating-rate loans are comprised of administered-rate loans that may be adjusted at the discretion of the lending institution and indexed/adjustable loans that are periodically adjusted based on changes in specified indices. Fixed-rate loans comprised the remaining 55% of loans outstanding at December 31, 2008 and 2007.

As of December 31, 2008 and 2007, 81% and 61% of the loans made in connection with international transactions, which were for the purpose of financing agricultural exports, were guaranteed through the United States Department of Agriculture's Commodity Credit Corporation.

Interest income on nonaccrual and accruing restructured loans that would have been recorded

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

under the original terms of such loans at December 31, 2008 were as follows:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Interest income that would have been recognized under original terms . . . . .	\$104	
Less: interest income recognized . . . . .	<u>(50)</u>	
Interest income not recognized . . . . .	<u>\$ 54</u>	
Impaired loans with related allowance . . . . .	\$ 839	\$138
Impaired loans with no related allowance . . . . .	<u>1,577</u>	<u>483</u>
Total impaired loans . . . . .	<u>\$2,416</u>	<u>\$621</u>
Allowance on impaired loans . . . . .	<u>\$ 245</u>	<u>\$ 32</u>

The following tables present information concerning impaired loans and include both the principal outstanding and the related accrued interest receivable on these loans. Accruing restructured loans are those loans whose terms have been modified and on which concessions have been granted because of borrower financial difficulties. The balances do not include restructured loans on which extensions or other non-monetary concessions have been granted; restructured loans on which monetary concessions have been granted are included in nonaccrual status pending the determination that the borrowers are able to perform according to the revised terms of the loan agreements.

The following table summarizes impaired loan information for the years ended December 31, 2008, 2007 and 2006:

	<b>2008</b>	<b>2007</b>	<b>2006</b>
Average impaired loans . . . . .	\$963	\$594	\$597
Interest income recognized on impaired loans . . . . .	55	70	61

Commitments to lend additional funds to debtors whose loans were classified as impaired were not significant at December 31, 2008 and 2007.

A summary of changes in the allowance for loan losses follows:

	<b>December 31,</b>			<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>2008</b>	<b>2007</b>				
Nonaccrual loans:						
Current as to principal and interest . . . . .	\$1,705	\$267	Balance at beginning of year . . . . .	\$ 781	\$734	\$755
Past due . . . . .	<u>577</u>	<u>245</u>	Loan loss reversals . . . . .	(8)	(19)	(29)
Total nonaccrual loans . . . . .	<u>2,282</u>	<u>512</u>	Provisions for loan losses . . . . .	416	100	64
Impaired accrual loans:			Loans charged-off . . . . .	(128)	(62)	(81)
Restructured accrual loans . . . . .	36	53	Recoveries . . . . .	29	28	31
Accrual loans 90 days or more past due . . . . .	<u>98</u>	<u>56</u>	Other . . . . .	<u>(154)*</u>	<u>    </u>	<u>(6)</u>
Total impaired accrual loans . . . . .	<u>134</u>	<u>109</u>	Balance at end of year . . . . .	<u>\$ 936</u>	<u>\$781</u>	<u>\$734</u>
Total impaired loans . . . . .	<u>\$2,416</u>	<u>\$621</u>				

\* Change in the allowance methodology at one Bank resulted in the reclassification to other liabilities as a reserve for unfunded commitments.

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

**NOTE 5 — PREMISES AND EQUIPMENT**

Premises and equipment consisted of the following:

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Land, buildings and improvements . . . . .	\$ 634	\$ 585
Furniture and equipment . . . . .	<u>487</u>	<u>448</u>
	1,121	1,033
Less: accumulated depreciation . . . . .	<u>(516)</u>	<u>(481)</u>
	<u>\$ 605</u>	<u>\$ 552</u>

**NOTE 6 — OTHER ASSETS AND OTHER LIABILITIES**

Other assets consisted of the following:

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Interest rate swaps and other derivatives . . . . .	\$2,279	\$ 584
Equipment held for lease . . . . .	840	741
Tobacco contracts receivables . . . . .	764	807
Unamortized debt issue costs . . . . .	131	98
Accounts receivable . . . . .	121	89
Equity investments in other System institutions . . . . .	70	70
Investment in preferred stock of Farmer Mac . . . . .	60	
Net deferred tax assets . . . . .	50	46
Other property owned . . . . .	46	32
Prepaid expenses . . . . .	28	44
Pension assets . . . . .		27
Other . . . . .	<u>180</u>	<u>164</u>
Total . . . . .	<u>\$4,569</u>	<u>\$2,702</u>

Other liabilities consisted of the following:

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Collateral held from derivative counterparties . . . . .	\$1,424	\$ 88
Pension and other postretirement benefit plan liabilities . . . . .	1,031	401
Patronage and dividends payable . . . . .	576	575
Accounts payable . . . . .	446	432
Reserve for unfunded commitments . . . . .	161	6
Accrued salaries and employee benefits . . . . .	141	125
Interest rate swaps and other derivatives . . . . .	134	63
Bank drafts payable . . . . .	86	91
Net deferred tax liabilities . . . . .	76	59
Protected borrower stock . . . . .	10	11
Other . . . . .	<u>294</u>	<u>244</u>
Total . . . . .	<u>\$4,379</u>	<u>\$2,095</u>

Substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of credit with exposure are reached by one of the counterparties to the other. At December 31, 2008, the Banks held \$1.424 billion of cash collateral pledged by derivative counterparties, as compared with \$88 million being held at December 31, 2007.

As part of the “Fair and Equitable Tobacco Reform Act of 2004,” tobacco producers are to receive 10 equal payments over 10 years under a contract with the Secretary of Agriculture. Certain Associations have entered into successor-in-interest contracts with tobacco producers. Under the contracts, the Associations have paid the producers a lump sum and have received the rights to the remaining contract payments.

Reserve for unfunded commitments provides for potential losses related to unfunded commitments. This reserve is determined using the same methodology as used for our allowance for loan losses.

On September 30, 2008, the five Banks invested \$60 million in aggregate in senior cumulative perpetual

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

preferred stock of Farmer Mac. Dividends on the preferred stock are cumulative and will be payable quarterly, in cash, at an annual interest rate of 10%, increasing by 2% in each of the first three years, up to a maximum of 16%. The preferred stock is callable at par value after nine months, and on any quarterly dividend date thereafter, and accounted for under the cost method. Additionally, the stock is redeemable in whole by Farmer Mac beginning nine months after the date of issuance with cash or certain qualifying assets.

Protection of certain borrower stock is provided under the Farm Credit Act, which requires System institutions, when retiring protected borrower stock, to retire the stock at par or stated value regardless of its book value. Protected borrower stock includes participation certificates and allocated equities that were outstanding as of January 6, 1988, or that were issued or allocated prior to October 6, 1988. If a System institution is unable to retire protected borrower stock at par or stated value due to the liquidation of the institution, amounts required to retire protected borrower stock would be obtained from the Insurance Fund, as discussed in Note 7. As a result of the borrower capital protection mechanisms contained in the Farm Credit Act, the at-risk characteristics necessary for such protected borrower stock to be classified as permanent equity have been substantially reduced. Accordingly, at December 31, 2008 and 2007, \$10 million and \$11 million of protected borrower stock has been classified as a liability in the accompanying Combined Statement of Condition.

#### NOTE 7 — FARM CREDIT INSURANCE FUND

The assets in the Insurance Fund are designated as restricted assets and the related capital is designated as restricted capital. The classification of the Insurance Fund as restricted assets (and as restricted capital) in the System's combined financial statements is based on the statutory requirement that the amounts in the Insurance Fund are to be used solely for the purposes specified in the Farm Credit Act, all of which benefit System institutions. The Insurance Fund is under the direct control of the Insurance Corporation, an independent U.S. government-controlled corporation, and not under the control of any System institution. A board of directors consisting of the Farm Credit Administration Board directs the Insurance Corporation.

The Insurance Corporation's primary asset is the Insurance Fund and the primary sources of funds for the Insurance Fund are:

- premiums paid by the Banks, which may be passed on to the Associations, and
- earnings on assets in the Insurance Fund.

Premiums will be due until the assets in the Insurance Fund for which no specific use has been identified or designated reach the "secure base amount," which is defined in the Farm Credit Act as 2% of the aggregate outstanding insured obligations (adjusted to reflect the System's reduced risk on loans and investments guaranteed by federal or state governments) or such other percentage of the aggregate outstanding insured obligations as the Insurance Corporation, in its sole discretion, determines to be actuarially sound.

The Insurance Corporation is required to expend funds in the Insurance Fund to:

- insure the timely payment of principal and interest on Systemwide Debt Securities, and
- ensure the retirement of protected borrower stock at par value.

The Insurance Corporation is authorized to use the Insurance Fund to cover its operating costs. Subject to the "least-cost determination" described below, the Insurance Corporation is authorized, in its sole discretion, to expend amounts in the Insurance Fund to:

- provide assistance to a financially stressed Bank or Association,
- make loans on the security of, or may purchase, and liquidate or sell, any part of the assets of any Bank or Association that is placed in receivership because of the inability of the institution to pay the principal or interest on any of its notes, bonds, debentures, or other obligations in a timely manner, or
- provide assistance to qualified merging institutions.

The Insurance Corporation cannot provide discretionary assistance to an eligible institution as described above unless the means of providing the assistance is the least costly means of all possible alternatives available to the Insurance Corporation. The alternatives may

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

include liquidation of the eligible institution (taking into account, among other factors, payment of the insured obligations issued on behalf of the institution).

In the event a Bank is unable to pay on a timely basis an insured debt obligation for which that Bank is primarily liable, the Insurance Corporation must expend amounts in the Insurance Fund to the extent available to insure the timely payment of principal and interest on the debt obligation. The provisions of the Farm Credit Act providing for joint and several liability of the Banks on the obligation cannot be invoked until all amounts in the Insurance Fund have been exhausted. However, because of other mandatory and discretionary uses of the Insurance Fund, there is no assurance that there will be sufficient funds to pay principal or interest on the insured debt obligation. The insurance provided through use of the Insurance Fund is not an obligation of and is not a guarantee by the United States government.

At December 31, 2003, the Insurance Fund attained the secure base amount. In addition, at the end of that year, the amount in the Insurance Fund exceeded the average secure base amount for the year. As a result, as required by statute, the Insurance Corporation allocated \$40 million to Allocated Insurance Reserve Accounts. The former Farm Credit System Financial Assistance Corporation stockholders are allocated 10% of the allocation and 90% is allocated to the Banks. These reserve accounts remain part of the Insurance Fund, and, therefore, may be used for statutorily authorized Insurance Corporation purposes. Pursuant to the Farm Credit Act, the earliest any payments could have been made from the reserve accounts was 2006, subject to certain conditions and limitations. No payments were made from the reserve accounts in 2006, 2007 or 2008 because the assets for which no specific use had been identified or designated was below the 2% secure base amount.

As of December 31, 2008, the assets in the Insurance Fund aggregated \$2.915 billion. These assets are

to be used, to the extent available, for the following identified purposes:

Assets for which no specific use has been identified or designated by the Insurance Corporation . . . . .	\$2,875
Allocated Insurance Reserve Accounts . . . . .	<u>40</u>
Aggregate assets in the Insurance Fund . . . . .	<u>\$2,915</u>

At December 31, 2008, assets in the Insurance Fund consisted of cash and cash equivalents, which includes investments in U.S. Treasury obligations with original maturities of 90 days or less of \$62 million, investments of \$2.589 billion, accrued interest receivable of \$21 million and premiums receivable from System institutions of \$243 million accrued on the basis of adjusted outstanding insured debt at December 31, 2008. As a result of the passage of the 2008 Farm Bill, the basis for the premium calculation was revised so that the calculation is now based on each Bank's pro rata share of adjusted outstanding insured debt.

At December 31, 2008 and 2007, the investments, which are classified as restricted assets and are carried at amortized cost, consisted of the following:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>2008:</b>				
U.S. Treasury obligations . . . . .	<u>\$2,589</u>	<u>\$82</u>	<u>\$(22)</u>	<u>\$2,649</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>2007:</b>				
U.S. Treasury obligations . . . . .	<u>\$1,907</u>	<u>\$19</u>	<u>\$(1)</u>	<u>\$1,925</u>

The amortized cost and fair value at December 31, 2008 by contractual maturity were as follows:

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less . . . . .	\$ 863	\$ 874
Due one year through five years . . . . .	1,676	1,719
Due after five years through ten years . . . . .	<u>50</u>	<u>56</u>
	<u>\$2,589</u>	<u>\$2,649</u>



**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

**NOTE 8 — SHORT-TERM BORROWINGS**

The System uses short-term borrowings as a source of funds. The following table shows short-term borrowings by category:

	2008		2007		2006	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
Systemwide discount notes:						
Outstanding at December 31 . . . . .	\$16,105	1.34%	\$19,660	4.34%	\$17,768	5.14%
Average during year . . . . .	16,419	2.57	17,830	5.02	13,526	4.92
Maximum month-end balance during year . . . . .	22,850		20,663		17,960	
Systemwide bonds(1):						
Outstanding at December 31 . . . . .	13,220	1.49	4,214	4.61	3,505	4.86
Average during year . . . . .	11,753	2.48	3,224	4.95	2,918	4.78
Maximum month-end balance during year . . . . .	13,220		4,214		3,505	

(1) Represents bonds issued with a maturity of one year or less.

**NOTE 9 — SYSTEMWIDE DEBT SECURITIES AND OTHER BONDS**

Aggregate maturities and the weighted average interest rate of Systemwide Debt Securities were as follows at December 31, 2008:

	Bonds		Medium-term notes		Discount notes		Total	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
2009 . . . . .	\$ 49,363	1.78%	\$254	6.75%	\$16,105	1.34%	\$ 65,722	1.69%
2010 . . . . .	32,847	2.26	139	6.43			32,986	2.28
2011 . . . . .	22,074	2.73	36	6.26			22,110	2.74
2012 . . . . .	9,197	3.48	26	4.15			9,223	3.48
2013 . . . . .	14,782	3.79	182	5.75			14,964	3.81
2014 and thereafter . . . . .	33,173	4.63	187	6.09			33,360	4.64
Total . . . . .	<u>\$161,436</u>	2.87	<u>\$824</u>	6.22	<u>\$16,105</u>	1.34	<u>\$178,365</u>	2.75

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

Included in Systemwide Debt Securities are callable debt issues consisting of the following:

<u>Year of Maturity</u>	<u>Amount</u>	<u>Range of Next Call Dates</u>
2009 . . . . .	\$ 356	January 2009-March 2009
2010 . . . . .	5,767	January 2009-October 2009
2011 . . . . .	7,530	January 2009-January 2010
2012 . . . . .	3,544	January 2009-December 2010
2013 . . . . .	9,026	January 2009-December 2011
2014 and thereafter . . . . .	<u>15,740</u>	January 2009-May 2015
Total . . . . .	<u>\$41,963</u>	

The average maturity of Systemwide discount notes at December 31, 2008 and 2007 was 4.4 months and 1.3 months. Pursuant to authorizations by the Farm Credit Administration, the maximum amount of Systemwide discount notes, medium-term notes and global debt securities that Banks in the aggregate may have outstanding at any one time is currently \$60 billion, \$40 billion and \$5 billion. There is no limit on the amount of Systemwide bonds that may be outstanding at any one time.

Systemwide Debt Securities are the joint and several obligations of the Banks. Payments of principal and interest to the holders of Systemwide Debt Securities with an outstanding balance aggregating \$178.365 billion at December 31, 2008 are insured by amounts held in the Insurance Fund as described in Note 7. Certain other bonds issued directly by individual Banks are the obligations solely of the issuing Bank. The aggregate amount of bonds issued directly by the Banks was \$1.404 billion at December 31, 2008 and \$852 million at December 31, 2007. All of these bonds mature in the following year, and had a weighted average interest rate of 0.57% for 2008 and 4.00% for 2007.

The Farm Credit Act and Farm Credit Administration regulations require each Bank to maintain specified eligible assets at least equal in value to the total amount of debt securities outstanding for which it is primarily liable as a condition for participation in the issuance of Systemwide Debt Securities. Each Bank was in compliance with these requirements as of December 31, 2008. At December 31, 2008, the combined Banks had specified eligible assets of \$192.2 billion, as compared with \$181.1 billion of Systemwide Debt Securities and other bonds and accrued interest payable at that date. The specified eligible

asset requirement does not provide holders of the securities with a security interest in any assets of the Banks.

Farm Credit Administration regulations provide that, in the event a Bank is placed in liquidation, holders of Systemwide Debt Securities have claims against the Bank's assets, whether or not these holders file individual claims. Under these regulations, the claims of these holders are junior to claims relating to costs incurred by the receiver in connection with the administration of the receivership, claims for taxes, claims of secured creditors and claims of holders of bonds issued by the Bank individually to the extent such bonds are collateralized in accordance with the requirements of the Farm Credit Act. These regulations further provide that the claims of holders of Systemwide Debt Securities are senior to all claims of general creditors.

Amounts paid to dealers in connection with the sale of Systemwide Debt Securities are deferred and amortized to interest expense using the straight-line method (which approximates the interest method) over the term of the related indebtedness.

**NOTE 10 — SUBORDINATED DEBT**

At December 31, 2008, there was \$1.050 billion of subordinated debt outstanding. In September 2008, the Farm Credit Bank of Texas issued \$50 million of 8.406% unsecured subordinated notes due in 2018, generating proceeds of \$49.4 million. Interest is payable semi-annually on March 15 and September 15.

In April 2008, CoBank issued \$500 million of 7.875% unsecured subordinated debt due in 2018, generating net proceeds of \$496.8 million. Interest is payable semi-annually on April 15 and October 15. CoBank also issued in June 2007 \$500 million of floating rate unsecured subordinated debt due in 2022 with interest at an annual rate equal to three-month LIBOR, reset quarterly, plus 0.60%, payable quarterly on September 15, December 15, March 15, and June 15.

The proceeds of each issuance were used to increase the Bank's regulatory permanent capital and total surplus pursuant to the Farm Credit Administration regulations and for general corporate purposes.

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

For each issuance, interest will be deferred if, as of the fifth business day prior to an interest payment date of the debt, any applicable minimum regulatory capital ratios are not satisfied. A deferral period may not last for more than five consecutive years or beyond the maturity date of the subordinated debt. During such a period, the issuing Bank may not declare or pay any dividends or patronage refunds, among other certain restrictions, until interest payments are resumed and all deferred interest has been paid.

This debt is subordinate to all other categories of creditors, including any claims of the holders of Systemwide Debt Securities and general creditors, and is senior to all stock and retained earnings. The debt is not a Systemwide Debt Security, and thus is not the joint and several liability of any of the other Banks, and is not insured by the Farm Credit System Insurance Corporation.

#### NOTE 11 — MANDATORILY REDEEMABLE PREFERRED STOCK

As of December 31, 2008, AgFirst FCB had 225,000 shares issued and outstanding of mandatorily redeemable cumulative preferred stock at \$1,000 per share that is redeemable on December 15, 2016. Preferred stock dividends are payable at the rate of 8.393% per annum of the \$1,000 per share par value. Beginning March 15, 2012, the rate will change to a floating rate equal to three-month LIBOR plus 3.615%. On or after the dividend payment date in December 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of \$1,000 per share. Although the mandatorily redeemable preferred stock has not been included in capital for financial reporting purposes, this issuance of preferred stock qualifies as capital for certain regulatory purposes.

#### NOTE 12 — CAPITAL STRUCTURE

##### Preferred Stock

As of December 31, 2008, the System had preferred stock issued and outstanding of \$1.771 billion that was issued separately by four Banks and three Associations. The preferred stock issued by the Banks is generally held by institutional investors or knowledgeable, high net worth individuals. The following

table presents the general terms of each perpetual preferred stock issuance by the Banks (par amount in whole dollars):

Bank	Issue Date	Amount	Shares Issued and Outstanding	Par Amount	Security Type and Dividend Rate
CoBank	June 2001	\$ 300	6,000,000	\$ 50	Cumulative perpetual 7.814% payable quarterly(1)
CoBank	November 2003	200	4,000,000	50	Cumulative perpetual 7.000% payable quarterly(2)
CoBank	July 2008	200	4,000,000	50	Non-cumulative subordinated perpetual 11.00% payable quarterly(3)
AgFirst	October 2003	150	150,000	1,000	Non-cumulative perpetual 7.300% payable semi-annually(4)
AgFirst	June 2007	250	250,000	1,000	Non-cumulative perpetual 6.585% payable semi-annually(5)
Texas	November 2003 and September 2005	200	200,000	1,000	Cumulative perpetual 7.561% payable semi-annually(6)
U.S. AgBank	March 2007	225	225,000	1,000	Non-cumulative perpetual 6.11% semi-annually(7)
		<u>\$1,525</u>			

(1) Beginning July 1, 2011, the rate will change to a floating rate equal to three-month LIBOR plus 2.72%. On July 1, 2016, the rate will increase an additional 200 basis points to three-month LIBOR plus 4.72%. The dividend rate, however, will never fall below 7.814%. The preferred stock is not mandatorily redeemable at any time, but on or after July 1, 2011 will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value plus accrued and unpaid dividends to the redemption date. The Bank may not enter into any agreements restricting its ability to declare or pay preferred stock dividends.

(2) The preferred stock is not mandatorily redeemable at any time, but will be redeemable at the option of the Bank on any dividend

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

payment date at par value plus accrued and unpaid dividends beginning January 2, 2009.

- (3) Beginning July 1, 2013, dividends will accrue at an annual rate equal to 3-Month USD LIBOR plus 6.79%. The preferred stock is not mandatorily redeemable at any time. However, it will be redeemable at par value, in whole or in part, at the Bank's option on July 1, 2013, and each July 1 thereafter.
- (4) The preferred stock is not mandatorily redeemable at any time, but will be redeemable at the option of the Bank on any dividend payment date at par value beginning with the December 2008 dividend payment date.
- (5) The preferred stock is perpetual, non-cumulative, fixed-to-floating rate subordinated preferred stock. Dividends will be payable, when, as and if declared by the Board of Directors in its sole discretion, semi-annually in June and December at an annual rate equal to 6.585% of the par value of \$1,000 per share up to the June 15, 2012 payment. From and after June 15, 2012 dividends will be payable quarterly at a floating rate equal to 3-month LIBOR plus a margin equal to 1.13%.
- (6) The dividend is paid semi-annually through the December 15, 2013 dividend payment date at a rate of 7.561%. Commencing with the March 15, 2014 dividend date, the dividend will be paid quarterly at a floating rate per annum equal to 3-month LIBOR plus 4.4575%. The preferred stock is not mandatorily redeemable at any time, but on or after December 15, 2013 will be redeemable in whole or in part, at the option of the Bank on any dividend payment date, at its par value plus accrued and unpaid dividends to the redemption date.
- (7) The preferred stock is perpetual, non-cumulative, fixed-to-floating preferred stock. Dividends will be paid, when, as and if declared by the Board of Directors in its sole discretion, semi-annually at an annual rate of 6.11% from initial issuance up to July 10, 2012. Beginning October 10, 2012, dividends will be paid quarterly at an annual rate equal to 3-month LIBOR plus 1.18%.

In addition, three Associations had Class H preferred stock outstanding of \$246 million at December 31, 2008. The purchase of this preferred stock is limited to existing common stockholders of each Association. The Association's board of directors sets the dividend rate and retirement of the stock is at the discretion of the board.

#### Capital Stock and Participation Certificates

In accordance with the Farm Credit Act, each borrower, as a condition of borrowing, is generally required to invest in capital stock or participation certificates of the Bank or Association that makes the loan. The statutory minimum amount of capital investment required for borrowers is 2% of the loan or one thousand dollars, whichever is less. The Associations are required to purchase stock in their affiliated

Bank. The different classes of capital stock and participation certificates and the manner in which capital stock and participation certificates are issued, retired and transferred are set forth in the respective Bank's or Association's bylaws. The Bank and/or Association generally has a first lien on the capital stock and participation certificates as collateral for the repayment of the borrower/stockholder loan.

Each borrower purchasing capital stock is generally entitled to one vote as a stockholder regardless of the number of shares held. In the case of Associations, the borrower usually does not purchase capital stock for cash; rather, the stock purchase is typically made by adding the aggregate par value of the stock to the principal amount of the related loan obligation.

Regulations concerning capitalization bylaws and the issuance and retirement of System equities provide that equities issued on or after October 6, 1988 must qualify as at-risk capital of System institutions. The retirement of at-risk capital must be solely at the discretion of the board of directors and not based on a date certain or on the occurrence of any event, such as the repayment of the borrower's loan.

The boards of directors of individual Banks and Associations generally may authorize the payment of dividends or patronage refunds as provided for in their respective bylaws. The payment of dividends and/or distribution of earnings is subject to regulations that establish minimum at-risk capital standards, as discussed below.

Capital consisted of the following at December 31, 2008:

	Combined Banks	Combined Associations	Combination Entries	System Combined
Preferred stock . . . . .	\$ 1,525	\$ 246		\$ 1,771
Capital stock and participation certificates . . . . .	4,235	514	\$(3,326)	1,423
Protected borrower stock . . . . .		10	(10)	
Restricted capital — Insurance Fund . . . . .			2,915	2,915
Accumulated other comprehensive loss . . . . .	(1,153)	(65)	(915)	(2,133)
Surplus . . . . .	<u>4,859</u>	<u>18,366</u>	<u>(77)</u>	<u>23,148</u>
Total capital . . . . .	<u>\$ 9,466</u>	<u>\$19,071</u>	<u>\$(1,413)</u>	<u>\$27,124</u>

Combined System surplus reflected net eliminations of \$77 million representing transactions between the Banks, the Associations, and/or the Insurance Fund primarily related to surplus allocations by certain

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

Banks to their Associations. The Associations owned capital stock and participation certificates of the Banks amounting to approximately \$3.3 billion. These amounts have been eliminated in the accompanying combined financial statements. Restricted capital is available only for the uses described in Note 7 and is not available for payment of dividends or patronage refunds. Accumulated other comprehensive loss, net of tax, at December 31, 2008 and 2007 was comprised of the following components:

	<u>2008</u>	<u>2007</u>
Unrealized losses on investments available-for-sale, net . . . . .	\$(1,028)	\$(190)
Unrealized losses on cash flow hedges, net . . . . .	(64)	(27)
Pension and other benefit plans . . . . .	<u>(1,041)</u>	<u>(326)</u>
	<u><u>\$(2,133)</u></u>	<u><u>\$(543)</u></u>

As discussed in Notes 9 and 21, only the Banks are statutorily liable for the payment of principal and interest on Systemwide Debt Securities. Under each Bank's bylaws, the Bank is authorized under certain circumstances to require its affiliated Associations and certain other equity holders to purchase additional Bank equities. In most cases, the Banks are limited as to the amounts of these purchases that may be required, generally with reference to a percentage of the Association's or other equity holder's direct loan from the Bank, and calls for additional equity investments may be subject to other limits or conditions. However, the Banks also generally possess indirect access to certain financial resources of their affiliated Associations through loan-pricing provisions and through Bank-influenced District operating and financing policies.

In case of liquidation or dissolution, preferred stock, capital stock, participation certificates and unallocated surplus would be distributed to equity holders, after the payment of all liabilities in accordance with Farm Credit Administration regulations, in the following order: (1) retirement of preferred stock at par, (2) retirement of all common stock and participation certificates at par, (3) retirement of all patronage surplus in amounts equal to the face amount of the applicable nonqualified written notices of allocation or such other notice, and (4) remaining unallocated

surplus and reserves would be paid to the holders of voting stock, nonvoting stock and participation certificates in proportion to patronage to the extent possible.

Farm Credit Administration's capital regulations require that the Banks and Associations achieve and maintain permanent capital of at least seven percent of risk-adjusted assets. In addition, Farm Credit Administration regulations require that: (1) all System institutions achieve and maintain a total surplus ratio of at least seven percent of risk-adjusted assets and a core surplus ratio of at least three and one-half percent of risk-adjusted assets and (2) all Banks achieve and maintain a net collateral ratio of at least 103 percent. Failure of an institution to meet any of these capital requirements may result in certain discretionary actions by the Farm Credit Administration that, if undertaken, could have a direct effect on the institution's financial and operational performance. At December 31, 2008, all System institutions reported compliance with these standards. Ranges of capital ratios reported by System institutions at December 31, 2008 were as follows:

System Institutions	Permanent Capital Ratio	Total Surplus Ratio	Core Surplus Ratio**	Net Collateral Ratio
Banks* . . . . .	14.0%–18.9%	11.3%–17.1%	6.4%–11.0%	104.6%–107.7%
Associations . . . . .	10.1%–27.5%	9.6%–27.1%	8.2%–25.6%	Not Applicable
Regulatory minimum required . . . . .	7.0%	7.0%	3.5%	103%***

\* See Note 21 for each Bank's permanent capital ratio and net collateral ratio at December 31, 2008 and 2007.

\*\* The Farm Credit Administration determined that one Bank may include a significant portion of its capital stock and participation certificates in its core surplus, subject to certain conditions, on a temporary basis that would likely continue until the earlier of December 31, 2012 or when the Farm Credit Administration promulgates a final capital rule that would be inconsistent with this treatment. As part of this determination, the Farm Credit Administration also imposed a requirement that the core surplus ratio be calculated excluding capital stock and participation certificates and established a 3.0% minimum for this ratio.

\*\*\* In connection with preferred stock and subordinated debt offerings, certain Banks are required by the Farm Credit Administration to maintain a minimum net collateral ratio of 104%.

System institutions are prohibited from reducing capital by retiring stock (other than protected borrower stock) or making certain distributions to shareholders if, after or due to the retirement or distribution, the institution would not meet the minimum capital adequacy standards established by the Farm Credit Administration under the Farm Credit Act.

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

By regulation, the Farm Credit Administration is empowered to direct a transfer of funds or equities by one or more Banks or Associations to another Bank or Association, under specified circumstances. The System has never been called on to initiate any transfers pursuant to this regulation and is not aware of any proposed action under this regulation.

#### NOTE 13 — EMPLOYEE BENEFIT PLANS

The Banks and substantially all Associations participate in defined benefit retirement plans. The Banks and Associations, except for CoBank and its related Associations, generally sponsor multi-employer plans that can not be attributed to any individual entity. Thus, these plans are recorded at the combined District level. All retirement plans are non-contributory and benefits are based on salary and years of service. As of January 1, 2007, many Banks and Associations have frozen participation in their defined benefit pension plans and offered defined contribution retirement plans to all employees hired subsequent to the freeze. In addition, System institutions provide certain healthcare and other postretirement benefits to eligible retired employees. Employees of System institutions may become eligible for healthcare and other postretirement benefits if they reach normal retirement age while working for the System.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS No. 158 were adopted at December 31, 2007 and resulted in a significant change in accumulated other comprehensive loss but had no effect on the statement of income.

SFAS No. 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, the System used a September 30 measurement date for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The System has applied the second approach, which allows for the use of the measurements determined for the prior year end.

Under this alternative, pension and postretirement benefit income measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 2007 measurement date) was recorded as an adjustment to beginning 2008 retained earnings. As a result, the System decreased retained earnings \$15 million, net of taxes and increased the pension and other postretirement benefit liabilities by \$15 million.

The following tables set forth the funding status and the amounts recognized in the System's Combined Statement of Condition for pension and other postretirement benefit plans:

	Pension Benefits		Other Benefits	
	December 31, 2008	2007	2008	2007
Change in benefit obligation:				
Benefit obligation at beginning of year . . . . .	\$1,983	\$1,942	\$ 203	\$ 218
Service cost . . . . .	68	57	5	5
Interest cost . . . . .	155	114	16	13
Plan participants' contributions . . . . .			2	2
Plan amendments . . . . .	(2)	(8)	(3)	
Actuarial loss (gain) . . . . .	124	(17)	8	(20)
Benefits paid . . . . .	(151)	(105)	(23)	(11)
Curtailments . . . . .				(4)
Benefit obligation at end of year . . . . .	<u>\$2,177</u>	<u>\$1,983</u>	<u>\$ 208</u>	<u>\$ 203</u>
Change in plan assets:				
Fair value of plan assets at beginning of year . . . . .	\$1,784	\$1,640	\$ 7	\$ 7
Actual return on plan assets . . . . .	(448)	222	(1)	
Employer contributions . . . . .	169	27	12	9
Plan participants' contributions . . . . .			5	2
Benefits and premiums paid . . . . .	(151)	(105)	(23)	(11)
Fair value of plan assets at end of year . . . . .	<u>\$1,354</u>	<u>\$1,784</u>	<u>\$ 0</u>	<u>\$ 7</u>
Funded status . . . . .	\$ (823)	\$ (199)	\$(208)	\$(196)
Fourth quarter employer contributions and other . . . . .		19		2
Net amount recognized at December 31 . . . . .	<u>\$ (823)</u>	<u>\$ (180)</u>	<u>\$(208)</u>	<u>\$(194)</u>
Amounts recognized in the balance sheet consist of:				
Pension asset . . . . .		\$ 27		
Pension liability . . . . .	\$ (823)	(207)	\$(208)	\$(194)
Net amount recognized . . . . .	<u>\$ (823)</u>	<u>\$ (180)</u>	<u>\$(208)</u>	<u>\$(194)</u>

The accumulated benefit obligation for all defined benefit pension plans was \$1.850 billion, \$1.621 billion and \$1.645 billion at December 31, 2008, 2007 and 2006.

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

The following represent the amounts included in accumulated other comprehensive loss (pre-tax) at December 31:

	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
Net actuarial gain/loss	\$1,078	\$359	\$ 19	\$ 11
Prior service costs	2	(2)	(34)	(41)
Transition asset	3	2	—	—
Total amount recognized in AOCL	<u>\$1,083</u>	<u>\$359</u>	<u>\$(15)</u>	<u>\$(30)</u>

Approximately \$68 million will be amortized from accumulated other comprehensive loss into net periodic benefit cost in 2009.

Information for pension plans with an accumulated benefit obligation in excess of plan assets.

	December 31,	
	2008	2007
Projected benefit obligation	\$2,177	\$582
Accumulated benefit obligation	1,850	479
Fair value of plan assets	1,354	436

The net periodic pension expense for defined benefit plans and other postretirement benefit plans included in the Combined Statement of Income is comprised of the following:

	Pension Benefits For the Years Ended December 31,		Other Benefits For the Years Ended December 31,	
	2008	2007	2008	2007
Components of net periodic benefit cost:				
Service cost	\$ 55	\$ 57	\$ 4	\$ 5
Interest cost	124	114	13	13
Expected return on plan assets	(155)	(133)	—	—
Net amortization and deferral	20	34	(8)	(4)
Curtailments	2	—	(1)	(4)
Net periodic benefit cost	<u>\$ 46</u>	<u>\$ 72</u>	<u>\$ 8</u>	<u>\$10</u>

Weighted average assumptions used to determine benefit obligations at December 31:

	Pension Benefits	
	2008	2007
Discount rate	6.27%-6.35%	6.35%-6.50%
Rate of compensation increase	4.50%-5.33%	4.42%-5.04%

	Other Benefits	
	2008	2007
Discount rate	6.25%-6.35%	6.35%-6.50%

Weighted average assumptions used to determine net periodic benefit cost for years ended December 31:

	Pension Benefits	
	2008	2007
Discount rate	6.35%-6.50%	6.00%
Expected long-term return on plan assets	8.00%-8.50%	8.00%-8.50%
Rate of compensation increase	4.46%-5.00%	4.50%-5.04%

	Other Benefits	
	2008	2007
Discount rate	6.00%-6.50%	6.00%
Expected long-term return on plan assets	—	6.00%

The expected long-term rate of return assumption is determined independently for each defined benefit pension plan and for each other postretirement benefit plan. Generally, plan trustees use historical return information to establish a best-estimate range for each asset class in which the plans are invested. Plan trustees select the most appropriate rate for each plan from the best-estimate range, taking into consideration the duration of plan benefit liabilities and plan sponsor investment policies.

For measurement purposes, annual rates of increase of 8.50% to 9.00% in the per capita cost of covered health benefits were assumed for 2009. The rates were assumed to step down to between 5.00% and 6.00% in various years beginning in 2011 — 2016, and remain at that level thereafter.

Assumed healthcare trend rates have a significant effect on the amounts reported for the health-care plans. A one percentage point change in the assumed healthcare cost trend rates would have the following effects:

	1% Increase	1% Decrease
Effect on total of service and interest cost	\$ 2	\$ (2)
Effect on postretirement benefit obligation	26	(21)

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

**Plan Assets**

The weighted-average asset allocations by asset category are as follows:

Asset Category	Pension Benefits December 31,		Other Benefits December 31,
	2008	2007	2007
Equity securities . . . . .	55%	65%	
Debt securities . . . . .	37	32	99%
Other . . . . .	<u>8</u>	<u>3</u>	<u>1</u>
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>

Note: There were no plan assets for other benefits at December 31, 2008.

The trustees of each defined benefit pension plan and other postretirement benefit plan set investment policies and strategies for the plan, including target allocation percentages for each category of plan asset. Generally, the funding objectives of the pension plans are to achieve and maintain plan assets adequate to cover the accumulated benefit obligations and to provide competitive investment returns and reasonable risk levels when measured against appropriate benchmarks. Plan trustees develop asset allocation policies based on plan objectives, characteristics of pension liabilities, capital market expectations, and asset-liability projections. Substantially all postretirement healthcare plans have no plan assets and are funded on a current basis by employer contributions and retiree premium payments.

Asset Category	Pension Benefits Target Allocation for Next Year
Equity securities . . . . .	45%-70%
Debt securities . . . . .	28%-60%
Other . . . . .	0%-10%

The Banks and Associations expect to contribute \$144 million to their pension plans and \$10 million to their other postretirement benefit plans in 2009.

The Banks and Associations expect to pay the following benefit payments, which reflect expected future service, as appropriate.

Year	Pension Benefits	Other Benefits
2009 . . . . .	\$122	\$10
2010 . . . . .	132	11
2011 . . . . .	143	12
2012 . . . . .	159	12
2013 . . . . .	162	13
2014 to 2018 . . . . .	935	73

The Banks and Associations also participate in defined contribution savings plans. Certain plans require Banks and Associations to match a percentage of employee contributions. Employer contributions to these plans were \$51 million, \$36 million and \$36 million for the years ended December 31, 2008, 2007 and 2006.

**NOTE 14 — INCOME TAXES**

The provision for income taxes was comprised of the following amounts:

	For the years Ended December 31,		
	2008	2007	2006
Current:			
Federal . . . . .	\$ 55	\$128	\$83
State and local . . . . .	11	7	9
Deferred:			
Federal . . . . .	76	9	(7)
State . . . . .	<u>11</u>	<u>(3)</u>	<u>(2)</u>
Provision for income taxes . . . . .	<u>\$153</u>	<u>\$141</u>	<u>\$83</u>



**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

The deferred income tax provision (benefit) results from differences between amounts of assets and liabilities as measured for income tax return and financial reporting purposes. The significant components of deferred tax assets and liabilities at December 31, 2008 and 2007 were as follows:

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Allowance for loan losses . . . . .	\$ 254	\$ 221
Employee benefit plan obligations . . . . .	69	60
Unrealized net losses on investments available-for-sale . . . . .	66	13
Loss carryforwards . . . . .	40	30
Other . . . . .	<u>68</u>	<u>52</u>
Gross deferred tax assets . . . . .	497	376
Less: valuation allowance . . . . .	<u>(95)</u>	<u>(64)</u>
Deferred tax assets, net of valuation allowance . . . . .	<u>402</u>	<u>312</u>
Deferred tax liabilities:		
Direct financing leases . . . . .	(345)	(239)
Pensions . . . . .	(30)	(28)
Patronage allocated by Banks to Associations . . . . .	(22)	(28)
Depreciation . . . . .	(4)	(3)
Other . . . . .	<u>(27)</u>	<u>(27)</u>
Gross deferred tax liabilities . . . . .	<u>(428)</u>	<u>(325)</u>
Net deferred tax liability . . . . .	<u>\$ (26)</u>	<u>\$ (13)</u>
System entities with net deferred tax assets (included in other assets) . . . . .	\$ 50	\$ 46
System entities with net deferred tax liabilities (included in other liabilities) . . . . .	<u>(76)</u>	<u>(59)</u>
	<u>\$ (26)</u>	<u>\$ (13)</u>

The provision for income taxes differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to

pretax income from continuing operations as a result of the following differences:

	<u>Year Ended December 31,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal tax at statutory rate . . . . .	\$1,043	\$ 967	\$ 837
State tax, net . . . . .	17	6	10
Effect of nontaxable entities . . . . .	(765)	(672)	(600)
Patronage distributions allocated by taxable entities . . . . .	(193)	(178)	(141)
Other . . . . .	<u>51</u>	<u>18</u>	<u>(23)</u>
Provision for income taxes . . . . .	<u>\$ 153</u>	<u>\$ 141</u>	<u>\$ 83</u>

System entities have unrecognized tax benefits for which liabilities have been established. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at December 31, 2007 . . . . .	\$ 3
Additions based on tax positions related to the current year . . . . .	3
Additions for tax positions of prior years . . . . .	12
Reductions for tax positions of prior years . . . . .	(9)
Settlements . . . . .	<u>(1)</u>
Balance at December 31, 2008 . . . . .	<u>\$ 8</u>

System entities recognize interest and penalties related to unrecognized tax benefits as an adjustment to income tax expense. The amount of interest recognized in 2008 was \$673 thousand and the total amount of penalties recognized in 2008 was \$209 thousand. At December 31, 2008, \$3.6 million of interest and \$490 thousand in penalties were accrued. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$8.2 million at December 31, 2008. System entities did not have any positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next 12 months. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

**NOTE 15 — FAIR VALUE MEASUREMENTS**

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

advantageous market for the asset or liability. See Note 1 — Organization and Significant Accounting Policies for additional information.

Assets and liabilities measured at fair value on a recurring basis at December 31, 2008 for each of the fair value hierarchy values are summarized below:

	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets:</b>				
Federal funds and securities purchased under resale agreements . . . . .		\$ 1,029		\$ 1,029
Investments available-for-sale . . . . .		28,845	\$6,299	35,144
Derivative assets . . . . .		2,278	1	2,279
Assets held in non-qualified benefits trusts . . . . .	\$ 72			72
<b>Total assets . . . . .</b>	<b>\$ 72</b>	<b>\$32,152</b>	<b>\$6,300</b>	<b>\$38,524</b>
<b>Liabilities:</b>				
Systemwide debt securities . . . . .		\$ 182		\$ 182
Derivative liabilities . . . . .		134		134
Collateral liabilities . . . . .	\$236	1,188		1,424
Standby letters of credit . . . . .		2	\$ 13	15
<b>Total liabilities . . . . .</b>	<b>\$236</b>	<b>\$ 1,506</b>	<b>\$ 13</b>	<b>\$ 1,755</b>

The table below represents a reconciliation of all Level 3 assets and liabilities measured at fair value on a recurring basis for the period from January 1, 2008 to December 31, 2008:

	Investment Securities	Derivative Assets	Derivative Liabilities	Standby Letters of Credit
Balance at January 1, 2008 . . . . .	\$ 7,672		\$ 1	\$11
Total gains or (losses) realized/unrealized:				
Included in earnings . . . . .	(81)	\$1	(1)	
Included in other comprehensive loss . . . . .	(401)			
Purchases, issuances and settlements, net . . . . .	(1,062)			2
Transfers into Level 3 . . . . .	171			
<b>Balance at December 31, 2008 . . . . .</b>	<b>\$ 6,299</b>	<b>\$1</b>	<b>\$ 0</b>	<b>\$13</b>
The amount of losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets or liabilities still held at December 31, 2008 . . . . .	\$ 82	\$0	\$ 0	\$ 0

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2008 for each of the fair value hierarchy values are summarized below:

	Fair Value Measurement Using		Total Fair Value	Total Losses
	Level 2	Level 3		
<b>Assets:</b>				
Loans* . . . . .	\$46	\$604	\$650	\$(217)

\* Represents the fair value of certain loans that were evaluated for impairment under SFAS No. 114. The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

**Valuation Techniques**

As more fully discussed in Note 1 — Organization and Summary of Significant Accounting Policies, SFAS No. 157 establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the reporting date. Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain of the estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction. The following represents a summary of the valuation techniques used by the System for assets and liabilities:

**Investment Securities**

Where quoted prices are available in an active market, available-for-sale securities are classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

quoted prices for similar securities received from pricing services, pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Such models incorporate prepayment assumptions and underlying mortgage- or asset-backed collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. Third-party valuations also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings and other market information. The valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant. Generally, these securities are classified as Level 2. This would include certain mortgage-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include asset-based securities and certain mortgage-backed securities, including those issued by Farmer Mac.

***Derivatives***

Exchange-traded derivatives valued using quoted prices would be classified within Level 1 of the valuation hierarchy. However, few classes of derivative contracts are listed on an exchange; thus, the majority of the derivative positions are valued using internally developed models that use as their basis readily observable market parameters, such as benchmark interest rate curves, volatility and other inputs that are observable directly or indirectly in the marketplace. These derivatives are classified within Level 2 of the valuation hierarchy. Such derivatives include basic interest rate swaps and options and credit default swaps. Derivatives that are valued based upon models with significant unobservable market parameters or that are normally traded less actively or have one-sided trade activity are classified within Level 3 of the valuation hierarchy.

***Assets Held in Non-Qualified Benefits Trusts***

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include

investments that are actively traded and have quoted net asset values that are observable in the marketplace.

***Systemwide Debt Securities***

Systemwide Debt Securities for which the fair value option has been elected are classified as Level 2 as the inputs into the valuation are generally based on readily observable market-based pricing information. The discounted cash flow method is used based on current rates for new debt securities with similar characteristics, including maturity date. The fair value is usually corroborated using observable inputs such as the Treasury Yield Curve, the Farm Credit Yield Curve and the LIBOR Swap Curve.

At adoption, the carrying amount of these debt securities was \$42 thousand greater than their fair value. During the 2008, \$6.6 million of losses from fair value changes were recorded in net gains on derivative and other transactions in the Combined Statement of Income. The following table reflects the difference between the fair value amount of Systemwide Debt Securities that are being measured at fair value under SFAS No. 159 and the aggregate unpaid principal amount.

	<b>December 31, 2008</b>
Fair value amount . . . . .	\$ 182
Aggregate unpaid principal . . . . .	<u>(175)</u>
Fair value amount less aggregate unpaid principal . . . . .	<u>\$ 7</u>

**NOTE 16 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

The following table presents the carrying amounts and fair values of the System's financial instruments at December 31, 2008 and 2007. Quoted market prices are generally not available for certain System financial instruments. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision.

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

Changes in assumptions could significantly affect the estimates.

The estimated fair values of the combined System financial instruments are as follows:

	December 31, 2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash, Federal funds sold and securities purchased under resale agreements . . . . .	\$ 4,787	\$ 4,787	\$ 2,625	\$ 2,625
Investments . . . . .	39,020	39,034	33,835	33,834
Loans . . . . .	161,423	164,004	142,906	143,991
Allowance for loan losses . . . . .	(936)		(781)	
Net loans . . . . .	160,487	164,004	142,125	143,991
Tobacco contract receivables . . . . .	764	791	807	819
Derivative assets . . . . .	2,279	2,279	584	584
Financial liabilities:				
Systemwide Debt Securities . . . . .	(178,365)	(180,706)	(154,443)	(155,368)
Subordinated debt . . . . .	(1,050)	(843)	(500)	(463)
Other bonds . . . . .	(1,404)	(1,404)	(852)	(852)
Other interest bearing liabilities . . . . .	(484)	(484)	(557)	(557)
Mandatorily redeemable preferred stock . . . . .	(225)	(279)	(225)	(250)
Derivative liabilities . . . . .	(134)	(134)	(63)	(63)
Other financial instruments:				
Commitments to extend credit . . . . .		(68)		(64)
Standby letters of credit . . . . .	(15)	(15)	(11)	(11)

A description of the methods and assumptions used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value follows:

*A. Cash, Federal Funds Sold and Securities Purchased Under Resale Agreements:* For cash and overnight investments, the carrying amount is a reasonable estimate of fair value. The fair value of term Federal funds sold and securities purchased under resale agreements is based on currently quoted market prices, which are reflective of current interest rates.

*B. Investment Securities:* Includes available-for-sale investments for liquidity, mission-related and other purposes, as well as held-to-maturity investments. See Note 16 for the valuation technique used to determine the fair value of investments.

*C. Loans:* Because no active market exists for the System's loans, fair value is estimated by

discounting the expected future cash flows using the Banks' and/or the Associations' current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Banks' and/or the Associations' loan rates as well as managements' estimates of credit risk, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows, primarily based on contractual terms, and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher interest rates which reflect the uncertainty of continued cash flows. For collateral dependent impaired loans, it is assumed that collection will result only from the disposition of the underlying collateral, as more fully discussed in Note 15.

*D. Bonds and Notes:* Systemwide Debt Securities are not all traded in the secondary market and those that are traded may not have readily available quoted market prices. Therefore, the fair value of the instruments is estimated by calculating the discounted value of the expected future cash flows. The discount rates used are based on the sum of quoted market yields for the Treasury yield curve and an estimated yield-spread relationship between System debt instruments and Treasury issues.

*E. Derivative Assets and Liabilities:* Exchange-traded derivatives are valued using quoted prices. However, the majority of the derivative positions are valued using internally developed models that use as their basis readily observable market parameters. See Note 15 for the valuation technique used to determine the fair value of derivatives.

*F. Commitments to Extend Credit and Standby Letters of Credit:* The fair value of

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

commitments is estimated using the fees currently charged for similar agreements, taking into account the remaining terms of the agreements and the creditworthiness of the counterparties. For fixed-rate loan commitments, estimated fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is estimated based on the cost to terminate the agreement or fees currently charged for similar agreements.

#### NOTE 17 — DERIVATIVE PRODUCTS AND HEDGING ACTIVITIES

The Banks and Associations maintain an overall interest rate risk management strategy that incorporates the use of derivative products to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Banks' and Associations' goals are to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that movements in interest rates do not adversely affect the net interest margin. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the Banks' gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the interest income and interest expense of hedged floating-rate assets and liabilities will increase or decrease. The effect of this variability in earnings is expected to be substantially offset by the Banks' gains and losses on the derivative instruments that are linked to these hedged assets and liabilities. The Banks consider the strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The Banks enter into derivative transactions, particularly interest rate swaps, to lower funding costs, diversify sources of funding, alter interest rate exposures arising from mismatches between assets and liabilities, or better manage liquidity. The Banks may also enter into derivatives with their customers

as a service to enable them to transfer, modify or reduce their interest rate risk by transferring this risk to the Bank. The Banks substantially offset this risk by concurrently entering into offsetting agreements with non-System institutional counterparties. Interest rate swaps allow the Banks to raise long-term borrowings at fixed rates and swap them into floating rates that are lower than those available to the Bank if floating rate borrowings were made directly. Under interest rate swap arrangements, the Banks agree with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating rate index.

A substantial amount of the System's assets are interest-earning assets (principally loans and investments) that tend to be medium-term floating-rate instruments while the related interest-bearing liabilities tend to be short- or medium-term fixed rate obligations. Given this asset-liability mismatch, interest rate swaps in which a Bank pays the floating rate and receives the fixed rate (receive fixed swaps) are used to reduce the impact of market fluctuations on a Bank's net interest income. Because the size of swap positions needed to reduce the impact of market fluctuations varies over time, a Bank also enters into swaps in which it receives the floating rate and pays the fixed rate (pay fixed swaps) when necessary to reduce its net position.

The Banks may purchase interest rate options, such as caps, in order to reduce the impact of rising interest rates on their floating-rate debt, and floors, in order to reduce the impact of falling interest rates on their floating-rate assets.

By using derivative products, Banks expose themselves to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the Bank's credit risk will equal the fair value gain in a derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes a Bank, thus creating a repayment (credit) risk for a Bank. When the fair value of the derivative contract is negative, a Bank owes the counterparty and, therefore, assumes no repayment risk.

## FARM CREDIT SYSTEM

### NOTES TO COMBINED FINANCIAL STATEMENTS — (continued) (dollars in millions, except as noted)

To minimize the risk of credit losses, the Banks almost exclusively deal with non-customer counterparties that have an investment grade or better credit rating from a major rating agency, and also monitor the credit standing and levels of exposure to individual counterparties. The Banks do not anticipate nonperformance by any of these counterparties. The Banks typically enter into master agreements that contain netting provisions. These provisions allow the Banks to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. A majority of derivative contracts are supported by collateral arrangements with counterparties. At December 31, 2008 and 2007, the System's exposure to counterparties, net of collateral, was \$639 million and \$398 million. At December 31, 2007, one Bank posted \$2 million in securities as collateral. No collateral was posted at December 31, 2008.

Each Bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the Committee's oversight of the Bank's asset/liability and treasury functions. Each Bank's ALCO is responsible for approving hedging strategies that are developed within parameters established by each Bank's board of directors through the Bank's analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the Bank's overall interest rate risk-management strategies.

#### *Fair-Value Hedges*

The Banks enter into interest rate swaps primarily to lower funding costs or to alter interest rate exposures arising from mismatches between assets and liabilities.

For the year ended December 31, 2008, the System recognized a net loss of \$14 million (reported as net interest income in the statement of operations), which represented the ineffective portion of all fair-value hedges, including the time value of option contracts. The System recognized a net loss of \$6 million for 2007 and net gain of \$1 million for 2006. All components of each derivative's gain or loss were included in the assessment of hedge effectiveness. In addition, the System recognized net losses on fair

value hedges of \$1 million for 2008, as compared with net gains of \$2 million and \$5 million recognized for 2007 and 2006, primarily due to the discontinuance of certain hedge transactions.

#### *Cash Flow Hedges*

The Banks use various types of interest rate swaps to convert floating-rate loans to fixed-rate loans. Specific types of loans and amounts that the Banks hedge are based on prevailing market conditions and the current shape of the yield curve. Banks also use basis swaps to "lock in" a desired spread between interest-earning assets and interest-bearing liabilities. These swaps may qualify for hedge accounting and usually have a term of two to three years, with a pay rate indexed to the rates received on floating-rate assets.

For the years ended December 31, 2008, 2007 and 2006, the System recognized net losses of \$2 million, \$2 million and \$1 million (reported as net interest income in the statement of operations), which represented the total ineffectiveness of all cash flow hedges, including the time value of option contracts. All components of each derivative's gain or loss were included in the assessment of hedge effectiveness. In addition, the System recognized gains on derivatives not designated as hedges of \$12 million in 2008, \$7 million in 2007 and \$11 million in 2006. The System also recognized losses on discontinuance of cash flow hedges of \$2 million, \$5 million and \$13 million in 2008, 2007 and 2006.

For cash flow hedges, gains and losses on derivative contracts that are reclassified from accumulated other comprehensive income to current-period earnings are included in the line item in which the hedged item is recorded in the same period the floating-rate asset, liability or forecasted transaction affects earnings. As of December 31, 2008, \$4 million of the deferred net losses on derivative instruments accumulated in other comprehensive income are expected to be reclassified as earnings during the next twelve months.

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

**NOTE 18 — RELATED PARTY TRANSACTIONS**

In the ordinary course of business, the Banks and Associations may enter into loan transactions with their officers and directors and non-System organizations with which such persons may be associated. These loans are subject to special approval requirements contained in Farm Credit Administration regulations and are, in the view of the lending System institution's management, made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers. Total loans outstanding to such persons were \$1.9 billion at both December 31, 2008 and December 31, 2007. During 2008 and 2007, \$6.8 billion and \$4.9 billion of new loans were made to such persons and repayments totaled \$6.8 billion and \$4.7 billion. In the opinions of Bank and Association managements, substantially all of such loans outstanding at December 31, 2008 and 2007 did not involve more than a normal risk of collectibility.

**NOTE 19 — COMMITMENTS AND CONTINGENCIES**

At December 31, 2008, various lawsuits were pending or threatened against System institutions. In the opinion of management, based on information currently available and taking into account the advice of legal counsel, the ultimate liability, if any, of pending legal actions will not have a material adverse impact on the System's combined results of operations or financial position.

The Banks and Associations may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of their borrowers and to manage their exposure to interest-rate risk. These

financial instruments include commitments to extend credit and standby letters of credit. In the normal course of business, various commitments are made to customers, such as commitments to extend credit and letters of credit, which represent credit-related financial instruments with off-balance-sheet risk.

A summary of the contractual amount of credit-related instruments is presented in the following table:

	December 31, 2008	December 31, 2007
Commitments to extend credit . . . . .	\$67,629	\$50,414
Standby letters of credit . . . . .	3,318	2,692
Commercial and other letters of credit . . . . .	339	230

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their contractual amounts are not reflected on the balance sheet until funded or drawn upon. Standby letters of credits are reflected on the balance sheet at fair value of the liability. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. No material losses are anticipated as a result of these transactions.

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

**NOTE 20 — QUARTERLY FINANCIAL DATA (UNAUDITED)**

The unaudited results of operations by quarter for the past three years are presented below:

	<u>2008 Quarter Ended</u>			
	<u>March 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>
Net interest income . . . . .	\$1,137	\$1,170	\$1,198	\$1,197
Provision for loan losses . . . . .	(33)	(30)	(61)	(284)
Net noninterest expense . . . . .	(287)	(303)	(280)	(355)
Provision for income taxes . . . . .	<u>(57)</u>	<u>(44)</u>	<u>(40)</u>	<u>(12)</u>
Net income . . . . .	<u>\$ 760</u>	<u>\$ 793</u>	<u>\$ 817</u>	<u>\$ 546</u>
	<u>2007 Quarter Ended</u>			
	<u>March 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>
Net interest income . . . . .	\$ 973	\$1,001	\$1,034	\$1,052
(Provision for loan losses) loan loss reversal . . . . .	1	(39)	(26)	(17)
Net noninterest expense . . . . .	(280)	(283)	(260)	(312)
Provision for income taxes . . . . .	<u>(40)</u>	<u>(39)</u>	<u>(21)</u>	<u>(41)</u>
Net income . . . . .	<u>\$ 654</u>	<u>\$ 640</u>	<u>\$ 727</u>	<u>\$ 682</u>
	<u>2006 Quarter Ended</u>			
	<u>March 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>
Net interest income . . . . .	\$ 854	\$ 876	\$ 910	\$ 944
(Provision for loan losses) loan loss reversal . . . . .	(5)	19	(2)	(47)
Net noninterest expense . . . . .	(265)	(261)	(268)	(293)
Provision for income taxes . . . . .	<u>(30)</u>	<u>(27)</u>	<u>(19)</u>	<u>(7)</u>
Net income . . . . .	<u>\$ 554</u>	<u>\$ 607</u>	<u>\$ 621</u>	<u>\$ 597</u>



**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

**NOTE 21 — COMBINING BANK-ONLY INFORMATION**

The following condensed combining statements include the statement of condition, statement of income and statement of changes in capital for the combined Banks without the affiliated Associations or other System institutions.

**Combining Bank-Only  
Statement of Condition**

**December 31, 2008**

	AgFirst Farm Credit Bank	AgriBank, FCB	Farm Credit Bank of Texas	U.S. AgBank, FCB	CoBank, ACB	Combination Entries	Combined Banks
<b>Assets</b>							
Cash . . . . .	\$ 8	\$ 69	\$ 13	\$ 198	\$ 3,127		\$ 3,415
Federal funds sold and securities purchased under resale agreements . . . . .	187	660	177		5		1,029
Investments (Note 3) . . . . .	8,075	8,733	3,028	5,320	11,537		36,693
Loans							
To Associations(1) . . . . .	14,997	44,943	8,296	18,500	15,030		101,766
To others . . . . .	6,242	7,811	3,107	1,045	29,520	\$(443)	47,282
Less: allowance for loan losses . . . . .	(45)	(14)	(12)	(3)	(329)		(403)
Net loans . . . . .	<u>21,194</u>	<u>52,740</u>	<u>11,391</u>	<u>19,542</u>	<u>44,221</u>	<u>(443)</u>	<u>148,645</u>
Accrued interest receivable . . . . .	107	602	68	190	350		1,317
Other assets . . . . .	340	482	106	164	1,922	403	3,417
Total assets . . . . .	<u>\$29,911</u>	<u>\$63,286</u>	<u>\$14,783</u>	<u>\$25,414</u>	<u>\$61,162</u>	<u>\$ (40)</u>	<u>\$194,516</u>
<b>Liabilities and Capital</b>							
Systemwide Debt Securities (Notes 8 and 9):							
Due within one year . . . . .	\$13,646	\$20,803	\$ 5,886	\$ 8,106	\$17,283	\$ (2)	\$ 65,722
Due after one year . . . . .	14,407	38,437	7,916	15,899	35,961	23	112,643
Total Systemwide Debt Securities . . . . .	<u>28,053</u>	<u>59,240</u>	<u>13,802</u>	<u>24,005</u>	<u>53,244</u>	<u>21</u>	<u>178,365</u>
Subordinated debt (Note 10) . . . . .			50		1,000		1,050
Accrued interest payable . . . . .	154	454	101	167	447	(1)	1,322
Other liabilities . . . . .	238	825	85	71	2,877	(8)	4,088
Mandatorily redeemable preferred stock (Note 11) . . . . .	225						225
Total liabilities . . . . .	<u>28,670</u>	<u>60,519</u>	<u>14,038</u>	<u>24,243</u>	<u>57,568</u>	<u>12</u>	<u>185,050</u>
Capital (Note 12)							
Preferred stock . . . . .	400		200	225	700		1,525
Capital stock and participation certificates . . . . .	435	1,624	233	573	1,401	(31)	4,235
Accumulated other comprehensive loss . . . . .	(357)	(395)	(26)	(213)	(145)	(17)	(1,153)
Surplus . . . . .	763	1,538	338	586	1,638	(4)	4,859
Total capital . . . . .	<u>1,241</u>	<u>2,767</u>	<u>745</u>	<u>1,171</u>	<u>3,594</u>	<u>(52)</u>	<u>9,466</u>
Total liabilities and capital . . . . .	<u>\$29,911</u>	<u>\$63,286</u>	<u>\$14,783</u>	<u>\$25,414</u>	<u>\$61,162</u>	<u>\$ (40)</u>	<u>\$194,516</u>

**FARM CREDIT SYSTEM**  
**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
(dollars in millions, except as noted)

**Combining Bank-Only  
Statement of Condition**

**December 31, 2007**

	AgFirst Farm Credit Bank	AgriBank, FCB	Farm Credit Bank of Texas	U.S. AgBank, FCB	CoBank, ACB	Combination Entries	Combined Banks
<b>Assets</b>							
Cash . . . . .	\$ 15	\$ 137	\$ 17	\$ 63	\$ 41		\$ 273
Federal funds sold and securities purchased under resale agreements . . . . .	459	562	126	113	647		1,907
Investments (Note 3) . . . . .	6,994	6,855	2,411	5,437	10,434		32,131
<b>Loans</b>							
To Associations(1) . . . . .	14,603	42,880	8,058	15,737	12,213		93,491
To others . . . . .	4,512	1,126	2,808	978	28,278	\$(406)	37,296
Less: allowance for loan losses . . . . .	(3)	(3)	(1)	(1)	(447)		(455)
Net loans . . . . .	<u>19,112</u>	<u>44,003</u>	<u>10,865</u>	<u>16,714</u>	<u>40,044</u>	<u>(406)</u>	<u>130,332</u>
Accrued interest receivable . . . . .	115	565	71	241	328		1,320
Other assets . . . . .	232	142	53	116	695	389	1,627
Total assets . . . . .	<u>\$26,927</u>	<u>\$52,264</u>	<u>\$13,543</u>	<u>\$22,684</u>	<u>\$52,189</u>	<u>\$ (17)</u>	<u>\$167,590</u>
<b>Liabilities and Capital</b>							
<b>Systemwide Debt Securities (Note 8 and 9):</b>							
Due within one year . . . . .	\$10,957	\$18,019	\$ 4,630	\$ 7,829	\$15,602	\$ (3)	\$ 57,034
Due after one year . . . . .	13,890	30,773	7,994	13,275	31,481	(4)	97,409
Total Systemwide Debt Securities . . . . .	24,847	48,792	12,624	21,104	47,083	(7)	154,443
Subordinated debt (Note 10) . . . . .					500		500
Accrued interest payable . . . . .	180	475	115	211	467		1,448
Other liabilities . . . . .	218	600	75	80	905	1	1,879
Mandatorily redeemable preferred stock (Note 11) . . . . .	225						225
Total liabilities . . . . .	<u>25,470</u>	<u>49,867</u>	<u>12,814</u>	<u>21,395</u>	<u>48,955</u>	<u>(6)</u>	<u>158,495</u>
<b>Capital (Note 12)</b>							
Preferred stock . . . . .	400		200	225	500		1,325
Capital stock and participation certificates . . . . .	365	1,073	202	555	1,292	(22)	3,465
Accumulated other comprehensive loss . . . . .	(39)	(65)	(4)	(83)	(28)	(16)	(235)
Surplus . . . . .	731	1,389	331	592	1,470	27	4,540
Total capital . . . . .	<u>1,457</u>	<u>2,397</u>	<u>729</u>	<u>1,289</u>	<u>3,234</u>	<u>(11)</u>	<u>9,095</u>
Total liabilities and capital . . . . .	<u>\$26,927</u>	<u>\$52,264</u>	<u>\$13,543</u>	<u>\$22,684</u>	<u>\$52,189</u>	<u>\$ (17)</u>	<u>\$167,590</u>

(1) These loans represent direct loans to Associations, not retail loans to borrowers. Since the Associations operate under regulations that require maintenance of certain minimum capital levels, adequate reserves, and prudent underwriting standards, these loans are considered to carry less risk. Accordingly, these loans typically have little or no associated allowance for loan losses. The majority of the credit risk resides with the Banks' and Associations' retail loans to borrowers. Association retail loans are not reflected in the combining Bank-only financial statements.

Further, the loans to the Associations are risk-weighted at 20% of the loan amount in the computation of each Bank's regulatory permanent capital, surplus and core surplus ratios. Based upon the lower risk-weighting of these loans to the Associations, the Banks, especially the Farm Credit Banks, typically operate with more leverage and lower earnings than would be expected from a traditional retail bank. In the case of the Agricultural Credit Bank, while it has certain loans to Associations, the majority of its loans are retail loans to cooperatives and other eligible borrowers.

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
(dollars in millions, except as noted)

	<b>AgFirst Farm Credit Bank</b>	<b>AgriBank, FCB</b>	<b>Farm Credit Bank of Texas</b>	<b>U.S. AgBank, FCB</b>	<b>CoBank, ACB</b>	<b>Combination Entries</b>	<b>Combined Banks</b>
<b>Combining Bank-Only Statement of Income</b>							
<b>2008</b>							
Interest income . . . . .	\$ 1,333	\$ 2,370	\$ 661	\$ 949	\$ 2,603	\$ 19	\$ 7,935
Interest expense . . . . .	<u>(967)</u>	<u>(2,027)</u>	<u>(543)</u>	<u>(847)</u>	<u>(1,741)</u>	<u>18</u>	<u>(6,107)</u>
Net interest income . . . . .	366	343	118	102	862	37	1,828
Provision for loan losses . . . . .	(43)	(11)	(21)	(2)	(55)		(132)
Noninterest income . . . . .	(21)	57	24	6	68	(73)	61
Noninterest expense . . . . .	(85)	(60)	(44)	(31)	(215)	(20)	(455)
Provision for income taxes . . . . .					<u>(127)</u>		<u>(127)</u>
Net income . . . . .	<u>\$ 217</u>	<u>\$ 329</u>	<u>\$ 77</u>	<u>\$ 75</u>	<u>\$ 533</u>	<u>\$(56)</u>	<u>\$ 1,175</u>
<b>2007</b>							
Interest income . . . . .	\$ 1,469	\$ 2,585	\$ 754	\$ 1,117	\$ 2,763	\$(14)	\$ 8,674
Interest expense . . . . .	<u>(1,208)</u>	<u>(2,380)</u>	<u>(656)</u>	<u>(988)</u>	<u>(2,118)</u>	<u>9</u>	<u>(7,341)</u>
Net interest income . . . . .	261	205	98	129	645	(5)	1,333
Loan loss reversal (provision for loan losses) . . . . .	(2)		(1)		5		2
Noninterest income . . . . .	3	24	13	17	44	(2)	99
Noninterest expense . . . . .	(70)	(46)	(36)	(29)	(181)	(16)	(378)
Provision for income taxes . . . . .					<u>(97)</u>		<u>(97)</u>
Net income . . . . .	<u>\$ 192</u>	<u>\$ 183</u>	<u>\$ 74</u>	<u>\$ 117</u>	<u>\$ 416</u>	<u>\$(23)</u>	<u>\$ 959</u>
<b>2006</b>							
Interest income . . . . .	\$ 1,223	\$ 2,146	\$ 653	\$ 950	\$ 2,164	\$(20)	\$ 7,116
Interest expense . . . . .	<u>(995)</u>	<u>(1,972)</u>	<u>(565)</u>	<u>(841)</u>	<u>(1,639)</u>	<u>3</u>	<u>(6,009)</u>
Net interest income . . . . .	228	174	88	109	525	(17)	1,107
Loan loss reversal (provision for loan losses) . . . . .	7		(2)		(4)		1
Noninterest income . . . . .	16	38	9	12	51	7	133
Noninterest expense . . . . .	(61)	(49)	(30)	(28)	(163)	(17)	(348)
Provision for income taxes . . . . .					<u>(74)</u>		<u>(74)</u>
Net income . . . . .	<u>\$ 190</u>	<u>\$ 163</u>	<u>\$ 65</u>	<u>\$ 93</u>	<u>\$ 335</u>	<u>\$(27)</u>	<u>\$ 819</u>

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

**Combining Bank-Only  
Statement of Changes in Capital**

	AgFirst Farm Credit Bank	AgriBank, FCB	Farm Credit Bank of Texas	U.S. AgBank, FCB	CoBank, ACB	Combination Entries	Combined Banks
<b>Balance at December 31, 2005</b> . . . . .	\$1,037	\$2,114	\$624	\$ 992	\$2,902	\$ 12	\$7,681
Comprehensive income							
Net income . . . . .	190	163	65	93	335	(27)	819
Change in unrealized losses on investments . . . . .	5	(2)	6	3	20		32
Change in unrealized losses on cash flow hedges . . . . .		(1)	(1)	9	(8)	9	8
Minimum pension liability adjustment . . . . .				3	2		5
Income tax benefit related to other comprehensive loss . . . . .					(5)		(5)
Total comprehensive income . . . . .	<u>195</u>	<u>160</u>	<u>70</u>	<u>108</u>	<u>344</u>	<u>(18)</u>	<u>859</u>
Preferred stock issued, net . . . . .							
Preferred stock dividends . . . . .	(11)		(15)		(38)		(64)
Capital stock and participation certificates issued . . . . .	88	182	26	33	13		342
Capital stock, participation certificates, and surplus retired . . . . .		(93)			(54)		(147)
Patronage and dividends . . . . .	<u>(128)</u>	<u>(110)</u>	<u>(41)</u>	<u>(57)</u>	<u>(127)</u>	<u>3</u>	<u>(460)</u>
<b>Balance at December 31, 2006</b> . . . . .	1,181	2,253	664	1,076	3,040	(3)	8,211
Comprehensive income							
Net income . . . . .	192	183	74	117	416	(23)	959
Change in unrealized losses on investments . . . . .	(40)	(34)	17	(37)	23		(71)
Change in unrealized losses on cash flow hedges . . . . .		(11)	1	1	2	9	2
Minimum pension liability adjustment . . . . .				2	(2)		
Income tax benefit related to other comprehensive loss . . . . .					(9)		(9)
Total comprehensive income . . . . .	<u>152</u>	<u>138</u>	<u>92</u>	<u>83</u>	<u>430</u>	<u>(14)</u>	<u>881</u>
Adjustment for the adoption of FASB Statement No. 158, net of tax . . . . .	(1)		(1)	(1)	(3)	(1)	(7)
Preferred stock issued, net . . . . .	247			221			468
Preferred stock dividends . . . . .	(20)		(15)	(11)	(37)		(83)
Capital stock and participation certificates issued . . . . .	57	169	37	8	11		282
Capital stock, participation certificates, and surplus retired . . . . .	(5)	(28)			(51)		(84)
Patronage and dividends . . . . .	<u>(154)</u>	<u>(135)</u>	<u>(48)</u>	<u>(87)</u>	<u>(156)</u>	<u>7</u>	<u>(573)</u>
<b>Balance at December 31, 2007</b> . . . . .	<u>\$1,457</u>	<u>\$2,397</u>	<u>\$729</u>	<u>\$1,289</u>	<u>\$3,234</u>	<u>\$(11)</u>	<u>\$9,095</u>
Adjustment for accounting changes:							
Change in measurement date — SFAS No. 158 . . . . .					(1)		(1)
<b>Balance at January 1, 2008</b> . . . . .	1,457	2,397	729	1,289	3,233	(11)	9,094
Comprehensive income							
Net income . . . . .	217	329	77	75	533	(56)	1,175
Change in unrealized losses on investments . . . . .	(318)	(290)	(17)	(134)	(138)		(897)
Change in unrealized losses on cash flow hedges . . . . .		(40)	(4)	3	(2)	5	(38)
Pension and other benefit plans . . . . .			(1)	1	(49)	(6)	(55)
Income tax benefit related to other comprehensive loss . . . . .					72		72
Total comprehensive income (loss) . . . . .	<u>(101)</u>	<u>(1)</u>	<u>55</u>	<u>(55)</u>	<u>416</u>	<u>(57)</u>	<u>257</u>
Preferred stock issued, net . . . . .					198		198
Preferred stock dividends . . . . .	(27)		(15)	(14)	(48)		(104)
Capital stock and participation certificates issued . . . . .	70	711	28	18	44		871
Capital stock, participation certificates, and surplus retired . . . . .		(160)			(41)		(201)
Patronage and dividends . . . . .	<u>(158)</u>	<u>(180)</u>	<u>(52)</u>	<u>(67)</u>	<u>(208)</u>	<u>16</u>	<u>(649)</u>
<b>Balance at December 31, 2008</b> . . . . .	<u>\$1,241</u>	<u>\$2,767</u>	<u>\$745</u>	<u>\$1,171</u>	<u>\$3,594</u>	<u>\$(52)</u>	<u>\$9,466</u>

**FARM CREDIT SYSTEM**

**NOTES TO COMBINED FINANCIAL STATEMENTS — (continued)**  
**(dollars in millions, except as noted)**

Certain Bank-only capital ratios and other information is as follows:

	<u>AgFirst FCB</u>	<u>AgriBank, FCB</u>	<u>FCB of Texas</u>	<u>U.S. AgBank, FCB</u>	<u>CoBank, ACB</u>
<b>December 31, 2008</b>					
Net collateral ratio . . . . .	105.6%	104.6%	105.4%	104.9%	107.7%
Permanent capital ratio . . . . .	17.2%	15.5%	14.0%	18.9%	14.8%
Liquidity in days . . . . .	153	125	134	147	257
Average liquidity in days during 2008 . . . . .	161	114	130	172	212
<b>December 31, 2007</b>					
Net collateral ratio . . . . .	106.0%	104.7%	105.2%	105.0%	107.1%
Permanent capital ratio . . . . .	20.6%	19.7%	13.4%	20.7%	12.1%
Liquidity in days . . . . .	165	84*	121	148	164
Average liquidity in days during 2007 . . . . .	181	122	153	183	137

\* The Bank originally calculated 106 days of liquidity. Subsequent to year-end, the Bank determined its interpretation of the Farm Credit Administration regulation, guiding the calculation of the ratio, should be modified. Using the modified interpretation, when applied retroactively, the Bank's liquidity position fell below the regulatory minimum of 90 days for 13 business days.

Bank-only information is considered meaningful because only the Banks are jointly and severally liable for the payment of principal and interest on Systemwide Debt Securities (See Notes 7 and 9 for additional information.) That means that each Bank is primarily liable for the payment of principal and interest on Systemwide Debt Securities issued to fund its lending activities and is also jointly and severally liable with respect to Systemwide Debt Securities issued to fund the other Banks.

The Associations are the primary owners of the Farm Credit Banks. The Agricultural Credit Bank (CoBank) is principally owned by cooperatives, other eligible borrowers and its affiliated Associations. Due to the financial and operational interdependence of the Banks and Associations, capital at the Association level reduces the Banks' credit exposure with respect to the direct loans between the Banks and each of their affiliated Associations. However, capital of the Associations may not be available if the provisions of joint and several liability were to be invoked. There are various limitations and conditions with respect to each Bank's access to the capital of its affiliated Associations, as more fully discussed in Note 12.

In the event a Bank is unable to timely pay principal or interest on an insured debt obligation for which the Bank is primarily liable, the Insurance Corporation must expend amounts in the Insurance

Fund to the extent available to insure the timely payment of principal and interest on the insured debt obligation. The provisions of the Farm Credit Act providing for joint and several liability of the Banks on the obligation cannot be invoked until the amounts in the Insurance Fund have been exhausted. However, because of other mandatory and discretionary uses of the Insurance Fund, there is no assurance that there will be sufficient funds to pay the principal or interest on the insured debt obligation.

Once joint and several liability is triggered, the Farm Credit Administration is required to make "calls" to satisfy the liability first on all non-defaulting Banks in the proportion that each non-defaulting Bank's available collateral (collateral in excess of the aggregate of the Bank's collateralized obligations) bears to the aggregate available collateral of all non-defaulting Banks. If these calls do not satisfy the liability, then a further call would be made in proportion to each non-defaulting Bank's remaining assets. On making a call on non-defaulting Banks with respect to a Systemwide Debt Security issued on behalf of a defaulting Bank, the Farm Credit Administration is required to appoint the Insurance Corporation as the receiver for the defaulting Bank. The receiver would be required to expeditiously liquidate the Bank.

**FARM CREDIT SYSTEM**

**SUPPLEMENTAL COMBINING INFORMATION**

The following condensed Combining Statements of Condition and Income present Bank-only and Insurance Fund information, as well as information related to the other entities included in the System's combined financial statements. As part of the combining process, all significant transactions between the Banks, the Associations, including loans made by the Banks to the Associations and the interest income/interest expense related thereto, and investments of the Associations in the Banks and the earnings related thereto, have been eliminated.

**COMBINING STATEMENT OF CONDITION (CONDENSED)**  
(in millions)

**December 31, 2008**

	<u>Combined Banks</u>	<u>Combined Associations</u>	<u>Eliminations</u>	<u>Combined without Insurance Fund</u>	<u>Insurance Fund</u>	<u>Combination Entries</u>	<u>System Combined</u>
Cash and investments . . . . .	\$ 41,137	\$ 2,670		\$ 43,807			\$ 43,807
Loans . . . . .	149,048	114,174	\$(101,799)	161,423			161,423
Less: allowance for loan losses . . . . .	<u>(403)</u>	<u>(529)</u>	<u>(4)</u>	<u>(936)</u>			<u>(936)</u>
Net loans . . . . .	148,645	113,645	(101,803)	160,487			160,487
Other assets . . . . .	4,734	7,113	(4,703)	7,144			7,144
Restricted assets . . . . .					\$2,915		2,915
Total assets . . . . .	<u>\$194,516</u>	<u>\$123,428</u>	<u>\$(106,506)</u>	<u>\$211,438</u>	<u>\$2,915</u>	<u>\$ 0</u>	<u>\$214,353</u>
Systemwide Debt Securities and subordinated debt . . . . .	\$179,415			\$179,415			\$179,415
Other liabilities . . . . .	5,410	\$104,357	\$(102,188)	7,579		\$ 10(a)	7,589
Mandatorily redeemable preferred stock . . . . .	<u>225</u>			<u>225</u>			<u>225</u>
Total liabilities . . . . .	<u>185,050</u>	<u>104,357</u>	<u>(102,188)</u>	<u>187,219</u>		<u>10</u>	<u>187,229</u>
Capital							
Protected borrower stock . . . . .		10		10		(10)(a)	
Preferred stock . . . . .	1,525	246		1,771			1,771
Capital stock and participation certificates . . . . .	4,235	514	(3,326)	1,423			1,423
Restricted capital . . . . .					\$2,915		2,915
Accumulated other comprehensive loss . . . . .	(1,153)	(65)	(915)	(2,133)			(2,133)
Surplus . . . . .	<u>4,859</u>	<u>18,366</u>	<u>(77)</u>	<u>23,148</u>			<u>23,148</u>
Total capital . . . . .	<u>9,466</u>	<u>19,071</u>	<u>(4,318)</u>	<u>24,219</u>	<u>2,915</u>	<u>(10)</u>	<u>27,124</u>
Total liabilities and capital . . . . .	<u>\$194,516</u>	<u>\$123,428</u>	<u>\$(106,506)</u>	<u>\$211,438</u>	<u>\$2,915</u>	<u>\$ 0</u>	<u>\$214,353</u>

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL COMBINING INFORMATION**  
**COMBINING STATEMENT OF CONDITION (CONDENSED) — (continued)**  
**(in millions)**

**December 31, 2007**

	<u>Combined Banks</u>	<u>Combined Associations</u>	<u>Eliminations</u>	<u>Combined without Insurance Fund</u>	<u>Insurance Fund</u>	<u>Combination Entries</u>	<u>System Combined</u>
Cash and investments . . . . .	\$ 34,311	\$ 2,149		\$ 36,460			\$ 36,460
Loans . . . . .	130,787	105,638	\$(93,519)	142,906			142,906
Less: allowance for loan losses . . . . .	<u>(455)</u>	<u>(321)</u>	<u>(5)</u>	<u>(781)</u>			<u>(781)</u>
Net loans . . . . .	130,332	105,317	(93,524)	142,125			142,125
Other assets . . . . .	2,947	6,462	(4,142)	5,267			5,267
Restricted assets . . . . .					\$2,599		2,599
Total assets . . . . .	<u>\$167,590</u>	<u>\$113,928</u>	<u>\$(97,666)</u>	<u>\$183,852</u>	<u>\$2,599</u>	<u>\$ 0</u>	<u>\$186,451</u>
Systemwide Debt Securities and subordinated debt . . . . .	\$154,943			\$154,943			\$154,943
Other liabilities . . . . .	3,327	\$ 96,201	\$(94,675)	4,853		\$ 11(a)	4,864
Mandatorily redeemable preferred stock . . . . .	<u>225</u>			<u>225</u>			<u>225</u>
Total liabilities . . . . .	<u>158,495</u>	<u>96,201</u>	<u>(94,675)</u>	<u>160,021</u>		<u>11</u>	<u>160,032</u>
Capital							
Protected borrower stock . . . . .		11		11		(11)(a)	
Preferred stock . . . . .	1,325	200		1,525			1,525
Capital stock and participation certificates . . . . .	3,465	510	(2,618)	1,357			1,357
Restricted capital . . . . .					\$2,599		2,599
Accumulated other comprehensive loss . . . . .	(235)	(4)	(304)	(543)			(543)
Surplus . . . . .	<u>4,540</u>	<u>17,010</u>	<u>(69)</u>	<u>21,481</u>			<u>21,481</u>
Total capital . . . . .	<u>9,095</u>	<u>17,727</u>	<u>(2,991)</u>	<u>23,831</u>	<u>2,599</u>	<u>(11)</u>	<u>26,419</u>
Total liabilities and capital . . . . .	<u>\$167,590</u>	<u>\$113,928</u>	<u>\$(97,666)</u>	<u>\$183,852</u>	<u>\$2,599</u>	<u>\$ 0</u>	<u>\$186,451</u>

Combination entry (a) reclassifies protected borrower stock to other liabilities in recognition of its reduced at-risk characteristics at the System level.

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL COMBINING INFORMATION**  
**COMBINING STATEMENT OF INCOME (CONDENSED)**

**For the Year Ended December 31,**  
**(in millions)**

	<u>Combined Banks</u>	<u>Combined Associations</u>	<u>Eliminations</u>	<u>Combined without Insurance Fund</u>	<u>Insurance Fund</u>	<u>Combination Entries</u>	<u>System Combined</u>
<b>2008</b>							
Net interest income . . . . .	\$1,828	\$ 2,861	\$ 13	\$ 4,702			\$ 4,702
Provision for loan losses . . . . .	(132)	(278)	2	(408)			(408)
Noninterest income . . . . .	61	1,028	(663)	426	\$319	\$(243)(b)	502
Noninterest expense . . . . .	(455)	(1,661)	149	(1,967)	(3)	243(b)	(1,727)
Provision for income taxes . . . . .	(127)	(26)	—	(153)	—	—	(153)
Net income . . . . .	<u>\$1,175</u>	<u>\$ 1,924</u>	<u>\$(499)</u>	<u>\$ 2,600</u>	<u>\$316</u>	<u>\$ 0</u>	<u>\$ 2,916</u>
<b>2007</b>							
Net interest income . . . . .	\$1,333	\$ 2,714	\$ 13	\$ 4,060			\$ 4,060
(Provision for loan losses) loan loss reversal . .	2	(83)	—	(81)			(81)
Noninterest income . . . . .	99	869	(604)	364	\$290	\$(192)(b)	462
Noninterest expense . . . . .	(378)	(1,527)	119	(1,786)	(3)	192(b)	(1,597)
Provision for income taxes . . . . .	(97)	(44)	—	(141)	—	—	(141)
Net income . . . . .	<u>\$ 959</u>	<u>\$ 1,929</u>	<u>\$(472)</u>	<u>\$ 2,416</u>	<u>\$287</u>	<u>\$ 0</u>	<u>\$ 2,703</u>
<b>2006</b>							
Net interest income . . . . .	\$1,107	\$ 2,469	\$ 8	\$ 3,584			\$ 3,584
(Provision for loan losses) loan loss reversal . .	1	(38)	2	(35)			(35)
Noninterest income . . . . .	133	715	(519)	329	\$252	\$(164)(b)	417
Noninterest expense . . . . .	(348)	(1,427)	109	(1,666)	(2)	164(b)	(1,504)
Provision for income taxes . . . . .	(74)	(9)	—	(83)	—	—	(83)
Net income . . . . .	<u>\$ 819</u>	<u>\$ 1,710</u>	<u>\$(400)</u>	<u>\$ 2,129</u>	<u>\$250</u>	<u>\$ 0</u>	<u>\$ 2,379</u>

Combination entry (b) eliminates the Insurance Fund premiums expensed by the Banks and the related income recognized by the Insurance Corporation.



**FARM CREDIT SYSTEM**

**SUPPLEMENTAL COMBINING INFORMATION**

The chartered territories of the Banks and their affiliated Associations (collectively, the District) include all or portions of the states and territories set forth below:

AgFirst Farm Credit Bank . . . . .	Alabama, Delaware, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Ohio, Pennsylvania, Puerto Rico, South Carolina, Tennessee, Virginia, and West Virginia
AgriBank, FCB . . . . .	Arkansas, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Wisconsin, and Wyoming
Farm Credit Bank of Texas . . . . .	Alabama, Louisiana, Mississippi, New Mexico, and Texas
U.S. AgBank, FCB . . . . .	Arizona, California, Colorado, Hawaii, Idaho, Kansas, Nevada, New Mexico, Oklahoma, Utah, and Wyoming
CoBank, ACB . . . . .	Serves eligible customers nationwide and Associations in the states of Alaska, Connecticut, Idaho, Maine, Massachusetts, Montana, New Hampshire, New Jersey, New York, Oregon, Rhode Island, Vermont, and Washington

Although the Banks are not commonly owned or controlled, they fund their operations primarily through the issuance of Systemwide Debt Securities for which they are jointly and severally liable. Further, each District operates in such an interdependent manner that we believe the financial results of the Banks

combined with their affiliated Associations are more meaningful than providing financial information of the Banks and Associations on a stand-alone basis. For the purpose of additional analysis, the following presentation reflects each District, the Insurance Fund and combination entries.

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL COMBINING INFORMATION**  
**COMBINING BANK AND ASSOCIATION (DISTRICT)**  
**STATEMENT OF CONDITION (CONDENSED)**  
**(in millions)**

**December 31, 2008**

	AgFirst District Combined	AgriBank District Combined	Texas District Combined	U.S. AgBank District Combined	CoBank District Combined	Insurance Fund and Combination Entries	System Combined
Cash and investments . . . . .	\$ 8,482	\$11,173	\$ 3,280	\$ 6,119	\$14,751	\$ 2	\$ 43,807
Loans . . . . .	23,078	57,152	16,590	23,125	46,072	(4,594)	161,423
Less: allowance for loan losses . . . .	(169)	(211)	(52)	(86)	(418)	—	(936)
Net loans . . . . .	22,909	56,941	16,538	23,039	45,654	(4,594)	160,487
Other assets . . . . .	1,021	2,354	353	658	2,379	379	7,144
Restricted assets . . . . .	—	—	—	—	—	2,915	2,915
Total assets . . . . .	<u>\$32,412</u>	<u>\$70,468</u>	<u>\$20,171</u>	<u>\$29,816</u>	<u>\$62,784</u>	<u>\$(1,298)</u>	<u>\$214,353</u>
Systemwide Debt Securities and subordinated debt . . . . .	\$28,053	\$59,240	\$13,852	\$24,005	\$54,244	\$ 21	\$179,415
Other liabilities . . . . .	1,012	1,959	3,989	1,325	3,461	(4,157)	7,589
Mandatorily redeemable preferred stock . . . . .	225	—	—	—	—	—	225
Total liabilities . . . . .	<u>29,290</u>	<u>61,199</u>	<u>17,841</u>	<u>25,330</u>	<u>57,705</u>	<u>(4,136)</u>	<u>187,229</u>
Capital							
Protected borrower stock . . . . .	5	4	—	1	—	(10)	—
Preferred stock . . . . .	400	—	200	471	700	—	1,771
Capital stock and participation certificates . . . . .	130	224	72	39	1,004	(46)	1,423
Restricted capital . . . . .	—	—	—	—	—	2,915	2,915
Accumulated other comprehensive loss . . . . .	(731)	(705)	(133)	(341)	(206)	(17)	(2,133)
Surplus . . . . .	3,318	9,746	2,191	4,316	3,581	(4)	23,148
Total capital . . . . .	<u>3,122</u>	<u>9,269</u>	<u>2,330</u>	<u>4,486</u>	<u>5,079</u>	<u>2,838</u>	<u>27,124</u>
Total liabilities and capital . . . .	<u>\$32,412</u>	<u>\$70,468</u>	<u>\$20,171</u>	<u>\$29,816</u>	<u>\$62,784</u>	<u>\$(1,298)</u>	<u>\$214,353</u>

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL COMBINING INFORMATION**  
**COMBINING BANK AND ASSOCIATION (DISTRICT)**  
**STATEMENT OF CONDITION (CONDENSED) — (continued)**  
**(in millions)**

**December 31, 2007**

	AgFirst District Combined	AgriBank District Combined	Texas District Combined	U.S. AgBank District Combined	CoBank District Combined	Insurance Fund and Combination Entries	System Combined
Cash and investments . . . . .	\$ 7,674	\$ 8,540	\$ 2,592	\$ 6,427	\$11,227		\$ 36,460
Loans . . . . .	20,728	48,894	15,114	19,756	41,854	\$(3,440)	142,906
Less: allowance for loan losses . . . .	(79)	(101)	(24)	(66)	(511)		(781)
Net loans . . . . .	20,649	48,793	15,090	19,690	41,343	(3,440)	142,125
Other assets . . . . .	938	1,903	319	612	1,131	364	5,267
Restricted assets . . . . .						2,599	2,599
Total assets . . . . .	<u>\$29,261</u>	<u>\$59,236</u>	<u>\$18,001</u>	<u>\$26,729</u>	<u>\$53,701</u>	<u>\$ (477)</u>	<u>\$186,451</u>
Systemwide Debt Securities and subordinated debt . . . . .	\$24,847	\$48,792	\$12,624	\$21,105	\$47,583	\$ (8)	\$154,943
Other liabilities . . . . .	623	1,508	3,126	1,179	1,463	(3,035)	4,864
Mandatorily redeemable preferred stock . . . . .	225						225
Total liabilities . . . . .	<u>25,695</u>	<u>50,300</u>	<u>15,750</u>	<u>22,284</u>	<u>49,046</u>	<u>(3,043)</u>	<u>160,032</u>
Capital							
Protected borrower stock . . . . .	5	5		1		(11)	
Preferred stock . . . . .	400		200	425	500		1,525
Capital stock and participation certificates . . . . .	128	211	69	48	935	(34)	1,357
Restricted capital . . . . .						2,599	2,599
Accumulated other comprehensive loss . . . . .	(154)	(171)	(34)	(128)	(40)	(16)	(543)
Surplus . . . . .	3,187	8,891	2,016	4,099	3,260	28	21,481
Total capital . . . . .	<u>3,566</u>	<u>8,936</u>	<u>2,251</u>	<u>4,445</u>	<u>4,655</u>	<u>2,566</u>	<u>26,419</u>
Total liabilities and capital . . . .	<u>\$29,261</u>	<u>\$59,236</u>	<u>\$18,001</u>	<u>\$26,729</u>	<u>\$53,701</u>	<u>\$ (477)</u>	<u>\$186,451</u>

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL COMBINING INFORMATION**  
**COMBINING BANK AND ASSOCIATION (DISTRICT)**  
**STATEMENT OF INCOME (CONDENSED)**  
**For the Year Ended December 31,**  
**(in millions)**

	<u>AgFirst District Combined</u>	<u>AgriBank District Combined</u>	<u>Texas District Combined</u>	<u>U.S. AgBank District Combined</u>	<u>CoBank District Combined</u>	<u>Insurance Fund, FAC &amp; Combination Entries</u>	<u>System Combined</u>
<b>2008</b>							
Net interest income . . . . .	\$ 817	\$1,564	\$ 468	\$ 634	\$1,179	\$ 40	\$ 4,702
Provision for loan losses . . . . .	(121)	(126)	(54)	(22)	(85)		(408)
Noninterest income . . . . .	27	280	38	48	117	(8)	502
Noninterest expense . . . . .	(359)	(709)	(184)	(314)	(381)	220	(1,727)
Provision for income taxes . . . . .		(22)		4	(135)		(153)
Net income . . . . .	<u>\$ 364</u>	<u>\$ 987</u>	<u>\$ 268</u>	<u>\$ 350</u>	<u>\$ 695</u>	<u>\$252</u>	<u>\$ 2,916</u>
<b>2007</b>							
Net interest income . . . . .	\$ 722	\$1,316	\$ 431	\$ 664	\$ 932	\$ (5)	\$ 4,060
Provision for loan losses . . . . .	(8)	(22)	(43)	(4)	(4)		(81)
Noninterest income . . . . .	39	172	26	46	87	92	462
Noninterest expense . . . . .	(341)	(636)	(171)	(282)	(340)	173	(1,597)
Provision for income taxes . . . . .		(36)		(4)	(101)		(141)
Net income . . . . .	<u>\$ 412</u>	<u>\$ 794</u>	<u>\$ 243</u>	<u>\$ 420</u>	<u>\$ 574</u>	<u>\$260</u>	<u>\$ 2,703</u>
<b>2006</b>							
Net interest income . . . . .	\$ 674	\$1,164	\$ 384	\$ 592	\$ 783	\$ (13)	\$ 3,584
(Provision for loan losses) loan loss reversal . . . . .	1	(15)	(9)	(8)	(4)		(35)
Noninterest income . . . . .	57	125	22	32	90	91	417
Noninterest expense . . . . .	(322)	(588)	(157)	(268)	(314)	145	(1,504)
Provision for income taxes . . . . .		(14)			(69)		(83)
Net income . . . . .	<u>\$ 410</u>	<u>\$ 672</u>	<u>\$ 240</u>	<u>\$ 348</u>	<u>\$ 486</u>	<u>\$223</u>	<u>\$ 2,379</u>

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL COMBINING INFORMATION**  
**COMBINING BANK AND ASSOCIATION (DISTRICT)**  
**STATEMENT OF CHANGES IN CAPITAL (CONDENSED)**  
(in millions)

	AgFirst District Combined	AgriBank District Combined	Texas District Combined	U.S. AgBank District Combined	CoBank District Combined	Insurance Fund, FAC & Combination Entries	System Combined
<b>Balance at December 31, 2005</b> . . . . .	\$3,145	\$7,819	\$1,955	\$3,732	\$4,077	\$2,046	\$22,774
Net income . . . . .	410	672	240	348	486	223	2,379
Change in unrealized losses on investments . . . . .	5	(2)	6	7	20		36
Change in unrealized losses on cash flow hedges . . . . .			(2)	9	(8)	9	8
Minimum pension liability adjustment . . . . .			16	12	16		44
Income tax benefit related to other comprehensive loss . . . . .		(1)		(1)	(7)		(9)
Total comprehensive income . . . . .	<u>415</u>	<u>669</u>	<u>260</u>	<u>375</u>	<u>507</u>	<u>232</u>	<u>2,458</u>
Protected borrower stock retired . . . . .	(2)	(2)				4	
Preferred stock issued, net . . . . .				(14)			(14)
Preferred stock dividends . . . . .	(11)		(15)	(9)	(37)		(72)
Capital stock and participation certificates issued . . . . .	10	25	23	23	18		99
Capital stock, participation certificates, and surplus retired . . . . .	(12)	(17)	(37)	(29)	(75)	(1)	(171)
Patronage and dividends . . . . .	<u>(236)</u>	<u>(95)</u>	<u>(74)</u>	<u>(96)</u>	<u>(147)</u>	<u>4</u>	<u>(644)</u>
<b>Balance at December 31, 2006</b> . . . . .	\$3,309	\$8,399	\$2,112	\$3,982	\$4,343	\$2,285	\$24,430
Net income . . . . .	412	794	243	420	574	260	2,703
Change in unrealized losses on investments . . . . .	(40)	(34)	17	(35)	23		(69)
Change in unrealized losses on cash flow hedges . . . . .		(11)	1	2	2	8	2
Minimum pension liability adjustment . . . . .			5	5	(2)		8
Income tax benefit related to other comprehensive loss . . . . .					(9)		(9)
Total comprehensive income . . . . .	<u>372</u>	<u>749</u>	<u>266</u>	<u>392</u>	<u>588</u>	<u>268</u>	<u>2,635</u>
Adjustment to initially apply FASB Statement No. 158, net of tax . . . . .	(116)	(106)	(30)	(45)	(14)	(1)	(312)
Protected borrower stock retired . . . . .	(1)	(1)				2	
Preferred stock issued, net . . . . .	247			268			515
Preferred stock dividends . . . . .	(21)		(16)	(21)	(36)		(94)
Capital stock and participation certificates issued . . . . .	24	22	14	13	1		74
Capital stock, participation certificates, and surplus retired . . . . .	(15)	(12)	(10)	(30)	(55)		(122)
Patronage and dividends . . . . .	<u>(233)</u>	<u>(115)</u>	<u>(85)</u>	<u>(114)</u>	<u>(172)</u>	<u>12</u>	<u>(707)</u>
<b>Balance at December 31, 2007</b> . . . . .	\$3,566	\$8,936	\$2,251	\$4,445	\$4,655	\$2,566	\$26,419
Adjustment due to the SFAS No. 158 accounting change . . . . .	(5)	(5)	(2)	(3)			(15)
<b>Balance at January 1, 2008</b> . . . . .	3,561	8,931	2,249	4,442	4,655	2,566	26,404
Net income . . . . .	364	987	268	350	695	252	2,916
Change in unrealized losses on investments . . . . .	(320)	(289)	(16)	(127)	(137)		(889)
Change in unrealized losses on cash flow hedges . . . . .		(40)	(4)	3	(2)	5	(38)
Pension and other benefit plans . . . . .	(257)	(205)	(79)	(89)	(102)	(6)	(738)
Income tax benefit related to other comprehensive loss . . . . .					75		75
Total comprehensive income (loss) . . . . .	<u>(213)</u>	<u>453</u>	<u>169</u>	<u>137</u>	<u>529</u>	<u>251</u>	<u>1,326</u>
Protected borrower stock retired . . . . .		(1)				1	
Preferred stock issued, net . . . . .				46	198		244
Preferred stock dividends . . . . .	(27)		(15)	(22)	(48)		(112)
Capital stock and participation certificates issued . . . . .	29	30	14	7	2		82
Capital stock, participation certificates, and surplus retired . . . . .	(28)	(17)	(12)	(16)	(37)		(110)
Patronage and dividends . . . . .	<u>(200)</u>	<u>(127)</u>	<u>(75)</u>	<u>(108)</u>	<u>(220)</u>	<u>20</u>	<u>(710)</u>
<b>Balance at December 31, 2008</b> . . . . .	<u>\$3,122</u>	<u>\$9,269</u>	<u>\$2,330</u>	<u>\$4,486</u>	<u>\$5,079</u>	<u>\$2,838</u>	<u>\$27,124</u>

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL FINANCIAL INFORMATION**  
**COMBINED BANK AND ASSOCIATION (DISTRICT)**  
**SELECTED KEY FINANCIAL RATIOS**  
**(unaudited)**

The following combining key financial ratios related to each combined Bank and its affiliated Associations is intended for the purpose of additional analysis.

	<u>AgFirst District Combined</u>	<u>AgriBank District Combined</u>	<u>Texas District Combined</u>	<u>U.S. AgBank District Combined</u>	<u>CoBank District Combined</u>
<b>December 31, 2008</b>					
Return on average assets . . . . .	1.17%	1.52%	1.40%	1.24%	1.16%
Return on average capital . . . . .	10.07%	10.71%	11.37%	7.56%	14.10%
Net interest margin . . . . .	2.66%	2.47%	2.49%	2.31%	2.01%
Net loan charge-offs as a % of average loans . . .	0.14%	0.03%	0.16%	0.01%	0.05%
Allowance for loan losses as a % of loans . . . . .	0.73%	0.37%	0.31%	0.37%	0.91%
Capital as a % of total assets . . . . .	9.63%	13.15%	11.55%	15.05%	8.09%
Risk funds as a % of loans . . . . .	14.26%	16.59%	14.36%	19.77%	11.93%
Debt to capital . . . . .	9.38:1	6.60:1	7.66:1	5.65:1	11.36:1
Operating expense as a % of net interest income and noninterest income . . . . .	42.36%	38.21%	36.41%	45.16%	29.45%
<b>December 31, 2007</b>					
Return on average assets . . . . .	1.48%	1.40%	1.44%	1.69%	1.24%
Return on average capital . . . . .	11.40%	9.12%	10.86%	9.51%	12.72%
Net interest margin . . . . .	2.64%	2.38%	2.60%	2.74%	2.03%
Net loan charge-offs (recoveries) as a % of average loans . . . . .	0.01%	0.03%	0.23%	0.01%	(0.04)%
Allowance for loan losses as a % of loans . . . . .	0.38%	0.21%	0.16%	0.33%	1.22%
Capital as a % of total assets . . . . .	12.19%	15.09%	12.50%	16.63%	8.67%
Risk funds as a % of loans . . . . .	17.58%	18.48%	15.05%	22.83%	12.34%
Debt to capital . . . . .	7.21:1	5.63:1	7.00:1	5.01:1	10.54:1
Operating expense as a % of net interest income and noninterest income . . . . .	44.50%	42.69%	37.40%	39.65%	33.60%

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL FINANCIAL INFORMATION**  
**(unaudited)**

The table below reflects the combined results of each Bank and its affiliated Associations (District) measurement under market value of equity and net interest income sensitivity analyses in accordance with their respective asset/liability management policies and District limits.

<u>District</u>	<u>Change in Market Value of Equity</u>			<u>Change in Net Interest Income</u>		
	<u>December 31, 2008</u>			<u>December 31, 2008</u>		
	<u>-6</u>	<u>+100</u>	<u>+200</u>	<u>-6</u>	<u>+100</u>	<u>+200</u>
AgFirst .....	0.10%	-0.23%	-0.62%	0.11%	5.31%	15.09%
AgriBank .....	-0.01	-0.48	-0.95	0.05	1.33	3.72
Texas .....	0.13	-2.41	-5.26	0.16	-3.10	1.93
U.S. AgBank .....	0.02	-1.57	-3.35	-0.32	7.32	14.68
CoBank .....	0.26	-4.46	-8.50	-0.24	0.34	-0.55

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL FINANCIAL INFORMATION**  
**(unaudited)**

**SELECTED ASSOCIATION KEY FINANCIAL INFORMATION**

The Banks serve as financial intermediaries between the capital markets and the retail lending activities of their related Associations. Accordingly, in addition to the supplemental combining Bank and Association (District) information provided on pages F-44 to F-51, selected financial information regarding the 10 largest Associations by asset size is provided below for the purpose of additional analysis.

**December 31, 2008**  
**(\$ in millions)**

	<u>Total Assets</u>	<u>Gross Loans</u>	<u>Net Income</u>	<u>Allowance for Loan Losses</u>	<u>Allowance for Loan Losses as a % of Gross Loans</u>	<u>Nonperforming Loans as a % of Gross Loans</u>	<u>Permanent Capital Ratio</u>
<b>AgriBank District</b>							
FCS of Mid-America, ACA . . . . .	\$13,930	\$11,996	\$162	\$33	0.28%	1.36%	13.33%
FCS of America, ACA . . . . .	13,280	12,464	243	55	0.44	0.92	13.41
AgStar Financial Services, ACA . . . . .	5,313	4,472	63	30	0.67	2.92	10.94
Greenstone FCS, ACA . . . . .	4,760	4,563	63	29	0.64	2.34	12.65
AgCountry, ACA . . . . .	3,312	3,050	65	9	0.30	1.43	14.08
<b>Texas District</b>							
Capital Farm Credit, ACA . . . . .	5,461	5,293	99	24	0.45	1.74	12.49
<b>U.S. AgBank District</b>							
Farm Credit West, ACA . . . . .	5,619	4,962	93	9	0.18	1.42	12.67
American AgCredit, ACA . . . . .	3,951	3,783	60	9	0.24	0.51	16.79
<b>CoBank District</b>							
Northwest FCS, ACA . . . . .	8,326	7,885	124	48	0.61	1.15	12.70
First Pioneer Farm Credit, ACA . . . . .	3,108	2,976	60	31	1.04	0.86	14.71

Note: None of the 10 largest Associations was in the AgFirst District.



**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL FINANCIAL INFORMATION**  
**(unaudited)**

Young, Beginning and Small Farmers and Ranchers

In line with our mission, we have policies and programs for making credit available to young, beginning and small farmers and ranchers.

The definitions of young, beginning and small farmers and ranchers (YBS) are:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan was originally made.
- Beginning: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the date the loan was originally made.
- Small: A farmer, rancher or producer or harvester of aquatic products who normally generates less than \$250 thousand in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

It is important to note that farmers/ranchers may be included in multiple categories since they are included in each category in which the definition is met.

The following table summarizes information regarding loans to young and beginning farmers and ranchers:

	<u>At December 31, 2008</u>	
	<u>Number of loans</u>	<u>Volume</u>
	(\$ in millions)	
Total loans and commitments . . . . .	841,156	\$171,114
Loans and commitments to young farmers and ranchers . . . . .	153,380	\$ 19,529
% of loans and commitments to young farmers and ranchers . . . . .	18.2%	11.4%
Loans and commitments to beginning farmers and ranchers . . . . .	216,674	\$ 32,977
% of loans and commitments to beginning farmers and ranchers . . . . .	25.8%	19.3%

The following table summarizes information regarding new loans made during 2008 to young and beginning farmers and ranchers:

	<u>For the Year Ended December 31, 2008</u>	
	<u>Number of new loans</u>	<u>Volume</u>
	(\$ in millions)	
Total new YBS loans and commitments . . . . .	316,000	\$69,051
New loans and commitments to young farmers and ranchers . . . . .	52,856	\$ 7,658
% of new loans and commitments to young farmers and ranchers . . . . .	16.7%	11.1%
New loans and commitments to beginning farmers and ranchers . . . . .	66,559	\$11,958
% of new loans and commitments to beginning farmers and ranchers . . . . .	21.1%	17.3%

**FARM CREDIT SYSTEM**  
**SUPPLEMENTAL FINANCIAL INFORMATION**  
**(unaudited)**

The following table summarizes information regarding loans to small farmers and ranchers:

	At December 31, 2008				
	Loan Size				Total
	\$50 thousand or less	\$50 to \$100 thousand	\$100 to \$250 thousand	Over \$250 thousand	
	(\$ in millions)				
Total number of loans and commitments . . .	396,382	165,326	166,285	113,163	841,156
Number of loans and commitments to small farmers and ranchers . . . . .	256,659	99,425	87,648	31,546	475,278
% of loans and commitments to small farmers and ranchers . . . . .	64.8%	60.1%	52.7%	27.9%	56.5%
Total loan and commitment volume . . . . .	\$ 7,811	\$ 11,648	\$ 25,499	\$126,156	\$171,114
Total loan and commitment volume to small farmers and ranchers . . . . .	\$ 5,030	\$ 6,937	\$ 13,180	\$ 17,542	\$ 42,689
% of loan and commitment volume to small farmers and ranchers . . . . .	64.4%	59.6%	51.7%	13.9%	24.9%

The following table summarizes information regarding new loans made during 2008 to small farmers and ranchers:

	For the Year Ended December 31, 2008				
	Loan Size				Total
	\$50 thousand or less	\$50 to \$100 thousand	\$100 to \$250 thousand	Over \$250 thousand	
	(\$ in millions)				
Total number of new YBS loans and commitments . . . . .	133,172	59,676	61,082	62,070	316,000
Number of new loans and commitments to small farmers and ranchers . . . . .	84,938	29,514	24,908	11,429	150,789
% of new loans and commitments to small farmers and ranchers . . . . .	63.8%	49.5%	40.8%	18.4%	47.7%
Total new YBS loan and commitment volume . . . . .	\$ 2,538	\$ 3,918	\$ 8,980	\$53,615	\$ 69,051
Total new loan and commitment volume to small farmers and ranchers . . . . .	\$ 1,594	\$ 1,986	\$ 3,818	\$ 6,831	\$ 14,229
% of loan and commitments volume to small farmers and ranchers . . . . .	62.8%	50.7%	42.5%	12.7%	20.6%

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## DIRECTORS AND MANAGEMENT

### Boards of Directors

Each Bank is governed by a board of directors that is responsible for establishing policies and procedures for the operation of the Bank. Each Bank's bylaws provide for the number, term, manner of election and qualifications of the members of the Bank's board. Farm Credit Administration regulations require at least two members of each Bank's board of directors be appointed by the other directors. Appointed members cannot be a director, officer, employee or stockholder of a System institution.

The following information sets forth the directors of each Bank as of December 31, 2008. The information includes the director's name, age, and business experience, including principal occupation and employment during the past five years. For additional discussion and information on the compensation of each Bank's board of directors, see the Bank's annual report.

### AgFirst Farm Credit Bank

Gary L. Alexander, 53, from Westminster, South Carolina, is owner and operator of Alexander Farms, Inc., a poultry production and property development business. He markets 3.2 million broilers a year through his 18-broiler house farm and develops residential properties. He currently serves on the board of directors of AgSouth Farm Credit, ACA and is a director of The Outdoor Dream Foundation, an organization providing outdoor adventures for children with life threatening illnesses and also a member of the S. C. Poultry Federation. Mr. Alexander became a director in 2008 and his term expires December 31, 2011.

William C. Bess, Jr., 65, from Lincolnton, North Carolina, is owner of Bess Farms, Inc., a grain and hay production operation and has a 70-head cow-calf operation. He serves on the boards of the national Farm Credit Council Board, the Farm Credit System's national trade organization, Farm Credit Council Services, and Carolina Farm Credit, ACA. He is also a member of the Cleveland County and Catawba Cattlemen's Associations. Mr. Bess became a director in 1995 and his term expires December 31, 2009.

Henry M. (Buddy) Frazee, 70, of Alachua, Florida, is a retired managing partner of a large cow-calf beef cattle operation, and is President of West Putnam Lakes, Inc. and H&P Frazee Enterprises, Inc., timber and land development companies. He is also managing partner, trustee of Ashley Lake Plantation and West Putnam Enterprises, land development partnerships. In addition, along with his son, he manages a 2,000-acre game preserve and deer hound kennel. He currently serves on the board of Farm Credit of North Florida, ACA. Mr. Frazee became a director in 2005 and his term expired on December 31, 2008.

Don W. Freeman, 68, of Montgomery, Alabama, manages a 400-acre cow-calf operation and a 80 unit river rental business near Lowndesboro, Alabama. He is a member of the national Farm Credit Council Board, Lowndes County Farmers Federation Board, and the Lowndes County Cattlemen's Association Board. He is also past president of the Alabama Chapter of the American Society of Farm Managers and Rural Appraisers. He is a member of First South Farm Credit, ACA. Mr. Freeman became a director in 1995 and his term expires December 31, 2009.

Dale R. Hershey, 61, from Manheim, Pennsylvania is a partner in Hershey Brothers Dairy Farms, a dairy operation which milks 285 cows, raises 250 dairy replacements, and grows 650 acres of corn, alfalfa, soybeans, barley, rye and hay. He is on the board of directors of MidAtlantic Farm Credit, ACA, is a delegate on the Leadership Council for Land O'Lakes and is a member of Pennsylvania Farm Bureau, Pennsylvania Dairy Stakeholders and the Pennsylvania Holstein Association. Mr. Hershey also is a member of the Lancaster County Blue Ribbon Commission for Agriculture and the Penn Township Ag Advisory Committee. Mr. Hershey became a director in 2008 and his term expires December 31, 2011.

Robert L. Holden, Sr., 62, is co-owner and operator of a dairy, a 900-acre row-crop farm, and a 200,000 broiler operation in Whigham, Georgia. He is a director of the Southwest Georgia Farm Credit, ACA, Georgia Milk Producers, Grady County Farm Bureau, American Dairy Association of Georgia, and First United Ethanol, LLC. Mr. Holden became a director in 1995 and his term expires December 31, 2010.

Paul M. House, 60, Vice Chairman of the Board, is from Nokesville, Virginia, where he grows corn, soybeans, wheat, hay and turf grass. He also operates a dairy. He serves as a director of the Farm Credit of the Virginias, ACA. Mr. House became a director in 2002 and his term expires December 31, 2011.

Thomas W. Kelly, 71, Chairman of the Board, is a farmer from Tyrone, Pennsylvania. A former dairyman and breeder of registered Holsteins, his farming operation now includes raising dairy heifers and growing corn, soybeans and hay. Along with his son, he handles land management for Spring Lane Hunt Club. He currently is an elected delegate to the Penn State Agricultural Council and a director of Mid-Atlantic Master Farmer Association and is a former director of Holstein Association, USA. Mr. Kelly became a director in 2001 and his term expires December 31, 2012.

Lyle Ray King, 64, of Ash, North Carolina, owns and operates a farm where he grows, timber, corn, soybeans and wheat. He currently serves on the boards of Cape Fear Farm Credit, ACA, Atlantic Telephone Membership Cooperative, and Landbank Resource Management, a real estate company. Mr. King became a director in 2005 and his term expires December 31, 2012.

M. Wayne Lambertson, 62, of Pokomoke City, Maryland, owns and operates with his son a 2,700-acre farm of corn, soybeans, and wheat, and a 300,000 capacity broiler operation. He is co-owner of a restaurant, Green Turtle, and partner in a development and construction company, J.W.L. Enterprise, LLC. He currently serves on the national Farm Credit Council Board, MidAtlantic Farm Credit, ACA board of directors and the board of the Delmarva Poultry Industry DPI, a trade organization. Mr. Lambertson became a director in 2002 and his term expires December 31, 2009.

James L. May, 59, is owner and operator of Mayhaven Farm in Waynesburg, Kentucky, where he owns 330 acres and leases another 700 acres. He is involved in the development and marketing of 500 heifers for replacement cows and embryo transfer. Mr. May's operation also includes 150 acres of alfalfa hay, 500 acres of corn and soybeans, and 100 acres of wheat. He currently serves as a member of the Central Kentucky Ag Credit board, Lincoln County Extension Council, Lincoln County Ag Development Board, and is a member of the Lincoln County Farm Bureau Board. Mr. May became a director in 2006 and his term expires December 31, 2009.

Eugene W. Merritt, Jr., 64, from Easley, South Carolina, is co-owner of an ornamental tree farm and is a landscape contractor. He also operates a 400-acre timber and grass farm. He serves on the boards of AgSouth Farm Credit, ACA; People Bancorp, commercial bank holding company; Peoples National Bank, a commercial bank; and Jackson Companies, a recreational company. Mr. Merritt became a director in 1995 and his term expires December 31, 2010.

James M. Norsworthy, III, 58, from Jackson, Louisiana. He runs 100 Cedars Cattle Farm, a 175-head cow-calf operation near Jackson, La. He also has a commercial hay operation with 125 acres in Alicia Bermuda hay and 150 acres in Bahia Grass hay and manages a 375-acre pine and hardwood timber operation. Mr. Norsworthy is a member of the board of directors of First South Farm Credit, ACA, and serves on the board of Feliciana Farm Bureau and is a past president of that organization. He is a member of East Feliciana Cattlemen's Association, American Angus Association and the Feliciana Forestry Association. He also served as a former mayor of the town of Jackson, Louisiana. Mr. Norsworthy became a director in 2008 and his term expires December 31, 2011.

Katherine A. Pace, 46, from Orlando, Florida, is a certified public accountant. Prior to forming her company, Family Business Consulting, LLC, she was a tax partner with KPMG, LLP, an audit, tax and advisory service firm, from 1985-2005. While at KPMG her practice included a variety of cooperative and agribusiness clients as well as participation in trade associations such as the National Society of Accountants for Cooperatives. She is a member of the American Institute of Certified Public Accountants, the Florida Institute of Certified Public Accountants and current and past member and director of numerous trade and charitable organizations. In addition to the AgFirst Bank, she serves as a director on an advisory board for a private for profit organization involved in agriculture. Ms. Pace became a director in 2006 and her term expires December 31, 2011. She is a board designated financial expert.

J. Dan Raines, Jr., 64, is a beef producer from Ashburn, Georgia. His operations include commercial beef cattle, registered Angus cattle and timber. He serves as a director on the boards of AgGeorgia Farm Credit, ACA and the Federal Agricultural Mortgage Corporation (Farmer Mac). Mr. Raines became a director in 1995 and his term expires December 31, 2009.

Walter L. Schmidlen, Jr., 68, from Elkins, West Virginia, is a past dairy farmer and now continues his cow-calf operation along with growing hay and corn on a 700-acre farm with lease/rented land. He is owner/operator of a farm equipment business. He presently serves on the board of the Farm Credit of the Virginias, ACA and was a former director of Southern States Cooperative and Sire Power. Mr. Schmidlen became a director in 2001 and his term expires December 31, 2012.

Robert G. Sexton, 49, is from Vero Beach, Florida. He is President of Oslo Citrus Growers Association and co-owner of Lost Legend, LLC, owner of Orchid Island Juice Company. He serves as a director of Farm Credit of South Florida, ACA, Oslo Citrus Growers Association, Lost Legend, LLC, Florida Citrus Packers, Indian River Citrus League, Highland Exchange Service Co-op, a packinghouse supply cooperative, McArthur Management Company, a management company for a large dairy, cattle and citrus agribusiness, Sexton Grove Holdings, a family citrus company, Sexton Properties, Oslo Packing Company, Patio Restaurant and Sexton, Inc., family commercial real estate companies, and Dancing Pigs, LLC, which owns Red, Hot and Blue BBQ restaurants. In addition, he is a member of the Indian River Farm Bureau. Mr. Sexton became a director in 2000 and his term expires December 31, 2011. He is a board designated financial expert.

Kenneth A. Spearman, 64, from Winter Haven, Florida, is a retired Director of Internal Audit for Florida's Natural Growers, Inc. who served 28 years with the citrus industry. He was Controller for Citrus Central, Inc. in Orlando, Florida from 1980-1991, was co-founder of a public accounting firm in Chicago, Illinois and was employed with Arthur Andersen & Co. He obtained his Masters Degree in Business Administration from Governors State University in University Park, Illinois, and his B.S. degree in accounting from Indiana University. He served as chairman of the board of trustees for the Lake Wales Medical Center. He is a member of the Institute of Internal Auditors, and the National Society of Accountants for Cooperatives, where he was also past National President. Mr. Spearman was appointed to the AgFirst board in January 2006 and his term expires December 31, 2009.

Robert H. Spiers, Jr., 63, is a full-time farmer, with a tobacco, corn, wheat, soybean and cotton operation on 1,100 acres in Dinwiddie County, Virginia. He currently serves on the boards of Colonial Farm Credit, ACA, Tobacco Associates, Inc. and Dinwiddie County Farm Bureau. He is also director and treasurer of the Old Hickory Hunt Club and a director on the Virginia Flue-cured Tobacco Board. He has been active on a number of Virginia Farm Bureau advisory committees. He became a director in 2006 and his term expires December 31, 2009.

William H. Voss, 67, is from McComb, Mississippi. He has commercial cattle and timber operations in Southwest Mississippi and is involved in land and commercial property management. His career includes production agriculture, agribusiness and real estate. He currently serves on the Board of directors of First South Farm Credit, ACA. He is a former agricultural commodities and securities broker and has served as chairman of the Mississippi Real Estate Commission and Chairman of the Pike County Farm Service Committee. He became a director in 2007 and his term expires December 31, 2010.

In 2008, each member of AgFirst FCB's board of directors received compensation of \$50,205, plus expenses.

### **AgriBank, FCB**

Armin Apple, 64, is a self-employed grain farmer in McCordsville, Indiana and a Hancock County Indiana Commissioner. Mr. Apple serves as chair of the Finance Committee. Mr. Apple also serves on the AgriBank District Farm Credit Council and is on the board of The Farm Credit Council. Mr. Apple became a director in 2003 and his term expires in 2011.

Ed Breuer, 44, is a self-employed grain and livestock farmer in Mandan, North Dakota. Mr. Breuer serves as chair of the Governance Committee. He is also a director of Farm Credit Services of Mandan, ACA. Mr. Breuer became a director in 2004 and his term expires in 2011.

Timothy Clayton, 54, appointed director, Plymouth, Minnesota is a Principal of the management consulting firm Emerging Capital, LLC. Mr. Clayton serves as chair of the Audit Committee. He is also a director of the National Federation of Independent Business in Washington, D.C., which provides political advocacy for small businesses. Mr. Clayton became a director in 2005 and his term expires in 2009.

Richard Davidson, 64, is a self-employed grain and livestock farmer in Washington C.H., Ohio. Mr. Davidson serves on the Finance Committee. Mr. Davidson became a director in 2005 and his term expires in 2009.

Roger Decker, 67, is a self-employed grain and livestock farmer in Westgate, Iowa. Mr. Decker serves on the Human Resources Committee. He is also a director of AMPI Milk Cooperative in New Ulm, Minnesota, serves on the AgriBank District Farm Credit Council and is on the board of The Farm Credit Council. Mr. Decker became a director in 2003 and his term expires in 2010.

Douglas Felton, 62, is a self-employed grain farmer in Cannon Falls, Minnesota. Mr. Felton serves as vice chair of the Governance Committee. He is also a director of D&T Enterprise of Minnesota, Inc., which is engaged in custom harvesting and agriculture production and is a director of Great Western Industrial Park, LLC, which is an industrial development company. He also serves on the AgriBank District Farm Credit Council and is on the board of The Farm Credit Council. Mr. Felton became a director in 1996 and his term expires in 2012.

Meredith Kapp, 66, is a self-employed grain and livestock farmer in Crosby, Missouri. Mr. Kapp serves on the Governance Committee. He is also a director of the Crosby-Helena Fire Protection District. Mr. Kapp became a director in 2004 and his term expires in 2012.

David Keller, 61, is a self-employed grain and livestock farmer in Mt. Carroll, Illinois. Mr. Keller serves on the Governance Committee. He is also a director of 1st Farm Credit Services, ACA. Mr. Keller became a director in 2005 and his term expires in 2009.

Thomas Klahn, 59, chairman, is a self-employed grain farmer in Lodi, Wisconsin. Mr. Klahn serves on the Audit Committee. He is also a director of Badgerland Farm Credit Services, ACA, and serves on the AgriBank District Farm Credit Council. Mr. Klahn became a director in 2002 and his term expires in 2009.

Lyndon Limberg, 66, is a self-employed farmer in Gary, South Dakota. He serves as the vice chair of the Human Resources Committee. He also serves on the board of the Antelope Valley Reformed Church in Gary, South Dakota. Mr. Limburg became a director in 2007 and his term expires in 2011.

Bill Mainer, 72, is a self-employed livestock and poultry farmer in Branch, Arkansas. Mr. Mainer serves on the Finance Committee. He is also a director of FCS of Western Arkansas, ACA, and serves on the AgriBank District Farm Credit Council. Mr. Mainer became a director in 1988 and his term expires in 2010.

James McElroy, 60, is a self-employed grain farmer in Waverly, Kentucky. Mr. McElroy serves on the Audit Committee. He is also a director of Union County Kentucky Soil and Conservation District, a natural resource conservation organization. Mr. McElroy became a director in 2000 and his term expires in 2010.

David Norman, 51, appointed director, Morrilton, Arkansas is Group Vice President of Enterprise and Agriculture of Winrock International, a non profit development foundation. Mr. Norman serves on the Governance Committee. He is also a board member of Volunteers for Economic Growth Alliance, an international development organization and the Arkansas Repertory Theatre. Mr. Norman became a director in 2003 and his term expires in 2011.

Thomas Payne, 67, appointed director, Columbia, Missouri, is the Vice Chancellor and Dean of the College of Agriculture, Food and Natural Resources and Director of the Missouri Agricultural Experiment Station at the University of Missouri. Dr. Payne serves on the Human Resources Committee. He is also a director of Agricultural Futures of America in Kansas City, Missouri. He also serves on the board of the Graduate Institute of Cooperative Leadership, Columbia, Missouri and as a member of the advisory board of the World Agricultural Forum, St. Louis, Missouri. Dr. Payne became a director in 2003 and his term expires in 2010.

John Schmitt, 52, is a self-employed grain and beef cattle farmer in Quincy, IL. He serves as the vice chair of the Audit Committee. He also is a director of 1st FCS, ACA, Normal, Illinois and Adams County Illinois Farm Bureau. Mr. Schmitt became a director in 2007 and his term expires in 2011.

William Stutzman, 61, is a self-employed cash crop farmer in Blissfield, Michigan and president of Ogden Telephone Company. Mr. Stutzman serves as chair of the Human Resources Committee. He is also a director of GreenStone Farm Credit Services, ACA, where he serves on their Audit Committee. He also serves on the Farm Credit Foundation Plan Sponsor Committee. Mr. Stutzman became a director in 2003 and his term expires in 2010.

Roy Tiarks, 58, is a self-employed grain and livestock farmer in Council Bluffs, Iowa. Mr. Tiarks serves on the Audit Committee. He is also a director of the Federal Farm Credit Banks Funding Corporation. Mr. Tiarks became a director in 1996 with AgAmerica, FCB and beginning January 1, 2003 became a director of AgriBank, FCB. His term expires in 2009.

Keri Votruba, 49, vice chairman, is a self-employed grain and livestock farmer in Hemingford, Nebraska. Mr. Votruba serves as vice-chair of the Finance Committee. Mr. Votruba became a director in 2004 and his term expires in 2012.

Sue Welch, 71, is a self-employed crop and timber farmer in Fayetteville, Tennessee. Ms. Welch serves on the Finance Committee. She also serves on the Lincoln County (Tennessee) Fair Association board as well as serves on the Lincoln County/Fayetteville TN Industrial Board and Lincoln County (Tennessee) Planning Commission board. Ms. Welch became a director in 2008 and her term expires in 2012.

In 2008, each member of AgriBank, FCB's board of directors received an annual retainer which was paid quarterly for attendance at meetings and other official activities. Director compensation was \$45,185, plus expenses, per director for 2008.

### **CoBank, ACB**

Gene Batali, 67, is the owner/operator of Batali Ranch, Inc., a specialized farming operation (spearmint) in Yakima, Washington. Mr. Batali serves on the Board's Governance and Risk Committees. Mr. Batali became a director in 2007 and his term expires in 2009.

D. Sheldon Brown, 62, is a dairy farmer in Salem, New York. Mr. Brown is secretary/treasurer/director of Woody Hill Farms, Inc., a dairy farm, and is also general partner in Woody Hill Farms, LLC, real property management, in Salem, New York. Mr. Brown serves on the Board's Audit Committee and is chairman of the Governance Committee. Mr. Brown became a director in 1998 and his term expires in 2009.

Rita M. Brown, 56, is the President of Commercial Services, Time Warner Cable, competitive business telecommunications services, in Syracuse, New York. She was formerly COO of Cleartel Communications in Delray Beach, Florida and senior vice president and general manager of CTSI, LLC in Dallas, Pennsylvania. Ms. Brown serves on the Board's Governance and Risk Committees. Ms. Brown became a director in 2000 and her term expires in 2010.

Everett Dobrinski, chairman, 62, is owner/operator of Dobrinski Farm, a cereal grain and oilseed farm in Makoti, North Dakota. Mr. Dobrinski serves as the board chairman of Verendrye Electric Cooperative. He serves as a director with North Dakota Coordinating Council for Cooperatives, Dakota Pride Cooperative, and The Farm Credit Council. Mr. Dobrinski serves as chairman of the Board's Executive Committee and the Board's Compensation Committee. Mr. Dobrinski became a director in 1999 and his term expires in 2011.

Randal J. Ethridge, 57, is executive vice president of People's Electric Cooperative, a rural electric distribution cooperative in Ada, Oklahoma, and owner/operator of Ethridge Ranch, a cattle ranching operation in Stroud, Oklahoma. Mr. Ethridge serves on the following boards: president/director, Science and Natural Resources Foundation; director, Oklahoma Association of Electric Cooperatives; and alternate director, Western Farmers Electric Cooperative. Mr. Ethridge serves on the Board's Risk Committee. Mr. Ethridge became a director in 1997 and his term expires in 2010.

William M. Farrow III, 53, is the CEO and Managing Partner of F.C. Partners Group, LLC, business advisor in Chicago, Illinois. He also is a member of the faculty and lecturer of managerial economics and decision science at Northwestern University in Evanston, Illinois. He was formerly EVP and CIO for the Chicago Board of Trade in Chicago, Illinois. Mr. Farrow serves as board advisor for Skyler Technology Inc. Mr. Farrow serves on the Board's Risk Committee. Mr. Farrow became a director in 2007 and his term expires in 2010.

Mary E. Fritz, second vice chairman, 59, is owner/operator of Quarter Circle JF Ranch, Inc., a dry land grain and cow/calf operation in Chester, Montana. Ms. Fritz serves as director of The Farm Credit Council. Ms. Fritz serves on the Board's Executive and Compensation Committees. Ms. Fritz became a director in 2003 and her term expires in 2011.



William H. Harris, 59, is the owner/operator of Harris Farms, a cash crop farming operation, and partner of HR&W Harvesting, processing vegetable farms in LeRoy, New York. Mr. Harris is also president of Eatwell Farms, Inc., custom field work in LeRoy, New York. Mr. Harris serves on the Board's Audit Committee. Mr. Harris became a director in 2001 and his term expires in 2011.

Daniel T. Kelley, first vice chairman, 60, is the owner/operator of Kelley Farms, a diversified corn and soybean operation in Normal, Illinois. Mr. Kelley serves as board chairman and president of Growmark, Inc., board chairman of FS Financial Services Corp., director of Evergreen FS, Inc., vice chairman of the Illinois Agricultural Leadership Foundation, and director of Nationwide Mutual Insurance Company. Mr. Kelley serves on the Board's Executive and Compensation Committees. Mr. Kelley became a director in 2004 and his term expires in 2009.

James A. Kinsey, 59, is owner/operator of Kinsey's Oak Front Farms, a purebred Angus seed-stock producer in Flemington, West Virginia. Mr. Kinsey serves as a director of Farm Credit of the Virginias, ACA and the Federal Farm Credit Banks Funding Corporation. Mr. Kinsey serves on the Board's Executive and Compensation Committees. Mr. Kinsey became a director in 2001 and his term expires in 2012.

Gary A. Miller, 48, is the president and CEO of GreyStone Power Corporation, an electric membership corporation in Douglasville, Georgia. Mr. Miller serves as a director of Wellstar Health System and of Oglethorpe Power Corporation, and as chairman of GRESCO Utility Supply, Inc. Mr. Miller serves on the Board's Audit Committee. Mr. Miller became a director in 2006 and his term expires in 2009.

Robert D. Nattier, 65, is the retired president and CEO of Mid Kansas Cooperative, a farm supply cooperative in Moundridge, Kansas. He is co-operator of 4-N, Inc., a grain and livestock operation, and owner of Foxridge Golf Club in Newton, Kansas. Mr. Nattier also serves as a director of the North Newton Housing Authority and Wheatland Homes. Mr. Nattier serves on the Board's Executive, Compensation, and Governance Committees. Mr. Nattier became a director in 2003 and his term expires in 2012.

Barry M. Sabloff, 62, is vice chairman/director of Marquette National Corporation, a bank holding company, and Marquette Bank, a community bank, in Chicago, Illinois. Mr. Sabloff is a director of Marquette Bank Education Foundation, Marquette Bank Affordable Housing Foundation, and Calypso Technology, Inc. Mr. Sabloff is trustee of Columbia College Chicago, member Board of Advisors of Sherwood Conservatory of Music at Columbia College Chicago, and director of The American School in London Foundation. Mr. Sabloff is the Board's financial expert and serves as chairman of the Board's Audit Committee. Mr. Sabloff became a director in 2005 and his term expires in 2012.

D. Wayne Seaman, 70, is president of Seaman Enterprises, consulting for boards and employees for cooperatives in Carroll, Iowa. Mr. Seaman also serves as a director on the following boards: CADC, Home State Bank, Highway Farms, Western Iowa Energy, and FC Feeds. Mr. Seaman serves on the Board's Executive, Compensation, and Governance Committees. Mr. Seaman became a director in 2000 and his term expired on December 31, 2008.

Richard W. Sitman, 55, is owner/operator of Jos. M. Sitman, Inc., a retail business in Greensburg, Louisiana. Mr. Sitman serves as the board chairman of Dixie Electric Membership Cooperative, DEMCO Energy Services, Inc., and Dixie Business Center. He also serves as board secretary of the Bank of Greensburg and as director of The Farm Credit Council. Mr. Sitman serves on the Board's Audit and Governance Committees. Mr. Sitman became a director in 1999 and his term expires in 2010.

Kevin A. Still, 51, is CEO and treasurer of Co-Alliance, LLP, a partnership of four cooperatives supplying energy, agronomy, and animal nutrition, producing swine, and marketing grain in Danville, Indiana. He is also CEO and treasurer of both Midland Co-op, Inc. and Frontier Co-op, Inc. in Danville, Indiana and LaPorte County Co-op in LaPorte, Indiana, agricultural retail cooperatives. He is director of Hartford Bio Energy and Chinook Bio Products LLC and is President of Still Farms LLC. Mr. Still serves as chairman on the Board's Risk Committee. Mr. Still became a director in 2002 and his term expires in 2010.

In 2008, each member of CoBank, ACB's board of directors was compensated for attendance at meetings and other official activities. Director compensation ranged from \$50,205 to \$65,267 for 2008, plus expenses.

## **Farm Credit Bank of Texas**

C. Kenneth Andrews, 75, is a rancher in Madisonville, Texas. He served on the bank's Audit Committee, Compensation Committee and the Tenth District Farm Credit Council board, and represented the district on The Farm Credit Council board from 1996 to 2005. Mr. Andrews became a director in 1994 and his term expired on December 31, 2008. Mr. Andrews retired from the bank's board upon the expiration of his term.

Ralph W. "Buddy" Cortese, 62, chairman of the board of directors, is a rancher/farmer in Fort Sumner, New Mexico. He is a member of the bank's Audit and Compensation committees and serves on the American Land Foundation Board. In June 2003, he was appointed to the Farmer Mac board with his appointment expiring in 2008. He is also a member of the Texas Agricultural Cooperative Council board of directors. Mr. Cortese became a director in 1995 and his term expires in 2010.

Joe R. Crawford, 71, is from Baileyton, Alabama, and owns and operates a cattle business. Mr. Crawford is vice chairman of the bank's Audit Committee and also serves on the bank's Compensation Committee and on the board of directors and the audit committee of the Federal Farm Credit Banks Funding Corporation. He is a member and past president of the Alabama Cattlemen's Association and a member of the National Cattlemen's Beef Association, the Alabama Farm Bureau and the Alabama Farmers Federation. Mr. Crawford became a director in 1998 and his term expires in 2009.

James F. Dodson, 55, is from Robstown, Texas and grows cotton and milo and operates a seed sales business with his family. Mr. Dodson serves on the bank's Audit Committee, Compensation Committee and serves as chairman of the Tenth District Farm Credit Council. He is also on the board of Cotton Incorporated. He is president of Dodson Farms, Inc., Dodson Ag, Inc.; the owner of Jimmy Dodson Farms; a partner in Weber Greene, Ltd; and managing partner in Weber Station LLC. In addition, Mr. Dodson serves on the boards of Gulf Coast Cooperative and South Texas Cotton and Grain Association and holds leadership positions in the National Cotton Council of America and American Cotton Producers. Mr. Dodson became a director in 2003 and his term expired on December 31, 2008. Mr. Dodson was reelected to the board with his new term expiring in 2011.

Elizabeth G. "Betty" Flores, 64, is from Laredo, Texas, where she served as city mayor from 1998 to 2006. Ms. Flores serves on the bank's Audit Committee and Compensation Committee. Previously, she was senior vice president of the Laredo National Bank. Ms. Flores serves on the boards of the Texas Agricultural Cooperative Council and the TMF Health Quality Institute, and is a graduate of Leadership Texas 1995 and Leadership America 2008. She is a partner with a family ranching and real estate limited partnership, E.G. Ranch, Ltd. She is a former member of the Federal Reserve Board Consumer Advisory Council. Ms. Flores became a director in 2006 and her term expires in 2009.

Jon "Mike" Garnett, 64, vice chairman of the board of directors and chairman of the bank's Compensation Committee, is from Spearman, Texas. Mr. Garnett raises grain and forage crops and runs stocker cattle. He is a member of the bank's Audit Committee, The Farm Credit Council board of directors, and The Farm Credit Council board of directors' legislative committee and serves on the State Technical Committee for the Natural Resources Conservation Service. Mr. Garnett became a director in 1999 and his term expires in 2010.

William F. Staats, 70, is from Baton Rouge, Louisiana. Dr. Staats is Louisiana Bankers Association chair emeritus of banking and professor emeritus, Department of Finance at Louisiana State University. He is chairman of the bank's Audit Committee and is the designated financial expert. Dr. Staats also serves on the bank's Compensation Committee. He serves on the boards of the Money Management International Education Foundation, Money Management International, SevenOaks Capital Associates, LLC and Platinum Healthcare Staffing, Inc. Dr. Staats is a member of the Farm Credit System Audit Committee. He is also a member of Texas Lutheran University board of regents. Dr. Staats became a director in 1997 and his term expires in 2011.

In 2008, each member of the FCB of Texas' board of directors was compensated for attendance at meetings and other official activities. Each director's compensation totaled \$50,205 for 2008, plus expenses.

## **U.S. AgBank, FCB**

Wayne Allen, 67, is from Nevada City, California. Mr. Allen is a rice producer. He is a member of Farm Credit West, ACA. He is a member of Cal West Seeds, a seed marketing cooperative, and served on the board of directors of that organization for 24 years. Mr. Allen serves on the Bank's Compensation Committee and on the Bank's Risk Management Committee. He became a director in 2003 and his current term expires in 2009.

Wesley D. Brantley, Jr., 68, is from Ada, Oklahoma. Mr. Brantley is a CPA and was an audit partner with Horne and Company, CPAs, in Ada, Oklahoma, from 1967 to 1998. His areas of practice included banks, savings and loans, farm cooperatives, insurance companies, colleges, and state and local governments. In 1998, Mr. Brantley accepted a position as Chief Financial Administrator of the Chickasaw Nation, a federally recognized Indian tribe. In this capacity, he was responsible for the tribe's financial statements, budget and grant writing departments, internal audit department, governmental and grant finance department, purchasing and supply department and oversight of the housing and tribal business finance department. Mr. Brantley has retired from this position and now serves in a consulting capacity. Mr. Brantley serves as chairperson of the Oklahoma Securities Commission, an agency that enforces Oklahoma securities law. Mr. Brantley serves on the Bank's Audit Committee and has been designated as a financial expert. He also serves on the Bank's Risk Management Committee. He became a director in 2005 and his current term expires in 2011.

Robert Bray, 53, is from Redvale, Colorado. Mr. Bray is a farmer and rancher, who also owns and operates a big game hunting business. He is a member of the Farm Credit Services of the Mountain Plains, ACA. He is a member of the Colorado Cattlemen's Association, Colorado Woolgrowers' Association, the Colorado Farm Bureau and is chairman of the Colorado Division of Wildlife. Mr. Bray serves on the Bank's Audit Committee and the Bank's Risk Management Committee. He became a director in 2008 and his term expires in 2011.

John J. "Jack" Breen, 66, is from Middletown, New Jersey. Mr. Breen is the retired managing director-administration of the Federal Farm Credit Banks Funding Corporation. Mr. Breen joined the Funding Corporation management team in 1991 with responsibility for Farm Credit System financing programs and selling group management. In 1996, he assumed responsibility for a newly created Administration Group encompassing all Funding Corporation operating activities. Mr. Breen serves on the Bank's Audit Committee and has been designated as a financial expert. He also serves on the Bank's Risk Management Committee. He became a director in 2004 and his current term expires in 2010.

Oghi A. "Tony" DeGiusti, Jr., 56, is from Tuttle, Oklahoma. Mr. DeGiusti is a farmer who produces alfalfa and grass hay and wheat. He also owns and operates a cow/calf stocker operation. Mr. DeGiusti is a member of Chisholm Trail Farm Credit, ACA. He serves as a director of the Grady County Alfalfa Hay Growers Association and is a member of the Oklahoma Farm Bureau and the American Farmers and Ranchers Insurance Company. Mr. DeGiusti serves as the chairman of the Bank's Compensation Committee and as vice chairman of the Bank's Risk Management Committee. He became a director in 2005 and his current term expires in 2011.

John Eisenhut, 63, Chairman, is from Turlock, California. Mr. Eisenhut is an almond grower and Manager of Grower Relations for Hilltop Ranch, an almond processor. He is a member of American AgCredit, ACA, and a member and former officer of the Stanislaus County Farm Bureau. He serves as an ex-officio member of the Bank's Compensation Committee and the Bank's Audit Committee. He also serves on the Bank's Risk Management Committee. He became a director in 2005 and his current term expires in 2009.

Lyle H. Gray, 74, is from Leon, Kansas. Mr. Gray is a rancher and stockman with a cow/calf/yearling operation. He is a member of Farm Credit Services of Central Kansas, ACA. Mr. Gray is a past member of the executive board of the Kansas Beef Council. He has formerly served as treasurer, vice chairman and chairman of the Cattlemen's Beef Promotion and Research Board, as a director of the National Cattlemen's Beef Association board, and as the president of the Kansas Livestock Association. Mr. Gray serves on the Bank's Compensation Committee and the Bank's Risk Management Committee. He became a director in 1990 and his current term expires in 2009.

J. Less Guthrie, 64, is from Porterville, California. Mr. Guthrie owns and operates a cow/calf and stocker cattle ranch and a diversified farming operation. He is a member of Farm Credit West, ACA. He is a director of Guthrie Investment Co., Inc. (farming and investments) and F&T Financial Services (consumer loans and debt collections), Mr. Guthrie serves on the board of directors of Guthrie Investment Co., Inc., and F&T Financial

Services. He also serves as the chairman of the board of directors of the Federal Farm Credit Banks Funding Corporation and on the board of directors of the California Cattlemen's Association. Mr. Guthrie serves on the Bank's Compensation Committee and the Bank's Risk Management Committee. He became a director in 1997 and his current term expires in 2010.

George D. Jenik, 74, is from Sterling, Colorado. Mr. Jenik, who is semi-retired, feeds cattle in a custom feedlot. Mr. Jenik serves as a director of George Jenik, Inc., a family farming corporation. He is a member of Premier Farm Credit, ACA. Mr. Jenik serves as a director of the Northern Water Conservancy District, a water distribution company, and is a member of the National Cattlemen's Association. Mr. Jenik served on the Bank's Audit Committee and the Bank's Risk Management Committee. His term expired in 2008, and he was not re-elected to the Board.

David S. Phippen, 58, is from Ripon, California. Mr. Phippen is an almond grower and a co-owner in an almond processing company. He is a member of American AgCredit, ACA. Mr. Phippen is a director of the Almond Board of California. He also serves as a director of the San Joaquin County Farm Bureau. Mr. Phippen serves as chairman of the Bank's Risk Management Committee. He also serves on the Bank's Audit Committee. He became a director in 2006 and his current term expires in 2009.

Glen A. ("Andy") Rector, 67, is from Agate, Colorado. Mr. Rector is a farmer and rancher with a cow/calf/yearling and wheat operation. He is in partnership with his two sons in Triple R Farms Partnership Ltd. Mr. Rector is a member of Farm Credit of Southern Colorado, ACA. He serves on the Bank's Compensation Committee and on the Bank's Risk Management Committee. He became a director in 2002 and his current term expires in 2010.

Sheldon D. Richins, 72, is from Henefer, Utah. Mr. Richins is a rancher and stockman with a cow/calf operation and is in partnership with his two sons. Mr. Richins is a member of Western AgCredit, ACA. Mr. Richins serves on the board of directors of The Farm Credit Council. He is a member of the National Cattlemen's Association. He also served as chairman of the Summit County Commission and as president of the Utah Association of Counties. Mr. Richins serves as vice chairman of the Bank's Compensation Committee. He also serves on the Bank's Risk Management Committee. He became a director in 2005 and his current term expires in 2011.

Edward L. Schenk, 70, is from Chickasha, Oklahoma. Mr. Schenk is a farmer and rancher, producing primarily alfalfa, wheat and livestock. He also practices veterinary medicine on a part-time basis. Mr. Schenk is a member of Chisholm Trail Farm Credit, ACA, and Farm Credit of Central Oklahoma, ACA. Mr. Schenk serves on the board of directors of the Farm Credit Council. Mr. Schenk serves on the Bank's Audit Committee and the Bank's Risk Management Committee. He became a director in 1995 and his current term expires in 2009.

Kenneth W. Shaw, Vice Chairman 58, is from Mountainair, New Mexico. Mr. Shaw is a rancher and stockman with a cow/calf/yearling operation. He is a member of Farm Credit of New Mexico, ACA. He is a director of the Central New Mexico Electric Cooperative. Mr. Shaw serves on the Bank's Compensation Committee and on the Bank's Risk Management Committee. He became a director in 1999 and his current term expires in 2010.

Donnell Spencer, 74 is from Richfield, Utah. Mr. Spencer is a farmer and rancher raising alfalfa and livestock. He is a board member and president of Diversified Spencer, Inc., a family farming corporation. Mr. Spencer is a member of Western AgCredit, ACA. Mr. Spencer serves on the Bank's Audit Committee. and on the Bank's Risk Management Committee. He became a director in 2000 and his current term expires in 2011.

David Vanni, 67, is from Gilroy, California. Mr. Vanni is the owner and operator of Rancho de Solis Winery, Inc., and Fratelli Ranch, LLC, in Santa Clara County, California. His operation consists of 40 acres of wine grapes and covers all aspects of a winery operation, including production and marketing. He is also an officer of Vanni Business Partners, LLC (investment development). Mr. Vanni is a member of American AgCredit, ACA. He is a member of the Santa Clara County Farm Bureau and serves on the Ag Advisory Committee to the Santa Clara Valley Water District Board. Mr. Vanni serves as vice chairman of the Bank's Audit Committee. He also serves on the Bank's Risk Management Committee. He became a director in 2007, and his current term expires in 2010.

Robert J. Wietharn, 47, is from Clay Center, Kansas. Mr. Wietharn is a farmer and pork producer. He manages and is a director of two family-owned corporations whose operations include marketing farrow-to-finish hogs and

raising corn and soybeans. He is a member of Frontier Farm Credit, ACA. Mr. Wietharn is a stockholder and chairman of the board of Valley Farmers, Inc. (grain elevator) and is involved in the manufacturing and sale of irrigation equipment. Mr. Wietharn serves as chairman of the Bank's Audit Committee. He also serves on the Bank's Risk Management Committee. He became a director in 2002, and his current term expires in 2010.

In 2008, 15 members of the U.S. AgBank, FCB board of directors were compensated \$44,000 for attendance at meetings and other official activities, plus expenses. One director whose term expired on September 30, 2008 was compensated \$33,000 and one director whose term commenced on October 1, 2008 was compensated \$11,000.

### **Federal Farm Credit Banks Funding Corporation**

F. Gerald Byrne, 62, is from Long Beach, Indiana and is a retired chairman and executive vice president of Bank One Capital Markets. Mr. Byrne serves on the Funding Corporation Audit Committee. Mr. Byrne became a director in 2007 and his term expires in 2010.

Joe R. Crawford, 71, is from Baileyton, Alabama and owns and operates a cattle business. Mr. Crawford is a member of the board of directors of the Farm Credit Bank of Texas. Mr. Crawford serves on the Funding Corporation Audit Committee. Mr. Crawford became a director in 2003 and his term expires in 2012.

Larry R. Doyle, 56, is the CEO of the Farm Credit Bank of Texas in Austin, Texas. Mr. Doyle serves on the Funding Corporation Governance Committee. Mr. Doyle became a director in 2006 and his term expires in 2011.

Robert B. Engel, 55, vice chairman, is president and CEO of CoBank, ACB in Denver, Colorado. He is chairman of the board of directors for Farm Credit Leasing. In addition, he serves on the Boards of Trustees for Regis University, the Graduate Institute of Cooperative Leadership, Mile High United Way, Buffalo Sabres Alumni Association and as trustee emeritus at Niagara University. He also serves on the executive council of the National Council of Farmer Cooperatives. Mr. Engel serves as the Chairman of the Funding Corporation Compensation Committee. He is a recipient of the Ellis Island Medal of Honor. Mr. Engel became a director in 2003 and his term expires in 2012.

J. Less Guthrie, 64, chairman, owns and operates a cow/calf and stocker cattle ranch and a diversified farming operation in Porterville, California. He is a member of Farm Credit West, ACA and a member of the board of directors of U.S. AgBank, FCB. Mr. Guthrie serves on the boards of directors of Guthrie Investment Co., Inc., and F&T Financial Services. He also serves on the board of directors of the California Cattlemen's Association (trade association). Mr. Guthrie became a director in 2000 and his term expires in 2010.

James A. Kinsey, 59, is owner/operator of Kinsey's Oak Front Farms, a purebred angus seed-stock producer, in Flemington, West Virginia. Mr. Kinsey is a member of the board of directors of CoBank, ACB and Farm Credit of the Virginias, ACA. He is the chairman of the Funding Corporation Governance Committee. Mr. Kinsey became a director in 2004 and his term expires in 2013.

F. A. Lowrey, 56, is president and CEO of AgFirst Farm Credit Bank in Columbia, South Carolina. Mr. Lowrey is a member of the boards of directors of the University of South Carolina Educational Foundation, the National Council of Farmer Cooperatives, and Palmetto Agribusiness Council. Mr. Lowrey also serves on the Funding Corporation Governance Committee. Mr. Lowrey became a director in 2001 and his term expires in 2010.

Jamie B. Stewart, Jr., 64, is a non-voting member of the board. Mr. Stewart is the president and CEO of the Federal Farm Credit Banks Funding Corporation in Jersey City, New Jersey. Prior to joining the Funding Corporation, Mr. Stewart was first vice president of the Federal Reserve Bank of New York. Mr. Stewart is a director of the Gestalt International Study Center and chairman of the Westchester Institute for Training. He became a director in 2004 and his term will expire when he retires.

Roy Tiarks, 58, is from Council Bluffs, Iowa. Mr. Tiarks raises corn and soybeans, and has a cow/calf operation. Mr. Tiarks is a member of the board of directors of AgriBank, FCB and is a director of the Coalition of American Agricultural Producers (trade association). He serves on the Funding Corporation Compensation Committee. Mr. Tiarks became a director in 2001 and his term expires in 2011.

Ann E. Trakimas, 52, is from Taos, New Mexico. Ms. Trakimas is a retired vice president and head of Financial Institutions Group from Goldman Sachs & Co. Ms. Trakimas is the chairman of the Funding Corporation Audit Committee and also serves on the Farm Credit System Audit Committee. Ms. Trakimas became a director in 2005 and her term expires in 2011.

Funding Corporation Bank director members and appointed members are compensated for their time served and for travel and related expenses, while Bank CEOs or presidents are only compensated for travel and related expenses. In 2008, the directors eligible for compensation were paid between \$34,139 and \$60,250 for the year, plus expenses.

**Certain Relationships and Related Transactions**

The System is a cooperatively owned network of agricultural lending institutions. Agricultural producers typically become members of an Association when they establish a borrowing/financing relationship with the Association. In CoBank’s case, its Associations, together with other borrowers of the Bank, own CoBank, as well as borrow from the Bank. Accordingly, most Bank directors are agricultural producers who are member/borrowers of an Association and, in the case of CoBank, its other member/borrowers.

As discussed in Note 18 to the accompanying combined financial statements, Banks and Associations may, in the ordinary course of business, enter into loan transactions with their officers and directors and other organizations with which officers and directors are associated. These loans are subject to special approval requirements contained in the Farm Credit Administration regulations and are, in the view of System institutions’ managements, made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

The following is a list of aggregate loan balances outstanding at December 31, 2008 to the directors of each Bank and its affiliated Associations and other organizations with which the directors are associated:

	<u>(in millions)</u>
AgFirst FCB . . . . .	\$284
AgriBank, FCB . . . . .	231
FCB of Texas . . . . .	179
U.S. AgBank, FCB . . . . .	752
CoBank, ACB . . . . .	486

**Senior Officers**

The chief executive officer and/or president and all other senior officers of each Bank and the Funding Corporation, together with their age and length of service at their present position as of December 31, 2008, as well as prior positions held if in the current position less than five years, are as follows:

<u>Name, Age and Title</u>	<u>Time in Position</u>	<u>Prior Experience</u>
<b>AgFirst Farm Credit Bank:</b>		
F.A. Lowrey, 56, <i>President and Chief Executive Officer</i>	11 years	CEO, Palmetto Farm Credit, ACA from April 1989 to January 1998.
Thomas S. Welsh, 61, <i>Executive Vice President, Chief Administrative and Legislative Officer</i>	11 years	Chief Marketing and Planning Officer from January 1996 until March 1998.
Leon T. Amerson, 46, <i>Executive Vice President, Chief Operating Officer</i>	2.5 years	Chief Financial Officer since March 1998 to September 2006.
Charl L. Butler, 51, <i>Senior Vice President, Chief Financial Officer</i>	1.8 years	Chief Financial Officer and Secretary at the National Bank of South Carolina from 1991 until 2007.
William L. Melton, 60, <i>Senior Vice President, Chief Lending Officer</i>	5.5 years	Senior Executive Officer/Bank Lending from January to July 2003, prior to that Lending Services Manager.

<u>Name, Age and Title</u>	<u>Time in Position</u>	<u>Prior Experience</u>
Benjamin F. Blakewood, 60, <i>Senior Vice President, Chief Information Officer</i>	10.5 years	Director of Information Technology from 1996 to 1998 at Affinity Technology Group.
Frederick T. Mickler, III, 59, <i>Senior Vice President and General Counsel</i>	11 years	Assistant General Counsel July 1989 until April 1998.
<b>AgriBank, FCB:</b>		
L. William York, 55, <i>Chief Executive Officer</i>	3 years	Senior Vice President of Global Operations and Chief Credit Officer of CNH Capital
Brian O'Keane, 40, <i>Chief Financial Officer</i>	1.5 years	Global Treasurer of CNH Capital
Ross B. Anderson, 59, <i>Senior Vice President and Chief Credit Officer</i>	17 years	
Greg Taylor, 48, <i>Senior Vice President, Business and Marketing Strategies</i>	2 years	Vice President of North America AgFinancial Services of CNH Capital
Greg C. Elwood, 58, <i>Vice President, Wholesale Lending and Relationship Management</i>	11 years	
Martin L. Fischer, 55, <i>Vice President and Treasurer</i>	9.5 years	
Jeff Moore, 48, <i>Vice President and Controller</i>	10.5 years	
Bill L. Johnson, 49, <i>Vice President, Operations and Information Management</i>	2.5 years	Executive Vice President — Strategic Business Solutions of Northwest Farm Credit Services, ACA; and Executive Vice President — Strategic Relationships of Farm Credit Financial Partners, Inc.
Sandi L. Schmiesing, 56, <i>Vice President, Human Resources and Administrative Services</i>	2.3 years	Senior Vice President of Farm Credit Council Services; and Owner/Consultant of Sand Castle Group, LLC
Donald W. Theuninck, 61, <i>Vice President, Audit</i>	17 years	
William J. Thone, 55, <i>Vice President, Secretary and General Counsel</i>	9.5 years	
<b>CoBank, ACB:</b>		
Robert B. Engel, 55, <i>President and Chief Executive Officer</i>	2.5 years	President and Chief Operating Officer since 2000
Brian P. Jackson, 50, <i>Executive Vice President and Chief Financial and Administrative Officer</i>	1.5 years	Executive Vice President and Chief Financial Officer since 2000
Douglas E. Wilhelm, 59, <i>Executive Vice President and Chief Credit and Risk Officer</i>	2.5 years	Senior Vice President, Risk Management Division since 2001
Philip S. DiPofi, 48, <i>Executive Vice President, Agribusiness Banking Group</i>	4 years	Senior Vice President, Strategic Relationships Division and Farm Credit Leasing since 2001
John C. Holsey, 59, <i>Executive Vice President, Global Financial Services Group</i>	8 years	
Mary E. McBride, 53, <i>Executive Vice President, Communications and Energy Banking Group</i>	5.5 years	
Robert L. O'Toole, 46, <i>Interim Division Manager — Human Resources</i>	5 months	Vice President of Human Resources since 2006
Allan S. Kantrowitz, 58, <i>Senior Vice President and General Counsel</i>	14 years	
<b>Farm Credit Bank of Texas:</b>		
Larry R. Doyle, 56, <i>Chief Executive Officer</i>	5.5 years	Executive Vice President and Chief Operating Officer, AgFirst Farm Credit Bank.
Thomas W. Hill, 58, <i>Senior Vice President, Chief Financial Officer and Chief Operations Officer</i>	5 years	Chief Financial Officer since 1994

<u>Name, Age and Title</u>	<u>Time in Position</u>	<u>Prior Experience</u>
Steven H. Fowlkes, 56, <i>Senior Vice President and Chief Credit Officer</i>	5 years	Senior Vice President since 1997
Kyle Pankonien, 56, <i>Vice President, Corporate Affairs, General Counsel and Corporate Secretary</i>	Appointed January 2008 1 year	Vice President, Corporate Affairs, Deputy General Counsel
William E. Zimmerman, 63, <i>Senior Vice President, Corporate Affairs, General Counsel and Corporate Secretary (retired January 2008)</i>	20 years	
<b>U.S. AgBank, FCB:</b>		
Darryl W. Rhodes, 58, <i>President and Chief Executive Officer</i>	2 years	Executive Vice President, Finance since 1991
David D. Janish, 50, <i>Senior Vice President, Finance</i>	2 years	President and CEO of AgVantis, Inc. since 2002
James L. Grauerholz, 59, <i>Senior Vice President, Administration</i>	14 years	
Dennis E. Grizzell, 60, <i>Senior Vice President, Credit</i>	14 years	
Gregory J. Buehne, 56, <i>Senior Vice President, Legal and Legislative Services</i>	2 years	Governance and Strategic Planning consulting for Farm Credit System entities from 2002 to 2007; prior to that, Senior Vice President and General Counsel for Western Farm Credit Bank
Thomas R. Kruse, 60, <i>Senior Vice President, Internal Audit and Quality Assurance</i>	2 years	Vice President — Risk Management since 1997
<b>Federal Farm Credit Banks Funding Corporation:</b>		
Jamie B. Stewart, Jr., 64, <i>President and Chief Executive Officer</i>	5 years	President and Chief Executive Officer; First Vice President of the Federal Reserve Bank of New York
Douglas A. Williams, 51, <i>Managing Director — Administration</i>	2 years	Managing Director — Finance since 1992
H. John Marsh, Jr., 56, <i>Managing Director — Financial Management Division</i>	16 years	
Kathleen M. Mullarkey, 61, <i>Senior Vice President, General Counsel and Corporate Secretary</i>	12 years	
Glenn R. Doran, 46, <i>Managing Director — Finance</i>	1.5 years	Senior Vice President — Finance since 2001
Scott Pearson, 46, <i>Senior Vice President and Director — Information Services</i>	1.5 years	Vice President and Director — Information Services since 2002

### **Membership, Farm Credit System Audit Committee**

The Farm Credit System Audit Committee is comprised of five members, all of whom are appointed by the board of directors of the Funding Corporation. The Funding Corporation Board has determined that each member of the System Audit Committee is financially literate and has designated one member to be the financial expert as defined by the Farm Credit Administration regulations. All members of the Committee are independent of management of the Funding Corporation or any System Bank or Association.

The membership of the Farm Credit System Audit Committee as of December 31, 2008, was as follows:

Robert M. Tetrault, 57, is president/owner of T/R Fish, Inc., a marketing/management company for commercial fishing in Portland, Maine, and president/owner of Tara Lynn II, Inc. and Robert Michael, Inc., commercial fishing groups in Portland, Maine. Mr. Tetrault is a director and former chairman of the board of Farm Credit of Maine, ACA and serves as a director on the following boards: Marine Resource Education Project, Land for Maine's Future, and is the director/owner of Vessel Services, Inc. He is also the General Partner in Portland Fish Pier



Associates owners of the Maine Trader Center. Mr. Tetrault became a member of the Audit Committee in 2004 and his term expires in 2011.

Ann E. Trakimas, 52, is from Taos, New Mexico. Ms. Trakimas is a retired vice president and head of Financial Institutions Group from Goldman Sachs & Co. Ms. Trakimas serves on the board of the Federal Farm Credit Banks Funding Corporation. Ms. Trakimas became a member of the Audit Committee in 2007 and her term expires in 2009.

William F. Staats, 70, is from Baton Rouge, Louisiana and serves as vice chairman of the Committee. Mr. Staats is Louisiana Bankers Association chair emeritus of banking and professor emeritus, Department of Finance at Louisiana State University. He is a director of the Farm Credit Bank of Texas and serves on the Bank's Compensation Committee and as chairman of the Bank's Audit Committee. He serves on the boards of the Money Management International Education Foundation, Money Management International, SevenOaks Capital Associates, LLC and Platinum Healthcare Staffing Inc. Mr. Staats became a member of the Audit Committee in 2004 and his term expires in 2010.

Norman N. Strauss, 67, is from Livingston, New Jersey. Mr. Strauss is an outside member of the Committee. He is a retired partner from Ernst & Young LLP where he was National Director of Accounting and is currently the Ernst & Young Professor in Residence at Baruch College in New York City. He is a member of the Financial Reporting Committee of the Institute of Management Accountants. Mr. Strauss became an Audit Committee member in 2008 and his term expires in 2011.

Arthur R. Wyatt, 81, is from the Village of Golf, Florida and Champaign, Illinois, is an outside member of the Committee and serves as chairman of the Committee. He is a retired partner of Arthur Andersen, LLP. The Funding Corporation board has designated Mr. Wyatt as an Audit Committee financial expert. Mr. Wyatt became an Audit Committee member in 1995 and his term expires in 2009.

The Committee held four meetings during 2008 and had one teleconference. All members were in attendance for each meeting and the teleconference. Each member of the Committee was compensated for attendance at meetings and other official activities. Compensation ranged from \$10,750 to \$64,750 for 2008, plus expenses.

## COMPENSATION OF CHIEF EXECUTIVE OFFICERS

### Compensation Discussion and Analysis

#### *Overview*

The philosophy of System institutions with respect to compensating each institution's senior officers is to attract, develop and retain senior officers who are highly qualified and proficient at executing each institution's strategic objectives and operational activities, and deliver performance results that optimize the return to the shareholders. In the case of the Banks, each Bank emphasizes:

- Establishing a clear link between the financial performance (e.g., earnings, capital, asset quality, liquidity, sensitivity to changes in interest rates, and customer satisfaction) of the Bank and each senior officer's total compensation package, including rewarding appropriate risk-taking with the Bank's capital to generate returns for the shareholders, while avoiding unnecessary risks, and
- Providing a total compensation package to each senior officer that is competitive within the financial services industry and their local market.

The total compensation philosophy of System institutions seeks to achieve the appropriate balance between market-based base salary and benefits, and variable incentive compensation that is designed to incent and reward both the current and long-term achievement of System institutions' strategic business objectives and business plans. System institutions believe that this philosophy fosters a performance-oriented, results-based culture wherein compensation varies on the basis of results achieved.

All System institutions are cooperatives with no publicly traded stock. Therefore, no stock options or other equity- or stock-based compensation programs have been, or can be, granted to senior officers of System institutions. However, it is a general practice across the System to reward the performance of an institution's senior officers with some form of non-equity incentive compensation.

The operations of the Funding Corporation are different than the Banks' operations. While the Banks generate income through loans, investments, and related operations, the primary functions of the Funding Corporation are to raise funds as an agent for the Banks in the debt markets and to issue the combined financial statements of the System. The performance of the Funding Corporation in these two areas is used to gauge the performance of each Funding Corporation senior officer for purposes of determining his or her total compensation package. All operating expenses of the Funding Corporation are reimbursed by the Banks through the assessment of fees; there are no revenues generated by the Funding Corporation.

In addition to compensation, System institutions provide a comprehensive and market-based package of employee benefits for health and welfare and for retirement purposes. Some retirement benefits are restored or enhanced for certain senior officers through one or more non-qualified retirement plans. In other words, while the benefits may be limited as the result of Internal Revenue Code limitations, the benefits that would have been accrued had the Internal Revenue Code limits not been in place are made up for certain senior officers through certain non-qualified retirement plans. In addition, certain institutions have provided for enhanced retirement benefits for named executives.

#### *CEO Compensation Policy*

The following discussion regarding compensation policy, summary compensation tables, and related disclosures focuses on the CEOs of the Banks and the Funding Corporation since they are the CEOs of the System entities responsible for the Systemwide disclosures.

The Bank and Funding Corporation CEOs generally have three primary forms of compensation: base pay in the form of a salary, non-equity incentive compensation, and retirement benefits.

### Base Pay in the Form of a Salary

The base salary component of each Bank's and the Funding Corporation's CEO recognizes the individual's particular experience, skills, responsibilities, and knowledge. Each Bank's and the Funding Corporation's compensation committee or executive committee serving as the compensation committee of each entity's board of directors reviews the appropriate level of base salary and benefits generally on an annual basis. Each committee takes into consideration industry factors and the local market place. Each committee may also use independent consultants or other means to obtain external comparative data for the CEOs of similar financial institutions, based upon asset size and other factors.

### Non-Equity Incentive Compensation

Each Bank and the Funding Corporation has some form of non-equity incentive compensation for its CEO. The overall objective of the incentive compensation is to align each CEO's performance objectives with the interests of the shareholders. The receipt of incentive compensation by each Bank CEO is based upon the performance of the Bank in achieving certain strategic and financial goals. In some cases, the Banks may have both short-term incentive compensation, which focuses on the current performance of the Bank, such as profitability, credit quality, capital adequacy and operating efficiency, and long-term incentive compensation, which focuses on the long-term success of the Bank, such as profitability, credit quality and capital adequacy. In the case of the Funding Corporation, the receipt of incentive compensation is based upon the performance of its specific functions noted previously. In addition, a portion of the incentive compensation may be based upon individual goals and performance. Also, in certain instances, the CEOs may be able to defer payment of a portion of the incentive compensation by directing the deferred amounts be invested in accordance with available options selected by retirement trust committees of the Banks or the Funding Corporation. For each Bank's and the Funding Corporation's CEO, a significant portion of their total compensation is "at-risk" in the form of incentive compensation.

### Retirement Benefits

Each Bank and the Funding Corporation CEO participates in a defined benefit retirement plan and a defined contribution plan. However, some of the defined benefit retirement plans are closed to new participants. In addition, some of the Banks and the Funding Corporation provide supplemental executive retirement plans and/or pension restoration plans for their CEOs. These plans provide for the portion of the CEO's benefit that cannot be paid from the retirement plan due to the pay and benefit limitations set by the Internal Revenue Code and/or provide enhanced retirement benefits to the CEO. Additional discussions of the retirement benefits for each Bank's and the Funding Corporation's CEO are set forth below.

### Additional Information

Additional discussion of each Bank's compensation policies can be obtained by reference to the discussions provided in the Bank's annual report.

## Summary Compensation Table

Name	Year	Salary	Non-equity incentive plan compensation	Change in pension value*	All other compensation	Total
<b>AgFirst Farm Credit Bank</b>						
F. A. Lowrey, President and CEO(1) . . . . .	2008	\$577,192	\$ 275,849	\$ 740,509	\$ 21,357	\$1,614,907
	2007	524,720	220,802	488,886	21,731	1,256,139
<b>AgriBank, FCB</b>						
L. William York, CEO(2) . . . . .	2008	476,250	241,316	44,784	38,847	801,197
	2007	441,667	204,889	33,567	33,901	714,024
<b>CoBank, ACB</b>						
Robert B. Engel, President and CEO(3) . .	2008	562,500	2,351,350	1,136,484	27,148	4,077,482
	2007	491,667	1,888,324	833,281	26,486	3,239,758
<b>Farm Credit Bank of Texas</b>						
Larry R. Doyle, CEO(4) . . . . .	2008	500,019	600,000	(5,810,710)	8,840,659	4,129,968
	2007	440,017	560,000	1,884,534	22,017	2,906,568
<b>U.S. AgBank, FCB</b>						
Darryl W. Rhodes, President and CEO(5) . . . . .	2008	450,000	360,000	2,425,236	33,261	3,268,497
	2007	438,901	340,000	1,237,759	41,627	2,058,287
<b>Federal Farm Credit Banks Funding Corporation</b>						
Jamie B. Stewart, Jr., President and CEO(6) . . . . .	2008	425,000	625,000	253,438	48,250	1,351,688
	2007	400,000	575,000	112,006	54,658	1,141,664

\* While preferential earnings on nonqualified deferred compensation are required to be reported with the change in pension value, the CEOs did not receive any preferential earnings in 2008 or 2007.

- (1) The Compensation Committee of the Board of Directors reviews Mr. Lowrey's performance annually, and the Board of Directors annually approves his compensation level, including base salary and incentive compensation. There is no employment agreement for Mr. Lowrey. The change in pension value and nonqualified deferred compensation earnings for 2008 reflect an additional three months of activity (15 months in total) due to the change in measurement date from September 30th to year-end as required by SFAS No. 158.
- (2) The Compensation Committee of the Board of Directors reviews Mr. York's performance annually, and the Board of Directors annually approves his compensation level, including base salary and incentive compensation. While being employed "at will," with no specified term of employment, the agreement provides that if Mr. York is terminated for any reason other than cause, his base salary and the employer-paid portion of medical and dental benefits will be continued for 12 months. In the event of a change in control and Mr. York is not named to the new CEO position, or a substantially similar role, in the successor organization, Mr. York will be given a severance payment equal to 24 months total compensation. Total compensation is defined as base pay plus annual incentive compensation. The annual incentive amount will be based on the average of the annual incentive earned for the two most recently completed annual incentive periods. In addition, the employer-paid portion of medical and dental benefits will be continued for 18 months.
- (3) The Compensation Committee of the Board of Directors reviews Mr. Engel's performance semi-annually, and the board annually approves his compensation level, including base salary, short-term and long-term incentive compensation. Mr. Engel is employed pursuant to an employment agreement that provides specified compensation and related benefits in the event that his employment is terminated, except for termination for cause. In the event of termination, except for cause, the employment agreement provides for the (a) payment of the prorated base salary and incentives through the date of the termination, (b) payments aggregating three times the sum of base salary and short-term incentives at target, (c) enhanced retirement benefits if the termination results from a change in control, (d) continuation of health and welfare benefits for a three year period, and (e) certain other benefits for a three year period, to the same extent as such benefits were being provided on the date of termination. These amounts are payable in monthly installments over the three year period. In order to receive these payments and other benefits, Mr. Engel must sign a release agreeing to give up any claims, actions or lawsuits against CoBank related to his employment. The agreement also provides for non-competition and non-solicitation by the President and CEO over the term of the three year period.
- (4) The Compensation Committee of the Board of Directors reviews Mr. Doyle's performance annually, and the Board of Directors annually approves his compensation level, including base salary and incentive compensation.

All other compensation included the \$8,500,000 payment made in January 2009 pursuant to the Compensation Agreement between the Bank and the CEO. In part, this payment was in exchange for the CEO's agreement to no longer participate in the Farm Credit Bank of Texas Supplemental Pension Plan. The CEO is also eligible for a \$4,500,000 payment in January 2010, although that payment will be prorated if his employment terminates prior to January 4, 2010. The prorated amount of \$4,500,000 as of December 31, 2008 was \$321,430, which was earned in 2008 and is also reflected in all other compensation. See the Pension Benefits Table Narrative Disclosure for a more detailed explanation of the Compensation Agreement and the payments provided thereunder.

- (5) The Board of Directors reviews Mr. Rhodes' performance semi-annually. Mr. Rhodes is employed "at will" pursuant to an employment agreement that expires December 31, 2011. Under this employment agreement, base salary, annual incentives, long-term incentives, and supplemental executive retirement plan (SERP) benefits have been pre-determined for each year of the employment agreement. In the event of termination by U.S. AgBank without cause, or by Mr. Rhodes with good reason as defined in the agreement, Mr. Rhodes shall receive six months' base salary and an additional six months vesting on annual and long-term incentives and the SERP. Under the employment agreement, if Mr. Rhodes' employment terminates due to his death prior to the end of 2011, a death benefit will be paid to his designated beneficiary.
- (6) The Compensation Committee of the Board of Directors reviews Mr. Stewart's performance annually and the Board of Directors annually approves the compensation level, including base salary and incentive compensation. While being employed "at will," with no specified term of employment, the agreement provides that if Mr. Stewart is terminated for any reason, he will receive a severance benefit equal to six months base salary.

### Pensions Benefits for the Year Ended December 31, 2008

Additional information on each Bank's pension benefits can be obtained by reference to the discussions provided in the Bank's annual report.

<u>Name</u>	<u>Plan Name</u>	<u>Number of Years Credited Service</u>	<u>Present Value of Accumulated Benefit</u>
<b>AgFirst Farm Credit Bank</b>			
F. A. Lowrey, President and CEO(1) . . . . .	AgFirst Farm Credit Retirement Plan	34.33	\$1,637,912
	AgFirst Farm Credit Bank Supplemental Retirement Plan	34.33	3,064,181
<b>AgriBank, FCB</b>			
L. William York, CEO(2) . . . . .	Seventh Farm Credit District Retirement Plan	18.89	184,797
<b>CoBank, ACB</b>			
Robert B. Engel, President and CEO(3) . . . . .	CoBank, ACB Retirement Plan	8.58	190,325
	Supplemental Executive Retirement Plan	8.58	740,776
	Executive Retirement Plan	8.58	3,216,762
<b>Farm Credit Bank of Texas</b>			
Larry R. Doyle, CEO(4) . . . . .	Farm Credit Bank of Texas Pension Plan	34.78	880,276
	Farm Credit Bank of Texas Supplemental Pension Plan	34.78	-0-
<b>U.S. AgBank, FCB</b>			
Darryl W. Rhodes, President and CEO(5) . . . . .	Ninth District Pension Plan	37.99	1,416,826
	Supplemental Executive Retirement Plan	37.99	5,500,000
<b>Federal Farm Credit Banks Funding Corporation</b>			
Jamie B. Stewart, Jr., President and CEO(6) . . . . .	CoBank, ACB Retirement Plan	4.92	182,815
	Supplemental Executive Retirement Plan	4.92	1,181,823

Note: No pension benefit payments were made to any CEO during 2008.

- (1) The AgFirst President and CEO participates in a defined benefit retirement plan. The President and CEO is eligible to retire and begin drawing unreduced pension benefits at age 65 or when years of credited service plus age equal "85." Upon retirement, annual payout is equal to 2% times years of credited service times the high three-year average compensation, subject to the Internal Revenue Code limitation of \$345,000 for 2008. For the purposes of determining the payout, "average compensation" is defined as regular salary (i.e., does not include bonuses or non-equity incentive plan compensation). Benefits under the plan are payable as a five-year certain and life annuity. Benefits under the plan are not subject to an offset for Social Security. Benefits that would have accrued had the IRS limits not been in place are made up through a non-qualified supplemental executive retirement plan.
- (2) The AgriBank CEO has a frozen benefit that he earned under the final average pay formula of the defined benefit retirement plan for his prior service with the AgriBank District. Upon his rehire, he began earning benefits under the cash balance defined benefit retirement plan formula; however, credit is provided for his prior service. His benefit is based on the Internal Revenue Code limitation of \$345,000 for 2008

at the contribution rate of 8%. In addition, he will receive an integrated contribution of 5% for all pay over the social security wage base of \$102,000 for 2008 up to the IRS compensation limit. Pay in excess of the IRS limit is excluded from his qualified retirement benefit.

- (3) The CoBank President and CEO participates in a final average pay defined benefit retirement plan, a noncontributory plan, an unfunded supplemental retirement plan and an unfunded executive retirement plan and is eligible to participate in a 401(k) retirement savings plan, which includes a matching contribution by the Bank. The President and CEO is also eligible for other postretirement benefits, upon reaching early retirement age. These primarily include access to medical plans. Participants in these other postretirement plans pay the premiums related to the plans. Eligible compensation as defined under the final average pay defined benefit plan is the highest 60 consecutive-month average, which includes base salary and incentive compensation measured over a period of one year or less, but excludes long-term incentive awards, expense reimbursements, taxable fringe benefits and certain other payments. Compensation in excess of the Internal Revenue Service Code limits is made up for via participation in an unfunded, non-qualified supplemental executive retirement plan. Retirement benefits are calculated assuming payment in the form of a single life annuity with five years certain and retirement at normal retirement age of 65. However, the actual form and timing of payments are based on participant elections. The plan requires five years of service to become vested. The benefit formula is 1.5% of eligible compensation up to the Social Security covered compensation plus 1.75% of eligible compensation in excess of Social Security covered compensation, all multiplied by years of service. In addition, an unfunded executive retirement plan has been adopted for the President and CEO. The President and CEO's agreement provides for a minimum retirement benefit of 34% of eligible compensation as of December 31, 2008, increasing to a maximum of 55% of eligible compensation as of December 31, 2015, with no reduction for early retirement. In order to enhance the retention of the President and CEO, the executive retirement plan provides for a 50% reduction in the target benefit level if the President and CEO voluntarily terminates employment on or before December 31, 2010. Further, the executive retirement plan is limited such that benefits provided under that plan are payable only if total retirement benefits payable per year from the three retirement plans does not exceed \$700,000, expressed as a single life annuity with five year certain. If the President and CEO had voluntarily terminated his employment on December 31, 2008, his lump sum distribution would have been approximately \$2.3 million.
- (4) The FCB of Texas CEO participates in a defined benefit retirement plan (the "pension plan"). Through the end of 2008, the CEO also participated in the Farm Credit Bank of Texas Supplemental Pension Plan (the "Supplemental Pension Plan"), which is a nonqualified deferred compensation plan. Compensation, as defined in the Pension Plan, includes wages, incentive compensation and deferrals to the 401(k) and flexible spending account plans, but excludes annual leave or sick leave that may be paid in cash at the time of termination, retirement, or transfer of employment, severance payments, retention bonuses, taxable fringe benefits, and any other payments. Pension Plan benefits are based on the average of monthly eligible compensation over the 60 consecutive months that produce the highest average after 1996 ("FAC60"). The Pension Plan's benefit formula for a Normal Retirement Pension is the sum of (a) 1.65% of FAC60 times "Years of Benefit Service" and (b) 0.50% of (i) FAC60 in excess of Social Security covered compensation times (ii) "Years of Benefit Service" (not to exceed 35). The CEO's Pension Plan benefit is offset by the CEO's pension benefits from another Farm Credit System institution. The present value of the CEO's accumulated Pension Plan and Supplemental Pension Plan benefits are calculated assuming retirement had occurred at the measurement date used for financial statement reporting purposes with retirement at age 56. The Pension Plan's benefit formula for the Normal Retirement Pension assumes that the CEO is married on the date the annuity begins, that the spouse is exactly 2 years younger than the CEO, and that the benefit is payable in the form of a 50 percent joint and survivor annuity. If any of those assumptions are incorrect, the benefit is recalculated to be the actuarial equivalent benefit. The Supplemental Pension Plan restores benefits under the Pension Plan that are limited or reduced (a) by the imposition of Internal Revenue Code limits, (b) by the exclusion of deferrals to a nonqualified deferred compensation plan from the definition of "Compensation" in the Pension Plan, and (c) by the commencement of benefits prior to "Normal Retirement Age" for a Participant who has satisfied the Rule of 85 and is at least age 55. After calculating the amount of Pension Plan benefits that are restored in the Supplemental Pension Plan, that amount is grossed-up for income taxes at a fixed rate. Supplemental Pension Plan benefits are payable 30 days after Separation from Service as a lump sum amount.

The CEO's earned benefit under the Supplemental Pension Plan was \$8,537,622 as of December 2008 and was projected to increase significantly in the coming years based upon his "Years of Benefit Service" and anticipated total compensation during 2009, 2010, 2011, and 2012. Therefore, under a Compensation Agreement between the Bank and the CEO that was executed in November 2008, the Board approved the settlement of the Bank's obligations to the CEO under the Supplemental Pension Plan in order (a) to limit the Bank's potential future liability under the Supplemental Pension Plan; (b) to decrease the impact upon the Bank and the Supplemental Pension Plan of changes in compensation paid to the CEO, changes in interest rates, and changes in law; (c) to remove uncertainty for the Bank and the CEO with respect to the amount of the Supplemental Pension Plan benefit; (d) to agree upon a fixed amount of compensation for the CEO during 2009 and 2010; and (e) to provide incentives for the CEO to remain employed at least through the period involving the development of an important lending systems project. Pursuant to the terms and conditions of the Compensation Agreement, the CEO received the following benefits: (i) a payment of \$8,500,000 in January 2009; (ii) deferred compensation in the amount of \$4,500,000 which will be paid to the CEO (or his beneficiary in the event of his death) in January 2010, unless the CEO's employment with the Bank terminates prior to January 4, 2010, in which case the \$4,500,000 payment will be prorated according to a schedule in the Compensation Agreement and paid within 60 days of such termination; (iii) annual base salary of \$750,000 for 2009 and 2010. In exchange for those benefits, the Compensation Agreement provides that the CEO will not (1) participate in the Supplemental Pension Plan as of January 1, 2009; (2) actively participate in another nonqualified plan the Bank has established; (3) earn any bonuses for performance during 2009 or 2010; and (4) receive the set severance payment of \$1,000,000 which was provided under Mr. Doyle's "employment at will" agreement dated February 26, 2003. Although the Compensation Agreement only covers the CEO's compensation through 2010, the Board of the Bank hopes to retain the CEO for a longer period, due to the current economic conditions. Therefore, the Compensation Agreement further provides that if the CEO remains employed past 2010, he shall be eligible for bonuses for years after 2010 and that base salary for years after 2010 shall be negotiated in late 2010.

The Compensation Agreement is not an employment contract. The deferred compensation provisions of the Compensation Agreement are intended to be an unfunded nonqualified deferred compensation plan for tax purposes, are not intended to meet the qualification requirements of Section 401(a) of the Internal Revenue Code, and are intended to be exempt from ERISA as a governmental plan exempted under ERISA § 4(b)(1). The Compensation Agreement was drafted to comply with the provisions of Section 409A of the Internal Revenue Code.

- (5) The U.S. AgBank President and CEO participates in two defined benefit pension plans: the Ninth Farm Credit District Pension Plan, which is a qualified defined benefit plan, and a Supplemental Executive Retirement Plan, which is a nonqualified deferred compensation plan. Additionally, Mr. Rhodes participates in a 401(k) defined contribution plan with an employer matching contribution and in a nonqualified deferred compensation plan that restores benefits limited by the IRS in the 401(k) plan and that allows discretionary employer contributions. In general, the pension plan will provide Mr. Rhodes with a 50% joint-and-survivor annuity benefit at normal retirement that is equal to 1.50% of his average monthly compensation during the 60 consecutive months in which he received his highest compensation (High 60) multiplied by his years of benefit service, plus 0.25% of the amount by which his High 60 exceeds covered compensation multiplied by his years of benefit service. The benefit is actuarially adjusted if Mr. Rhodes chooses a different form of distribution than a 50% joint-and-survivor annuity. The pension plan takes into account compensation up to the applicable Internal Revenue Code limitation of \$345,000 for 2008. Prior to December 19, 2008, Mr. Rhodes participated in the U.S. AgBank District Pension Restoration Plan (Pension Restoration Plan) and in a SERP (Old SERP). The Pension Restoration Plan restores benefits under the pension plan that are limited by the Internal Revenue Code and by the exclusion of deferrals to a nonqualified deferred compensation plan from the definition of Compensation in the pension plan. To determine the amount payable through the Old SERP, the benefits under the pension plan and the Pension Restoration Plan were first recalculated by using Mr. Rhodes, average monthly compensation during the 36 consecutive months in which he received the highest compensation rather than the High 60. Then, the amount was offset by the actual benefits payable from the pension plan and the Pension Restoration Plan. As of December 19, 2008, Mr. Rhodes is no longer a participant in the Pension Restoration Plan and the Old SERP, and his vested benefits under those two plans have been replaced by the guaranteed SERP payments set forth in his employment agreement. Additional SERP benefits under the employment agreement will be paid, depending on the length of his continued employment with U.S. AgBank.
- (6) The Funding Corporation President and CEO participates in a final average pay defined benefit retirement plan and participates in a 401(k) retirement savings plan, which includes a matching contribution by the Funding Corporation. Additionally, he participates in a supplemental executive retirement plan. The retirement plan benefits are payable in the form of a single life annuity with five years certain and calculated assuming retirement at the normal retirement age of 65. The plan requires five years of vesting service to become vested. The 2008 compensation covered by the retirement plan is subject to Internal Revenue Code limitations. The supplemental executive retirement plan ensures, among other things, that the President and CEO receives the full amount of benefits to which he would have been entitled in the absence of limits on benefit levels imposed by the Internal Revenue Code. For the President and CEO, this plan provides a potential supplemental retirement benefit based on 30% of the highest four-year average of base salary plus 25% of incentive compensation. These benefits become 100% vested upon the completion of six years of service. After seven years, the percentage increases to 40%. Additional benefits can be incrementally earned up to a maximum of 50% upon completion of nine years of service. The annual benefits payable from the supplemental executive retirement plan are offset by annual benefits payable from the retirement plan.

## AUDIT COMMITTEE REPORT

The Farm Credit Administration regulations with respect to disclosure to investors in Systemwide Debt Securities require the board of directors of the Funding Corporation to establish and maintain a System Audit Committee. These regulations specify that the System Audit Committee may not consist of less than three members and at least one member must be a financial expert. A financial expert must be the chairman of the System Audit Committee. Every member must be free from any relationship that, in the opinion of the board of directors of the Funding Corporation, would interfere with the exercise of independent judgment as a System Audit Committee member. The System Audit Committee reports to the board of directors of the Funding Corporation. The charter can be found on the Funding Corporation's website at [www.farmcredit-ffcb.com](http://www.farmcredit-ffcb.com). The responsibilities of the System Audit Committee include:

- the oversight of the Funding Corporation's system of internal controls related to the preparation of the System's quarterly and annual information statements,
- the integrity of the System's quarterly and annual information statements,
- the review and assessment of the impact of accounting and auditing developments on the System's combined financial statements,
- the review and assessment of the impact of accounting policy changes related to the preparation of the System's combined financial statements,
- the appointment, compensation, retention and oversight of the System's independent auditors,
- the pre-approval of allowable non-audit services at the System level,
- the receipt of various reports from management on internal controls, off-balance sheet arrangements, critical accounting policies, and material alternative accounting treatments,
- the review and approval of the scope and planning of the annual audit by the System's independent auditors,
- the approval of policies and procedures for the preparation of the System's quarterly and annual information statements,
- the review and approval of the System's quarterly and annual information statements and financial press releases, after discussions with management and the independent auditors, and
- the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters at the System level.

The System Audit Committee has reviewed and discussed the System's 2008 combined financial statements and the System's report on internal control over financial reporting, which were prepared under the oversight of the System Audit Committee, with senior management of the Funding Corporation and the independent auditors. In addition, the System Audit Committee discussed with the independent auditors the matters required to be discussed by Statement of Auditing Standards No. 114.

The System Audit Committee has also received the written disclosures and the letter from the independent auditors required by Independence Standards Board Standard No. 1, and has discussed with the independent auditors their independence.

Based on the review and discussions referred to above, the System Audit Committee recommended that the audited combined financial statements be included in the System's *Annual Information Statement — 2008*.

Arthur R. Wyatt (Chairman)  
William F. Staats (Vice Chairman)  
Norman N. Strauss  
Robert M. Tetrault  
Ann E. Trakimas



## AUDIT FEES

The following table sets forth the aggregate fees billed for professional services rendered for the System by its independent auditor, PricewaterhouseCoopers LLP, for the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
	(in thousands)	
Audit .....	\$8,255	\$8,087
Audit-related .....	439	404
Tax .....	371	331
All Other .....	74	27
Total .....	<u>\$9,139</u>	<u>\$8,849</u>

The *Audit* fees were for professional services rendered for the audits of System entities and the audit of the System's internal control over financial reporting.

The *Audit-related* fees were for issuances of comfort letters for preferred stock offerings and subordinated debt issuances, and employee benefit plan audits.

*Tax* fees were for services related to tax compliance, including the preparation of tax returns and claims for refunds, and tax planning and tax advice.

*All Other* fees were for services rendered for other advisory and assistance services, which were approved by the appropriate audit committee.

## EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of December 31, 2008, the Funding Corporation carried out an evaluation under the supervision and with the participation of the Funding Corporation's management, including the President and CEO and the Managing Director — Financial Management Division, of the effectiveness of the design and operation of the Funding Corporation's disclosure controls and procedures<sup>1</sup> with respect to this annual information statement. This evaluation relies upon the evaluations made by the individual Banks and the related certifications they provide to the Funding Corporation. Based upon and as of the date of the Funding Corporation's evaluation, the President and CEO and the Managing Director — Financial Management Division concluded that the disclosure controls and procedures are effective in alerting them on a timely basis of any material information relating to the System that is required to be disclosed by the System in the reports it files or submits to the Farm Credit Administration. There have been no significant changes in the System's internal control over financial reporting<sup>2</sup> that occurred during the quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the System's internal control over financial reporting.

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<sup>1</sup> For purposes of this discussion, "disclosure controls and procedures" are defined as controls and procedures of the System that are designed to ensure that the financial information required to be disclosed by the System in this annual information statement is recorded, processed, summarized and reported, within the time periods specified under the rules and regulations of the Farm Credit Administration.

<sup>2</sup> For purposes of this discussion, "internal control over financial reporting" is defined as a process designed by, or under the supervision of, the System's principal executives and principal financial officers, or persons performing similar functions, and effected by the System's boards of directors, managements and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the System's combined financial statements for external purposes in accordance with generally accepted accounting principles and 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 System; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the System's combined financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the System are being made only in accordance with authorizations of managements and directors of the System; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the System's assets that could have a material effect on the System's combined financial statements.

## CERTIFICATION

I, Jamie B. Stewart, Jr., certify that:

1. I have reviewed the *Annual Information Statement — 2008* of the Farm Credit System.

2. Based on my knowledge, this annual information statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual information statement.

3. Based on my knowledge, the financial statements, and other financial information included in this annual information statement, fairly present in all material respects the financial condition, results of operations and cash flows of the System as of, and for, the periods presented in this annual information statement.

4. The System's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures<sup>1</sup> and internal control over financial reporting<sup>2</sup> for the System and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the System, including its combined entities, is made known to us by others within those entities, particularly during the period in which this annual information statement is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;


(c) evaluated the effectiveness of the System's disclosure controls and procedures and presented in this annual information statement our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual information statement based on such evaluation; and

(d) disclosed in this annual information statement any change in the System's internal control over financial reporting that occurred during the System's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the System's internal control over financial reporting.

5. The System's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the System's auditors and the System Audit Committee:

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the System's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the System's internal control over financial reporting.



Jamie B. Stewart, Jr.  
President and CEO

Date: February 27, 2009

<sup>1</sup> See footnote 1 on page S-24.

<sup>2</sup> See footnote 2 on page S-24.

## CERTIFICATION

I, H. John Marsh, Jr., certify that:

1. I have reviewed the *Annual Information Statement — 2008* of the Farm Credit System.
2. Based on my knowledge, this annual information statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual information statement.
3. Based on my knowledge, the financial statements, and other financial information included in this annual information statement, fairly present in all material respects the financial condition, results of operations and cash flows of the System as of, and for, the periods presented in this annual information statement.
4. The System's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures<sup>1</sup> and internal control over financial reporting<sup>2</sup> for the System and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the System, including its combined entities, is made known to us by others within those entities, particularly during the period in which this annual information statement is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the System's disclosure controls and procedures and presented in this annual information statement our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual information statement based on such evaluation; and
  - (d) disclosed in this annual information statement any change in the System's internal control over financial reporting that occurred during the System's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the System's internal control over financial reporting.
5. The System's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the System's auditors and the System Audit Committee:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the System's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the System's internal control over financial reporting.



H. John Marsh, Jr.  
Managing Director — Financial  
Management Division

Date: February 27, 2009

<sup>1</sup> See footnote 1 on page S-24.

<sup>2</sup> See footnote 2 on page S-24.

## INDEX TO ANNUAL INFORMATION STATEMENT

<u>Category</u>	<u>Location*</u>
<b>Description of Business</b>	Pages 5 – 14, 22 – 32, 37 – 40, 43, 44, Notes 1, 2, 4, 7, 9, 10, 12, 17, 19 and Pages S-28 – S-31
<b>Federal Regulation and Insurance</b>	Pages 5, 15 – 21, 57, 58, 68 – 71, and Notes 1, 7, 9, 10 and 12
<b>Description of Legal Proceedings and Enforcement Actions</b>	Pages 15, 26, 71 and Note 19
<b>Description of Debt Securities</b>	Pages 5, 6, 15, 19 – 21, 38, 57, 58, 62, 63 and Notes 8 and 9
<b>Description of Liabilities</b>	Pages 5, 6, 15, 19 – 21, 38, 57, 58, 62, 63 and Notes 6, 8, 9, 10, 11, 13 and 14
<b>Description of Capital</b>	Pages 10, 16, 20, 64 – 69, Notes 2, 11, 12 and Pages F-42 and F-51
<b>Selected Financial Data</b>	Pages 3 and 4
<b>Management’s Discussion and Analysis of Financial Condition and Results of Operations</b>	Pages 27 – 72
<b>Directors and Management</b>	Pages S-2 – S-15
<b>Compensation of Directors and Senior Officers</b>	Pages S-4 – S-21
<b>Related Party Transactions</b>	Page 26, Note 18 and Page S-12
<b>Relationship with Independent Auditors</b>	Pages 26 and S-23
<b>Financial Statements</b>	Pages F-1 – F-43
<b>Supplemental Combining Information</b>	Pages F-44 – F-51
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<b>Young, Beginning and Small Farmers and Ranchers</b>	Pages F-55 and F-56
<b>System Audit Committee</b>	Pages 13, 14, S-14, S-15 and S-22

\* As used herein, the references to “Notes” mean the Notes to Combined Financial Statements found on pages F-8 through F-43 of this annual information statement.

**FARM CREDIT SYSTEM ENTITIES (As of January 1, 2009)**

**BANKS**

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

AgriBank, FCB  
375 Jackson Street  
St. Paul, MN 55101-1810  
(651) 282-8800

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

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

U.S. AgBank, FCB  
P.O. Box 2940  
Wichita, KS 67201-2940  
(316) 266-5100

**CERTAIN OTHER ENTITIES**

Farm Credit Leasing Services Corporation  
600 Highway 169 South, Suite 300  
Minneapolis, MN 55426-1219  
(952) 417-7800

Federal Farm Credit Banks  
Funding Corporation  
10 Exchange Place, Suite 1401  
Jersey City, NJ 07302-3913  
(201) 200-8000

FCS Building Association  
1501 Farm Credit Drive  
McLean, VA 22102-5090  
(703) 883-4000

The Farm Credit Council  
50 F Street, NW  
Washington, DC 20001-1530  
(202) 626-8710

**ASSOCIATIONS**

**AgFirst District**

AgCarolina Financial, ACA  
4000 Poole Road  
Raleigh, NC 27610

AgChoice Farm Credit, ACA  
900 Bent Creek Blvd.  
Mechanicsburg, PA 17050-1860

Ag Credit, ACA  
610 W. Lytle Street  
Fostoria, OH 44830-3422

AgGeorgia Farm Credit, ACA  
468 Perry Parkway  
Perry, GA 31069

AgSouth Farm Credit, ACA  
26 South Main Street  
Statesboro, GA 30458

ArborOne, ACA  
800 Woody Jones Blvd.  
Florence, SC 29501

Cape Fear Farm Credit, ACA  
333 East Russell Street  
Fayetteville, NC 28301

Carolina Farm Credit, ACA  
146 Victory Lane  
Statesville, NC 28625

Central Kentucky, ACA  
640 S. Broadway, Room 108  
Lexington, KY 40588

Chattanooga, ACA  
2826 Amnicola Highway  
Chattanooga, TN 37406

Colonial Farm Credit, ACA  
7104 Mechanicsville Turnpike  
Mechanicsville, VA 23111

Farm Credit of Central Florida, ACA  
115 S. Missouri Avenue, Suite 400  
Lakeland, FL 33815

Farm Credit of North Florida, ACA  
12300 U.S. Highway 441  
Alachua, FL 32615

Farm Credit of Northwest Florida, ACA  
5052 Highway 90 East  
Marianna, FL 32446

Farm Credit of South Florida, ACA  
11903 Southern Blvd.  
Suite 200  
Royal Palm Beach, FL 33411

Farm Credit of Southwest Florida, ACA  
330 North Brevard Avenue  
Arcadia, FL 34266

Farm Credit of the Virginias, ACA  
106 Sangers Lane  
Staunton, VA 24401

First South Farm Credit, ACA  
713 S. Pear Orchard Road, Suite 300  
Ridgeland, MS 39157

Jackson Purchase, ACA  
328 East Broadway  
Mayfield, KY 42066

MidAtlantic Farm Credit, ACA  
45 Aileron Court  
Westminster, MD 21157

Puerto Rico Farm Credit, ACA  
213 Manuel V. Domenech Avenue  
Hato Rey, PR 00918

Southwest Georgia Farm Credit, ACA  
305 Colquitt Highway  
Bainbridge, GA 39817

#### **AgriBank District**

1st Farm Credit Services, ACA  
2000 Jacobssen Drive  
Normal, IL 61761

AgCountry Farm Credit Services, ACA  
1900 44th Street South  
Fargo, ND 58108-6020

AgHeritage Farm Credit Services, ACA  
119 East Third Street, Suite 200  
Little Rock, AR 72201

AgStar Financial Services, ACA  
1921 Premier Drive  
Mankato, MN 56002-4249

Badgerland Financial, ACA  
315 Broadway  
Baraboo, WI 53913-0069

Delta ACA  
118 E. Speedway  
Dermott, AR 71638

Farm Credit Midsouth, ACA  
3000 Prosperity Drive  
Jonesboro, AR 72404

Farm Credit Services of America, ACA  
5015 So 118th Street  
Omaha, NE 68137

Farm Credit Services of Illinois, ACA  
2101 W. Park Court  
Champaign, IL 61821

Farm Credit Services of Mandan, ACA  
1600 Old Red Trail  
Mandan, ND 58554-5501

Farm Credit Services of Mid-America, ACA  
1601 UPS Drive  
Louisville, KY 40232-4390

Farm Credit Services of North Dakota, ACA  
3100 10th Street, SW  
Minot, ND 58702-0070

Farm Credit Services of Western Arkansas, ACA  
3115 West 2nd Court  
Russellville, AR 72801

FCS Financial, ACA  
1934 E. Miller Street  
Jefferson City, MO 65101-3881

GreenStone Farm Credit Services, ACA  
1760 Abbey Road  
East Lansing, MI 48823

Progressive Farm Credit Services, ACA  
240 North Kingshighway  
Sikeston, MO 63801

United Farm Credit Services, ACA  
3881 Abbott Drive  
Willmar, MN 56201-1560

#### **CoBank District**

Farm Credit of Maine, ACA  
615 Minot Avenue  
Auburn, ME 04210

Farm Credit of Western New York, ACA  
4363 Federal Drive  
Batavia, NY 14020-4105

First Pioneer Farm Credit, ACA  
240 South Road  
Enfield, CT 06082-4414

Northwest Farm Credit Services, ACA  
1700 South Assembly Street  
Spokane, WA 99220

Yankee Farm Credit, ACA  
289 Hurricane Lane, Suite 102  
Williston, VT 05495

### **Texas District**

AgCredit of South Texas, ACA  
555 South International Boulevard  
Weslaco, TX 78596

Ag New Mexico, Farm Credit Services, ACA  
233 Fairway Terrace North  
Clovis, NM 88101

AgriLand, Farm Credit Services  
3210 W. Northwest Loop 323  
Tyler, TX 75702

AgTexas Farm Credit Services  
6901 Quaker Avenue, Suite 300  
Lubbock, TX 79413

Capital Farm Credit, ACA  
507 E. 26th Street  
Bryan, TX 77803

Central Texas Farm Credit, ACA  
215 W. Elm Street  
Coleman, TX 76834

Federal Land Bank Association of  
North Alabama, FLCA  
1949 St. Joseph Drive, N.W.  
Cullman, AL 35055

Federal Land Bank Association of  
North Mississippi, FLCA  
5509 Highway 51 North  
Senatobia, MS 38668

Federal Land Bank Association of South Alabama,  
FLCA  
7602 Halcyon Summit Drive  
Montgomery, AL 36117

Great Plains Ag Credit, ACA  
5701 I-40 West  
Amarillo, TX 79106

Heritage Land Bank, ACA  
4608 Kinsey Drive, Suite 100  
Tyler, TX 75703

Land Bank South  
132 Riverview Drive, Suite C  
Flowood, MS 39232

Legacy AgCredit, ACA  
303 Connally Street  
Sulphur Springs, TX 75482  
Lone Star, ACA  
1612 Summit Drive, Suite 300  
Fort Worth, TX 76102

Louisiana Ag Credit, ACA  
1564 North Hazel Street  
Arcadia, LA 71001

Louisiana Federal Land Bank Association, FLCA  
2413 Tower Drive  
Monroe, LA 71201

Panhandle-Plains Land Bank, FLCA  
5700 Southwest 45th  
Amarillo, TX 79109-5204

Texas AgFinance, Farm Credit Services  
545 South Highway 77  
Robstown, TX 78380

Texas Land Bank, ACA  
13525 Sandalwood Drive  
Waco, TX 76712

### **U.S. AgBank District**

AgPreference, ACA  
3120 North Main  
Altus, OK 73521

American AgCredit, ACA  
200 Concourse Boulevard  
Santa Rosa, CA 95403

Chisholm Trail Farm Credit, ACA  
805 Chisholm Trail  
Enid, OK 73703

Farm Credit of Central Oklahoma, ACA  
Mission and Georgia  
Anadarko, OK 73005



Farm Credit of Enid, ACA  
1605 W. Owen K. Garriott Road  
Enid, OK 73703

Farm Credit of Ness City, FLCA  
114 West Main Street  
Ness City, KS 67560

Farm Credit of New Mexico, ACA  
5651 Balloon Fiesta Parkway NE  
Albuquerque, NM 87113

Farm Credit of Southern Colorado, ACA  
3625 Citadel Drive South  
Colorado Springs, CO 80909

Farm Credit of Southwest Kansas, ACA  
1606 E. Kansas Avenue  
Garden City, KS 67846

Farm Credit of Western Kansas, ACA  
1055 South Range Avenue  
Colby, KS 67701

Farm Credit of Western Oklahoma, ACA  
3302 Williams Avenue  
Woodward, OK 73801

Farm Credit of the Heartland, ACA  
7940 W. Kellogg Drive  
Wichita, KS 67209

Farm Credit Services of Colusa-Glenn, ACA  
605 Jay Street  
Colusa, CA 95932

Farm Credit Services of East Central  
Oklahoma, ACA  
601 E. Kenosha Street  
Broken Arrow, OK 74012

Farm Credit Services of Hawaii, ACA  
2850 Pa'a Street, Suite 100  
Honolulu, HI 96819

Farm Credit Services of The Mountain Plains, ACA  
4505 29th Street  
Greeley, CO 80634

Farm Credit Services Southwest, ACA  
3003 S. Fair Lane  
Tempe, AZ 85282

Farm Credit West, ACA  
1478 Stone Point Drive, Suite 450  
Roseville, CA 95661

Federal Land Bank Association of Kingsburg,  
FLCA  
1580 Ellis Street  
Kingsburg, CA 93631

Fresno-Madera Farm Credit, ACA  
4635 West Spruce Ave.  
Fresno, CA 93722

Frontier Farm Credit, ACA  
2401 N. Seth Child Road  
Manhattan, KS 66502

High Plains Farm Credit, ACA  
605 Main Street  
Larned, KS 67550

Idaho Agricultural Credit Association  
188 West Judicial  
Blackfoot, ID 83221

Northern California Farm Credit, ACA  
3435 Silverbell Road  
Chico, CA 95973

Premier Farm Credit, ACA  
202 Poplar Street  
Sterling, CO 80751

Western AgCredit, ACA  
10980 South Jordan Gateway  
South Jordan, UT 84095

Yosemite Farm Credit, ACA  
800 West Monte Vista Avenue  
Turlock, CA 95382

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