# 2012 ANNUAL REPORT
## TEXAS FARM CREDIT DISTRICT

# 2012

A YEAR OF

STRENGTH

AND

AGILITY

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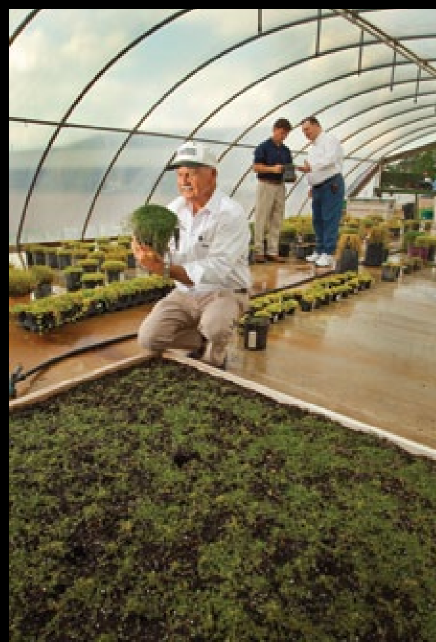


Farmers and ranchers are a tough breed, skilled at adapting to variable weather conditions, markets and technologies, while helping to meet the world's growing need for food and fiber. Whatever Mother Nature and market forces throw at them, they have to be strong and agile. Their business success depends on their ability to plan for the worst, deal with the unexpected, and take advantage of new technologies and research.

The Texas Farm Credit District shares that agility and strength. Last year, our district rebounded from the effects of the previous year's drought and a weak economy with increased earnings, improved credit quality and a higher quality loan portfolio. By adapting to changing conditions and sizing new opportunities, we have continued to be a reliable source of competitive financing for agriculture and rural America.

# BOARD OF DIRECTORS
# FARM CREDIT BANK OF TEXAS

(Left to right)
Jon M. "Mike" Garnett
Brad C. Bean
James F. "Jimmy" Dodson, Chairman
Lester Little, Vice Chairman
Ralph W. "Buddy" Cortese
Elizabeth G. "Betty" Flores
William F. Staats

The Texas Farm Credit District benefits from a deep leadership bench provided by the Farm Credit Bank of Texas Board of Directors. The board members establish policies for the bank, provide strategic direction, oversee management and ensure that the bank operates in a safe and sound manner. In doing so, they are guided by their years of experience in agriculture, business and finance.

Five of the directors are farmers or ranchers who were elected by the local financing cooperatives that own the bank. Two directors have banking backgrounds and were appointed by the elected board members.

### Joe R. Crawford Retires From Board

Joe R. Crawford retired on December 31, 2012, after 14 years of service on the Farm Credit Bank of Texas Board of Directors. He is succeeded on the bank board by Brad C. Bean of Mississippi.

Crawford was first elected to the bank board in 1998. From 2004 to 2012, he represented the bank on the Federal Farm Credit Banks Funding Corporation Board of Directors, where he served on the audit committee beginning in 2008. Prior to joining the bank board, he served on the board of the Federal Land Bank Association of North Alabama, now Alabama Farm Credit, ACA.

A former U.S. Air Force and NASA engineer, Crawford is a past president of the Alabama Cattlemen's Association. He has owned and operated a cattle business in Baileyton, Ala., since 1968.

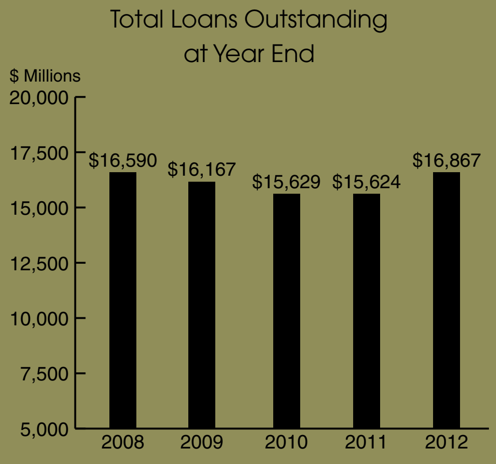
The Texas Farm Credit District reported strong financial results for 2012, highlighted by record earnings of $409.4 million for the year. This represented an increase of $40.7 million, or 11 percent, over 2011 net income. Net interest income for 2012 totaled $615.2 million, compared with $608.1 million for 2011.

Loan volume increased 8 percent to a record $16.87 billion at December 31, 2012, from $15.62 billion at December 31, 2011. Credit quality also improved, with 96.8 percent of loan volume considered acceptable or special mention at year-end 2012, compared with 95.4 percent a year earlier.

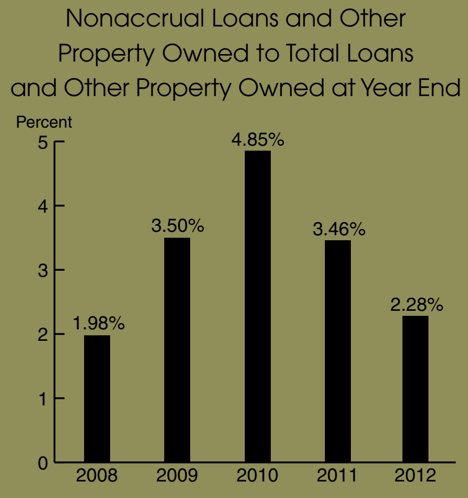
## 2012 FINANCIAL HIGHLIGHTS

*(Dollars in Thousands)*

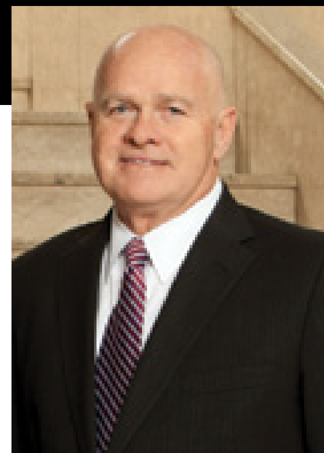
| | |
|---|---|
| Total Loans | $16,866,732 |
| Total Assets | $21,125,642 |
| Net Income | $409,415 |
| Return on Average Assets | 2.00% |
| Return on Average Members' Equity | 12.42% |







# MESSAGE TO STOCKHOLDERS



For the Texas Farm Credit District, 2012 was a very positive year — a year in which we strengthened our balance sheet, returned outstanding value to our stockholders and took important steps to better serve our customers in the future.

Net income for the year totaled $409.4 million — an 11 percent increase from 2011 and more than double our earnings during the global economic slump of 2009. This accomplishment can be attributed largely to an improvement in asset quality and growth in earning assets, as well as a refund of insurance premiums from the Farm Credit System Insurance Corporation.

District loan volume increased to a record $16.87 billion at year-end 2012, up 8 percent from the previous year. The increase was fueled by a 25 percent growth in a diverse group of industries, occurring largely in the Farm Credit Bank of Texas' participation loan portfolio.

We are pleased with our increased lending activity and take pride in our improved credit quality. We ended 2012 with 96.8 percent of the district's loan portfolio considered acceptable or other assets especially mentioned. This increase was a reflection of the generally improved markets and growing conditions throughout most of our five-state territory, as well as the efforts by district lenders to reduce nonaccrual loan volume by nearly 37 percent.

Last year, the Texas Farm Credit District joined other co-ops around the world in recognizing 2012 as the International Year of Cooperatives. However, it doesn't take a proclamation to recognize that our cooperative philosophy works in the best interests of our customers. True to our business model, Farm Credit Bank of Texas shared a significant portion of its 2012 earnings with the district associations and Other Financing Institutions that own the bank, effectively reducing their cost of funding to the same cost that the bank pays in the capital markets, giving them a distinct advantage in the marketplace. This in turn allowed those lenders to declare a total of $199.8 million in patronage payments and allocated equities to their customers based on 2012 earnings.

With a view to the future, Farm Credit Bank of Texas continued to upgrade and invest in the district's lending systems and integrated technology infrastructure. We are confident that these initiatives, which include developing new business systems and improving data storage, speed and security, will allow all district lending institutions to operate more effectively and provide their customers with the products and services they need to be successful.

As we look back on our accomplishments in 2012 and welcome the opportunities and challenges that 2013 brings, we wish each of our customers — agricultural producers, agribusinesses and rural real estate owners — an outstanding year ahead.

Larry R. Doyle
Chief Executive Officer
Farm Credit Bank of Texas

# Five-Year Summary of Selected Combined Financial Data

FARM CREDIT BANK OF TEXAS AND DISTRICT ASSOCIATIONS

| *(dollars in thousands)* | **2012** | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| **Balance Sheet Data** | | | | | |
| Cash, federal funds sold and overnight investments | **$ 536,979** | $ 453,406 | $ 473,760 | $ 521,457 | $ 233,580 |
| Investment securities | **3,415,554** | 3,287,928 | 3,231,562 | 2,179,312 | 3,046,397 |
| Loans | **16,866,732** | 15,624,013 | 15,628,890 | 16,167,170 | 16,590,071 |
| Less allowance for loan losses | **106,842** | 114,117 | 163,145 | 144,731 | 51,653 |
| Net loans | **16,759,890** | 15,509,896 | 15,465,745 | 16,022,439 | 16,538,418 |
| Other property owned, net | **98,211** | 87,956 | 78,124 | 53,324 | 6,495 |
| Other assets | **315,008** | 303,305 | 306,393 | 340,631 | 341,422 |
| **Total assets** | **$ 21,125,642** | $ 19,642,491 | $ 19,555,584 | $ 19,117,163 | $ 20,166,312 |
| Obligations with maturities of one year or less | **$ 9,031,899** | $ 8,750,813 | $ 8,991,040 | $ 8,788,651 | $ 10,148,876 |
| Obligations with maturities greater than one year | **8,807,662** | 7,787,550 | 7,598,213 | 7,811,108 | 7,687,719 |
| **Total liabilities** | **17,839,561** | 16,538,363 | 16,589,253 | 16,599,759 | 17,836,595 |
| Preferred stock | **482,000** | 482,000 | 482,000 | 202,754 | 202,754 |
| Capital stock and participation certificates | **59,859** | 60,024 | 61,843 | 63,202 | 63,859 |
| Allocated retained earnings | **419,721** | 374,231 | 327,435 | 266,991 | 211,450 |
| Unallocated retained earnings | **2,412,571** | 2,257,527 | 2,121,822 | 2,061,299 | 1,984,421 |
| Additional paid-in-capital | **22,737** | 22,737 | 22,622 | — | — |
| Accumulated other comprehensive loss | **(110,807)** | (92,391) | (49,391) | (76,842) | (132,767) |
| **Total members' equity** | **3,286,081** | 3,104,128 | 2,966,331 | 2,517,404 | 2,329,717 |
| **Total liabilities and members' equity** | **$ 21,152,642** | $ 19,642,491 | $ 19,555,584 | $ 19,117,163 | $ 20,166,312 |
| **Statement of Income Data** | | | | | |
| Net interest income | **$ 615,163** | $ 608,056 | $ 580,170 | $ 535,792 | $ 470,428 |
| Provision for loan losses | **(33,631)** | (45,048) | (141,457) | (172,140) | (53,514) |
| Noninterest expense, net | **(171,132)** | (193,167) | (163,687) | (167,837) | (148,842) |
| (Provision for) benefit from income taxes | **(985)** | (1,175) | 291 | 2,609 | (344) |
| **Net income** | **$ 409,415** | $ 368,666 | $ 275,317 | $ 198,424 | $ 267,728 |
| **Key Financial Ratios** (unaudited) | | | | | |
| Net income to: | | | | | |
| Average assets | **2.00%** | 1.88% | 1.41% | 1.01% | 1.40% |
| Average members' equity | **12.42** | 11.75 | 9.87 | 8.02 | 11.37 |
| Net interest income to average earning assets | **3.12** | 3.23 | 3.09 | 2.82 | 2.50 |
| Net charge-offs to average loans | **0.22** | 0.60 | 0.75 | 0.48 | 0.16 |
| Total members' equity to total assets | **15.55** | 15.80 | 15.17 | 13.17 | 11.55 |
| Allowance for loan losses to total loans | **0.63** | 0.73 | 1.04 | 0.90 | 0.31 |
| Regulatory permanent capital ratio (bank only) | **18.64** | 20.85 | 22.00 | 15.98 | 14.03 |
| Total surplus ratio (bank only) | **15.92** | 17.36 | 17.83 | 12.47 | 11.25 |
| Core surplus ratio (bank only) | **9.92** | 10.48 | 10.67 | 7.11 | 6.40 |
| Net collateral ratio (bank only) | **107.94** | 108.27 | 107.91 | 105.83 | 105.40 |
| **Net Income Distributions** (unaudited) | | | | | |
| Net income distributions declared and accrued | | | | | |
| Preferred stock cash dividends | **$ 43,761** | $ 43,761 | $ 45,601 | $ 15,122 | $ 15,122 |
| Patronage distributions | | | | | |
| Cash | **106,624** | 87,032 | 82,846 | 52,303 | 71,402 |
| Allocated earnings | **103,986** | 101,375 | 59,818 | 55,648 | 80,558 |

# Combined Average Balances and Net Interest Earnings

FARM CREDIT BANK OF TEXAS AND DISTRICT ASSOCIATIONS
(unaudited)
December 31,

| | 2012 | | | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **Average Balance** | **Interest** | **Average Rate** | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| **Assets** | | | | | | | | | |
| Investment securities and federal funds sold | **$ 3,366,284** | **$ 59,397** | **1.76%** | $ 3,314,502 | $ 65,812 | 1.99% | $ 2,993,627 | $ 77,701 | 2.60% |
| Loans | **16,347,166** | **749,901** | **4.59** | 15,520,926 | 762,843 | 4.91 | 15,785,538 | 797,608 | 5.05 |
| **Total interest-earning assets** | **19,713,450** | **809,298** | **4.11** | 18,835,428 | 828,655 | 4.40 | 18,779,165 | 875,309 | 4.66 |
| Cash | **394,613** | | | 465,851 | | | 415,056 | | |
| Accrued interest receivable | **150,307** | | | 158,379 | | | 176,560 | | |
| Allowance for loan losses | **(109,300)** | | | (151,712) | | | (152,810) | | |
| Other noninterest-earning assets | **291,918** | | | 263,066 | | | 248,680 | | |
| **Total average assets** | **$ 20,440,988** | | | $ 19,571,012 | | | $ 19,466,651 | | |
| **Liabilities and Members' Equity** | | | | | | | | | |
| Bonds, medium-term notes and subordinated debt, net | **$ 11,546,068** | **$ 161,958** | **1.40%** | $ 10,654,490 | $ 186,475 | 1.75% | $ 11,488,249 | $ 262,706 | 2.29% |
| Discount notes, net, and other | **5,214,915** | **32,177** | **0.62** | 5,442,773 | 34,124 | 0.63 | 4,830,875 | 32,433 | 0.67 |
| **Total interest-bearing liabilities** | **16,760,983** | **194,135** | **1.16** | 16,097,263 | 220,599 | 1.37 | 16,319,124 | 295,139 | 1.81 |
| Noninterest-bearing liabilities | **384,621** | | | 335,056 | | | 358,340 | | |
| **Total liabilities** | **17,145,604** | | | 16,432,319 | | | 16,677,464 | | |
| Members' equity and retained earnings | **3,295,384** | | | 3,138,693 | | | 2,789,187 | | |
| **Total average liabilities and members' equity** | **$ 20,440,988** | | | $ 19,571,012 | | | $ 19,466,651 | | |
| Net interest rate spread | | **$ 615,163** | **2.95%** | | $ 608,056 | 3.03% | | $ 580,170 | 2.85% |
| Net interest margin | | | **3.12%** | | | 3.23% | | | 3.09% |

# Management's Discussion and Analysis

*(dollars in thousands, except as noted)*

The following commentary provides a discussion and analysis of the combined financial position and results of operations of the Farm Credit Bank of Texas (bank), the Federal Land Credit Association (FLCA) and the Agricultural Credit Associations (ACAs) for the years ended December 31, 2012, 2011 and 2010. The FLCA and ACAs collectively are referred to as "associations," and the bank and its affiliated associations are collectively referred to as "the district." The commentary should be read in conjunction with the accompanying combined financial statements, notes to the combined financial statements (notes) and additional sections of this report. The accompanying combined financial statements were prepared under the oversight of the bank's audit committee.

The district, which serves Texas, Alabama, Mississippi, Louisiana and portions of New Mexico, is part of the federally chartered Farm Credit System (System). The bank provides funding to the associations, which, in turn, provide credit to their borrower-shareholders. As of December 31, 2012, the district comprised the bank, one FLCA and 16 ACAs. The bank also had funding relationships with certain Other Financing Institutions (OFIs).

## Forward-Looking Information

This annual information report 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, 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 United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## Critical Accounting Policies

The combined 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 value of certain assets or liabilities. We consider these policies critical because management has to make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," to the accompanying combined financial statements. The following is a summary of certain critical policies.

- Allowance for loan losses — 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. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which identifies loans that may be impaired. Each of these 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. If the present value of expected future cash flows (or, alternatively, the fair value of the collateral) is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), an impairment is recognized by making an addition to the allowance for loan losses with a corresponding charge to the provision for loan losses or by similarly adjusting an existing valuation allowance. In addition to these specific allowances, general allowances for loan losses are recorded to reflect expected credit deterioration and inherent losses in that portion of loans that are not individually evaluated.
- Valuation methodologies — Management applies 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. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Third-party valuation services are utilized by management to obtain fair values for the majority of the bank's investments. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, certain mortgage-related securities, 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 district's results of operations.
- Pensions — The bank and its related associations participate in defined benefit retirement plans. These plans are noncontributory, and benefits are based on salary and years of service. In addition, the bank and its related associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits.

Pension expense is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. 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. We selected the discount rate by reference to the Aon Hewitt AA Only Above-Median Yield Curve, actuarial analyses and industry norms. The Hewitt yield curves are determined based on actual corporate bond yields for bonds rated AA as of the measurement date.

## OVERVIEW

### General

The district's loan portfolio totaled $16.9 billion at December 31, 2012, an 8.0 percent increase from the prior year. The district's net income for 2012 was $409.4 million, an increase of $40.7 million, or 11.1 percent, from the $368.7 million in net income for 2011. The district's $40.7 million increase in net income for 2012 was driven by a $36.9 million increase in noninterest income, an $11.5 million decrease in provisions for loan losses, and a $7.1 million increase in net interest income, offset by a $14.8 million increase in noninterest expense. The improvement in the district's net interest income was primarily driven by growth in earning assets, partially offset by a decrease in the net interest rate spread. The bank continues to benefit from debt management, and its ability to exercise call options on debt and replace it with debt with lower interest rates.

### Funding

During 2012, the System continued to have reliable access to the debt capital markets to support its mission of providing credit to farmers, ranchers and other eligible borrowers. Investor demand for Systemwide debt securities has remained favorable across all products. Given the low interest rate environment, the bank continues to refinance callable bonds when possible in order to lower its cost of funds. The bank has continued to have reliable access to funding at competitive rates and terms necessary to support our lending and business operations. Future ratings action affecting the U.S. government and related entities (including the System) may affect our borrowing cost and/or limit our access to the debt capital markets, reducing our flexibility to issue debt across the full spectrum of the yield curve.

### Agricultural Outlook

During 2012 the Midwestern portion of the nation suffered from an intense drought which rivaled the drought that impacted the district during 2011. While many of the Midwestern states suffered from drought and agricultural hardship, weather conditions as a whole were generally improved across the district during 2012. States within the eastern portion of the district, such as Louisiana and Mississippi, benefited from increased moisture resulting in healthier farm conditions, while portions of far eastern Alabama continued to struggle with areas of exceptional drought. Portions of Texas benefited from rains throughout the year, while conditions across northwest Texas and much of New Mexico continued to experience drought ranging from severe to exceptional.

A generally cooler weather pattern resulted in better than average crop yields for both dry-land and irrigated corn and soybean farmers across a large portion of the eastern district states, as well as central, eastern and the coastal prairies of Texas. Strong crop and grain prices benefited farmers in these areas, improving overall portfolio profitability. Irrigated farmers in those areas of Texas and New Mexico most affected by drought experienced increased production costs and below average yields, but most were still profitable due to higher grain prices. While dry-land cotton farmers in northwestern Texas and New Mexico continued to struggle with lower prices and poor crop yields, a large majority of losses were mitigated by multi-peril crop insurance.

During 2012 a general rise in protein prices benefited poultry growers, integrators and hog producers. While feed costs remained high for these segments, profitability remained strong due to a curb in domestic demand for beef which shifted to chicken and pork. With higher feed costs and poor pasture conditions, there was a continued trend toward reduced cattle supply across most of the district during 2012. While higher feeder carcass prices helped profitability, high grain prices and production costs pressured feedlot margins.

A significant improvement in overall weather conditions coupled with strong grain and protein prices improved overall district profitability during 2012. District portfolios continued to be supported by high levels of non-ag income, increased portfolio diversification and strong credit quality of existing borrowers. While uncertainty generally drives larger macro-economic forces, diligent on-farm risk management continues to be the greatest hedge against rising production costs for district borrowers.

Trends toward a growing job market, improved demand for housing and construction, and continued growth in key commodity prices across our primary agricultural concentrations should play a key role in maintaining credit quality and growing district loan portfolios into 2013.

### Financial Highlights

- ❖ Net income totaled $409.4 million for the year ended December 31, 2012, compared to $368.7 million for 2011 and $275.3 million for 2010, reflecting an increase of 11.1 percent from 2011 and an increase of 48.7 percent over 2010.
- ❖ Net interest income for the year ended December 31, 2012, was $615.2 million compared to $608.1 million for 2011 and $580.2 million for 2010, reflecting 1.2 and 6.0 percent increases over the years ended December 31, 2011 and 2010, respectively.
- ❖ Return on average assets and return on average members' equity for the year ended December 31, 2012, were 2.00 percent and 12.42 percent, respectively, compared to 1.88 percent and 11.75 percent for 2011 and 1.41 percent and 9.87 percent for 2010, respectively.
- ❖ Patronage distributions declared totaled $210.6 million in 2012, compared to $188.4 million and $142.7 million in 2011 and 2010, respectively.
- ❖ The aggregate principal amount of loans outstanding at December 31, 2012, was $16.87 billion, compared to $15.62 billion at December 31, 2011, reflecting an increase of 8.0 percent.
- ❖ On March 8, 2012, Fitch Ratings applied revised criteria for rating all financial institutions' hybrid capital instruments. This resulted in a downgrade in the bank's cumulative preferred stock rating from "A" to "BBB+" and a downgrade in its noncumulative preferred stock rating from "A" to "BBB." Fitch continues to rate the bank's long- and short-term Issuer Default

Rating at "AA-" and "F1+" with a stable outlook. On October 11, 2012, Fitch Ratings affirmed (with a "stable" outlook) the bank's ratings for long- and short-term Issuer Default Rating at "AA-" and "F1+," respectively; its cumulative preferred stock at "BBB+"; noncumulative preferred stock at "BBB"; and subordinated debt at "A+."

- On August 2, 2011, Moody's Investors Service affirmed the bank's investment grade of Aa2 issuer rating. Previously, Moody's had affirmed the bank's A1 subordinated debt rating, A2 cumulative preferred stock rating and A3 noncumulative preferred stock rating, citing the bank's strong credit performance, very high support from the System and very high support from the U.S. government. In Moody's annual credit opinion for the bank issued August 1, 2012, the bank's ratings remained the same. While the issuer outlook changed from "ratings under review" to "negative" due to linkage with the U.S. government's "negative" outlook on its AAA long-term debt rating, the bank's preferred stock ratings have a "stable" outlook based on strong market conditions for agriculture and consistent financial performance.

## RESULTS OF OPERATIONS

### Net Income

The district's net income of $409.4 million for the year ended December 31, 2012, reflected an increase of 11.1 percent from net income of $368.7 million for the year ended December 31, 2011, and an increase of 48.7 percent from net income of $275.3 million for 2010. The return on average assets increased to 2.00 percent for the year ended December 31, 2012, from 1.88 percent reported for the year ended December 31, 2011. This increase was due primarily to a $36.9 million increase in noninterest income, a decrease of $11.5 million in the district's provision for loan losses discussed more fully in the "Loan Portfolio" section of this discussion, an increase of $7.1 million in net interest income, and a $190 decrease in provision for income taxes, offset by a $14.8 million increase in noninterest expense.

### Changes in Components of Net Income

| | 2012 vs. 2011 | 2011 vs. 2010 |
|---|---|---|
| Net income, prior period | $ 368,666 | $ 275,317 |
| Increase (decrease) due to: | | |
| Decrease in interest income | (19,357) | (46,654) |
| Decrease in interest expense | 26,464 | 74,540 |
| Net interest income | 7,107 | 27,886 |
| Provision for loan losses | 11,417 | 96,409 |
| Noninterest income | 36,861 | (20,065) |
| Noninterest expense | (14,826) | (9,415) |
| Benefit from (provision for) income taxes | 190 | (1,466) |
| Total change in net income | 40,749 | 93,349 |
| Net income | $ 409,415 | $ 368,666 |

Discussion of the changes in components of net income is included in the following narrative.

### Interest Income

Total interest income for the year ended December 31, 2012, was $809.3 million, a decrease of $19.4 million, or 2.3 percent, compared to 2011. Total interest income for 2011 was $828.7 million, a decrease of $46.7 million, or 5.3 percent, from 2010. The decreases for 2012 and 2011 were due to a decrease in yield on earning assets net of a slight increase in average interest-earning assets.

The following table illustrates the impact that volume and yield changes had on interest income over these periods.

| | Year Ended December 31, | |
|---|---|---|
| | 2012 vs. 2011 | 2011 vs. 2010 |
| Increase in average earning assets | $ 878,022 | $ 56,263 |
| Average yield, prior year | 4.40% | 4.66% |
| Interest income variance attributed to change in volume | 38,628 | 2,622 |
| Average earning assets, current year | 19,713,450 | 18,835,428 |
| Decrease in average yield | (0.29)% | (0.26)% |
| Interest income variance attributed to change in yield | (57,985) | (49,276) |
| Net change in interest income | $ (19,357) | $ (46,654) |

### Interest Expense

Total interest expense for the year ended December 31, 2012, was $194.1 million, a decrease of $26.4 million, or 12.0 percent, from the prior year. Total interest expense for the year ended December 31, 2011, was $220.6 million, a decrease of $74.5 million, or 25.3 percent, from 2010. The decrease for 2012 was due primarily to a decrease in the average rate on debt and a decrease in interest-bearing liabilities. During 2012, the bank was able to reduce its interest expense by calling and replacing $8.9 billion in debt with debt which had lower interest rates, which resulted in a savings of approximately $21.9 million, net of related concession expenses. The decrease for 2011 was due primarily to a decrease in the average rate on debt and a decrease in interest-bearing liabilities. During 2011, the bank was able to reduce its interest expense by calling $9.0 billion in debt and replacing it with debt that had lower interest rates, which resulted in a savings of approximately $25.4 million, net of related concession expenses.

The following table illustrates the impact that volume and rate changes had on interest expense over these periods.

| | Year Ended December 31, | |
|---|---|---|
| | 2012 vs. 2011 | 2010 vs. 2010 |
| Increase (decrease) in average interest-bearing liabilities | $ 663,720 | $ (221,861) |
| Average rate, prior year | 1.37% | 1.81% |
| Interest expense variance attributed to change in volume | 9,096 | (4,016) |
| Average interest-bearing liabilities, current year | 16,760,983 | 16,097,263 |
| Decrease in average rate | (0.21)% | (0.44)% |
| Interest expense variance attributed to change in rate | (35,560) | (70,524) |
| Net change in interest expense | $ (26,464) | $ (74,540) |

## Analysis of Operating Margin to Average Earning Assets

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | **2012** | 2011 | 2010 |
| Net interest margin | **3.12%** | 3.23% | 3.09% |
| Operating expense | **1.20** | 1.15 | 1.12 |
| Operating margin | **1.92%** | 2.08% | 1.97% |

## Net Interest Income

Net interest income increased by $7.1 million, or 1.2 percent, from 2011 to 2012 and increased by $27.9 million, or 4.8 percent, from 2010 to 2011. Factors responsible for these changes are illustrated in Figure 1.

Net interest income for 2012 increased from 2011 due to an increase in average-earning assets, offset by an 8-basis-point decrease in the interest rate spread, which is the difference between the average rate received on interest-earning assets and the average rate paid on interest-bearing debt.

The increase in average-earning assets was due primarily to an increase in the bank' investments and participation loan portfolios, and to a slight increase in loan growth at the district's associations. The bank has been able to reduce its cost of debt during 2012, 2011 and 2010 by taking advantage of callable debt features. While continuing to benefit from debt management in 2012, decline in interest rates resulted in a decrease in the district's net interest rate spread and interest margin. During 2012, the bank called $8.9 billion in debt, replacing it with debt that had more favorable terms. District associations in the aggregate were able to improve their net interest rate spread.

Net interest income for 2011 increased from 2010 due to an 18-basis-point increase in the interest rate spread and an increase in average-earning assets.

## Provision for Loan Losses

The provision for loan losses for 2012 was $33.6 million, reflecting a decrease of $11.5 million from the $45.1 million provision recorded in 2011. The provision for loan losses at the bank increased by $10.7 million, while the associations' provisions decreased by $22.0 million. The decrease is due primarily to a reduction in required specific provisions for loan losses on impaired loans. Specific provisions for 2012 decreased from those of 2011 as credit quality of the loan portfolio has improved. The specific provisions reflect credit deterioration primarily in those agricultural sectors that continue to be impacted by volatility in commodity prices, such as the livestock, timber and dairy industries, as well as those borrowers impacted by the overall downturn in the general economy, primarily ethanol, meat processing, land in transition and geothermal power.

## Noninterest Income

Noninterest income of $78.5 million reflected an increase of $36.9 million, or 88.5 percent, from 2011 to 2012. The increase was primarily due to a $22.9 million increase in Farm Credit System Insurance Corporation (FCSIC or Insurance Fund) refund distributions of excess reserves from prior periods recorded during the second quarter of 2012, a $5.4 million increase in fees for loan-related services, a $2.8 million increase in fair value on loans purchased in the secondary market, a $2.1 million decrease in losses from a 2011 write-off of capitalized software costs at the bank due to redirection of its data warehouse initiative, a $2.0 million decrease in impairment losses recognized due to the estimated amount of credit loss related to other-than-temporary impairments on investment securities which is more fully discussed in the "Investments" section of this discussion and in Note 3, "Investment Securities," and a $1.7 million increase in all other noninterest items, collectively, offset by a $95 decrease in patronage income. The increase in loan-related fee income reflects the increase in lending volume at the bank and includes a $5.1 million increase in prepayment fees from 2011.

Noninterest income for 2011 of $41.7 million reflected a decrease of $20.1 million, or 32.5 percent, from 2010 to 2011. The decrease was primarily due to a $22.3 million decrease in Insurance Fund refund distributions of excess reserves from prior periods recorded during the first quarter of 2010, a $3.4 million decrease in fees for loan-related services, a $529 decrease in gain on sale of investments, a $257 increase in impairment losses recognized due to the estimated amount of credit loss related to other-than-temporary impairments on investment securities which is more fully discussed in the "Investments" section of this discussion and in Note 3, "Investment Securities," and a $1.3 million decrease in all other noninterest items, collectively, offset by a $7.2 million decrease in losses at an association on the sale of loans at fair value to the bank and a $481 increase in patronage income. The decrease

Figure 1

### Analysis of Net Interest Income

| | 2012 | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| | **Average Balance** | **Interest** | Average Balance | Interest | Average Balance | Interest |
| Loans | **$ 16,347,166** | **$ 749,901** | $ 15,520,926 | $ 762,843 | $ 15,785,538 | $ 797,608 |
| Investments | **3,366,284** | **59,397** | 3,314,502 | 65,812 | 2,993,627 | 77,701 |
| Total earning assets | **19,713,450** | **809,298** | 18,835,428 | 828,655 | 18,779,165 | 875,309 |
| Interest-bearing liabilities | **16,760,983** | **194,135** | 16,097,263 | 220,599 | 16,319,124 | 295,139 |
| Impact of capital | **$ 2,952,467** | | $ 2,738,165 | | $ 2,460,041 | |
| NET INTEREST INCOME | | **$ 615,163** | | $ 608,056 | | $ 580,170 |

| | **Average Yield** 2012 | Average Yield 2011 | Average Yield 2010 |
|---|---|---|---|
| Yield on loans | 4.59% | 4.91% | 5.05% |
| Yield on investments | 1.76 | 1.99 | 2.60 |
| Yield on earning assets | 4.11 | 4.40 | 4.66 |
| Cost of interest-bearing liabilities | 1.16 | 1.37 | 1.81 |
| Interest rate spread | 2.95 | 3.03 | 2.85 |
| Impact of capital | 0.17 | 0.20 | 0.24 |
| Net interest income/average earning assets | 3.12 | 3.23 | 3.09 |

in loan-related fee income reflects the decrease in lending activity at the district associations and includes a $2.1 million decrease in prepayment fees from 2010.

## Noninterest Expenses

Noninterest expenses for 2012 totaled $249.7 million, increasing $14.8 million, or 6.3 percent, from 2011. The increase was primarily due to an increase of $12.6 million in salaries and employment benefits, a $6.7 million increase in other operating expenses, and an increase of $1.6 million in occupancy and equipment expense, offset by a decrease of $4.9 million in net losses on other property owned (OPO) and a $1.2 million decrease in premiums to the FCSIC. The $12.6 million increase in salaries and employee benefits was due primarily to a $7.8 million increase in retirement expenses for the district, a $6.4 million increase in compensation and related payroll taxes at the district's associations, a $795 increase in compensation and related payroll taxes at the bank, and a $746 increase in all other salaries and benefits expenses, collectively, offset by a $3.2 million decrease in the bank's supplemental defined benefit pension plan (which was terminated in 2011). The $1.6 million increase in occupancy and equipment expenses included a $1.1 million increase in computer expense ($734 at the bank and $346 at the district associations), including a $511 increase in depreciation at the bank due in part to the implementation of internally developed systems, a $319 increase in cost of space at the district's associations, and a $183 increase in furniture and equipment at the district's associations, offset by a $12 decrease in all other occupancy and equipment expenses, collectively. The $4.9 million decrease in losses on OPO was primarily due to an increase of $4.2 million at the bank and a decrease of $9.1 million at district associations. The decrease included a $2.6 million increase in gains on disposal of OPO, a $1.4 million decrease in net expenses on OPO, and a decrease in the provision for losses on OPO of $906. Premiums to the Insurance Fund decreased due primarily to the effects of a premium rate decrease from the 6-basis-point rate in 2011 to a rate of 5 basis points for 2012, offset slightly by an increase in average covered debt. The increase in other operating expenses included a $2.0 million increase in association advertising and member relations, a $1.6 million increase in professional and contract services at the bank (due primarily to information technology initiatives), a $905 increase in travel expenses at the district's associations, a $556 increase in directors' expenses at the associations, a $529 increase in association training expenses, and a $473 increase in assessments from the Funding Corporation.

Noninterest expenses for 2011 totaled $234.8 million, increasing $9.4 million, or 4.2 percent, from 2010. The increase was primarily due to an increase of $3.6 million in net losses on other property owned (OPO), an increase of $2.7 million in salaries and employment benefits, an increase of $1.5 million in occupancy and equipment expense, a $1.1 million increase in premiums to the FCSIC, and a $446 increase in other operating expenses. The $3.6 million increase in losses on OPO was primarily due to an increase of $1.9 million at the bank and an increase of $1.7 million at district associations. The district's increase included an increase in the provision for losses on OPO of $2.4 million and a $1.5 million increase in losses on disposal of OPO, offset by a $302 decrease in net expenses on OPO. The provision for loan losses on OPO reflects a decline in fair value or underlying collateral value on OPO. The $2.7 million increase in salaries and employee benefits was due primarily to a $7.4 million increase in compensation and related payroll taxes at the district's associations, a $1.8 million increase in other benefits at the district's associations, a $548 decrease in salaries capitalized in software development at the bank and a $44 increase in all other salaries and benefits expenses, collectively, offset by a $6.1 million decrease in retirement expenses for the district and a $925 decrease in compensation and related payroll taxes at the bank. The $6.1 million decrease in retirement expenses for the district was the result of a $6.8 million decrease in the district defined benefit pension plan (DB plan), net of a $357 increase in the bank's supplemental defined benefit pension plan (which was terminated in 2011), and a $345 increase in all other retirement plans. The decrease in the DB plan included a $2.7 million improvement on expected return on plan assets, a $2.6 million decrease in actuarial losses, an $828 decrease in interest costs and a $664 decrease in service costs. The $1.5 million increase in occupancy and equipment expenses included an $809 increase in cost of space at the bank due to a lease amendment and extension on the bank's headquarters location, a $714 increase in computer expense, including a $506 increase in depreciation at the bank which included the effects of increased depreciation on the bank's loan accounting system placed into service in July 2010, and a $6 increase in all other occupancy and equipment expenses, collectively. The increase in Insurance Fund premiums was due to an increase in the premium rate from 5 basis points in 2010 to 6 basis points in 2011 on outstanding debt, net of a decrease in average debt on which the premiums are based. The decrease in capitalization of salaries and benefits related to internally developed software is due primarily to the completion and implementation of the first phase in the bank's lending systems in July 2010.

Operating expense (salaries and employee benefits, occupancy and equipment, Insurance Fund premiums, and other operating expenses) statistics are set forth below for each of the three years ended December 31,

| | **2012** | 2011 | 2010 |
|---|---|---|---|
| Excess of net interest income over operating expense | **$ 379,359** | $ 391,968 | $ 369,909 |
| Operating expense as a percentage of net interest income | **38.33%** | 35.54% | 36.24% |
| Operating expense as a percentage of net interest income and noninterest income | **33.99** | 33.26 | 32.76 |
| Operating expense as a percentage of average loans | **1.44** | 1.39 | 1.33 |
| Operating expense as a percentage of average earning assets | **1.20** | 1.15 | 1.12 |

The district's operating expense statistics for 2012 reflect the increase in noninterest income, which outpaced the growth in operating expenses, and the increase in net interest income. The statistics for 2011 reflect the district's growth in net interest income, which outpaced increases in operating expenses. Net interest income has increased 1.2 percent and 4.8 percent for the years ended December 31, 2012 and 2011, respectively, while operating expenses increased at the rates of 9.1 percent and 2.8 percent, respectively, for the same periods. Average loans increased 5.3 percent in 2012 and decreased 1.7 percent in 2011. Average investments increased 1.6 percent and 10.7 percent in 2012 and 2011, respectively. Average earning assets increased 4.7 percent and 0.3 percent in 2012 and 2011, respectively.

## CORPORATE RISK PROFILE

### Overview

The district 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 of loss arising from the inability to meet obligations when they come due without incurring unacceptable losses;
- operational risk — risk of loss 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 Farm Credit System (System) and agriculture by the federal and state governments.

### Structural Risk Management

Structural risk results from the fact that the bank and its related associations are part of the System, which is comprised of banks and associations that are cooperatively owned, directly or indirectly, by their borrowers. While System institutions are financially and operationally interdependent, 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 payments of Systemwide debt securities. Although capital at the association level reduces a bank's credit exposure with respect to its direct 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, the System utilizes two integrated contractual 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 (CIPA 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. The measurement standard established under the CIPA is intended to provide an early-warning mechanism to assist in monitoring the financial condition of each district. The performance standard under the CIPA is based on the average CIPA score over a four-quarter period.

Periodically, the ratios in the CIPA model are reviewed to take into consideration current performance standards in the financial services industry. In connection with the most recent review, effective June 30, 2011, certain ratios were revised to continue to align them with the current financial conditions and performance in the financial services industry.

The MAA is designed to provide for the timely identification and resolution of individual bank financial issues and establishes performance criteria and procedures for the banks that provide operational oversight and control over a bank's access to System funding. The performance criteria set forth in the MAA are as follows:

- the defined CIPA scores,
- the net collateral ratio of a bank, and
- the permanent capital ratio of a bank.

The bank net collateral ratio is net collateral (primarily earning assets) divided by total liabilities less subordinated debt, subject to certain limits, and the bank 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.

If a bank fails to meet the above performance criteria, it will be placed into one of three categories. Each category gives the other System banks progressively more control over a bank that has declining financial performance under the MAA performance criteria. 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. A bank exits these categories by returning to compliance with the agreed-upon performance criteria.

The criteria for the net collateral ratio and the permanent capital ratio are:

| | Net Collateral Ratio | Permanent Capital Ratio |
|---|---|---|
| Category I | <104%* | <8.0% |
| Category II | <103% | <7.0% |
| Category III | <102% | <5.0% |

*The bank is required to maintain a net collateral ratio of at least 50 basis points greater than its 104 percent regulatory minimum to avoid being placed in Category I.

As required by the MAA, the banks and the Funding Corporation undertake a periodic formal review of the MAA to consider whether any amendments are appropriate. In connection with the most recent review, the banks and the Funding Corporation agreed to enter into the Second Amended and Restated MAA, which became effective on January 1, 2012. The revised MAA retains the same general framework and most of the provisions of the previous MAA. One important change requires the banks to maintain a net collateral ratio of at least 50 basis points greater than the regulatory minimum in order to avoid being placed in Category I.

During the three years ended December 31, 2012, all banks met the agreed-upon standards for the net collateral and permanent capital ratios required by the MAA. As of December 31, 2012, all banks met the agreed-upon standard of financial condition and performance required by the CIPA. During the three years ended December 31, 2012, the banks met the defined CIPA score required by the MAA.

## Credit Risk Management

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 portfolio 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 institution sets their own underwriting standards and lending policies, approved by the board of directors, that provide direction to 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 — requirements that govern intended use of loan funds.

The retail credit risk management process begins with an analysis of the borrower's credit history, repayment capacity and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based on cash flows from operations or other sources of income, including non-farm income. Real estate loans with terms greater than 10 years 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 loans with terms greater than 10 years may be made only in amounts up to 85 percent of the original appraised value of the property taken as security or up to 97 percent 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. 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-rating 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 4-point scale addressing loss given default. The 14-point risk-rating scale provides for nine "acceptable" categories, one "other assets especially mentioned" category, two "substandard" categories, one "doubtful" category and one "loss" category. The loss given default scale establishes ranges of anticipated economic loss if the loan defaults. The calculation of economic loss includes principal and interest as well as collections costs, legal fees and staff costs.

By buying and selling loans or interests in loans to or from other institutions within the System or outside the System, we limit our exposure to either a borrower or commodity concentration. This also allows us to manage growth and capital, and to improve geographic diversification.

Portfolio credit risk is also evaluated with the goal of managing the concentration of credit risk. Concentration risk is reviewed and measured by industry, product, geography and customer limits.

## Loan Portfolio

The loan portfolio consists only of retail loans. Bank loans to its affiliated associations have been eliminated in the combined financial statements. See Note 2, "Summary of Significant Accounting Policies," and Note 4, "Loans and Allowance for Loan Losses," to the accompanying financial statements for further discussions. Gross loan volume of $16.87 billion at December 31, 2012, reflected an increase of $1.24 billion, or 8.0 percent, from the $15.62 billion loan portfolio balance at December 31, 2011. Loans, net of the allowance for loan losses, represented 79.3 percent, 79.0 percent and 79.1 percent of total assets as of December 31, 2012, 2011 and 2010, respectively.

Agricultural real estate mortgage loans totaled $10.26 billion at December 31, 2012, an increase of $95.4 million, or 0.9 percent, from 2011, and currently comprise approximately 60.8 percent of the district's loan portfolio. Commercial loans for agricultural production, processing and marketing totaled $4.01 billion, an increase of $694.3 million, or 20.9 percent, from 2011, and represented 23.8 percent of the loan portfolio at December 31, 2012. All other loans, including energy loans, communications loans, farm-related business loans, rural home loans and loans to OFIs, increased by $453.0 million. The composition of the district's loan portfolio by category may be found in Note 4, "Loans and Allowance for Loan Losses," to the accompanying combined financial statements. The increase of loan volume in 2012 was primarily related to a $773.5 million increase in the bank's participation and loan portfolio and a $489.1 million increase in district associations' loan portfolios. In 2011, association loan volume decreased by $393.1 million, and in 2010 association loan volume decreased by $721.8 million primarily due to general economic conditions, which have resulted in a decline of demand for rural real estate, pay-downs afforded by high commodity prices for some district borrowers, and enhanced credit standards.

The diversity of states underlying the district's loan portfolio is reflected in the following table:

| | December 31, | | |
|---|---|---|---|
| | **2012** | 2011 | 2010 |
| Texas | **54%** | 56% | 59% |
| Alabama | **7** | 8 | 8 |
| Mississippi | **7** | 7 | 7 |
| Louisiana | **4** | 4 | 4 |
| Florida | **1** | 1 | 2 |
| All other states | **27** | 24 | 20 |
| Total | **100%** | 100% | 100% |

The bank and district associations review the credit quality of the loan portfolio as a part of their credit risk practices, using the classifications of the Uniform Classification System which is used by all System institutions. The classifications are defined as follows:

- Acceptable — Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (Special Mention) — 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, but have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- **Loss** — Assets are considered uncollectible.

The following table discloses the credit quality of the district's loan portfolio at December 31,

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Acceptable | **93.9%** | 91.2% | 87.9% |
| Special mention | **2.9** | 4.2 | 5.3 |
| Substandard/doubtful/loss | **3.2** | 4.6 | 6.8 |
| Total | **100.0%** | 100.0% | 100.0% |

Loans classified as "doubtful" or "loss" are included in the "substandard" classification in the above table. During 2012, overall credit quality reflected some improvement from prior years. Volatility in the general economy and in agricultural sectors resulted in some migration to more adverse classifications in 2010 and 2011. 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 were 96.8 percent at December 31, 2012, compared to 95.4 percent at December 31, 2011, and 93.2 percent at December 31, 2010.

## High-Risk Assets

Nonperforming loan volume is composed of nonaccrual loans, restructured loans, and loans 90 days or more past due and still accruing interest, and is referred to as impaired loans. High-risk assets consist of impaired loans and other property owned. Total high-risk assets have decreased by $136.8 million, or 23.6 percent, from $579.3 million at December 31, 2011, to $442.5 million at December 31, 2012. The decrease in high-risk assets during 2012 includes a $166.1 million decrease in nonaccrual loans. The decrease in nonaccrual loans was primarily the result of repayments and the movement of loans to OPO totaling $233.4 million, charge-offs totaling $43.1 million and transfers to accrual loans of $36.8 million, offset by $119.1 million in additions to nonaccrual from accrual status and $23.2 million in advances on nonaccrual. The decrease in nonaccrual loans included significant decreases in beef and livestock, loans related to land in transition, dairy, and canned fruits and vegetable sectors, while having significant increases in the meat-packing and ethanol sectors. The $24.1 million increase in formally restructured loans is primarily the result of beef and livestock loans to one borrower which had been in nonaccrual status and have had improved performance while operating under restructuring agreements.

The following table discloses the components of the district's high-risk assets at December 31,

| *(in millions)* | 2012 | 2011 | 2010 |
|---|---|---|---|
| Nonaccrual loans | **$ 289.4** | $ 455.5 | $ 683.1 |
| Formally restructured loans | **53.7** | 29.6 | 9.0 |
| Loans past due 90 days or more and still accruing interest | **1.2** | 6.3 | 2.4 |
| Other property owned, net | **98.2** | 87.9 | 78.1 |
| Total | **$ 442.5** | $ 579.3 | $ 772.6 |

At December 31, 2012, $119.4 million, or 41.3 percent, of loans classified as nonaccrual were current as to principal and interest, compared to $206.4 million, or 45.3 percent, of nonaccrual loans at December 31, 2011, and $282.9 million, or 41.4 percent, at December 31, 2010.

Figures 2, 3 and 4 provide analyses of the relationships of nonaccrual loans and high-risk assets to total loans and members' equity at December 31, 2012, 2011 and 2010. Due to expected improvements related to these higher risk profiles and in the general economic environment, the district anticipates credit quality of the loan portfolio will improve in 2013.

## Allowance and Provision for Loan Losses

At December 31, 2012, the allowance for loan losses was $106.8 million, or 0.6 percent of total loans outstanding, compared to $114.1 million (0.7 percent) and $163.1 million (1.04 percent) at December 31, 2011 and 2010, respectively. Net charge-offs of $35.9 million, $93.6 million and $119.0 million were recorded in 2012, 2011 and 2010, respectively. Charge-offs during 2012 included significant charge-offs on loans related to land in transition, ethanol, dairy, beef and cattle, and meat-packing loans. The district's provision for loan losses of $33.6 million for 2012 reflected a decrease of $11.4 million, or 25.3 percent, from the provision recorded for 2011, due primarily to provisions related to the

Figure 2

**Nonaccrual Loans**
as a Percentage of Total Loans at Year End

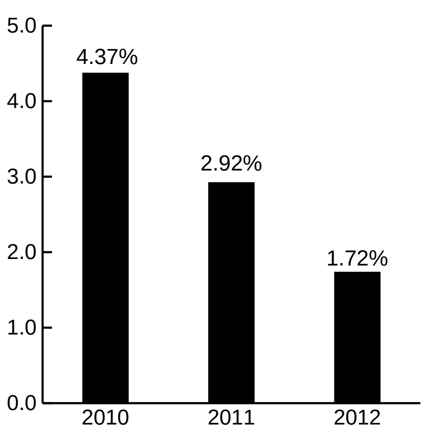



Figure 3

**High-Risk Assets**
as a Percentage of Total Members' Equity at Year End

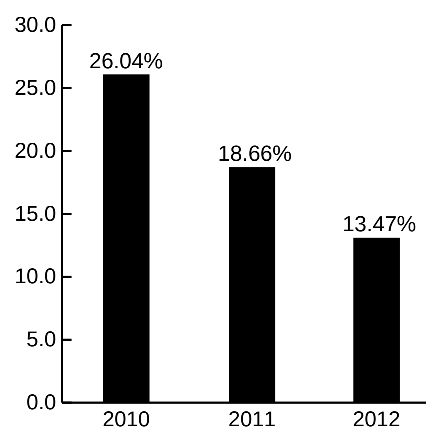



Figure 4

**High-Risk Assets**
as a Percentage of Total Loans and Other Property Owned at Year End

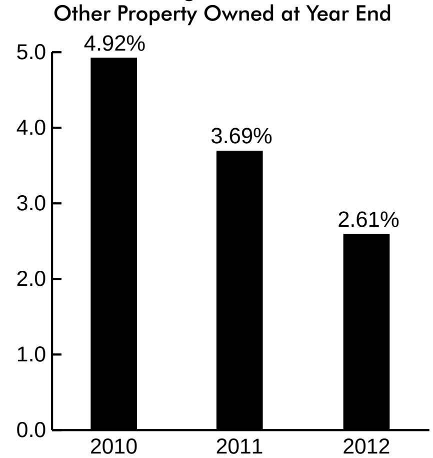


Figure 5

## Interest Rate Gap Analysis
as of December 31, 2012

| | Interest-Sensitive Period | | | | | | |
|---|---|---|---|---|---|---|---|
| | One Month or Less | Over One Through Six Months | Over Six Through Twelve Months | **Total Twelve Months or Less** | Over One Year but Less Than Five Years | Over Five Years and Non-Rate Sensitive | **Total** |
| **Earning Assets** | | | | | | | |
| Total loans | $ 5,882,595 | $ 2,389,037 | $ 2,031,579 | **$ 10,303,211** | $ 5,391,511 | $ 1,172,010 | **$ 16,866,732** |
| Total investments | 1,346,172 | 325,271 | 274,950 | **1,946,393** | 1,192,502 | 300,796 | **3,439,691** |
| Total earning assets | 7,228,767 | 2,714,308 | 2,306,529 | **12,249,604** | 6,584,013 | 1,472,806 | **20,306,423** |
| **Interest-Bearing Liabilities** | | | | | | | |
| Total interest-bearing funds* | 6,388,574 | 1,832,156 | 2,327,127 | **10,547,857** | 5,800,378 | 1,028,813 | **17,377,048** |
| Excess of earning assets over interest-bearing liabilities | — | — | — | **—** | — | 2,929,375 | **2,929,375** |
| Total interest-bearing liabilities | 6,388,574 | 1,832,156 | 2,327,127 | **10,547,857** | 5,800,378 | 3,958,188 | **$ 20,306,423** |
| Interest rate sensitivity gap | $ 840,193 | $ 882,152 | $ (20,598) | **$ 1,701,747** | $ 783,635 | $ (2,485,382) | |
| Cumulative interest rate sensitivity gap | $ 840,193 | $ 1,722,345 | $ 1,701,747 | **$ 1,701,747** | $ 2,485,382 | | |

*The impact of interest rate swaps is included with interest-bearing funds.

loans described in the "Provision for Loan Losses" section of this discussion. The allowance for loan losses for the district represents the aggregate of each 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 entity is particular to that institution and is not available to absorb losses realized by other institutions. The allowance for loan losses at each period end was considered by management to be adequate to absorb probable losses existing in and inherent to its loan portfolio. Management's evaluations consider factors including loan loss experience, portfolio quality, loan portfolio composition, current agricultural production conditions and economic conditions.

The following table provides an analysis of key statistics related to the allowance for loan losses at December 31:

| | **2012** | 2011 | 2010 |
|---|---|---|---|
| Allowance for loan losses as a percentage of: | | | |
| Average loans | **0.7%** | 0.7% | 1.0% |
| Loans at year end | | | |
| Total loans | **0.6** | 0.7 | 1.0 |
| Nonaccrual loans | **36.9** | 25.1 | 23.9 |
| Total impaired loans | **31.0** | 23.2 | 23.5 |
| Net charge-offs to average loans | **0.2** | 0.6 | 0.8 |
| Provision expense to average loans | **0.2** | 0.3 | 0.9 |

## Interest Rate Risk Management

Asset/liability management is the bank's process for directing and controlling the composition, level and flow of funds related to the bank's and district's interest-rate-sensitive assets and liabilities. The bank is able to manage the balance sheet composition by using various debt issuance strategies and hedging transactions to match its asset structure. Management's objective is to generate adequate and stable net interest income in a changing interest rate environment.

The bank uses a variety of techniques to manage its financial exposure to changes in market interest rates. These include monitoring the difference in the maturities or repricing cycles of interest-rate-sensitive assets and liabilities; monitoring the change in the market value of interest-rate-sensitive assets and liabilities under various interest rate scenarios; and simulating changes in net interest income under various interest rate scenarios.

The interest rate risk inherent in a district association's loan portfolio is substantially mitigated through its funding relationship with the bank. The bank manages interest rate risk through its direct loan pricing and asset/liability management process. Under the Farm Credit Act of 1971, as amended, a district association is obligated to borrow only from the bank unless the bank approves borrowing from other funding sources. An association's indebtedness to the bank, under a general financing agreement between the bank and the association, represents demand borrowings by the association to fund the majority of its loan advances to association members.

The district's net interest income is determined by the difference between income earned on loans and investments and the interest expense paid on funding sources, typically Systemwide bonds, medium-term notes, discount notes and subordinated debt. The district's level of net interest income is affected by both changes in market interest rates and timing differences in the maturities or repricing cycles of interest-rate-sensitive assets and liabilities. Depending upon the direction and magnitude of changes in market interest rates, the district's net interest income may be affected either positively or negatively by the mismatch in the maturity or the repricing cycle of interest-rate-sensitive assets and liabilities.

The rate sensitivity gap analysis in Figure 5 sets forth a static measurement of the district's volume of interest-rate-sensitive assets and liabilities outstanding as of December 31, 2012, which are projected to mature or reprice in each of the future time periods shown. The "interest rate sensitivity gap" line reflects the mismatch, or gap, in the maturity or repricing of interest-rate-sensitive assets and liabilities. A gap position can be either positive or negative. A positive gap indicates that a greater volume of assets than liabilities reprices or matures in a given time period, and conversely, a negative gap indicates that a greater volume of liabilities than assets reprices or matures in a given time period. On a 12-month cumulative basis, the district has a positive gap position, indicating that the district has an exposure to decreasing interest rates. This would occur when interest income on maturing or repricing assets decreases sooner than the maturing or repricing cycle of interest-bearing liabilities.

To reflect the expected cash flow and repricing characteristics of the district's balance sheet, an estimate of expected prepayments on loans and mortgage-related investments is used to adjust the maturities of the loans and investments in the earning assets section of the gap analysis. Changes in market interest rates will affect the volume of prepayments on loans. Correspondingly, adjustments have been made to reflect the characteristics of callable debt instruments and the effect derivative financial instruments have on the repricing structure of the district's balance sheet.

The bank uses derivative financial instruments to manage the district's interest rate risk and liquidity position. Interest rate swaps for asset/liability management purposes are used to change the repricing characteristics of liabilities to match the repricing characteristics of the assets they support. The bank does not hold, and is restricted by policy from holding, derivative financial instruments for trading purposes and is not a party to leveraged derivative transactions.

At December 31, 2012, the bank had two fair value interest rate swap contracts with a total notional amount of $100.0 million. The interest rate swap contracts had a net fair value of $91. In addition, at December 31, 2012, the bank held interest rate caps with a notional amount of $695.0 million and a fair value of $665. See Note 16, "Derivative Instruments and Hedging Activity," to the accompanying combined financial statements for further discussion. Unrealized losses on interest rate caps, the difference between the amortized cost and fair value, are recorded as a reduction of accumulated other comprehensive income. To the extent that its derivatives have a negative fair value, the bank has a payable on the instrument and the counterparty is exposed to the credit risk of the bank. To the extent that its derivatives have a positive fair value, the bank has a receivable on the instrument and is therefore exposed to credit risk from the counterparty. To manage this credit risk, the bank has bilateral collateral agreements to reduce potential exposure, diversify counterparties in the swap transactions and monitor the credit ratings of all counterparties with whom it transacts. Figure 6 summarizes the bank's activity in derivative financial instruments for 2012.

Figure 6

### Activity in Derivative Financial Instruments

(Notional Amounts)

| *(in millions)* | |
|---|---|
| Balance at December 31, 2011 | $ 820 |
| Additions | 50 |
| Maturities/amortizations | (75) |
| **Balance at December 31, 2012** | **$ 795** |

Interest rate risk exposure as measured by simulation modeling calculates the district's expected net interest income and market value of equity based upon projections of interest-rate-sensitive assets, liabilities, derivative financial instruments and interest rate scenarios. The bank monitors the district's financial exposure to instantaneous and parallel changes in interest rates of 200 basis points up or down over a rolling 12-month period. Per FCA regulations, when the current three-month Treasury bill interest rate is less than 4 percent, the minus 200-basis-point scenario should be replaced with a downward shock equal to one-half of the three-month Treasury bill rate. As of December 31, 2012, projected district net interest income would increase by $56.2 million, or 9.2 percent, if interest rates were to increase by 200 basis points, and would decrease by $22.7 million, or 3.7 percent, if interest rates were to decrease by 1 basis point. In general, the bank's ability to exercise call options on debt benefits the district in the event of decreasing interest rates. In a rising interest rate scenario, the benefit of rate increases on investments, association loans and the bank's participation loans would outpace the increase in the cost of debt.

## Liquidity Risk Management

The district's liquidity risk management practices ensure the district's ability to meet its 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 bank's primary source of liquidity is the ability to issue Systemwide debt securities, which are the general unsecured joint and several obligations of the System banks as discussed below. As a secondary source of liquidity, the bank maintains an investment portfolio comprised primarily of high-quality liquid securities. The securities provide a stable source of income for the bank, and their high quality ensures the portfolio can quickly be converted to cash should the need arise.

FCA regulations require 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 the 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. At December 31, 2012, the bank had 231 days of liquidity coverage, as compared with 239 days at December 31, 2011.

The System banks have worked together to enhance liquidity within the Farm Credit System. As of December 31, 2009, the bank implemented new internal liquidity guidelines to maintain a minimum of 120 days of liquidity with the first 15 days of liquidity composed of cash, cash equivalents and Treasury securities, and an additional 30 days composed of high-quality government guaranteed securities, resulting in a total of 45 days of high-quality liquidity. These guidelines were designed to allow the bank to continue normal operations should a market disruption occur that would prevent the bank from accessing the Systemwide debt market. As of December 31, 2012, the bank had 31 days of liquidity coverage from cash and cash equivalents and an additional 129 days of liquidity coverage from government guaranteed securities. In total, the bank maintained 231 days of liquidity coverage at December 31, 2012.

In addition, the bank maintains a $150.0 million commercial bank committed line of credit which is tested periodically. The current line of credit will mature on June 28, 2013, at which time it is expected to be renewed.

## Funding Sources

The bank continually raises funds to support our mission to provide credit and related services to the rural and agricultural sectors, repay maturing Systemwide debt securities, and meet other obligations. As a government-sponsored enterprise, the bank has had access to the nation's and world's capital markets. This access has provided us with a dependable source of competitively priced debt that is critical to support our mission of providing funding to the rural and agricultural sectors. Moody's Investors Service and Standard & Poor's rate the System's long-term debt as Aaa and AAA, respectively. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's government-sponsored enterprise status. Standard and Poor's rating change on long-term debt of the System from AAA to AA+ was in concert with its downgrade of the sovereign credit rating on the United States of America from AAA to AA+. Material changes to the factors considered could result in a different debt rating. However, as a result of the System's financial performance, credit quality and standing in the capital markets, we anticipate continued access to funding necessary to support System needs. The U.S. government does not guarantee, directly or indirectly, Systemwide debt securities.

To support possible short-term credit needs, the bank maintains a $150.0 million commercial bank committed line of credit, which is tested periodically.

In September 2008, the bank issued $50.0 million in subordinated debt in a private placement to one investor. The debt is a 10-year instrument with a coupon rate of 8.406 percent. Prior to the bank's issuance of its Class B noncumulative subordinated perpetual preferred stock (Class B) in August 2010, the subordinated debt received preferential regulatory capital and collateral treatment, being includible in portions of permanent capital and total surplus and being excludable from total liabilities for purposes of net collateral ratio calculation. Regulatory conditions related to the issuance of the Class B preferred stock reduced the benefit of these preferential ratio treatments, which would previously have been ratably removed 20.0 percent per year during years six to 10 of the debt's term.

The bank receives ratings from two rating agencies. On March 8, 2012, Fitch Ratings applied revised criteria for rating all financial institutions' hybrid capital instruments. This resulted in the downgrades of 1,068 outstanding hybrid capital instruments across the financial services sector. The impact to the bank was a downgrade in its cumulative preferred stock rating from "A" to "BBB+" and a downgrade in its noncumulative preferred stock rating from "A" to "BBB." Fitch continues to rate the bank's long- and short-term Issuer Default Rating at "AA-" and "F1+" with a stable outlook. On October 11, 2012, Fitch Ratings affirmed (with a "stable" outlook) the bank's ratings for long- and short-term Issuer Default Rating at "AA-" and "F1+," respectively, its cumulative preferred stock at "BBB+," noncumulative preferred stock at "BBB" and subordinated debt at "A+." On August 2, 2011, Moody's Investors Service affirmed the bank's investment grade of Aa2 issuer rating. Previously, Moody's had affirmed the bank's A1 subordinated debt rating, A2 cumulative preferred stock rating and A3 noncumulative preferred stock rating, citing the bank's strong credit performance, very high support from the System and very high support from the U.S. government. In Moody's annual credit opinion for the bank issued August 1, 2012, the bank's ratings remained the same. While the issuer outlook changed from "ratings under review" to "negative" due to linkage with the U.S. government's "negative" outlook on its AAA long-term debt rating, the bank's preferred stock ratings have a "stable" outlook based on strong market conditions for agriculture and consistent financial performance.

The following table provides a summary of the period-end balances of the debt obligations of the district *(dollars in millions)*:

| | December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Bonds and term notes outstanding | **$ 12,481** | $ 11,031 | $ 10,708 |
| Average effective interest rate | **1.08%** | 1.44% | 1.74% |
| Average life (years) | **3.0** | 3.1 | 2.9 |
| Subordinated debt outstanding | **$ 50** | $ 50 | $ 50 |
| Average effective interest rate | **8.41%** | 8.41% | 8.41% |
| Average life (years) | **5.8** | 6.8 | 7.8 |
| Discount notes outstanding | **$ 1,429** | $ 1,614 | $ 2,072 |
| Average effective interest rate | **0.17%** | 0.16% | 0.25% |
| Average life (days) | **93** | 149 | 122 |
| Notes payable to other System banks | **$ 3,400** | $ 3,400 | $ 3,400 |
| Average effective interest rate | **0.74%** | 0.72% | 0.72% |
| Average life (years) | **1.0 or less** | 1.0 or less | 1.0 or less |

The following table provides a summary of the average balances of the debt obligations of the district *(dollars in millions)*:

| | For the years ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Average interest-bearing liabilities outstanding | **$ 16,761** | $ 16,097 | $16,319 |
| Average interest rates on interest-bearing liabilities | **1.16%** | 1.37% | 1.81% |

## Investments

As permitted under FCA regulations, a bank is authorized to hold eligible investments for the purposes of maintaining a diverse source of liquidity, profitably managing short-term surplus funds and managing interest rate risk. The bank is authorized to hold an amount not to exceed 35 percent of loans outstanding. FCA regulations also permit an association to hold eligible investments with the approval of its affiliated bank.

FCA regulations also define eligible investments by specifying credit rating criteria, final maturity limit and percentage of investment portfolio limit for each investment type. Generally, the bank's investments must be highly rated by a Nationally Recognized Statistical Rating Organization, such as Moody's Investors (Moody's) Service, Standard & Poor's and Fitch Ratings.

The following table discloses the district's available-for-sale liquidity portfolio at December 31,

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | **Amortized Cost** | **Fair Value** | Amortized Cost | Fair Value |
| FDIC-guaranteed corporate debt | **$ —** | **$ —** | $ 169,871 | $ 169,999 |
| Agency-guaranteed debt | **65,811** | **65,766** | — | — |
| Corporate debt | **208,360** | **208,622** | 83,306 | 82,464 |
| Federal agency collateralized mortgage-backed securities: | | | | |
| GNMA | **1,593,563** | **1,615,008** | 1,689,535 | 1,719,158 |
| FNMA & FHLMC | **1,281,140** | **1,297,535** | 1,011,508 | 1,023,548 |
| Other collateralized mortgage-backed securities | **28,082** | **26,938** | 49,208 | 40,872 |
| Asset-backed securities | **17,852** | **17,131** | 15,080 | 13,721 |
| **Total liquidity investments** | **$ 3,194,808** | **$ 3,231,000** | $ 3,018,508 | $3,049,762 |

While the district's investments in federal agency collateralized mortgage-backed securities have remained relatively constant, demand for those instruments has resulted in smaller margins. The decrease in FDIC-guaranteed corporate debt is due to the maturity of those investments, which are no longer available. The district has increased investments in corporate debt and in agency-guaranteed debt, consisting of debt guaranteed by the Export-Import Bank of the United States.

The district's other investments, totaling $184.6 million, consisted of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS). The bank held AMBS with a fair value of $115.5 million in an available-for-sale other investments portfolio, and associations held AMBS with an amortized cost of $69.1 million in a held-to-maturity portfolio. The Farmer Mac securities are backed by loans originated by the associations and previously held by the associations under the Farmer Mac long-term standby commitments to purchase agreements.

Farmer Mac is a government-sponsored enterprise and is examined and regulated by FCA. It provides secondary market arrangements for agricultural and rural home mortgage loans that meet certain underwriting standards. Farmer Mac is authorized to provide loan guarantees or be a direct pooler of agricultural mortgage loans. Farmer Mac is owned by both System and non-System investors, and its board of directors has both System and non-System representation. Farmer Mac is not liable for any debt or obligation of any System institution, and no System institution other than Farmer Mac is liable for any debt or obligation of Farmer Mac.

The bank's available-for-sale other investments portfolio consisted of Farmer Mac AMBS at December 31:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | **Amortized Cost** | **Fair Value** | Amortized Cost | Fair Value |
| Agricultural mortgage-backed securities | **$ 117,567** | **$ 115,479** | $ 112,597 | $ 110,921 |

At December 31, 2012, the bank had 12 investments which were ineligible for liquidity purposes as a result of credit downgradings. These investments had credit ratings at December 31, 2012, that were below AAA by Moody's, Standard & Poor's and Fitch Ratings. These investments had an amortized cost of $30.5 million and a fair value of $28.7 million, with an unrealized loss of $1.9 million at December 31, 2012. To date, the FCA has not required disposition of any of these securities. While these investments do not meet the FCA's standards for liquidity, they are included in the net collateral calculation, albeit at their lower market value rather than the normal book value for qualifying investments. During 2012, the bank recognized credit losses on one other-than-temporarily impaired investment security totaling $1. Noncredit losses on these investments, totaling $1.5 million, are included as a charge against accumulated other comprehensive income at December 31, 2012. There were sales of two OTTI securities in September 2012 and November 2012, which had book values of $6.5 million and $4.2 million, respectively, realizing a gain of $14 and a loss of $89, respectively.

The composition and characteristics of the district's investment securities are described in Note 3, "Investment Securities," to the accompanying combined financial statements.

The following table sets forth investments available-for-sale within the liquidity portfolio at fair value by credit rating:

| | Eligible | | | | Ineligible | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| December 31, 2012 | AAA/Aaa | AA/Aa | F1/P1/A1 | Split Rated | AA/Aa | A/A | BBB/Baa | B/B | CCC/Caa | CC/Ca | Total |
| Agency-guaranteed debt* | $ — | $ — | $ — | $ 65,766 | $ — | $ — | $ — | $ — | $ — | $ — | $ 65,766 |
| Corporate debt | — | 101,448 | 25,018 | 82,156 | — | — | — | — | — | — | 206,622 |
| Federal agency collateralized mortgage-backed securities* | | | | | | | | | | | |
| GNMA | — | — | — | 1,615,008 | — | — | — | — | — | — | 1,615,008 |
| FNMA & FHLMC | — | — | — | 1,297,535 | — | — | — | — | — | — | 1,297,535 |
| Other collateralized mortgage-backed securities | — | — | — | — | 3,371 | 320 | 5,749 | 8,817 | 6,199 | 2,482 | 26,938 |
| Asset-backed securities | 8,291 | — | 5,743 | 1,384 | — | — | — | — | 1,713 | — | 17,131 |
| Total | $ 8,291 | $ 101,448 | $ 30,761 | $ 3,061,849 | $ 3,371 | $ 320 | $ 5,749 | $ 8,817 | $ 7,912 | $ 2,482 | $ 3,231,000 |

*At December 31, 2012, due to credit rating actions in 2011 which downgraded the credit rating of the U.S. government from "AAA" to "AA+" and also lowered the long-term credit ratings of government-sponsored enterprises due to the potential reduction in the capacity of the U.S. government to support these securities, these investments were reported as eligible split-rated investments.

| | Eligible | | | Ineligible | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| December 31, 2011 | AAA/Aaa | AA/Aa | Split Rated | AA/Aa | BBB/Baa | BB/Ba | B3/ CCC/CC | CCC/Caa | CC/Ca | Total |
| FDIC-guaranteed corporate debt* | $ 30,045 | $ — | $ 139,954 | $ — | $ — | $ — | $ — | $ — | $ — | $ 169,999 |
| Corporate debt | — | 67,531 | 14,933 | — | — | — | — | — | — | 82,464 |
| Federal agency collateralized mortgage-backed securities* | | | | | | | | | | |
| GNMA | — | — | 1,719,158 | — | — | — | — | — | — | 1,719,158 |
| FNMA & FHLMC | — | — | 1,023,548 | — | — | — | — | — | — | 1,023,548 |
| Other collateralized mortgage-backed securities | — | — | 3,066 | 6,273 | — | 8,684 | — | 20,207 | 2,642 | 40,872 |
| Asset-backed securities | 10,271 | — | 1,835 | — | — | — | — | 1,615 | — | 13,721 |
| Total | $ 40,316 | $ 67,531 | $ 2,902,494 | $ 6,273 | $ — | $ 8,684 | $ — | $ 21,822 | $ 2,642 | $ 3,049,762 |

*At December 31, 2011, due to credit rating actions in 2011 which downgraded the credit rating of the U.S. government from "AAA" to "AA+" and also lowered the long-term credit ratings of government-sponsored enterprises due to the potential reduction in the capacity of the U.S. government to support these securities, these investments were reported as eligible split-rated investments.

## Capital Adequacy

Bank Class A Cumulative Perpetual Preferred Stock (Class A preferred stock) – On November 7, 2003, the bank issued 100,000 shares of $1,000 per share par value Class A preferred stock for net proceeds of $98,644, after expenses of $1,356 associated with the offering. The dividend rate is 7.561 percent, payable semi-annually to December 15, 2013, after which dividends are payable quarterly at a rate equal to the three-month London Interbank Offered Rate (LIBOR) plus 445.75 basis points. On September 26, 2005, the bank issued an additional 100,000 shares of cumulative perpetual preferred stock with the same terms. During 2010, the bank repurchased $18.0 million par value of the Class A preferred stock at a net premium and cost of $529. For regulatory purposes, the preferred stock is treated as equity, and is not mandatorily redeemable. The Class A preferred stock ranks, as to dividends and other distributions (including patronage) upon liquidation, dissolution or winding up, prior to all other classes and series of equity securities of the bank. "Dividend/patronage stopper" clauses in the preferred stock offerings require the payment or declaration of current period dividends on the preferred stock issuances before any other patronage can be declared, and was required before payment of the December 31, 2012, bank investment and direct note patronage to associations and OFIs could be paid.

Bank Class B Noncumulative Subordinated Perpetual Preferred Stock (Class B preferred stock) – On August 26, 2010, the bank issued $300.0 million of Class B noncumulative subordinated perpetual preferred stock, representing three hundred thousand shares at $1,000 per share par value for net proceeds of $296.6 million. The net proceeds of the issuance were used to increase the bank's capital and for general corporate purposes. Dividends on the preferred stock, if declared by the board of directors at its sole discretion, are noncumulative and are payable semi-annually in arrears on the fifteenth day of June and December in each year, commencing December 15, 2010, at an annual fixed rate of 10 percent of par value of $1,000 per share. The Class B preferred stock is not mandatorily redeemable at any time, but may be redeemed in whole or in part at the option of the bank after the dividend payment date in June 2020. The Class B preferred stock ranks junior, both as to dividends and upon liquidation to our Class A preferred stock, and senior to all of our outstanding capital stock. For regulatory purposes, the Class B preferred stock is included in permanent capital, total surplus and core surplus within certain limitations. Due to regulatory limitations on third-party capital, the preferred stock issuance will reduce the benefit of the subordinated debt's favorable treatment in net collateral ratio calculations. "Dividend/patronage stopper" clauses in the preferred stock offerings require the payment or declaration of current period dividends on the preferred stock issuances before any other patronage can be declared, and was required before payment of the December 31, 2012, bank investment and direct note patronage to associations and OFIs could be paid.

Borrower equity purchases required by association capitalization bylaws (see Note 9, "Members' Equity"), combined with a history of growth in retained earnings at district institutions, have resulted in district institutions being able to maintain strong capital positions. The $3.29 billion capital position of the district at December 31, 2012, reflects an increase of 5.9 percent over the December 31, 2011, capital position of $3.10 billion. This increase is attributable to net income of $409.4 million earned in 2012, offset by patronage paid of $106.6 million, a net decrease in capital stock and allocated earnings of $58.7 million, dividends accrued and paid on preferred stock totaling $43.8 million, and an increase in other comprehensive loss of $18.4 million.

Accumulated other comprehensive loss totaled $110.8 million at December 31, 2012, an increase of $18.4 million from December 31, 2011, due to a $22.4 million increase in unrealized losses related to pension and other postretirement benefits and a $533 increase in unrealized losses on cash flow hedge instruments, offset by an increase of $4.5 million in unrealized gains on investment securities. The increase in unrealized losses on pension and other postretirement benefits was due primarily to a reduction in the discount rate used to determine the projected benefit obligations for those benefits at December 31, 2012.

The return on average members' equity for the year ended December 31, 2012, was 12.42 percent, compared to 11.75 percent and 9.9 percent reported for the years ended December 31, 2011 and 2010, respectively.

FCA regulations require System institutions to compute a total surplus ratio, a core surplus ratio and a net collateral ratio (bank only), and maintain at least the minimum standard for each ratio. In those instances where an entity may not be in compliance, the regulations require the entity to submit a corrective plan to the FCA designed to move the institution into compliance. As of

December 31, 2012, the bank and all district associations were in compliance with the regulations. Note 9, "Members' Equity," to the accompanying combined financial statements outlines the ranges of capital ratios for the bank and district associations. The bank's permanent capital ratio of 18.6 percent at December 31, 2012, is considered adequate, in accordance with the capital plan adopted by the bank's board of directors. An analysis of the trend in the district's capital ratios is presented in Figures 7, 8 and 9.

## 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. The 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, we 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 are developed with higher risk areas receiving more review. The board of directors is responsible for defining the role of the audit committee in providing oversight and review of the institution's internal controls.

## Political Risk Management

We, as part of the System, are an instrumentality 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 (council), which is a full-service, federal trade association 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. Additionally, we take an active role in representing the individual interests of System institutions and their borrowers before Congress. In addition to The Farm Credit Council, each district has its own council, which is a member of The Farm Credit Council. The district councils represent the interests of their members on a local and state level, as well as on a federal level.

## Recent Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Balance Sheet – Disclosures about Offsetting Assets and Liabilities." The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities. The requirements apply to recognized financial instruments and derivative instruments that are offset in accordance with the rights of offset set forth in accounting guidance and for those recognized financial instruments and derivative instruments that are subject to an enforceable master

Figure 7

**Members' Equity**
as a Percentage of Net Loans
at Year End

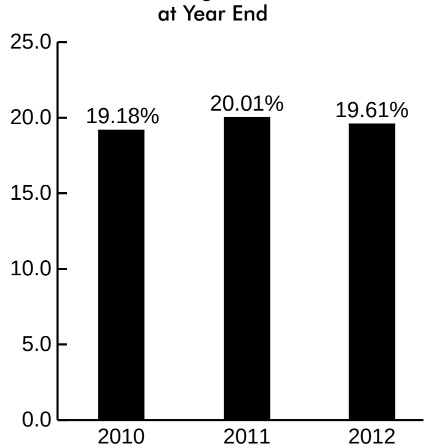



Figure 8

**Members' Equity**
as a Percentage of Total Assets
at Year End

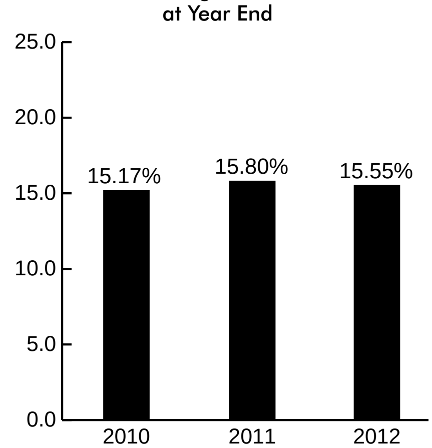
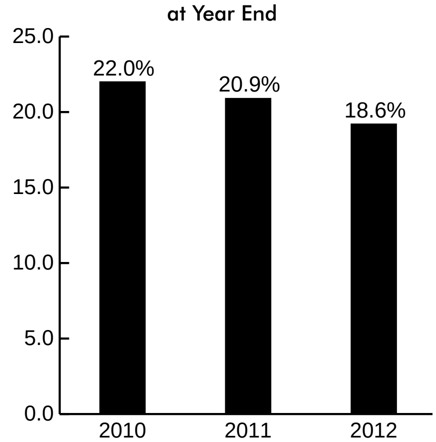



Figure 9

**Regulatory Permanent**
**Capital Ratio (bank)**
at Year End



netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retrospectively for all comparative periods and is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance will not impact the financial condition or results of operations of the district, but will result in additional disclosures.

In September 2011, the FASB issued guidance entitled, "Compensation – Retirement Benefits – Multiemployer Plans." The guidance is intended to provide more information about an employer's financial obligations to a multiemployer pension plan, which should help financial statement users better understand the financial health of significant plans in which the employer participates. The additional disclosures include: a) a description of the nature of plan benefits, b) a qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer, and c) other quantitative information to help users understand the financial information about the plan. The amendments are effective for annual periods for fiscal years ending after December 15, 2012, for nonpublic entities. The amendments should be applied retrospectively for all prior periods presented. The adoption did not impact the district's financial condition or results of operation.

In June and December 2011, the FASB issued guidance entitled, "Comprehensive Income – Presentation of Comprehensive Income." This guidance is intended to increase the prominence of other comprehensive income in financial statements. The main provisions of the guidance provide that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements. This guidance did not change the items that must be reported in other comprehensive income. With either approach, an entity is required to present reclassification adjustments for items reclassified from other comprehensive income to net income in the statement(s). The December 2011 guidance deferred the effective date for the presentation of reclassification adjustments.

This guidance was to be applied retrospectively and was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance did not impact the financial condition or results of operations of the district, but resulted in changes to the presentation of comprehensive income.

## Regulatory Matters

As of December 31, 2012, the Farm Credit Administration had enforcement actions in place against three associations in the district, which have not had, and are not expected to have, a significant impact on the bank.

On October 3, 2012, FCA published final regulations related to System institutions' disclosures to shareholders and investors on compensation, retirement programs and related benefits for the CEO, senior officers, highly compensated individuals, and certain individual employees or other groups of employees, and requiring System banks and associations to provide for a nonbinding advisory vote on senior officer compensation by shareholders under certain circumstances. This regulation became effective on December 17, 2012, except that enhanced compensation disclosures have been delayed until the 2013 annual report and advisory votes on compensation increases of 15 percent or more are not required until 2015 using a baseline year of 2013.

On November 5, 2012, FCA published a final rule that strengthens its regulations governing investment management, interest rate risk management and association investments, revises the list of eligible investments, and reduces the regulatory burden for divestiture of investments that fail to meet eligibility criteria after purchase. This rule became effective December 31, 2012.

On May 1, 2012, FCA published a final rule amending its regulations requiring boards of directors of System institutions to adopt an operational and strategic business plan to include, among other things, a human capital plan that describes the institution's outreach toward diversity and inclusion, the strengths and weaknesses of its workforce and management, describes the institution's succession programs, and includes strategies and actions to strive for diversity and inclusion within the institution's workforce and management. In addition, each association business plan would be required to include a marketing plan that furthers the objective of the System to be responsive to the credit needs of all eligible and creditworthy agricultural producers and other eligible persons with specific attention to diversity and inclusion. This regulation became effective June 18, 2012.

On May 11, 2011, FCA, together with the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Federal Housing Finance Agency, published a proposed rule that would establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap participants and major security-based swap participants subject to those agencies' regulation. This rule would implement sections 731 and 764 of the Dodd-Frank Act requiring these agencies to adopt rules to establish capital requirements and initial and variation margin requirements for noncleared swaps and noncleared security-based swaps. The comment period for this proposed rule expired July 11, 2011. In October 2012, the agencies re-opened the comment period to allow for additional comments after the Basel Committee for Banking Supervision and the International Organization of Securities Commissions issued a consultative document dealing with margin requirements. The extended comment period expired on November 26, 2012.

On July 8, 2010, the FCA published an advance notice of proposed rulemaking to facilitate the development of capital adequacy regulations that would more closely align the minimum capital requirements for the System with the Tier 1/Tier 2 capital structure delineated in the new Basel Accord and the capital requirements of the other federal banking regulators. The deadline for comments expired May 4, 2011. FCA is continuing to study these requirements and a proposed regulation remains on its regulatory performance plan for 2013.

On September 13, 2012, FCA published a proposed rule establishing a framework for System institutions to use unincorporated business entities (UBEs) organized under state law for certain business activities. The comment period for this proposed regulation expired November 13, 2012.

On December 27, 2011, FCA published a proposed rule amending its liquidity regulations to strengthen liquidity risk management of System banks, improve the quality of assets maintained in the banks' liquidity reserve and bolster the ability of System banks to fund their obligations and continue their operations during times of economic, financial or market adversity. The comment period for this rule expired February 27, 2012.

On June 21, 2012, the Farm Credit System Insurance Corporation published for comment a draft Policy Statement Concerning Assistance to Troubled System Institutions to replace the corporation's current Policy Statement Concerning Stand-Alone Assistance which provides additional transparency concerning the corporation's authority to provide assistance, discusses how the least-cost test might be performed, enhances the criteria of what is to be included in assistance proposals, and adds a section discussing assistance agreements. The comment period expired October 22, 2012.

On August 26, 2011, FCA published an advance notice of proposed rulemaking soliciting comments on compliance with section 939A of the Dodd-Frank Act which requires removal of all regulatory requirements relating to credit rating and substitution of other alternative creditworthiness standards. The comment period for this ANPRM expired November 25, 2011. Publication of a proposed rule is anticipated in 2013.

On November 8, 2011, the Internal Revenue Service published an advance notice of proposed rulemaking to facilitate development of a proposed rule with respect to the definition of "governmental benefit plans" in which the agency proposed that a "fact-and-circumstances" test be applied to determine governmental plan status. The deadline for comments was February 6, 2012.

On January 10, 2013, the Bureau of Consumer Financial Protection (bureau) issued a final rule amending Regulation Z (Truth in Lending) by expanding the types of mortgage loans that are subject to the protections of the Home Ownership and Equity Protections Act of 1994 (HOEPA), revising and expanding the tests for coverage under HOEPA, and imposing additional restrictions on mortgages that are covered by HOEPA, including a pre-loan counseling requirement. The final rule also amends Regulation Z and Regulation X (Real Estate Settlement Procedures Act) by imposing certain other requirements related to homeownership counseling, including a requirement that consumers receive information about homeownership counseling providers.

On January 10, 2013, the bureau issued a final rule implementing sections 1411 and 1412 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which generally require creditors to make a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage or temporary loan) and establishes certain protections from liability under this requirement for "qualified mortgages." The final rule also implements section 1414 of the Dodd-Frank Act, which limits prepayment penalties. Finally, the final rule requires creditors to retain evidence of compliance with the rule for three years after a covered loan is consummated.

On January 10, 2013, the bureau issued a final rule amending Regulation Z to implement statutory changes made by the Dodd-Frank Act that lengthen the time for which a mandatory escrow account established for a higher priced mortgage loan must be maintained. The rule also exempts certain transactions from the statute's escrow requirement. The primary exemption applies to mortgage transactions extended by creditors that operate predominantly in rural or underserved areas, originate a limited number of first-lien covered transactions, have assets below a certain threshold, and do not maintain escrow accounts on mortgage obligations they currently service.

On January 17, 2013, the bureau issued a final rule amending Regulation X and Regulation Z. The final rules implement provisions of the Dodd-Frank Act regarding mortgage loan servicing.Specifically, the Regulation X final rule implements Dodd-Frank Act sections addressing servicers' obligations to correct errors asserted by mortgage loan borrowers; to provide certain information requested by such borrowers; and to provide protections to such borrowers in connection with force-placed insurance. Additionally, the final rule addresses servicers' obligations to establish reasonable policies and procedures to achieve certain delineated objectives; to provide information about mortgage loss mitigation options to delinquent borrowers; to establish policies and procedures for providing delinquent borrowers with continuity of contact with servicer personnel capable of performing certain functions; and to evaluate borrowers' applications for available loss mitigation options. Further, the final rule modifies and streamlines certain existing servicing-related provisions of Regulation X.

The Regulation Z final rule implements Dodd-Frank Act sections addressing initial rate adjustment notices for adjustable-rate mortgages, periodic statements for residential mortgage loans, prompt crediting of mortgage payments, and responses to requests for payoff amounts. This final rule also amends current rules governing the scope, timing, content and format of disclosures to consumers regarding the interest rate adjustments of their variable-rate transactions.

On January 18, 2013, the bureau issued a final rule amending Regulation B, which implements the Equal Credit Opportunity Act (ECOA), to implement an ECOA amendment concerning appraisals and other valuations that was enacted as part of the Dodd-Frank Act. In general, the revisions to Regulation B require creditors to provide to applicants free copies of all appraisals and other written valuations developed in connection with an application for a loan to be secured by a first lien on a dwelling, and require creditors to notify applicants in writing that copies of appraisals will be provided to them promptly.

On January 18, 2013, the bureau issued a final rule to amend Regulation Z jointly with the Federal Reserve Board, FDIC, FHFA, NCUA and OCC. The revisions to Regulation Z implement a new provision requiring appraisals for "higher risk mortgages" that was added to TILA by the Dodd-Frank Act. For mortgages with an annual percentage rate that exceeds the average prime offer rate by a specified percentage, the final rule requires creditors to obtain an appraisal or appraisals meeting certain specified standards, provide applicants with a notification regarding the use of the appraisals, and give applicants a copy of the written appraisals used.

On January 20, 2013, the bureau issued a final rule amending Regulation Z implementing requirements and restrictions imposed by the Dodd-Frank Act concerning loan originator compensation; qualifications of, and registration or licensing of loan originators; mandatory arbitration; and the financing of single-premium credit insurance. The final rule revises or provides additional commentary on Regulation Z's restrictions on loan originator compensation, including application of these restrictions to prohibitions on dual compensation and compensation based on a term of a transaction or a proxy for a term of a transaction, and to record-keeping requirements. The final rule also establishes tests for when loan originators can be compensated through certain profits-based compensation arrangements.

# REPORT OF MANAGEMENT

*The Farm Credit Bank of Texas and the Texas Farm Credit District Associations*

The accompanying combined financial statements of the Farm Credit Bank of Texas (bank) and its affiliated associations, collectively referred to as the district, are prepared by management, which is responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The combined financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. The combined financial statements, in the opinion of management, present fairly the financial condition of the district. Other financial information included in the annual report is consistent with that in the combined financial statements.

To meet its responsibility for reliable financial information, management depends on the accounting and internal control systems which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost must be reasonable in relation to the benefits derived. To monitor compliance, financial operations audits are performed as well as review of internal controls over financial reporting. The combined financial statements are audited by PricewaterhouseCoopers LLP (PwC), independent auditors, who also conduct a review of internal controls to the extent necessary to comply with auditing standards generally accepted in the United States of America. The Farm Credit Bank of Texas and district associations are also examined by the Farm Credit Administration.

In the opinion of management, the combined financial statements are true and correct and fairly state the financial position of the bank and district associations at December 31, 2012, 2011 and 2010. The independent auditors have direct access to the audit committee, which is composed solely of directors who are not officers or employees of the bank or district associations.

The undersigned certify that we have reviewed the December 31, 2012, annual report of the Farm Credit Bank of Texas and district associations, that the report has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information included herein is true, accurate and complete to the best of our knowledge and belief.

James F. Dodson
*Chairman of the Board*

Larry R. Doyle
*Chief Executive Officer*

Amie Pala
*Chief Financial Officer*

March 1, 2013

# REPORT OF AUDIT COMMITTEE

*The Farm Credit Bank of Texas and the Texas Farm Credit District Associations*

The audit committee (committee) is composed of the entire board of directors of the Farm Credit Bank of Texas (bank). The committee oversees the bank's system of internal controls and the adequacy of management's action with respect to recommendations arising from those internal control activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on the bank's website at www.farmcreditbank.com. In 2012, 10 committee meetings were held, with some of these meetings including executive sessions between the committee and PricewaterhouseCoopers LLP (PwC) and the bank's internal auditor. The committee approved the appointment of PwC as independent auditors for 2012.

Management is responsible for the bank's internal controls and for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the district's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue a report thereon. The committee's responsibilities include monitoring and overseeing these processes.

In this context, the committee reviewed and discussed the district's audited financial statements for the year ended December 31, 2012, with management and PwC. The committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards No. 114 (The Auditor's Communications With Those Charged With Governance).

PwC has provided to the committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions With Audit Committees). The committee discussed with appropriate representatives of PwC the firm's independence from the bank. The committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining the auditor's independence. Furthermore, throughout 2012 the committee has discussed with management and PwC such other matters and received such assurances from them as the committee deemed appropriate. Both PwC and the bank's internal auditor directly provided reports on significant matters to the committee.

William F. Staats, Chairman
Brad C. Bean, Vice Chairman
Ralph W. Cortese
James F. Dodson
Elizabeth G. Flores
Jon M. Garnett
Lester Little

Audit Committee Members

March 1, 2013

# REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Farm Credit Bank of Texas' (bank's) principal executive and principal financial officer are responsible for establishing and maintaining adequate internal control over financial reporting for the district'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 bank's principal executive and principal financial officer, or persons performing similar functions, and effected by its board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the 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 district; (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 are being made only in accordance with authorizations of management and directors of the district; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the district's assets that could have a material effect on its combined financial statements.

The bank's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2012. In making the assessment, 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. This evaluation relies upon the evaluations made by the individual associations and the related certification they provide to the bank.

Based on the assessment performed, the district concluded that as of December 31, 2012, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the district determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2012. A review of the assessment performed was reported to the bank's audit committee.

| | |
|---|---|
| Larry R. Doyle | Amie Pala |
| Chief Executive Officer | Chief Financial Officer |

March 1, 2013

pwc

## Independent Auditor's Report

To the Board of Directors and Members of
Farm Credit Bank of Texas and Texas District Associations:

We have audited the accompanying combined financial statements of Farm Credit Bank of Texas and Texas District Associations (the District), which comprise the combined balance sheets as of December 31, 2012, 2011 and 2010, and the related combined statements of comprehensive income, of changes in members' equity and of cash flows for the years then ended.

### *Management's Responsibility for the Combined Financial Statements*

Management is responsible for the preparation and fair presentation of the combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on the combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the District's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Farm Credit Bank of Texas and Texas District Associations at December 31, 2012, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 1, 2013

*PricewaterhouseCoopers LLP, 300 West 6th Street, Suite 1800, Austin, Texas 78701*
*T: (512) 477-1300, F: (512) 477-8681, www.pwc.com/us*

# Combined Balance Sheets

FARM CREDIT BANK OF TEXAS AND DISTRICT ASSOCIATIONS

| | December 31, | | |
|---|---|---|---|
| *(dollars in thousands)* | **2012** | 2011 | 2010 |
| **Assets** | | | |
| Cash | **$ 512,842** | $ 432,719 | $ 453,322 |
| Federal funds sold and overnight investments | **24,137** | 20,687 | 20,438 |
| Investment securities | **3,415,554** | 3,287,928 | 3,231,562 |
| Loans (includes $65,074, $0 and $0 at fair value held under fair value option) | **16,866,732** | 15,624,013 | 15,628,890 |
| Less allowance for loan losses | **106,842** | 114,117 | 163,145 |
| Net loans | **16,759,890** | 15,509,896 | 15,465,745 |
| Accrued interest receivable | **131,429** | 141,567 | 154,023 |
| Other property owned, net | **98,211** | 87,956 | 78,124 |
| Premises and equipment, net | **71,709** | 61,820 | 62,539 |
| Other assets | **111,870** | 99,918 | 89,831 |
| **Total assets** | **$ 21,125,642** | $ 19,642,491 | $ 19,555,584 |
| **Liabilities and members' equity** | | | |
| Liabilities | | | |
| Bonds and notes, net | **$ 17,310,860** | $ 16,045,541 | $ 16,179,932 |
| Subordinated debt | **50,000** | 50,000 | 50,000 |
| Accrued interest payable | **34,369** | 37,912 | 45,881 |
| Patronage distributions payable | **101,182** | 83,440 | 66,011 |
| Preferred stock dividends payable | **21,881** | 21,881 | 21,881 |
| Other liabilities | **321,269** | 299,589 | 225,548 |
| **Total liabilities** | **17,839,561** | 16,538,363 | 16,589,253 |
| **Commitments and contingencies (Note 13)** | | | |
| **Members' equity** | | | |
| Preferred stock | **482,000** | 482,000 | 482,000 |
| Common stock and participation certificates | **59,859** | 60,024 | 61,843 |
| Allocated retained earnings | **419,721** | 374,231 | 327,435 |
| Unallocated retained earnings | **2,412,571** | 2,257,527 | 2,121,822 |
| Additional paid-in-capital | **22,737** | 22,737 | 22,622 |
| Accumulated other comprehensive loss | **(110,807)** | (92,391) | (49,391) |
| **Total members' equity** | **3,286,081** | 3,104,128 | 2,966,331 |
| **Total liabilities and members' equity** | **$ 21,125,642** | $ 19,642,491 | $ 19,555,584 |

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

# Combined Statements of Comprehensive Income

FARM CREDIT BANK OF TEXAS AND DISTRICT ASSOCIATIONS

| | Year Ended December 31, | | |
|---|---|---|---|
| *(dollars in thousands)* | **2012** | 2011 | 2010 |
| Investment securities and other | **$ 59,397** | $ 65,812 | $ 77,701 |
| Loans | **749,901** | 762,843 | 797,608 |
| **Total interest income** | **809,298** | 828,655 | 875,309 |
| Bonds, notes and subordinated debt | **169,527** | 195,648 | 270,945 |
| Notes payable and other | **24,608** | 24,951 | 24,194 |
| **Total interest expense** | **194,135** | 220,599 | 295,139 |
| **Net interest income** | **615,163** | 608,056 | 580,170 |
| Provision for loan losses | **33,631** | 45,048 | 141,457 |
| **Net interest income after provision for loan losses** | **581,532** | 563,008 | 438,713 |
| Patronage income | **17,231** | 17,326 | 16,845 |
| Fees for loan-related services | **31,528** | 26,145 | 29,577 |
| Refunds from Farm Credit System Insurance Corporation | **22,862** | — | 22,268 |
| Loss from sale of investment securities | **—** | — | 529 |
| Gain on loans held under fair value option | **2,810** | — | — |
| Other (losses) gains, net | **—** | — | (6,347) |
| Other income, net | **4,167** | 277 | 684 |
| Impairment losses on investments | | | |
| Total other-than-temporary impairment losses | **(76)** | (2,906) | (2,743) |
| Less: portion of loss recognized in other comprehensive income | **—** | (819) | (913) |
| Net impairment loss recognized in earnings | **(76)** | (2,087) | (1,830) |
| **Total noninterest income** | **78,522** | 41,661 | 61,726 |
| Salaries and employee benefits | **146,976** | 134,402 | 131,661 |
| Occupancy and equipment expense | **18,170** | 16,601 | 15,071 |
| Insurance Fund premiums | **7,663** | 8,830 | 7,720 |
| Losses on other property owned, net | **13,850** | 18,740 | 15,152 |
| Other operating expenses | **62,995** | 56,255 | 55,809 |
| **Total noninterest expense** | **249,654** | 234,828 | 225,413 |
| **Income before income taxes** | **410,400** | 369,841 | 275,026 |
| Provision for (benefit from) income taxes | **985** | 1,175 | (291) |
| **Net income** | **$ 409,415** | $ 368,666 | $ 275,317 |
| **Other comprehensive (loss) income** | | | |
| Change in postretirement benefit plans | **(22,410)** | (44,615) | 18,085 |
| Change in unrealized gain on investments | **4,527** | 4,991 | 11,367 |
| Change in cash flow derivative instruments | **(533)** | (3,376) | (2,001) |
| **Total other comprehensive (loss) income** | **(18,416)** | (43,000) | 27,451 |
| **Comprehensive Income** | **$ 390,999** | $ 325,666 | $ 302,768 |

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

# Combined Statements of Changes in Members' Equity

FARM CREDIT BANK OF TEXAS AND DISTRICT ASSOCIATIONS

| *(dollars in thousands)* | Preferred Stock | Common Stock and Participation Certificates | Retained Earnings Allocated | Retained Earnings Unallocated | Retained Earnings Total | Additional Paid-in-Capital | Accumulated Other Comprehensive (Loss) Income | Total Members' Equity |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2009 | $ 202,754 | $ 63,202 | $ 266,991 | $ 2,061,299 | $ 2,328,290 | $ — | $ (76,842) | $ 2,517,404 |
| Net income | — | — | — | 275,317 | 275,317 | — | — | 275,317 |
| Other comprehensive income | — | — | — | — | — | — | 27,451 | 27,451 |
| Capital stock/participation certificates and allocated retained earnings issued | — | 4,606 | 626 | — | 626 | — | — | 5,232 |
| Capital stock/participation certificates retired | — | (5,965) | — | — | — | — | — | (5,965) |
| Preferred stock issued | 300,000 | — | — | — | — | — | — | 300,000 |
| Issuance costs on preferred stock | — | — | — | (3,432) | (3,432) | — | — | (3,432) |
| Preferred stock repurchased | (20,754) | — | — | — | — | — | — | (20,754) |
| Net premium and costs on repurchase of preferred stock | — | — | — | (529) | (529) | — | — | (529) |
| Impact of association merger: | | | | | | | | |
| Equity issued upon association merger | — | 3,688 | — | — | — | 22,622 | — | 26,310 |
| Equity retired upon association merger | — | (3,688) | — | (22,568) | (22,568) | — | — | (26,256) |
| Preferred stock dividends accrued | — | — | — | (21,881) | (21,881) | — | — | (21,881) |
| Cash dividends on preferred stock | — | — | — | (23,720) | (23,720) | — | — | (23,720) |
| Patronage distributions | | | | | | | | |
| Cash | — | — | — | (82,846) | (82,846) | — | — | (82,846) |
| Members' equity | — | — | 59,818 | (59,818) | — | — | — | — |
| Balance at December 31, 2010 | 482,000 | 61,843 | 327,435 | 2,121,822 | 2,449,257 | 22,622 | (49,391) | 2,966,331 |
| Comprehensive income | | | | | | | | |
| Net income | — | — | — | 368,666 | 368,666 | — | — | 368,666 |
| Other comprehensive loss | — | — | — | — | — | — | (43,000) | (43,000) |
| Capital stock/participation certificates and allocated retained earnings issued | — | 7,003 | — | — | — | — | — | 7,003 |
| Capital stock/participation certificates and allocated retained earnings retired | — | (8,822) | (54,579) | (624) | (55,203) | — | — | (64,025) |
| Equity related to association merger | — | — | — | (169) | (169) | 115 | — | (54) |
| Preferred stock dividends accrued | — | — | — | (21,881) | (21,881) | — | — | (21,881) |
| Cash dividends–preferred stock | — | — | — | (21,880) | (21,880) | — | — | (21,880) |
| Patronage distributions | | | | | | | | |
| Cash | — | — | — | (87,032) | (87,032) | — | — | (87,032) |
| Members' equity | — | — | 101,375 | (101,375) | — | — | — | — |
| Balance at December 31, 2011 | 482,000 | 60,024 | 374,231 | 2,257,527 | 2,631,758 | 22,737 | (92,391) | 3,104,128 |
| Net income | — | — | — | 409,415 | 409,415 | — | — | 409,415 |
| Other comprehensive loss | — | — | — | — | — | — | (18,416) | (18,416) |
| Capital stock/participation certificates and allocated retained earnings issued | — | 8,711 | — | — | — | — | — | 8,711 |
| Capital stock/participation certificates and allocated retained earnings retired | — | (8,876) | (58,496) | — | (58,496) | — | — | (67,372) |
| Cash dividends – preferred stock | — | — | — | (43,761) | (43,761) | — | — | (43,761) |
| Patronage distributions | | | | | | | | |
| Cash | — | — | — | (106,624) | (106,624) | — | — | (106,624) |
| Members' equity | — | — | 103,986 | (103,986) | — | — | — | — |
| **Balance at December 31, 2012** | **$ 482,000** | **$ 59,859** | **$ 419,721** | **$ 2,412,571** | **$ 2,832,292** | **$ 22,737** | **$ (110,807)** | **$ 3,286,081** |

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

# Combined Statements of Cash Flows

FARM CREDIT BANK OF TEXAS AND DISTRICT ASSOCIATIONS

| *(dollars in thousands)* | Year Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| **Operating Activities** | | | |
| Net income | **$ 409,415** | $ 368,666 | $ 275,317 |
| Reconciliation of net income to net cash provided by operating activities | | | |
| Provision for loan losses | **33,631** | 45,048 | 141,457 |
| Provision for losses on other property owned | **14,615** | 15,521 | 13,167 |
| Depreciation and amortization on premises and equipment | **7,546** | 6,694 | 6,275 |
| Accretion of net premium (discount) on loans | **2,159** | (200) | (736) |
| Amortization and accretion on debt instruments | **(3,789)** | (4,319) | (4,821) |
| Accretion of net premium (discount) on investments | **620** | 6,910 | (5,773) |
| Increase in fair value of loans held under fair value option | **(2,021)** | — | — |
| Loss (gain) on sale of investment securities | **—** | — | (529) |
| Loss on impairment of available-for-sale investments | **76** | 2,087 | 1,830 |
| Allocated equity patronage from System bank | **(12,445)** | (12,467) | (12,487) |
| Gain on sales of other property owned, net | **(2,327)** | (244) | (1,292) |
| Gain on sales of premises and equipment, net | **(5,263)** | (3,292) | (5,696) |
| Decrease in accrued interest receivable | **10,138** | 12,456 | 23,071 |
| (Increase) decrease in other assets, net | **(448)** | (203) | 22,598 |
| Decrease in accrued interest payable | **(3,543)** | (7,969) | (24,193) |
| Increase (decrease) in other liabilities, net | **11,474** | (3,862) | (20,080) |
| Net cash provided by operating activities | **459,838** | 424,826 | 408,108 |
| **Investing Activities** | | | |
| Net (increase) decrease in federal funds sold | **(3,450)** | (249) | 52 |
| Investment securities | | | |
| Purchases | **(1,280,239)** | (974,765) | (2,075,085) |
| Proceeds from maturities, calls and prepayments | **1,087,700** | 914,393 | 971,512 |
| Proceeds from sales | **68,744** | — | 66,635 |
| Redemption of Farmer Mac preferred stock | **—** | — | 7,000 |
| (Increase) decrease in loans | **(1,352,722)** | (182,273) | 384,652 |
| Expenditures from purchase of loans | **—** | — | (32,822) |
| Proceeds from sales of other property owned, net | **35,380** | 68,165 | 27,468 |
| Proceeds from sales of premises and equipment | **4,264** | 3,551 | 4,119 |
| Expenditures for premises and equipment | **(16,436)** | (8,380) | (11,712) |
| Net cash used in investing activities | **(1,456,759)** | (179,558) | (658,181) |
| **Financing Activities** | | | |
| Bonds and notes issued | **15,306,425** | 15,285,508 | 19,497,527 |
| Bonds and notes retired | **(14,037,395)** | (15,413,746) | (19,483,209) |
| (Decrease) increase in advanced conditional payments | **(682)** | 10,926 | (2,967) |
| Equity (related to) issued upon merger | **—** | (54) | 54 |
| Bank Class B preferred stock issued | **—** | — | 300,000 |
| Issuance costs on preferred stock | **—** | — | (3,432) |
| Bank Class A preferred stock repurchased | **—** | — | (18,000) |
| Association preferred stock retired | **—** | — | (2,754) |
| Net premium and costs on repurchase of Class A preferred stock | **—** | — | (529) |
| Capital stock and participation certificates issued | **8,711** | 7,003 | 5,232 |
| Capital stock and participation certificates retired and allocated retained earnings distributed | **(67,372)** | (64,025) | (5,965) |
| Cash dividends on preferred stock | **(43,761)** | (21,880) | (23,720) |
| Cash dividends and patronage distributions paid | **(88,882)** | (69,603) | (59,809) |
| Net cash provided by (used in) financing activities | **1,077,044** | (265,871) | 202,428 |
| Net increase (decrease) in cash | **80,123** | (20,603) | (47,645) |
| Cash at beginning of year | **432,719** | 453,322 | 500,967 |
| Cash at end of year | **$ 512,842** | $ 432,719 | $ 453,322 |
| **Supplemental Schedule of Noncash Investing and Financing Activities** | | | |
| Financed sales of other property owned | **$ 10,924** | $ 2,001 | $ 11,835 |
| Loans transferred to other property owned | **68,847** | 91,273 | 75,978 |
| Net increase in unrealized gains on investment securities | **4,527** | 4,991 | 11,367 |
| Patronage distributions payable | **101,182** | 83,440 | 66,011 |
| Preferred stock dividends payable | **21,881** | 21,881 | 21,881 |
| Transfer of surplus to additional paid-in-capital related to association merger | **—** | — | 22,568 |
| **Supplemental Schedule of Noncash Changes in Fair Value Related to Hedging Activities** | | | |
| Increase (decrease) in bonds and notes | **$ 78** | $ (1,834) | $ 956 |
| **Supplemental Information** | | | |
| Cash paid during the year for: | | | |
| Interest | **$ 197,678** | $ 228,568 | $ 319,332 |
| Income taxes | **88** | 327 | 291 |

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

# Notes to Combined Financial Statements

*Farm Credit Bank of Texas and District Associations*

*(dollars in thousands, except per share amounts and as noted)*

## Note 1 — Organization and Operations

### A. Organization:

The Farm Credit Bank of Texas (bank) is one of the banks of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations established by acts of Congress. The System is currently subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes.

As of December 31, 2012, the nation was served by three Farm Credit Banks (FCBs), each of which has specific lending authority within its chartered territory, and one Agricultural Credit Bank (ACB) — collectively, the "System banks" — which has nationwide lending authority for lending to cooperatives. The ACB also has lending authorities of an FCB within its chartered territories. The bank is chartered to service the states of Alabama, Louisiana, Mississippi, New Mexico and Texas.

Each FCB and the ACB serve one or more Agricultural Credit Associations (ACAs) and/or Federal Land Credit Associations (FLCAs). The bank and its related associations collectively are referred to as the Farm Credit Bank of Texas and affiliated associations (district). The district's one FLCA, 16 ACA parent associations, each containing two wholly-owned subsidiaries (an FLCA and a Production Credit Association [PCA]), certain Other Financing Institutions (OFIs) and preferred stockholders jointly owned the bank at December 31, 2012. The FLCA and ACAs collectively are referred to as associations.

Each FCB and the ACB provides funding for its district associations and is responsible for supervising certain activities of the associations within their districts. The FCBs and/or associations make loans to or for the benefit of eligible borrower-stockholders for qualified agricultural purposes. District associations borrow the majority of funds from their related bank. The System banks obtain a substantial majority of their funds for lending operations through the sale of consolidated Systemwide bonds and notes to the public, but also obtain a portion of their funds from internally generated earnings and from the issuance of common and preferred stock and, to a lesser extent, from the issuance of subordinated debt.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the bank and associations. The FCA examines the activities of System institutions to ensure their compliance with the Farm Credit Act, FCA regulations, and safe and sound banking practices.

### B. Operations:

The Farm Credit Act sets forth the types of authorized lending activities and financial services which can be offered by the bank and the associations and defines the eligible borrowers which they may serve. The associations are authorized to provide, or participate with other lenders to provide, credit, credit commitments and related services to eligible borrowers. Eligible borrowers are defined as (a) bona fide farmers and ranchers and producers or harvesters of aquatic products, (b) persons furnishing to farmers and ranchers services directly related to their on-farm operating needs, (c) owners of rural homes, (d) rural residents and (e) farm-related businesses. The bank also may lend to any national bank, state bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings institution, credit union or any association of agricultural producers (aggregately referred to as OFIs) engaged in the making of loans to farmers and ranchers, and any corporation engaged in the making of loans to producers or harvesters of aquatic products.

The associations also serve as intermediaries in offering credit life and multi-peril crop insurance and financial management services to their borrowers.

FCA regulations require borrower information be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

The FLCA borrows funds from the bank and in turn originates and services long-term real estate mortgage loans made to their members. The OFIs borrow from the bank and, in turn, originate and service short- and intermediate-term loans for their members. The ACAs borrow from the bank and in turn may originate and service both long-term real estate mortgage and short- and intermediate-term loans to their members. ACAs may form a parent-subsidiary structure and may operate their long-term mortgage activities through an FLCA subsidiary and their short- and intermediate-term lending activities through a PCA subsidiary. In the states of Alabama, Louisiana, Mississippi, New Mexico and Texas, the bank may purchase from the FLCA and ACAs long-term real estate mortgage loans and, from ACAs, short- and intermediate-term loans.

The bank, in conjunction with other banks in the System, jointly owns several service organizations which were created to provide a variety of services for the System. The bank has ownership interests in the following service organizations:

- Federal Farm Credit Banks Funding Corporation (Funding Corporation) — provides for the issuance, marketing and processing of Systemwide debt securities using a network of investment dealers and dealer banks. The Funding Corporation also provides financial management and reporting services.
- Farm Credit System Building Association — leases premises and equipment to the FCA, as required by the Farm Credit Act.
- Farm Credit System Association Captive Insurance Company — as a reciprocal insurer, provides insurance services to its member organizations.

In addition, The Farm Credit Council acts as a full-service, federated trade association which represents the System before

Congress, the executive branch and others, and provides support services to System institutions on a fee basis.

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used to (1) insure the timely payment of principal and interest on Systemwide debt obligations (insured debt), (2) ensure the retirement of protected borrower capital at par or stated value and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses, by the Insurance Corporation, of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the associations, into the Insurance Fund based on its annual average adjusted outstanding insured debt until the assets in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums and may return excess funds above the secure base amount to System institutions.

## Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the combined bank and associations 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 the bank and associations to make estimates and assumptions that affect the amounts reported in the combined financial statements and accompanying notes. Significant estimates are discussed in these notes as applicable. Certain amounts in prior years' combined financial statements have been reclassified to conform to the current year's presentation.

The accompanying combined financial statements include the accounts of the bank and associations, and reflect the investments in and allocated earnings of the service organizations in which the bank has partial ownership interests. All significant transactions and balances between the bank and associations have been eliminated in combination. The multiemployer structure of the district's defined benefit retirement plan results in the recording of the plan upon combination only.

### A. Cash:

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

### B. Investment Securities:

The bank and associations, as permitted under FCA regulations, hold eligible investments for the purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk.

The bank's investments are to be held for an indefinite time period and, accordingly, have been classified as available for sale at December 31, 2012, 2011 and 2010, respectively. These investments are reported at fair value, and unrealized holding gains and losses on investments are netted and reported as a separate component of members' equity in the balance sheet. 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. The bank reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income. In subsequent periods, if the present value of cash flows expected to be collected is less than the amortized cost basis, the bank would record an additional other-than-temporary impairment and adjust the yield of the security prospectively. The amount of total other-than-temporary impairment for an available-for-sale security that previously was impaired is determined as the difference between its carrying amount prior to the determination of other-than-temporary impairment and its fair value. Gains and losses on the sales of investments available-for-sale are determined using the specific identification method. Premiums and discounts are amortized or accreted into interest income over the term of the respective issues. The bank does not hold investments for trading purposes.

The bank and associations may also hold additional investments in accordance with mission-related investment programs, approved by the Farm Credit Administration. These programs allow the bank and associations to make investments that further the System's mission to serve rural America. Mission-related investments are not included in liquidity calculations and are not covered by the eligible investment limitations specified by the FCA regulations. Mortgage-backed securities issued by Federal Agricultural Mortgage Corporation (Farmer Mac) are considered other investments and are also excluded from the limitation and liquidity calculations. Mission-related investments for which the associations have 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.

At December 31, 2012, the district held other investments, totaling $184.6 million, which consisted of Farmer Mac guaranteed agricultural mortgage-backed securities (AMBS). The bank held AMBS with a fair value of $115.5 million in an available-for-sale other investments portfolio, and associations held AMBS with an amortized cost of $69.1 million in a held-to-maturity portfolio. The Farmer Mac securities are backed by loans originated by the associations and previously held by the associations under the Farmer Mac long-term standby commitments to purchase agreements.

Farmer Mac is a government-sponsored enterprise and is examined and regulated by FCA. It provides secondary market arrangements for agricultural and rural home mortgage loans that meet certain underwriting standards. Farmer Mac is authorized to provide loan guarantees or be a direct pooler of agricultural mortgage loans. Farmer Mac is owned by both System and non-System investors, and its board of directors has both System and non-System representation. Farmer Mac is not liable for any debt or obligation of any System institution and no System institution other than Farmer Mac is liable for any debt or obligation of Farmer Mac.

The district's holdings in investment securities are more fully described in Note 3, "Investment Securities."

**C. Loans and Allowance for Loan Losses:**

Long-term real estate mortgage loans can have maturities ranging from five to 40 years. Substantially all short-term and intermediate-term loans are made for agricultural production or operating purposes and have maturities of 10 years or less.

Loans are carried at their principal amount outstanding adjusted for charge-offs and any unearned income or unamortized discount. Interest on loans is accrued and credited to interest income based on the daily principal amount outstanding. Funds which are held by the district on behalf of the borrowers, where legal right of setoff exists, and which can be used to reduce outstanding loan balances at the district's discretion, are netted against loans in the combined balance sheets.

Loan origination fee income and direct loan origination costs are capitalized and the net fee or cost is amortized over the life of the related loans as an adjustment to yield.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

A restructured loan constitutes a troubled debt restructuring if for economic or legal reasons related to the debtor's financial difficulties the bank or association grants a concession to the debtor that it would not otherwise consider. A concession is generally granted in order to minimize the bank or association's economic loss and avoid foreclosure. Concessions vary by program and are borrower-specific and may include interest rate reductions, term extensions, payment deferrals or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. A loan restructured in a troubled debt restructuring is an impaired loan.

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 circumstances indicate that full collection of principal and interest is in doubt. In accordance with FCA regulations, all loans 180 days or more past due are considered nonaccrual. When a loan is placed in nonaccrual status, accrued interest that is considered uncollectible is either reversed (if current year interest) or charged against the allowance for loan losses (if prior year interest). Loans are charged off at the time they are determined to be uncollectible.

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, payments are recognized as interest income. Nonaccrual loans may be returned to accrual status when contractual 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. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The bank and related associations use a two-dimensional loan rating model based on an internally generated combined System risk-rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the probability of default categories carries a distinct percentage of default probability. The 14-point risk-rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between "1" and "9" is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (nonviable) rating indicates that the probability of default is almost certain.

The credit risk-rating methodology is a key component of the bank's and associations' allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the 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 the institutions' expectations and predictions of those circumstances. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through reversals of provisions for loan losses and loan charge-offs. The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The allowance for loan losses includes components for loans individually evaluated for impairment, loans collectively evaluated for impairment and loans acquired with deteriorated credit quality. Generally, for loans individually evaluated the allowance for loan losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, if the loan is collateral-dependent. For those loans collectively evaluated for impairment, the allowance for loan losses is determined using the risk-rating model.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan portfolio. A specific allowance may be established for impaired loans under authoritative accounting guidance. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral-dependent.

**D. Other Property Owned:**

Other property owned, consisting of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at fair value, based on appraisal, less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. On at least an annual basis, revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in losses (gains) on other property owned, net.

**E. Premises and Equipment:**

Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation expense is calculated using the straight-line method over the estimated useful lives of 40 years for buildings and improvements, three to 10 years for furniture, equipment and certain leasehold improvements, and three years for automobiles. Computer software and hardware are amortized over three to 10 years. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized and amortized over the remaining useful life of the asset.

**F. Other Assets and Other Liabilities:**

Direct expenses incurred in issuing debt are deferred and amortized using the prospective level yield method over the term of related indebtedness.

The bank and associations are authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. ACPs which are held by the district but cannot be used to reduce outstanding loan balances, except at the direction of the borrower, are classified as other liabilities in the combined balance sheets. ACPs are not insured, and interest is generally paid by the associations on such balances. The total outstanding gross balances of advance conditional payments, both netted against loans and classified as other liabilities, at December 31, 2012, 2011 and 2010 were $103.6 million, $108.2 million and $88.7 million, respectively.

Derivative financial instruments are included on the balance sheet at fair value, as either other assets or other liabilities.

**G. Employee Benefit Plans:**

Employees of the bank and associations participate in one of two districtwide retirement plans and are eligible to participate in the 401(k) plan of the district. Within the 401(k) plan, a certain percentage of employee contributions is matched by the bank and associations. The 401(k) plan costs are expensed as incurred. Additionally, certain qualified individuals in the bank and associations may participate in a separate, nonqualified supplemental 401(k) plan.

As more fully described in Note 11, "Employee Benefit Plans," these plans are accounted for and reported in accordance with authoritative accounting guidance. The bank and all associations provide certain health care benefits to eligible retired employees and directors. District employees' eligibility for these benefits upon retirement is dependent on conditions set by each district employer.

The structure of the district's defined benefit plan is characterized as multiemployer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (bank and associations). No portion of any surplus assets is available to any participating employer. Participating employers are jointly and severally liable for the plan obligations. Upon withdrawal or termination of their participation in the plan, a participating employer must pay all associated costs of its withdrawal from the plan, including its unfunded liability (the difference between replacement annuities and the withdrawing employer's share of allocated plan assets) and associated costs of withdrawal. As a result, participating employers of the plans only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. The majority of plan obligations, assets and the components of annual benefit expenses are recorded and reported upon combination at the district level only.

Certain qualified individuals in the bank also participated in a nonqualified supplemental defined benefit pension plan, which was terminated effective January 16, 2011, with no further vesting or benefit accrual after that date. All remaining vested benefits were distributed to the participating bank employees in lump sums after a required one-year deferral period.

Authoritative accounting guidance requires the accrual of the expected cost of providing postretirement benefits other than pensions (primarily health care 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.

**H. Income Taxes:**

The bank, the FLCA and the FLCA subsidiaries of ACA parent companies are exempt from federal and certain other income taxes as provided in the Farm Credit Act. The ACAs and their PCA subsidiaries provide for federal and certain other income taxes.

Certain ACAs operate as cooperatives which qualify for tax treatment under Subchapter T of the Internal Revenue Code. These ACAs and their PCA subsidiaries can exclude from taxable income amounts distributed as qualified patronage distributions to borrowers in the form of cash, stock or allocated retained earnings. Provisions for income taxes for these ACAs are made only on the earnings not distributed as qualified patronage distributions. Certain ACAs distribute patronage on the basis of taxable income. In this method, deferred income taxes are provided on the taxable income of ACAs on the basis of a proportionate share of the tax effect of temporary differences not allocated in patronage form. Other ACAs distribute patronage on the basis of book income. In this method, deferred taxes are recorded on the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. For all ACAs, a valuation allowance is provided for the deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduce taxable earnings.

As of December 31, 2012, deferred income taxes have not been provided by the ACAs and their PCA subsidiaries on $34.3 million of pre-1993 patronage distributions from the bank because management's intent is to (1) permanently invest these and other undistributed earnings in the bank, thereby indefinitely postponing their conversion to cash, or (2) pass any distributions related to pre-1993 earnings to borrowers through qualified patronage allocations. No deferred taxes have been provided on the bank's post-1994 unallocated earnings. The bank currently has no plans to distribute unallocated bank earnings and does not contemplate circumstances which, if distributions were made, would result in income taxes being paid at the association level.

**I. Derivative Instruments and Hedging Activity:**

In the normal course of business, the bank enters into derivative financial instruments, including interest rate swaps and caps, which are principally used to manage interest rate risk on assets, liabilities and firm commitments. Derivatives are recorded on the balance sheet as assets and liabilities at fair value.

For fair-value hedge transactions which hedge changes in the fair value of assets, liabilities or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash flow hedges, which hedge the exposure to variability in expected future cash flows, changes in the fair value of the derivative are reflected in accumulated other comprehensive income. The bank formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific liabilities on the balance sheet. The bank uses interest rate swaps whose critical terms match the corresponding hedged item, thereby qualifying for short-cut treatment under the provisions of authoritative accounting guidance, and are presumed to be highly effective in offsetting changes in the fair value. The bank would discontinue hedge accounting prospectively when the bank determines that a derivative has not been or is not expected to be effective as a hedge. In the event that hedge accounting were discontinued and the derivative remained outstanding, the bank would carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings. See Note 16, "Derivative Instruments and Hedging Activity" for additional disclosures about derivative instruments.

**J. Fair Value Measurements:**

The Financial Accounting Standards Board (FASB) guidance 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. Included in Level 1 are assets held in trust funds, which relate to deferred compensation and our supplemental retirement plans. 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 instruments are cash balances; therefore, fair value approximates face value. Pension plan assets that are derived from observable inputs, including corporate bonds and mortgage-backed securities, are reported in Level 2.

Level 3 — Unobservable inputs are those that are supported by little or no market activity and that are significant to the determination of 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 the district's Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS), non-agency securities, certain loans and other property owned.

The fair value disclosures are presented in Note 15, "Fair Value Measurements."

**K. Recently Issued or Adopted Accounting Pronouncements:**

In December 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Balance Sheet — Disclosures about Offsetting Assets and Liabilities." The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities. The requirements apply to recognized financial instruments and derivative instruments that are offset in accordance with the rights of offset set forth in accounting guidance and for those recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. This guidance is to be applied retrospectively for all comparative periods and is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this guidance will not impact the district's financial condition or its results of operations, but will result in additional disclosures.

In September 2011, the FASB issued guidance entitled, "Compensation – Retirement Benefits – Multiemployer Plans." The guidance is intended to provide more information about an employer's financial obligations to a multiemployer pension plan, which should help financial statement users better understand the financial health of significant plans that the employer participates. The additional disclosures include: a) a description of the nature of plan benefits, b) a qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer, and c) other quantitative information to help users understand the financial information about the plan. The amendments are effective for annual periods for fiscal years ending after December 15, 2012, for nonpublic entities. The amendments should be applied retrospectively for all prior periods presented. The adoption did not impact the district combined financial condition or results of operation.

In June 2011 and December 2011, the FASB issued guidance entitled, "Comprehensive Income – Presentation of Comprehensive Income." This guidance is intended to increase the prominence of other comprehensive income in financial statements. The main provision of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements. This guidance did not change the items that must be reported in other comprehensive income. With either approach, an entity is required to present reclassification adjustments for items reclassified from other comprehensive income to net income in the statement(s). The December 2011 guidance deferred the effective date for the presentation of reclassification adjustments.

This guidance is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance did not impact financial condition or results of operations, but resulted in changes to the presentation of comprehensive income.

**L. Off-Balance-Sheet Credit Exposures:**

Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

**M. Merger Accounting:**

The authoritative guidance on business combinations applies to all transactions in which an entity obtains control of one or more businesses and requires the acquirer to use the acquisition method of accounting and recognize assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date.

For System institutions, because the stock in each association is fixed in value, the stock issued pursuant to the merger provides no basis for estimating the fair value of the consideration transferred pursuant to the merger. In the absence of a purchase price determination, the acquiring association would identify and estimate the acquisition date fair value of the equity interests (net assets) of the acquired association instead of the acquisition date fair value of the equity interests transferred as consideration. The fair value of the assets acquired, including specific intangible assets and liabilities assumed, are measured based on various estimates using assumptions that management believes are reasonable utilizing information currently available. The excess value received, by the acquiring association from the acquired association, over the par value of capital stock and participation certificates issued in the merger is considered to be additional paid-in capital.

## Note 3 — Investment Securities

The district's available-for-sale investments include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio consists primarily of agency-guaranteed debt instruments, corporate debt, mortgage-backed investments, asset-backed investments and corporate debt. At December 31, 2012, the district's other investments portfolio consisted of AMBS held by district associations in a held-to-maturity portfolio with an amortized cost of $69.1 million and AMBS held by the bank in an available-for-sale portfolio with a fair value of $115.5 million. The bank's AMBS were purchased from district associations as a part of the bank's Capitalized Participation Pool (CPP) program. In accordance with this program, any positive impact to the net income of the bank can be returned as patronage to the association if declared by the bank's board of directors. The declared patronage approximates the net earnings of the respective pool, which is eliminated upon combination.

Investments in the available-for-sale liquidity portfolio and held-to-maturity investments at December 31, 2012, 2011 and 2010 follow:

| | **December 31, 2012** | | | | |
|---|---|---|---|---|---|
| | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** | **Weighted Average Yield** |
| **Agency-guaranteed debt** | **$ 65,811** | **$ 126** | **$ (171)** | **$ 65,766** | **1.53%** |
| **Corporate debt** | **208,360** | **486** | **(224)** | **208,622** | **0.99** |
| **Federal agency collateralized mortgage-backed securities** | | | | | |
| **GNMA** | **1,593,563** | **22,143** | **(698)** | **1,615,008** | **1.60** |
| **FNMA and FHLMC** | **1,281,140** | **16,395** | **—** | **1,297,535** | **1.45** |
| **Other collateralized mortgage-backed securities** | **28,082** | **—** | **(1,144)** | **26,938** | **4.98** |
| **Asset-backed securities** | **17,852** | **59** | **(780)** | **17,131** | **1.13** |
| **Total liquidity investments** | **$3,194,808** | **$39,209** | **$ (3,017)** | **$3,231,000** | **1.52%** |
| **Held-to-maturity investments:** | | | | | |
| **Agricultural mortgage-backed securities** | **$ 69,075** | **$ 233** | **$ (556)** | **$ 68,752** | **4.62%** |

| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
| FDIC-guaranteed corporate debt | $ 169,871 | $ 128 | $ — | $ 169,999 | 0.36% |
| Corporate debt | 83,306 | 8 | (850) | 82,464 | 1.08 |
| Federal agency collateralized mortgage-backed securities | | | | | |
| GNMA | 1,689,535 | 29,635 | (12) | 1,719,158 | 1.80 |
| FNMA and FHLMC | 1,011,508 | 12,626 | (586) | 1,023,548 | 1.88 |
| Other collateralized mortgage-backed securities | 49,208 | — | (8,336) | 40,872 | 6.11 |
| Asset-backed securities | 15,080 | 2 | (1,361) | 13,721 | 1.65 |
| Total liquidity investments | $ 3,018,508 | $42,399 | $(11,145) | $ 3,049,762 | 1.78% |
| Held-to-maturity investments: | | | | | |
| Agricultural mortgage-backed securities | $ 127,245 | $ 953 | $ (1,159) | $ 127,039 | 4.99% |

| | December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
| FDIC-guaranteed corporate debt | $ 300,531 | $ 1,724 | $ (164) | $ 302,091 | 0.84% |
| Federal agency collateralized mortgage-backed securities | | | | | |
| GNMA | 1,650,736 | 22,543 | (701) | 1,672,578 | 1.88 |
| FNMA and FHLMC | 873,286 | 13,910 | (345) | 886,851 | 2.20 |
| Other collateralized mortgage-backed securities | 71,192 | 68 | (6,342) | 64,918 | 5.97 |
| Asset-backed securities | 11,493 | 1 | (1,489) | 10,005 | 3.13 |
| Total liquidity investments | $ 2,907,238 | $38,246 | $ (9,041) | $ 2,936,443 | 1.97% |
| Held-to-maturity investments: | | | | | |
| Agricultural mortgage-backed securities | $ 154,616 | $ 543 | $ (1,283) | $ 153,876 | 5.17% |

Investments in the available-for-sale other investments portfolio follow:

| | **December 31, 2012** | | | | |
|---|---|---|---|---|---|
| | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** | **Weighted Average Yield** |
| **Agricultural mortgage-backed securities** | **$ 117,567** | **$ —** | **$(2,088)** | **$ 115,479** | **4.36%** |

| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
| Agricultural mortgage-backed securities | $ 112,597 | $ — | $(1,676) | $ 110,921 | 4.79% |

| | December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
| Agricultural mortgage-backed securities | $ 145,122 | $ — | $(4,619) | $ 140,503 | 5.07% |

A summary of contractual maturity, amortized cost, estimated fair value and weighted average yield of the available-for-sale liquidity portfolio at December 31, 2012, follows:

| | **Due In One Year Or Less** | **Due After One Year Through Five Years** | **Due After Five Years Through 10 Years** | **Due After 10 Years** | **Total** |
|---|---|---|---|---|---|
| Agency-guaranteed debt | $ — | $ — | $ — | $ 65,766 | $ 65,766 |
| Corporate debt | 82,225 | 126,397 | — | — | 208,622 |
| Federal agency collateralized mortgage-backed securities | | | | | |
| GNMA | — | — | 37,041 | 1,577,967 | 1,615,008 |
| FNMA and FHLMC | 2,709 | 1,018 | 112,007 | 1,181,801 | 1,297,535 |
| Other collateralized mortgage-backed securities | — | — | 58 | 26,880 | 26,938 |
| Asset-backed securities | 5,744 | — | — | 11,387 | 17,131 |
| Total fair value | $ 90,678 | $ 127,415 | $ 149,106 | $2,863,801 | $ 3,231,000 |
| Total amortized cost | $ 90,466 | $ 127,244 | $ 145,097 | $2,832,001 | $ 3,194,808 |
| Weighted average yield | 0.68% | 1.13% | 2.55% | 1.51% | 1.52% |

Collateralized mortgage obligations (CMOs) have stated contractual maturities in excess of 15 years. However, the security structure of the CMOs is designed to produce a relatively short-term life. At December 31, 2012, the CMO portfolio had a weighted average remaining life of approximately three years.

Investments in the available-for-sale other investments portfolio at December 31, 2012, follows:

| | Due After One Year Through Five Years |
|---|---|
| Fair value of agricultural mortgage-backed securities | $ 115,479 |
| Total amortized cost | 117,567 |
| Weighted average yield | 4.36% |

Investments in the district's held-to-maturity investment portfolio follow:

| | Due After One Year Through Five Years | Due After Five Years Through 10 Years | Total |
|---|---|---|---|
| Fair value | $ 46,435 | $ 22,317 | $ 68,752 |
| Amortized cost | 46,286 | 22,789 | 69,075 |
| Weighted average yield | 4.86% | 4.12% | 4.62% |

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 overcollateralization and the priority of payments of senior classes over junior classes. The bank performs 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. At December 31, 2012, the bank held 12 investments that were ineligible for liquidity purposes by FCA standards. Those ineligible securities had an amortized cost basis of $30.5 million and a fair value of $28.7 million at December 31, 2012.

Proceeds and related gains and losses on investment securities follow:

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2012** | 2011 | 2010 |
| Proceeds on sales | **$ 10,573** | $ — | $ 66,635 |
| Realized losses on sales | **75** | — | — |
| Realized gains on sales | — | — | 529 |
| Realized losses due to impairment | **1** | 2,087 | 1,830 |

The net realized gain and loss is included on the combined statements of income as part of total noninterest income.

At December 31, 2012, the district had 28 investments that were in a loss position. The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category, and the length of time the securities have been in a continuous unrealized loss position. The continuous loss position is based on the date the impairment occurred. An investment is considered impaired if its fair value is less than its cost.

| | **December 31, 2012** | | | | | |
|---|---|---|---|---|---|---|
| | **Less Than 12 Months** | | **Greater Than 12 Months** | | **Total** | |
| | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** |
| **Agency-guaranteed debt** | **$ 29,640** | **$ (171)** | **$ —** | **$ —** | **$ 29,640** | **$ (171)** |
| **Corporate debt** | **44,767** | **(224)** | **—** | **—** | **44,767** | **(224)** |
| **Federal agency collateralized mortgage-backed securities** | | | | | | |
| **GNMA** | **151,676** | **(698)** | **—** | **—** | **151,676** | **(698)** |
| **FNMA and FHLMC** | **32** | **—** | **—** | **—** | **32** | **—** |
| **Other collateralized mortgage-backed securities** | **5,749** | **(2)** | **21,189** | **(1,142)** | **26,938** | **(1,144)** |
| **Asset-backed securities** | **—** | **—** | **3,096** | **(780)** | **3,096** | **(780)** |
| **Total** | **$ 231,864** | **$ (1,095)** | **$ 24,285** | **$ (1,922)** | **$ 256,149** | **$ (3,017)** |

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | Greater Than 12 Months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| FDIC-guaranteed corporate debt | $ — | $ — | $ — | $ — | $ — | $ — |
| Corporate debt | 72,455 | (850) | — | — | 72,455 | (850) |
| Federal agency collateralized mortgage-backed securities | | | | | | |
| GNMA | — | — | 8,575 | (12) | 8,575 | (12) |
| FNMA and FHLMC | 207,672 | (530) | 20,801 | (56) | 228,473 | (586) |
| Other collateralized mortgage-backed securities | 11,232 | (1,936) | 29,639 | (6,400) | 40,871 | (8,336) |
| Asset-backed securities | 739 | (3) | 3,449 | (1,358) | 4,188 | (1,361) |
| Total | $ 292,098 | $ (3,319) | $ 62,464 | $ (7,826) | $ 354,562 | $ (11,145) |

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | Greater Than 12 Months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| FDIC-guaranteed corporate debt | $ 199,490 | $ (164) | $ — | $ — | $ 199,490 | $ (164) |
| Federal agency collateralized mortgage-backed securities | | | | | | |
| GNMA | 395,835 | (700) | — | — | 395,835 | (700) |
| FHMA and FHLMC | 118,925 | (346) | — | — | 118,925 | (346) |
| Other collateralized mortgage-backed securities | 9,647 | (626) | 50,691 | (5,716) | 60,338 | (6,342) |
| Asset-backed securities | — | — | 6,342 | (1,489) | 6,342 | (1,489) |
| Total | $ 723,897 | $ (1,836) | $ 57,033 | $ (7,205) | $ 780,930 | $ (9,041) |

As more fully discussed in Note 2, "Summary of Significant Accounting Policies," the guidance for other-than-temporary impairment contemplates numerous factors in determining whether an impairment is other-than-temporary, including: (i) whether or not an entity intends to sell the security; (ii) whether it is more likely than not that an entity would be required to sell the security before recovering its costs; or (iii) whether an entity does not expect to recover the security's entire amortized cost basis (even if it does not intend to sell).

The bank and associations perform a quarterly evaluation on a security-by-security basis considering all available information. If the bank or association intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss equals the entire difference between amortized cost and fair value of the security. When the bank or an association does not intend to sell securities in an unrealized loss position, other-than-temporary impairment is considered using various factors, including the length of time and the extent to which the fair value is less than cost; adverse conditions specifically related to the industry, geographic area and the condition of the underlying collateral; payment structure of the security; ratings by rating agencies; the creditworthiness of bond insurers; and volatility of the fair value changes. A bank or association uses estimated cash flows over the remaining lives of the underlying collateral to assess whether credit losses exist. In estimating cash flows, the bank and associations consider factors such as expectations of relevant market and economic data, including underlying loan level data for mortgage-backed and asset-backed securities and credit enhancements.

During 2012, the bank recognized credit losses on one other-than-temporarily impaired investment security totaling $1. Noncredit losses on these investments, totaling $1.5 million, are included as a charge against accumulated other comprehensive income at December 31, 2012. There were sales of two OTTI securities in September 2012 and November 2012, which had book values of $6.5 million and $4.2 million, respectively, realizing a gain of $14 and a loss of $89, respectively. The bank recognized other-than-temporary impairment losses on five mortgage-backed investments and one asset-backed investment during 2011. The credit portion of the impairment losses, totaling $2,087 for 2011, was recognized as a loss in earnings of $1,895 in the first quarter, and $192 in the second quarter. The non-credit-related impairment losses on the six investments, totaling $819, are included as a charge against other comprehensive income. In 2010, the bank recognized other-than-temporary impairment losses on four mortgage-backed securities and two asset-backed securities; the credit portion of the impairment losses, totaling $1,830, was recognized as a loss in earnings of $1,342 in the first quarter, $474 in the second quarter and $14 in the fourth quarter.

As the bank has no intent of selling the remaining securities deemed other-than-temporarily impaired and will not more likely than not be required to sell the securities before recovery, the credit loss portion of impairment was recognized through earnings for 2012. To measure the amount related to credit loss in the determination of other-than-temporary impairment, the bank utilizes an independent third party's services for cash flow modeling and projection of credit losses for specific non-agency residential mortgage-backed securities and subprime asset-backed securities. Significant inputs utilized in the methodology of the modeling include assumptions surrounding market data (interest rates and home prices) and the applicable securities' loan level data. Loan level data evaluated include loan status, coupon and resets, FICO scores, loan-to-value, geography, property type, etc. Loan level data is then combined with assumptions surrounding future behavior of home prices, prepayment rates, default rates and loss severity to arrive at cash flow projections for the underlying collateral. Default rate assumptions are generally estimated using historical loss and performance information to estimate future defaults. The loss severity assumptions are obtained from independent third parties or through research using available data on the underlying collateral type from sources including broker/dealers and rating agencies. The present value of these cash flow projections is then evaluated against the specific security's structure and credit enhancement to determine if the bond will absorb losses.

The following are the assumptions used at:

| **Assumptions Used** | **December 31, 2012** | |
|---|---|---|
| | **Mortgage-Backed Securities** | **Asset-Backed Securities** |
| **Default by range** | **0.8% - 7.1%** | **3.9% - 7.5%** |
| **Prepayments rate by range** | **5.0% - 20.7%** | **2.6% - 6.3%** |
| **Loss severity by range** | **12.5% - 56.1%** | **51.5% - 62.9%** |

| Assumptions Used | December 31, 2011 | |
|---|---|---|
| | Mortgage-Backed Securities | Asset-Backed Securities |
| Default by range | 2.7% - 12.0% | 8.3% - 13.5% |
| Prepayments rate by range | 3.9% - 14.4% | 1.5% - 2.5% |
| Loss severity by range | 31.2% - 52.9% | 58.3% - 64.2% |

The following table details the activity related to the credit loss component of the amortized cost of debt securities that have been written down for other-than-temporary impairment and the credit component of the loss that is recognized in earnings for the past three years:

| | **For the Twelve Months Ended December 31,** | | |
|---|---|---|---|
| | **2012** | 2011 | 2010 |
| Credit loss component, beginning of period | **$ 9,921** | $ 7,834 | $ 6,005 |
| Additions: | | | |
| Initial credit impairment | **—** | 241 | 300 |
| Subsequent credit impairment | **1** | 1,846 | 1,529 |
| Reductions: | | | |
| For securities sold | **(4,838)** | — | — |
| Credit loss component, end of period | **$ 5,084** | $ 9,921 | $ 7,834 |

## Note 4 — Loans and Allowance for Loan Losses

A summary of the district's loan types at December 31 follows:

| | **2012** | 2011 | 2010 |
|---|---|---|---|
| Real estate mortgage | **$ 10,261,127** | $ 10,165,704 | $ 10,487,949 |
| Production and intermediate term | **1,831,402** | 1,668,820 | 1,792,513 |
| Agribusiness | | | |
| Loans to cooperatives | **172,652** | 171,904 | 274,621 |
| Processing and marketing | **2,183,437** | 1,651,723 | 1,346,887 |
| Farm-related business | **215,141** | 235,023 | 172,501 |
| Communication | **320,590** | 279,696 | 264,634 |
| Energy | **1,296,812** | 902,666 | 881,227 |
| Water and waste disposal | **105,043** | 101,698 | 50,261 |
| Rural home | **203,171** | 198,630 | 209,708 |
| Mission-related | **192,030** | 151,685 | 64,096 |
| Agricultural export finance | **13,648** | 229 | 245 |
| Loans to other financial institutions | **67,106** | 82,901 | 75,737 |
| Lease receivables | **4,573** | 13,334 | 8,511 |
| Total | **$ 16,866,732** | $ 15,624,013 | $ 15,628,890 |

The FCA approved a program that allows the bank and its associations to purchase investments in debt instruments called "Rural America Bonds." This program is intended to help meet the growing financing needs of agriculture and rural America, improve the income and economic well-being of American farmers and ranchers, and enhance the economic vibrancy of rural areas that support agriculture. Loans related to this initiative are included in "mission-related" loans in the previous table.

The bank and associations purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information on loan participations, excluding syndications, at December 31, 2012.

| | Other Farm Credit Institutions (Outside of Texas District) | | Non–Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage | $ 93,297 | $ 168,278 | $ 65,105 | $ 23,431 | $ 158,402 | $ 191,709 |
| Production and intermediate term | 266,731 | 314,594 | 60,800 | 17,167 | 327,531 | 331,761 |
| Agribusiness | 1,141,972 | 18,246 | 131,891 | 1,438 | 1,273,863 | 19,684 |
| Communication | 317,036 | — | — | — | 317,036 | — |
| Energy | 1,301,732 | 3,454 | — | — | 1,301,732 | 3,454 |
| Water and waste disposal | 105,193 | — | — | — | 105,193 | — |
| Agricultural export finance | 13,450 | — | — | — | 13,450 | — |
| Lease receivables | 4,050 | — | 122 | — | 4,172 | — |
| Direct note receivable from district associations | — | 3,400,000 | — | — | — | 3,400,000 |
| Mission-related | 8,115 | — | 4,488 | — | 12,603 | — |
| **Total** | **$ 3,251,576** | **$ 3,904,572** | **$ 262,406** | **$ 42,036** | **$ 3,513,982** | **$ 3,946,608** |

At December 31, 2012, the bank had a total of $3.4 billion of direct notes sold to another System bank. The sales included participations of nine of its direct notes receivable from district associations. The purpose of these sales was to diversify the credit exposure of the bank by providing capital for liquidity and expansion of the capital markets loan participations portfolio.

During 2012, the district elected the fair value option for certain callable loans purchased on the secondary market at a significant premium. The fair value option provides an irrevocable option to elect fair value as an alternative measurement for selected financial assets. The fair value of loans held under the fair value option totaled $65,074 at December 31, 2012. Fair value is used for both the initial and subsequent measurement of the designated instrument, with the changes in fair value recognized in net income. On these instruments, the related contractual interest income and premium amortization are recorded as Interest Income in the Statements of Comprehensive Income. The remaining changes in fair value on these instruments are recorded as net gains (losses) in Noninterest Income on the Statements of Comprehensive Income. The fair value of these instruments is included in Level 2 in the fair value hierarchy for assets recorded at fair value on a recurring basis.

The following is a summary of the transactions on loans for which the fair value option has been elected for the 12 months ended December 31, 2012:

| | |
|---|---|
| Balance at January 1, 2012 | $ — |
| New transaction elected for fair value option | 94,502 |
| Maturities, repayments and calls by issuers | (30,032) |
| Net gains (losses) on financial instruments under fair value option | 2,810 |
| Change in premium | (2,206) |
| Balance at December 31, 2012 | $ 65,074 |

The district's concentration of credit risk in various agricultural commodities is shown in the following table at December 31 (*dollars in millions*):

| | **2012** | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| Commodity | **Amount** | **%** | Amount | % | Amount | % |
| Livestock | **$ 5,874** | **35%** | $ 5,806 | 37% | $ 5,975 | 38% |
| Crops | **2,172** | **13** | 1,958 | 13 | 2,027 | 13 |
| Timber | **1,493** | **9** | 1,508 | 10 | 1,636 | 11 |
| Cotton | **739** | **4** | 695 | 4 | 757 | 5 |
| Poultry | **545** | **3** | 528 | 3 | 522 | 3 |
| Dairy | **506** | **3** | 461 | 3 | 479 | 3 |
| Rural home | **203** | **1** | 199 | 1 | 210 | 1 |
| Other | **5,335** | **32** | 4,469 | 29 | 4,023 | 26 |
| Total | **$ 16,867** | **100%** | $ 15,624 | 100% | $ 15,629 | 100% |

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

In March 2010, the bank purchased loans which had experienced credit deterioration and other property owned from a district association. The purchase of the loan assets and other property owned by the bank was completed to ensure the district association remained a viable stand-alone institution. This purchase activity avoided a nonaccrual classification of a district association direct note receivable and protected the bank's charter in the state where the district association was located and has lending authorities. The loans, which had book balances at the association totaling $40,069, were purchased at fair value of $32,822. The fair value was derived by discounting the total estimated cash flows of $36,341 using appropriate yield curves, resulting in an accretable discount of $3,519. The bank recognized additional provisions for loan losses totaling $2,001 related to these loans during 2010, the effect of which reduces the resulting accretable discount, which will be accreted into interest income on a level-yield basis over the life of the loans. At December 31, 2010, the balance of these loans, net of the unaccreted discount of $1,814, was $21,911. At December 31, 2011, the balance of these loans, net of the unaccreted discounts of $439, was $12,949. Provision for loan losses on these loans in 2011 totaled $2.3 million. At December 31, 2012, the balance of these loans, including the fully accreted discount, totaled $4.4 million, and had a related allowance for loan losses totaling $1.0 million. The financial impact of the purchases to the bank was and continues to be negligible due to the size of the bank's balance sheet and its financial strength.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loans. Interest income recognized and cash payments received on nonaccrual impaired loans are applied in a similar manner as for nonaccrual loans, as described in Note 2, "Summary of Significant Accounting Policies."

The following table presents information concerning nonaccrual loans, accruing restructured loans and accruing loans 90 days or more past due. Restructured loans are loans whose terms have been modified and on which concessions have been granted because of borrower financial difficulties.

| | December 31, | | |
|---|---|---|---|
| | **2012** | 2011 | 2010 |
| Nonaccrual loans | | | |
| Current as to principal and interest | **$ 119,433** | $ 206,413 | $ 282,850 |
| Past due | **169,987** | 249,081 | 400,217 |
| Total nonaccrual loans | **289,420** | 455,494 | 683,067 |
| Accrual loans | | | |
| Restructured | **53,713** | 29,588 | 8,983 |
| 90 days or more past due | **1,159** | 6,293 | 2,396 |
| Total impaired accrual loans | **54,872** | 35,881 | 11,379 |
| Total impaired loans | **$ 344,292** | $ 491,375 | $ 694,446 |

There were $21.7 million in commitments to lend additional funds to borrowers whose loans were classified as nonaccrual or restructured at December 31, 2012.

Nonperforming assets (including related accrued interest) and related credit quality statistics are as follows:

| | December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| **Nonaccrual loans** | | | |
| Real estate mortgage | **$ 176,969** | $ 318,798 | $ 440,836 |
| Agribusiness | **84,431** | 57,205 | 129,220 |
| Production and intermediate term | **20,276** | 60,511 | 102,027 |
| Communication | **6,042** | 4,479 | 6,129 |
| Rural residential real estate | **1,639** | 1,828 | 2,019 |
| Lease receivables | **63** | 2,881 | 2,836 |
| Energy and water/waste disposal | — | 9,043 | — |
| Mission-related loans | — | 749 | — |
| Total nonaccrual loans | **289,420** | 455,494 | 683,067 |
| **Accruing restructured loans** | | | |
| Real estate mortgage | **34,072** | 19,321 | 1,491 |
| Production and intermediate term | **14,414** | 2,439 | 2,510 |
| Agribusiness | **5,193** | 7,796 | 4,982 |
| Rural residential real estate | **34** | 32 | — |
| Total accruing restructured loans | **53,713** | 29,588 | 8,983 |
| **Accruing loans 90 days or more past due** | | | |
| Real estate mortgage | **439** | 1,432 | 2,198 |
| Production and intermediate term | **86** | 2,177 | 93 |
| Agribusiness | **—** | 2,684 | — |
| Rural residential real estate | **126** | — | 105 |
| Mission-related loans | **508** | — | — |
| Total accruing loans 90 days or more past due | **1,159** | 6,293 | 2,396 |
| Total nonperforming loans | **344,292** | 491,375 | 694,446 |
| Other property owned, net | **98,211** | 87,956 | 78,124 |
| Total nonperforming assets | **$ 442,503** | $ 579,331 | $ 772,570 |

One credit quality indicator utilized by the bank and associations is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- Acceptable — assets expected to be fully collectible and represent the highest quality
- Other assets especially mentioned (OAEM) — 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 factors, conditions and values that make collection in full highly questionable, and
- Loss — assets are considered uncollectible

The following table presents loans and related accrued interest classified under the Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of December 31:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| **Real estate mortgage** | | | |
| Acceptable | **93.7%** | 91.5% | 89.2% |
| OAEM | **3.3** | 4.0 | 4.3 |
| Substandard/Doubtful | **3.0** | 4.5 | 6.5 |
| | **100.0%** | 100.0% | 100.0% |
| **Production and intermediate term** | | | |
| Acceptable | **92.9%** | 89.6% | 83.0% |
| OAEM | **3.6** | 5.2 | 8.1 |
| Substandard/Doubtful | **3.5** | 5.2 | 8.9 |
| | **100.0%** | 100.0% | 100.0% |
| **Agribusiness** | | | |
| Acceptable | **92.6%** | 87.1% | 76.4% |
| OAEM | **3.1** | 6.6 | 12.7 |
| Substandard/Doubtful | **4.3** | 6.3 | 10.9 |
| | **100.0%** | 100.0% | 100.0% |
| **Energy and water/waste disposal** | | | |
| Acceptable | **97.2%** | 94.8% | 99.0% |
| OAEM | **—** | 2.2 | — |
| Substandard/Doubtful | **2.8** | 3.0 | 1.0 |
| | **100.0%** | 100.0% | 100.0% |
| **Communication** | | | |
| Acceptable | **98.1%** | 98.4% | 97.7% |
| OAEM | **—** | — | — |
| Substandard/Doubtful | **1.9** | 1.6 | 2.3 |
| | **100.0%** | 100.0% | 100.0% |
| **Rural home** | | | |
| Acceptable | **95.7%** | 95.8% | 95.2% |
| OAEM | **1.8** | 1.9 | 2.7 |
| Substandard/Doubtful | **2.5** | 2.3 | 2.1 |
| | **100.0%** | 100.0% | 100.0% |
| **Agricultural export finance** | | | |
| Acceptable | **100.0%** | 100.0% | 100.0% |
| OAEM | **—** | — | — |
| Substandard/Doubtful | **—** | — | — |
| | **100.0%** | 100.0% | 100.0% |
| **Lease receivables** | | | |
| Acceptable | **98.7%** | 78.6% | 63.5% |
| OAEM | **—** | — | 2.6 |
| Substandard/Doubtful | **1.3** | 21.4 | 33.9 |
| | **100.0%** | 100.0% | 100.0% |
| **Loans to other financing institutions** | | | |
| Acceptable | **100.0%** | 100.0% | 100.0% |
| OAEM | **—** | — | — |
| Substandard/Doubtful | **—** | — | — |
| | **100.0%** | 100.0% | 100.0% |
| **Mission-related** | | | |
| Acceptable | **96.7%** | 95.1% | 89.5% |
| OAEM | **—** | 0.4 | 0.6 |
| Substandard/Doubtful | **3.3%** | 4.5 | 9.9 |
| | **100.0%** | 100.0% | 100.0% |
| **Total loans** | | | |
| Acceptable | **93.9%** | 91.2% | 87.9% |
| OAEM | **2.9** | 4.2 | 5.3 |
| Substandard/Doubtful | **3.2** | 4.6 | 6.8 |
| | **100.0%** | 100.0% | 100.0% |

The following table provides an age analysis of past due loans (including accrued interest) as of December 31, 2012:

| | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total Loans | Recorded Investment Greater Than 90 Days Past Due and Accruing |
|---|---|---|---|---|---|---|
| **Real estate mortgage** | **$ 53,789** | **$ 77,918** | **$ 131,707** | **$ 10,220,785** | **$ 10,352,492** | **$ 439** |
| **Production and intermediate term** | **6,173** | **14,123** | **20,296** | **1,827,259** | **1,847,555** | **86** |
| **Agribusiness** | **10,297** | **45,737** | **56,034** | **2,524,671** | **2,580,705** | **—** |
| **Energy and water/waste disposal** | **—** | **—** | **—** | **1,406,516** | **1,406,516** | **—** |
| **Communication** | **—** | **—** | **—** | **320,927** | **320,927** | **—** |
| **Rural residential real estate** | **1,929** | **251** | **2,180** | **202,001** | **204,181** | **126** |
| **Agricultural export finance** | **—** | **—** | **—** | **13,676** | **13,676** | **—** |
| **Lease receivables** | **—** | **—** | **—** | **4,689** | **4,689** | **—** |
| **Loans to OFIs** | **—** | **—** | **—** | **67,196** | **67,196** | **—** |
| **Mission-related** | **1,020** | **508** | **1,528** | **192,231** | **193,759** | **508** |
| **Total** | **$ 73,208** | **$ 138,537** | **$ 211,745** | **$ 16,779,951** | **$ 16,991,696** | **$ 1,159** |

The following table provides an age analysis of past due loans (including accrued interest) as of December 31, 2011:

| | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total Loans | Recorded Investment Greater Than 90 Days Past Due and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 53,518 | $ 171,907 | $ 225,425 | $ 10,040,235 | $ 10,265,660 | $ 1,432 |
| Production and intermediate term | 8,939 | 27,704 | 36,643 | 1,647,985 | 1,684,628 | 2,177 |
| Agribusiness | 2,900 | 26,970 | 29,870 | 2,037,299 | 2,067,169 | 2,684 |
| Energy and water/waste disposal | — | 9,044 | 9,044 | 1,001,752 | 1,010,796 | — |
| Communication | — | — | — | 280,176 | 280,176 | — |
| Rural residential real estate | 2,415 | 574 | 2,989 | 196,735 | 199,724 | — |
| Agricultural export finance | — | — | — | 230 | 230 | — |
| Lease receivables | — | 2,759 | 2,759 | 10,707 | 13,466 | — |
| Loans to OFIs | — | — | — | 83,023 | 83,023 | — |
| Mission-related | 3,095 | — | 3,095 | 149,710 | 152,805 | — |
| Total | $ 70,867 | $ 238,958 | $ 309,825 | $ 15,447,852 | $ 15,757,677 | $ 6,293 |

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges or acquisition costs and may also reflect a previous direct write-down of the investment.

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of December 31, 2012, the total recorded investment of troubled debt restructured loans was $86.3 million, including $32.6 million classified as nonaccrual and $53.7 million classified as accrual, with specific allowance for loan losses of $3.9 million. As of December 31, 2012, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were $80.

The following table presents additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the years ended December 31, 2012, and December 31, 2011. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The postmodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

December 31, 2012:

| | Premodification Outstanding Recorded Investment* | Postmodification Outstanding Recorded Investment* |
|---|---|---|
| **Troubled debt restructurings:** | | |
| **Real estate mortgage** | **$ 24,536** | **$ 23,469** |
| **Production and intermediate term** | **4,765** | **4,011** |
| **Agribusiness** | **692** | **681** |
| **Total** | **$ 29,993** | **$ 28,161** |

December 31, 2011:

| | Premodification Outstanding Recorded Investment* | Postmodification Outstanding Recorded Investment* |
|---|---|---|
| Troubled debt restructurings: | | |
| Real estate mortgage | $ 26,365 | $ 24,886 |
| Production and intermediate term | 17,124 | 16,147 |
| Agribusiness | 1,863 | 1,781 |
| Rural residential real estate | 51 | 39 |
| Total | $ 45,403 | $ 42,853 |

Note: Premodification represents the recorded investment prior to restructuring, and postmodification represents the recorded investment following the restructuring. The recorded investment is the face amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges or acquisition costs and may also reflect a previous direct write-down of the investment.

A payment default is defined as a payment that is 30 days past due after the date the loan was restructured. The payment defaults on troubled debt restructured loans in 2012 were payment defaults on two borrowers at a district association. The following table presents information regarding troubled debt restructurings that occurred within the previous 12 months and for which there was a payment default during the period:

| | Recorded Investment at December 31, 2012 | Recorded Investment at December 31, 2011 |
|---|---|---|
| Troubled debt restructurings that subsequently defaulted: | | |
| Real estate mortgage | $ 8,070 | $ 1,651 |
| Production and intermediate term | 2,054 | — |
| Total | $ 10,124 | $ 1,651 |

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table:

| | Loans Designated as TDRs (Accrual and Nonaccrual) | | TDRs in Nonaccrual Status | |
|---|---|---|---|---|
| | December 31, 2012 | December 31, 2011 | December 31, 2012 | December 31, 2011 |
| Real estate mortgage | $ 57,642 | $ 36,645 | $ 23,570 | $ 17,324 |
| Production and intermediate term | 18,430 | 19,038 | 4,016 | 16,599 |
| Agribusiness | 10,160 | 12,216 | 4,967 | 4,420 |
| Rural residential real estate | 34 | 32 | — | — |
| Total | $ 86,266 | $ 67,931 | $ 32,553 | $ 38,343 |

Additional impaired loan information at December 31, 2012, is as follows:

| | Recorded Investment at 12/31/2012 | Unpaid Principal Balance* | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| **Impaired loans with a related allowance for credit losses** | | | | | |
| Real estate mortgage | $ 53,674 | $ 66,770 | $ 13,062 | $ 77,864 | $ 382 |
| Production and intermediate term | 10,482 | 16,657 | 3,963 | 16,487 | 61 |
| Processing and marketing | 58,367 | 59,241 | 27,055 | 41,496 | 644 |
| Farm-related business | 8,646 | 8,755 | 3,064 | 12,639 | 40 |
| Energy and water/waste disposal | — | — | — | 2,223 | — |
| Communication | 5,369 | 5,369 | 2,824 | 4,259 | — |
| Rural residential real estate | 562 | 567 | 93 | 440 | 2 |
| Lease receivables | — | — | — | 686 | — |
| Mission-related | — | — | — | 77 | — |
| Total | $ 137,100 | $ 157,359 | $ 50,061 | $ 156,171 | $ 1,129 |
| **Impaired loans with no related allowance for credit losses** | | | | | |
| Real estate mortgage | $ 157,806 | $ 161,842 | $ — | $ 205,712 | $ 5,460 |
| Production and intermediate term | 24,294 | 42,037 | — | 31,508 | 1,330 |
| Loans to cooperatives | — | — | — | — | — |
| Processing and marketing | 22,276 | 51,148 | — | 23,875 | 2,583 |
| Farm-related business | 335 | 4,546 | — | 2,766 | 578 |
| Energy and water/waste disposal | — | 22,796 | — | 1,423 | — |
| Communication | 673 | 673 | — | 1,881 | 24 |
| Rural residential real estate | 1,237 | 1,360 | — | 1,276 | 17 |
| Lease receivables | 63 | 63 | — | 71 | — |
| Mission-related | 508 | 4,296 | — | 1,834 | 97 |
| Total | $ 207,192 | $ 288,761 | $ — | $ 270,346 | $ 10,089 |
| **Total impaired loans** | | | | | |
| Real estate mortgage | $ 211,480 | $ 228,612 | $ 13,062 | $ 283,576 | $ 5,842 |
| Production and intermediate term | 34,776 | 58,694 | 3,963 | 47,995 | 1,391 |
| Loans to cooperatives | — | — | — | — | — |
| Processing and marketing | 80,643 | 110,389 | 27,055 | 65,371 | 3,227 |
| Farm-related business | 8,981 | 13,301 | 3,064 | 15,405 | 618 |
| Energy and water/waste disposal | — | 22,796 | — | 3,646 | — |
| Communication | 6,042 | 6,042 | 2,824 | 6,140 | 24 |
| Rural residential real estate | 1,799 | 1,927 | 93 | 1,716 | 19 |
| Lease receivables | 63 | 63 | — | 757 | — |
| Mission-related | 508 | 4,296 | — | 1,911 | 97 |
| Total | $ 344,292 | $ 446,120 | $ 50,061 | $ 426,517 | $ 11,218 |

*Unpaid principal balance represents the contractual obligations of the loans.

Additional impaired loan information at December 31, 2011, is as follows:

| | Recorded Investment at 12/31/2011 | Unpaid Principal Balance* | Related Allowance | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| **Impaired loans with a related allowance for credit losses** | | | | | |
| Real estate mortgage | $ 118,349 | $ 150,418 | $ 24,586 | $ 112,857 | $ 710 |
| Production and intermediate term | 23,467 | 34,507 | 12,407 | 25,907 | 87 |
| Processing and marketing | 15,675 | 16,176 | 7,828 | 26,296 | 313 |
| Farm-related business | 10,953 | 11,449 | 2,655 | 11,103 | 109 |
| Energy and water/waste disposal | 9,043 | 9,043 | 850 | 8,511 | — |
| Communication | 3,770 | 3,770 | 2,989 | 4,119 | — |
| Rural residential real estate | 477 | 492 | 119 | 313 | 4 |
| Lease receivables | 2,759 | 2,759 | 27 | 2,800 | — |
| Mission-related | 94 | 664 | 94 | 2 | 2 |
| Total | $ 184,587 | $ 229,278 | $ 51,555 | $ 191,908 | $ 1,225 |
| **Impaired loans with no related allowance for credit losses** | | | | | |
| Real estate mortgage | $ 221,202 | $ 237,867 | $ — | $ 395,248 | $ 10,484 |
| Production and intermediate term | 41,660 | 64,060 | — | 40,527 | 1,351 |
| Loans to cooperatives | — | — | — | — | 9 |
| Processing and marketing | 32,299 | 59,019 | — | 32,470 | 577 |
| Farm-related business | 8,759 | 19,116 | — | 10,689 | 159 |
| Energy and water/waste disposal | — | 13,753 | — | 1 | 4 |
| Communication | 709 | 709 | — | 1,433 | — |
| Rural residential real estate | 1,382 | 1,515 | — | 962 | 15 |
| Lease receivables | 122 | 122 | — | 47 | — |
| Mission-related | 655 | 3,809 | — | 2,537 | 3 |
| Total | $ 306,788 | $ 399,970 | $ — | $ 483,914 | $ 12,602 |
| **Total impaired loans** | | | | | |
| Real estate mortgage | $ 339,551 | $ 388,285 | $ 24,586 | $ 508,105 | $ 11,194 |
| Production and intermediate term | 65,127 | 98,567 | 12,407 | 66,434 | 1,438 |
| Loans to cooperatives | — | — | — | — | 9 |
| Processing and marketing | 47,974 | 75,195 | 7,828 | 58,766 | 890 |
| Farm-related business | 19,712 | 30,565 | 2,655 | 21,792 | 268 |
| Energy and water/waste disposal | 9,043 | 22,796 | 850 | 8,512 | 4 |
| Communication | 4,479 | 4,479 | 2,989 | 5,552 | — |
| Rural residential real estate | 1,859 | 2,007 | 119 | 1,275 | 19 |
| Lease receivables | 2,881 | 2,881 | 27 | 2,847 | — |
| Mission-related | 749 | 4,473 | 94 | 2,539 | 5 |
| Total | $ 491,375 | $ 629,248 | $ 51,555 | $ 675,822 | $ 13,827 |

*Unpaid principal balance represents the contractual obligations of the loans.

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans were as follows at December 31:

| | **2012** | 2011 | 2010 |
|---|---|---|---|
| Interest income which would have been recognized under the original loan terms | **$ 22,009** | $ 37,194 | $ 45,935 |
| Less: Interest income recognized | **11,218** | 13,828 | 7,570 |
| Foregone interest income | **$ 10,791** | $ 23,366 | $ 38,365 |

A summary of changes in the allowance for loan losses and period end recorded investment (including accrued interest) in loans follows:

| | Real Estate Mortgage | Production and Intermediate Term | Agribusiness | Communications | Energy and Water/Waste Disposal | Rural Residential Real Estate | Agricultural Export Finance | Lease Receivables | Loans to OFIs | Mission-Related | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for Loan Losses:** | | | | | | | | | | | |
| Balance at December 31, 2011 | $ 62,514 | $ 21,748 | $ 23,241 | $ 3,374 | $ 2,624 | $ 436 | $ — | $ 58 | $ — | $ 122 | $ 114,117 |
| Charge-offs | (22,745) | (8,309) | (2,795) | — | (8,988) | (191) | — | — | — | (92) | (43,120) |
| Recoveries | 3,645 | 2,698 | 852 | — | — | 14 | — | — | — | 1 | 7,210 |
| Provision for loan losses | (1,055) | 4,827 | 15,456 | (772) | 15,056 | 139 | 3 | (28) | — | 5 | 33,631 |
| Other* | 509 | (25) | (1) | — | (5,479) | — | — | — | — | — | (4,996) |
| Balance at December 31, 2012 | $ 42,868 | $ 20,939 | $ 36,753 | $ 2,602 | $ 3,213 | $ 398 | $ 3 | $ 30 | $ — | $ 36 | $ 106,842 |
| Ending Balance: individually evaluated for impairment | 11,828 | 3,732 | 32,129 | 2,286 | — | 110 | — | — | — | — | 50,085 |
| Ending Balance: collectively evaluated for impairment | 30,227 | 16,963 | 4,624 | 316 | 3,213 | 288 | 3 | 30 | — | 36 | 55,700 |
| Ending Balance: loans acquired with deteriorated credit quality | 813 | 244 | — | — | — | — | — | — | — | — | 1,057 |
| **Recorded Investments in Loans Outstanding:** | | | | | | | | | | | |
| Balance at December 31, 2012 | $10,352,492 | $ 1,847,555 | $ 2,580,705 | $ 320,927 | $ 1,406,516 | $ 204,181 | $ 13,676 | $ 4,689 | $ 67,196 | $ 193,759 | $ 16,991,696 |
| Ending Balance: loans individually evaluated for impairment | $ 215,540 | $ 33,311 | $ 82,075 | $ 7,425 | $ 943 | $ 2,274 | $ — | $ 63 | $ — | $ — | $ 341,631 |
| Ending Balance: loans collectively evaluated for impairment | $10,133,958 | $ 1,812,761 | $ 2,498,630 | $ 313,502 | $ 1,405,573 | $ 201,907 | $ 13,676 | $ 4,626 | $ 67,196 | $ 193,759 | $ 16,645,588 |
| Ending Balance: loans acquired with deteriorated credit quality | $ 2,994 | $ 1,483 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 4,477 |

*Reserve for losses on standby letters of credit and unfunded commitments recorded in other liabilities

| | Real Estate Mortgage | Production and Intermediate Term | Agribusiness | Communications | Energy and Water/Waste Disposal | Rural Residential Real Estate | Agricultural Export Finance | Lease Receivables | Loans to OFIs | Mission-Related | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for Credit Losses** | | | | | | | | | | | |
| Balance at December 31, 2010 | $ 95,914 | $ 31,290 | $ 28,656 | $ 3,925 | $ 2,101 | $ 995 | $ 1 | $ 45 | $ — | $ 218 | $ 163,145 |
| Charge-offs | (56,826) | (12,769) | (25,498) | — | (3,519) | (264) | — | — | — | (3,709) | (102,585) |
| Recoveries | 1,063 | 3,238 | 4,214 | — | 429 | 43 | — | — | — | — | 8,987 |
| Provision for loan losses | 22,659 | 72 | 15,955 | (550) | 3,625 | (338) | (1) | 13 | — | 3,613 | 45,048 |
| Other | (296) | (83) | (86) | (1) | (12) | — | — | — | — | — | (478) |
| Balance at December 31, 2011 | $ 62,514 | $ 21,748 | $ 23,241 | $ 3,374 | $ 2,624 | $ 436 | $ — | $ 58 | $ — | $ 122 | $ 114,117 |
| Ending Balance: individually evaluated for impairment | $ 26,268 | $ 12,408 | $ 14,243 | $ 2,989 | $ 850 | $ 69 | $ — | $ 27 | $ — | $ 94 | $ 56,948 |
| Ending Balance: collectively evaluated for impairment | $ 35,019 | $ 9,303 | $ 8,998 | $ 385 | $ 1,774 | $ 367 | $ — | $ 31 | $ — | $ 28 | $ 55,905 |
| Ending Balance: loans acquired with deteriorated credit quality | $ 1,227 | $ 37 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 1,264 |
| **Recorded Investments in Loans Outstanding** | | | | | | | | | | | |
| Balance at December 31, 2011 | $ 10,265,660 | $ 1,684,628 | $ 2,067,169 | $ 280,176 | $ 1,010,796 | $ 199,724 | $ 230 | $ 13,466 | $ 83,023 | $ 152,805 | $ 15,757,677 |
| Ending Balance: loans individually evaluated for impairment | $ 382,732 | $ 76,114 | $ 94,844 | $ 4,411 | $ 11,671 | $ 2,380 | $ — | $ 2,887 | $ — | $ 707 | $ 575,746 |
| Ending Balance: loans collectively evaluated for impairment | $ 9,871,340 | $ 1,600,624 | $ 1,972,325 | $ 275,765 | $ 999,125 | $ 197,344 | $ 230 | $ 10,579 | $ 83,023 | $ 152,098 | $ 15,162,453 |
| Ending Balance: loans acquired with deteriorated credit quality | $ 11,588 | $ 7,890 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 19,478 |

| | Real Estate Mortgage | Production and Intermediate Term | Agribusiness | Communications | Energy and Water/Waste Disposal | Rural Residential Real Estate | International | Lease Receivables | Loans to OFIs | Mission-Related | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for Credit Losses:** | | | | | | | | | | | |
| Balance at December 31, 2009 | $ 97,132 | $ 14,759 | $ 23,054 | $ 6,533 | $ 3,134 | $ 119 | $ — | $ — | $ — | $ — | $ 144,731 |
| Charge-offs | 66,492 | 16,722 | 25,743 | 2,272 | 17,745 | 127 | — | — | — | — | 129,101 |
| Recoveries | 4,188 | 2,967 | 1,501 | 417 | 1,025 | 1 | — | — | — | — | 10,099 |
| Provision for loan losses | 65,127 | 30,286 | 29,844 | (753) | 15,687 | 1,002 | 1 | 45 | — | 218 | 141,457 |
| Adjustment due to merger | 4,418 | — | — | — | — | — | — | — | — | — | 4,418 |
| Other | 377 | — | — | — | — | — | — | — | — | — | 377 |
| Balance at December 31, 2010 | $ 95,914 | $ 31,290 | $ 28,656 | $ 3,925 | $ 2,101 | $ 995 | $ 1 | $ 45 | $ — | $ 218 | $ 163,145 |
| Ending Balance: individually evaluated for impairment | $ 52,058 | $ 24,509 | $ 23,451 | $ 3,236 | $ — | $ 137 | $ — | $ 10 | $ — | $ — | $ 103,401 |
| Ending Balance: collectively evaluated for impairment | $ 42,323 | $ 6,666 | $ 5,205 | $ 689 | $ 2,101 | $ 858 | $ 1 | $ 35 | $ — | $ — | $ 57,878 |
| Ending Balance: loans acquired with deteriorated credit quality | $ 1,751 | $ 115 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 1,866 |
| **Recorded Investments in Loans Outstanding** | | | | | | | | | | | |
| Balance at December 31, 2010 | $10,597,700 | $ 1,810,574 | $ 1,802,018 | $ 265,495 | $ 937,912 | $ 210,974 | $ 245 | $ 8,622 | $ 75,892 | $ 64,501 | $15,773,933 |
| Ending Balance: loans individually evaluated for impairment | $ 431,343 | $ 102,896 | $ 134,202 | $ 6,129 | $ — | $ 2,124 | $ — | $ 2,836 | $ — | $ — | $ 679,530 |
| Ending Balance: loans collectively evaluated for impairment | $10,147,553 | $ 1,702,004 | $ 1,667,816 | $ 259,366 | $ 937,912 | $ 208,850 | $ 245 | $ 5,786 | $ 75,892 | $ 64,501 | $15,069,925 |
| Ending Balance: loans acquired with deteriorated credit quality | $ 18,804 | $ 5,674 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 24,478 |

## Note 5 — Premises and Equipment

Premises and equipment comprised the following at:

| | December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Land | **$ 13,815** | $ 12,630 | $ 12,071 |
| Buildings and improvements | **46,746** | 43,899 | 41,940 |
| Furniture and equipment | **55,712** | 46,715 | 47,506 |
| | **116,273** | 103,244 | 101,517 |
| Accumulated depreciation | **(44,564)** | (41,424) | (38,978) |
| Total | **$ 71,709** | $ 61,820 | $ 62,539 |

Included in the district's furniture and equipment at December 31, 2012, is $8.6 million in capitalized costs related to the bank's development of a lending system. The system, designed for participation loans and direct notes, was implemented effective July 2010. Depreciation on that system began upon implementation. Also included in furniture and equipment is $5.8 million related to the overall enterprise information technologies roadmap which outlines the needs and activities designed to enhance the accounting and informational capabilities related to district association lending and financial information as well as the bank's capital markets loan portfolios. Depreciation on the delivery systems also began upon implementation in 2012.

On September 30, 2003, the bank entered into a lease for approximately 102,500 square feet of office space to house its headquarters facility. The lease was effective September 30, 2003, and its term was from September 1, 2003, to August 31, 2013. On November 16, 2010, the bank entered into a lease amendment which extended the term of the lease to August 31, 2024. In addition, the lease amendment included expansion of the leased space to approximately 111,500 square feet of office space. Under the terms of the lease amendment, the bank will pay annual base rental ranging from $18 per square foot in the first year to $26 per square foot in the last year. Annual lease expenses for the facility, including certain operating expenses passed through from the landlord, were $3.4 million, $3.4 million and $2.6 million for 2012, 2011 and 2010, respectively.

Following is a schedule of the minimum lease payments for the bank and district associations on building and computer equipment leases:

| | Minimum Lease Payments |
|---|---|
| 2013 | $ 3,861 |
| 2014 | 2,837 |
| 2015 | 3,163 |
| 2016 | 3,605 |
| 2017 | 3,291 |
| Total minimum lease payments | $ 16,757 |

## Note 6 — Other Property Owned

Other property owned (OPO), consisting of real and personal property acquired through foreclosure or deed in lieu of foreclosure, is recorded at fair value, based on appraisal, less estimated selling costs upon acquisition. OPO totaled $98,211, $87,956 and $78,124 at December 31, 2012, 2011 and 2010, respectively, after allowances on OPO totaling $10,320, $6,608 and $13,978 for those respective years. The $98,211 balance of OPO at December 31, 2012, consisted of $30,739 held by the bank and $67,472 held by district associations.

Net gain (loss) on OPO consists of the following for the years ended:

| | December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Gain (loss) on sale, net | **$ 2,327** | $ (244) | $ 1,292 |
| Carrying value adjustments | **(14,615)** | (15,521) | (13,167) |
| Operating expense, net | **(1,562)** | (2,975) | (3,277) |
| Net loss on other property owned | **$ (13,850)** | $ (18,740) | $ (15,152) |

## Note 7 — Other Assets and Other Liabilities

Other assets comprised the following at December 31:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Investment in another System bank | **$ 59,879** | $ 47,439 | $ 34,979 |
| Other accounts receivable | **19,847** | 21,626 | 21,914 |
| Unamortized debt issue costs | **11,531** | 11,123 | 9,242 |
| Fair value of derivatives | **756** | 1,726 | 6,512 |
| Deferred tax assets, net | **4,514** | 4,915 | 5,225 |
| Other, net | **15,343** | 13,089 | 11,959 |
| Total | **$ 111,870** | $ 99,918 | $ 89,831 |

Other liabilities comprised the following at December 31:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Pension liability | **$ 132,126** | $ 115,054 | $ 81,415 |
| Accounts payable | **52,248** | 61,508 | 43,872 |
| Postretirement benefits | **61,867** | 52,717 | 49,442 |
| Advance conditional payments | **29,558** | 30,420 | 19,314 |
| Bank draft payable | **25,792** | 18,481 | 24,001 |
| FCSIC premium payable | **5,993** | 6,807 | 6,049 |
| Deferred tax liabilities | **872** | 775 | 161 |
| Income taxes payable | **404** | 302 | 392 |
| Fair value of derivatives | **—** | 486 | 5 |
| Other, net | **12,409** | 13,039 | 897 |
| Total | **$ 321,269** | $ 299,589 | $ 222,548 |

## Note 8 — Bonds and Notes

### Systemwide Debt Securities and Notes Payable:

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide debt securities issued by the banks through the Funding Corporation. Certain conditions must be met before the bank can participate in the issuance of Systemwide debt securities. The bank is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable as a condition for participation in the issuance of Systemwide debt. This requirement does not provide holders of Systemwide debt securities, or bank and other bonds, with a security interest in any assets of the banks. The System banks and the Funding Corporation have entered into the amended and restated Market Access Agreement (MAA), which establishes criteria and procedures for the banks to provide certain information to the Funding Corporation and, under certain circumstances, for restricting or prohibiting an individual bank's participation in Systemwide debt issuances, thereby reducing other System banks' exposure to statutory joint and several liability. At December 31, 2012, the bank was, and currently remains, in compliance with the conditions and requirements of the MAA. In general, each bank determines its participation in each issue of Systemwide debt securities based on its funding and operating requirements, subject to the availability of eligible assets as described above and subject to Funding Corporation determinations and FCA approval. At December 31, 2012, the bank had such specified eligible assets totaling $15.2 billion, and obligations and accrued interest payable totaling $13.9 billion, resulting in excess eligible assets of $1.3 billion.

Each issuance of Systemwide debt securities ranks equally, in accordance with the FCA regulations, with 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 district's participation in Systemwide debt securities and notes payable to other System bank at December 31, 2012 follows (*dollars in millions*):

| | Systemwide Bonds | | Systemwide Discount Notes | | Notes Payable to Other System Bank | | Total | |
|---|---|---|---|---|---|---|---|---|
| Year of Maturity | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate |
| 2013 | $ 3,434.2 | 0.53% | $ 1,429.4 | 0.17% | $ 3,400.0 | 0.74% | $ 8,263.6 | 0.55% |
| 2014 | 2,597.0 | 0.66 | — | — | — | — | 2,597.0 | 0.66 |
| 2015 | 1,657.2 | 0.86 | — | — | — | — | 1,657.2 | 0.86 |
| 2016 | 1,344.5 | 1.11 | — | — | — | — | 1,344.5 | 1.11 |
| 2017 | 1,444.7 | 1.50 | — | — | — | — | 1,444.7 | 1.50 |
| Subsequent years | 2,003.9 | 2.41 | — | — | — | — | 2,003.9 | 2.41 |
| Total | $12,481.5 | 1.08% | $ 1,429.4 | 0.17% | $ 3,400.0 | 0.74% | $17,310.9 | 0.94% |

In the preceding table, the weighted average effective rate reflects the effects of interest rate swaps used to manage the interest rate risk on the bonds and notes issued by the bank. The bank's interest rate swap strategy is discussed more fully in Note 2, "Summary of Significant Accounting Policies," and Note 16, "Derivative Instruments and Hedging Activity."

Discount notes are issued with maturities ranging from one to 365 days. The average maturity of discount notes at December 31, 2012, was 93 days.

The bank's Systemwide debt includes callable debt, consisting of the following at December 31, 2012:

| Year of Maturity | Amount | Range of First Call Dates |
|---|---|---|
| 2013 | $ 420,000 | 1/1/2013 – 1/26/2013 |
| 2014 | 1,450,000 | 1/1/2013 – 4/23/2013 |
| 2015 | 1,075,000 | 1/3/2013 – 3/18/2013 |
| 2016 | 1,015,000 | 1/2/2013 – 7/11/2013 |
| 2017 | 765,000 | 1/1/2013 – 7/10/2013 |
| Subsequent years | 989,000 | 1/1/2013 – 6/22/2015 |
| Total | $ 5,714,000 | 1/1/2013 – 6/22/2015 |

Callable debt may be called on the first call date and, generally, every day thereafter with seven business days' notice. Expenses associated with the exercise of call options on debt issuances are included in interest expense.

As described in Note 1, "Organization and Operations," the Insurance Fund is available to ensure the timely payment of principal and interest on bank bonds and Systemwide debt securities (insured debt) of insured System banks to the extent that net assets are available in the Insurance Fund. All other liabilities in the combined financial statements are uninsured. At December 31, 2012, the assets of the Insurance Fund aggregated $3.3 billion; however, due to the other authorized uses of the Insurance Fund, there is no assurance that the amounts in the Insurance Fund will be sufficient to fund the timely payment of principal and interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon.

**Subordinated Debt:**

In September 2008, the bank issued $50.0 million of 8.406 percent unsecured subordinated notes due in 2018, generating proceeds of $49.4 million. The proceeds were used to increase regulatory permanent capital and total surplus pursuant to Farm Credit Administration regulations and for general corporate purposes. Due to regulatory limitations on third-party capital (including preferred stock and subordinated debt) instituted upon the issuance of the bank's Class B Noncumulative Subordinated Perpetual Preferred Stock, subordinated debt is no longer qualified for inclusion in permanent capital or total surplus. This debt is unsecured and subordinate to all other categories of creditors, including general creditors, and senior to all classes of shareholders. Interest is payable semi-annually on March 15 and September 15. 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. The subordinated debt is not considered Systemwide debt and is not guaranteed by the Farm Credit System or any banks in the System. Payments on the subordinated notes are not insured by the Farm Credit Insurance Fund. In accordance with FCA's approval of the bank's subordinated debt offering, the bank's minimum net collateral ratio for all regulatory purposes while any subordinated debt is outstanding will be 104 percent, instead of the 103 percent stated by regulation.

**Other:**

At December 31, 2012, the bank had a total of $3.4 billion of direct notes sold to another System bank. The sales included participations of nine of its direct notes receivable from district associations. The purpose of these sales was to diversify the credit exposure of the bank by providing capital for liquidity and expansion of the capital markets loan participations portfolio. At the district level the sold portion is reflected as notes payable to another System bank.

The bank maintains a $150.0 million commercial bank committed line of credit to support possible general short-term credit needs. The current line of credit will mature on June 28, 2013, at which time it is expected to be renewed.

## Note 9 — Members' Equity

Descriptions of the bank's and associations' capitalization requirements, regulatory capitalization requirements, and restrictions and equities are provided below.

**A. Capitalization Requirements:**

As a condition of borrowing, in accordance with the Farm Credit Act, each borrower is required to invest in common stock (in the case of mortgage or agricultural loans) or participation certificates (in the case of rural residence or farm-related business loans) of their respective association. Capitalization bylaws of the associations establish minimum and maximum stock purchase requirements for borrowers. The initial investment requirement of the associations ranges from the statutory minimum of $1,000 to 2 percent of the loan amount, and in some cases, $1,000 to 2 percent per customer. The capitalization bylaws also limit the capital contributions that an institution can require from its borrowers to 10 percent of defined borrowings for associations. If necessary, each association's board of directors may modify, within the range defined in their bylaws, the capitalization requirements to meet the association's capital needs.

A borrower obtaining a mortgage or agricultural loan purchases voting common stock which entitles the holder to a single vote, regardless of the number of shares held in the respective association. Within two years after a borrower's loan is repaid in full, any voting common stock held by the borrower will be converted to nonvoting common stock. A borrower obtaining a rural residence or farm-related business loan purchases participation certificates which provide no voting rights to their owner.

Each class of nonvoting stock must approve, as a class, the adoption of future revisions of capitalization bylaws if the class of stock is affected by a change in the preference provided for in the proposed capitalization bylaws.

Capitalization bylaws for each association provide for the amount of voting common stock or participation certificates that are required to be purchased by a borrower as a percentage of the loan obtained. The borrower acquires ownership of the common stock or participation certificates at the time the loan is made, but usually does not make a cash investment; the aggregate par value is added to the principal amount of the related loan obligation. The bank and the associations have a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

### B. Regulatory Capitalization Requirements and Restrictions:

FCA's capital adequacy regulations require the bank and associations to achieve and maintain, at minimum, permanent capital of 7 percent of risk-adjusted assets and off-balance-sheet commitments. The Farm Credit Act has defined permanent capital to include all capital except stock and other equities that may be retired upon the repayment of the holder's loan or otherwise at the option of the holder, or is otherwise not at risk. Risk-adjusted assets have been defined by regulations as the balance sheet assets and off-balance-sheet commitments adjusted by various percentages ranging from 0 to 100 percent, depending on the level of risk inherent in the various types of assets. The bank and associations are prohibited from reducing permanent capital by retiring stock or by making certain other distributions to stockholders unless the minimum permanent capital standard is met.

The bank's permanent capital ratio at December 31, 2012, was 18.64 percent and exceeded FCA standards. All associations currently meet the minimum capital standard established by FCA regulations. Except as noted below, all associations are currently able to retire stock or distribute earnings in accordance with the Farm Credit Act and FCA regulatory restrictions. Three associations are currently operating under written supervisory agreements with FCA which allow them to make patronage distributions only with the prior approval of FCA. One association is operating under a supervisory letter that requires prior FCA approval for patronage distributions if the association's permanent capital ratio falls below 16 percent, which level the association currently exceeds. Management knows of no reasons why the bank and associations would be prohibited from retiring stock.

The following table sets forth the ranges of capital standards for the district at December 31, 2012:

| | Permanent Capital Ratio Ranges % | Core Surplus Ratio Ranges % | Total Surplus Ratio Ranges % |
|---|---|---|---|
| Bank | 18.64 | 9.92 | 15.92 |
| FLCA | 20.37 | 19.94 | 19.94 |
| ACAs | 12.19 – 20.68 | 12.01 – 20.23 | 12.01 – 20.23 |
| Regulatory minimum standard | 7.00 | 3.50 | 7.00 |

The bank is required by FCA regulations to achieve and maintain net collateral of 103 percent of total liabilities. However, the issuance of subordinated debt resulted in FCA requiring the net collateral to be 104 percent of total liabilities while any subordinated debt is outstanding. Net collateral consists of loans, real or personal property acquired in connection with loans, marketable investments, and cash and cash equivalents.

At December 31, 2012, the bank's net collateral ratio was 107.94 percent.

### C. Description of Associations' Equities:

The following is a summary of the associations' stock and participation certificates outstanding:

| Stock and Participation Certificates | Par Value | Number of Shares at December 31, 2012 | 2011 | 2010 |
|---|---|---|---|---|
| Stock | | | | |
| Common – voting (eligible for dividends, convertible) | $ 5.00 | **11,191,051** | 11,240,062 | 11,534,470 |
| Common – nonvoting (eligible for dividends, convertible) | $ 5.00 | **47,220** | 46,881 | 41,429 |
| Participation certificates – nonvoting (eligible for dividends, convertible) | $ 5.00 | **442,170** | 427,840 | 439,183 |

In the event of the liquidation or dissolution of an association, any assets of the association remaining after payment or retirement of all liabilities shall be distributed to stockholders in the following order:

First, holders of preferred stock at par value, if any;

Second, ratably to holders of all classes of common stock and participation certificates at par value or face amount;

Third, ratably to the holders of allocated retained earnings on the basis of oldest allocations first;

Fourth, ratably to the holders of nonqualified written notices of allocation on the basis of the oldest allocations first;

Then, the remainder of assets ratably to all holders of common stock and participation certificates, in proportion to the aggregate patronage of each such holder to the total patronage of all holders.

ACA bylaws provide for operation as cooperatives which qualify for tax treatment under Subchapter T of the Internal Revenue Code. Under cooperative operations, earnings of the ACA may be distributed to borrowers. Patronage distributions are generally in the form of allocated retained earnings and cash. At least 20 percent of the total patronage distribution must be paid in cash. Amounts not distributed are retained as unallocated retained earnings.

### D. Description of Bank Equities:

Class A Cumulative Perpetual Preferred Stock (Class A preferred stock) – On November 7, 2003, the bank issued 100,000 shares of $1,000 per share par value Class A preferred stock for net proceeds of $98,644, after expenses of $1,356 associated with the offering. The dividend rate is 7.561 percent, payable semi-annually to December 15, 2013, after which dividends are payable quarterly at a rate equal to the three-month London Interbank Offered Rate (LIBOR) plus 445.75 basis points. On

September 26, 2005, the bank issued an additional 100,000 shares of cumulative perpetual preferred stock with the same terms. During 2010, the bank repurchased $18.0 million par value of the Class A preferred stock at a net premium and costs of $529. For regulatory purposes, the preferred stock is treated as equity, and is not mandatorily redeemable. Dividends on preferred stock are recorded as declared. The preferred stock ranks, as to dividends and other distributions (including patronage) upon liquidation, dissolution or winding up, prior to all other classes and series of equity securities of the bank. In 2010, Class A preferred stock dividends of $21,851 were declared, of which $14,970 were paid and $6,881 were payable at December 31, 2010, which was an accrual of the amount payable on the next dividend date, June 15, 2011, required by "dividend/patronage stopper" clauses in the preferred stock offerings. The clauses require the payment or declaration of current period dividends on the preferred stock issuances before any other patronage can be declared. In 2011, Class A preferred stock dividends of $13,761 were declared and paid. At December 31, 2011, dividends payable on Class A preferred stock totaled $6,881. In 2012, Class A preferred stock dividends of $13,761 were declared and paid. At December 31, 2012, dividends payable on Class A preferred stock totaled $6,881.

Class B Noncumulative Subordinated Perpetual Preferred Stock (Class B preferred stock) – On August 26, 2010, the bank issued $300.0 million of Class B noncumulative subordinated perpetual preferred stock, representing 300,000 shares at $1,000 per share par value for net proceeds of $296.6 million. The net proceeds of the issuance were used to increase the bank's capital and for general corporate purposes. Dividends on the preferred stock, if declared by the board of directors at its sole discretion, are noncumulative and are payable semi-annually in arrears on the fifteenth day of June and December in each year, commencing December 15, 2010, at an annual fixed rate of 10 percent of par value of $1,000 per share. The Class B preferred stock is not mandatorily redeemable at any time, but may be redeemed in whole or in part at the option of the bank after the dividend payment date in June 2020. The Class B preferred stock ranks junior, both as to dividends and upon liquidation to our Class A preferred stock, and senior to all of our outstanding capital stock. For regulatory purposes, the Class B preferred stock is included in permanent capital, total surplus and core surplus within certain limitations. Due to regulatory limitations on third-party capital, the preferred stock issuance will require that subordinated debt no longer receive favorable treatment in net collateral ratio calculations. In 2010, Class B preferred stock dividends of $23,750 were declared, of which $8,750 were paid and $15,000 were payable at December 31, 2010, which is an accrual of the amount payable on the next dividend date, June 15, 2011, required by "dividend/patronage stopper" clauses in the preferred stock offerings. In 2011, Class B preferred stock dividends totaling $30.0 million were declared and paid. At December 31, 2011, dividends payable on Class B preferred stock totaled $15,000. In 2012, Class B preferred stock dividends totaling $30.0 million were declared and paid. At December 31, 2012, dividends payable on Class B preferred stock totaled $15,000.

Class A Voting Common Stock – According to the bank's bylaws, the minimum and maximum stock investments that the bank may require of the ACAs and FLCA are 2 percent (or one thousand dollars, whichever is greater) and 5 percent, respectively, of each association's average borrowings from the bank. The investments in the bank are required to be in the form of Class A voting common stock (with a par value of $5 per share) and allocated retained earnings. The current investment required of the associations is 2 percent of their average borrowings from the bank. No Class A voting common stock may be retired except at the sole discretion of the bank's board of directors, and provided that after such retirement, the bank shall meet minimum capital adequacy standards as may from time to time be promulgated by the FCA or such higher level as the board may from time to time establish in the bank's Capital Plan. There were 42,226 shares, 43,078 shares and 45,326 shares of Class A voting common stock issued and outstanding at December 31, 2012, 2011 and 2010, respectively. Class A voting common stock includes 706 shares purchased by district associations as a condition of the bank's Capitalized Participation Pool (CPP) program. Under the CPP program, the stock investment that the bank requires is 1.6 percent of each AMBS pool and 8 percent of each loan pool. These intercompany balances and transactions are eliminated in combination.

Class A Nonvoting Common Stock – The bank requires OFIs to make cash purchases of Class A nonvoting common stock (with a par value of $5 per share) in the bank based on a minimum and maximum of 2 percent (or one thousand dollars, whichever is greater) and 5 percent, respectively, of the OFIs' average borrowings from the bank. No Class A nonvoting common stock may be retired except at the sole discretion of the bank's board of directors, and provided that after such retirement, the bank shall meet minimum capital adequacy standards as may from time to time be promulgated by the FCA or such higher level as the board may from time to time establish in the bank's Capital Plan. The bank has a first lien on these equities for the repayment of any indebtedness to the bank. There were 291 shares, 290 shares and 354 shares of Class A nonvoting common stock issued and outstanding at December 31, 2012, 2011 and 2010, respectively. One OFI paid off its direct note in December 31, 2011, resulting in a stock retirement of $231.

**E. Additional Paid-in-Capital**

The $22,737 in additional paid-in-capital represents the excess value received by acquiring associations from acquired associations over the par value of capital stock issued in association mergers. Additional paid-in-capital is considered unallocated surplus for purposes of shareholder distributions. Generally, patronage is paid out of current year earnings and as such, this would not be paid out in the form of patronage. In the case of liquidation, additional paid-in-capital would be treated as unallocated surplus and distributed to shareholders after other obligations of the association had been satisfied.

**F. Accumulated Other Comprehensive Loss:**

Following is a summary of the components of accumulated other comprehensive (loss) income (AOCI) and the changes occurring during the year ended December 31, 2012:

| | Total | Unrealized Gain on Securities | Retirement Benefit Plans | Cash Flow Derivative Instruments |
|---|---|---|---|---|
| **Balance, January 1, 2012** | **$ (92,391)** | **$ 29,577** | **$ (116,286)** | **$ (5,682)** |
| **Change in unrealized gains on available-for-sale securities** | | | | |
| **Net change in unrealized gains on investment securities** | **(42)** | **(42)** | | |
| **Decrease in noncredit portion of other-than-temporary impairment (OTTI) losses** | **4,493** | **4,493** | | |
| **Reclassification adjustment for OTTI credit losses included in net income** | **76** | **76** | | |
| **Net change in unrealized gains on securities** | **4,527** | **4,527** | | |
| **Change in retirement benefit plans** | | | | |
| **Actuarial losses** | **(35,322)** | | **(35,322)** | |
| **Amounts amortized into net periodic expense:** | | | | |
| **Amortization of prior service credits** | **(1,389)** | | **(1,389)** | |
| **Amortization of net losses** | **14,301** | | **14,301** | |
| **Net change in retirement benefit plans** | **(22,410)** | | **(22,410)** | |
| **Change in cash flow derivative instruments** | | | | |
| **Unrealized losses on interest rate caps** | **(1,072)** | | | **(1,072)** |
| **Reclassification of loss recognized in interest expense** | **539** | | | **539** |
| **Net change in cash flow derivative instruments** | **(533)** | | | **(533)** |
| **Total other comprehensive (loss) income** | **(18,416)** | **4,527** | **(22,410)** | **(533)** |
| **Balance, December 31, 2012** | **$ (110,807)** | **$ 34,104** | **$ (138,696)** | **$ (6,215)** |

Following is a summary of the components of accumulated other comprehensive (loss) income (AOCI) and the changes occurring during the year ended December 31, 2011:

| | Total | Unrealized Gain on Securities | Retirement Benefit Plans | Cash Flow Derivative Instruments |
|---|---|---|---|---|
| Balance, January 1, 2011 | $ (49,391) | $ 24,586 | $ (71,671) | $ (2,306) |
| Change in unrealized gains on available-for-sale securities | | | | |
| Net change in unrealized gains on investment securities | 5,680 | 5,680 | | |
| Increase in noncredit portion of other-than-temporary impairment (OTTI) losses | (2,776) | (2,776) | | |
| Reclassification adjustment for OTTI credit losses included in net income | 2,087 | 2,087 | | |
| Net change in unrealized gains on securities | 4,991 | 4,991 | | |
| Change in retirement benefit plans | | | | |
| Actuarial losses | (52,183) | | (52,183) | |
| Amounts amortized into net periodic expense: | | | | |
| Amortization of prior service credits | (144) | | (144) | |
| Amortization of net losses | 7,712 | | 7,712 | |
| Net change in retirement benefit plans | (44,615) | | (44,615) | |
| Change in cash flow derivative instruments | | | | |
| Losses on interest rate caps | (3,437) | | | (3,437) |
| Gains on cash flow interest rate swaps | 5 | | | 5 |
| Reclassification of loss recognized in interest expense | 56 | | | 56 |
| Net change in cash flow derivative instruments | (3,376) | | | (3,376) |
| Total other comprehensive (loss) income | (43,000) | 4,991 | (44,615) | (3,376) |
| Balance, December 31, 2011 | $ (92,391) | $ 29,577 | $ (116,286) | $ (5,682) |

Following is a summary of the components of accumulated other comprehensive income (loss) (AOCI) and the changes occurring during the year ended December 31, 2010:

| | Total | Unrealized Gain on Securities | Retirement Benefit Plans | Cash Flow Derivative Instruments |
|---|---|---|---|---|
| Balance, January 1, 2010 | $ (76,842) | $ 13,218 | $ (89,756) | $ (304) |
| Change in unrealized gains on available-for-sale securities | | | | |
| Net change in unrealized gains on investment securities | 8,757 | 8,757 | | |
| Increase in noncredit portion of other-than-temporary impairment (OTTI) losses | 780 | 780 | | |
| Reclassification adjustment for OTTI credit losses included in net income | 1,830 | 1,830 | | |
| Net change in unrealized gains on securities | 11,367 | 11,367 | | |
| Change in retirement benefit plans | | | | |
| Actuarial gains | 7,567 | | 7,567 | |
| Amounts amortized into net periodic expense: | | | | |
| Amortization of prior service credits | (1,341) | | (1,341) | |
| Amortization of net losses | 11,859 | | 11,859 | |
| Net change in retirement benefit plans | 18,085 | | 18,085 | |
| Change in cash flow derivative instruments | | | | |
| Losses on interest rate caps | (1,996) | | | (1,996) |
| Losses on cash flow interest rate swaps | (5) | | | (5) |
| Net change in cash flow derivative instruments | (2,001) | | | (2,001) |
| Total other comprehensive income (loss) | 27,451 | 11,367 | 18,085 | (2,001) |
| Balance, December 31, 2010 | $ (49,391) | $ 24,585 | $ (71,671) | $ (2,305) |

## Note 10 — Income Taxes

The information that follows relates only to the district's ACAs, as the bank and the FLCA are exempt from federal and other income taxes.

The provision for (benefit from) income taxes follows for years ended December 31:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Current | | | |
| Federal | $ 488 | $ 250 | $ 131 |
| State | — | — | — |
| Total current | 488 | 250 | 131 |
| Deferred | | | |
| Federal | 437 | 980 | (336) |
| State | 60 | (55) | (86) |
| Total deferred | 497 | 925 | (422) |
| Total provision for (benefit from) income taxes | $ 985 | $ 1,175 | $ (291) |

The provision for (benefit from) income tax differs from the amount of income tax determined by applying the statutory federal income tax rate to pretax income as a result of the following differences for years ended December 31:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Federal tax at statutory rate | $ 98,598 | $ 80,265 | $ 57,128 |
| State tax, net | 60 | (55) | (86) |
| Effect of nontaxable entities | (91,154) | (74,348) | (70,912) |
| Valuation allowance | (3,063) | 14,006 | 10,689 |
| Patronage distributions | (5,037) | (6,585) | (3,229) |
| Capital download to associations | 25 | 573 | (273) |
| Other, net | 1,556 | (12,681) | 6,392 |
| Total provision for (benefit from) income taxes | $ 985 | $ 1,175 | $ (291) |

Deferred tax assets and liabilities comprised the following elements at December 31:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Allowance for loan losses | $ 5,591 | $ 9,622 | $ 13,416 |
| Allowance for acquired property | 43 | 677 | 63 |
| Postretirement benefits | 2,138 | 2,049 | 1,933 |
| Net operating loss carryforward | 32,900 | 31,676 | 14,670 |
| Other | 169 | 278 | 525 |
| Gross deferred tax assets | 40,841 | 44,302 | 30,607 |
| Less valuation allowance | (36,325) | (39,388) | (25,382) |
| Adjusted gross deferred tax assets | 4,516 | 4,914 | 5,225 |
| FCBT stock redemption | (599) | (573) | — |
| Other | (275) | (202) | (161) |
| Gross deferred tax liabilities | (874) | (775) | (161) |
| Net deferred tax assets | $ 3,642 | $ 4,139 | $ 5,064 |

There were no uncertain tax positions and related liabilities for unrecognized tax benefits recorded at December 31, 2012. Any penalties and interest related to income taxes would be accounted for as an adjustment to income tax expense.

## Note 11 — Employee Benefit Plans

Employees of the district participate in either the district's defined benefit retirement plan (DB plan) or in a nonelective defined contribution feature (DC plan) within the Farm Credit Benefits Alliance 401(k) plan. In addition, all employees are eligible to participate in the Farm Credit Benefits Alliance 401(k) plan.

The DB plan is noncontributory, and benefits are based on salary and years of service. The legal name of the plan is Farm Credit Bank of Texas Pension Plan; its employer identification number is 74-1110170. The "projected unit credit" actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan in 1998 and beyond, to facilitate reorganization and/or restructuring. Under authoritative accounting guidance, there were no pension plan termination benefits recognized resulting from employees who qualified for an early retirement option under a retention plan at December 31, 2012, 2011 and 2010.

Additionally, certain qualified individuals in the bank participated in a separate, nonqualified defined benefit supplemental pension plan. Effective January 16, 2011, the bank's board of directors approved the termination of the bank's nonqualified defined benefit supplemental pension plan. As a result, no further vesting or benefit accrual occurred under the plan following January 16, 2011, and all remaining unpaid vested benefits were distributed in a cash lump-sum payment to the participating bank employees after a required one-year deferral period.

Participants in the DC plan generally include employees who elected to transfer from the DB plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the nonelective pension feature of the DC plan direct the placement of their employers' contributions made on their behalf into various investment alternatives.

The district also participates in the Farm Credit Benefits Alliance 401(k) plan, which offers a pre-tax and after-tax compensation deferral feature. Employers match 100 percent of employee contributions for the first 3 percent of eligible compensation and then match 50 percent of employee contributions on the next 2 percent of eligible compensation, for a maximum employer contribution of 4 percent of eligible compensation. Employer contributions for the DC plan and the 401 (k) plan totaled $3.9 million, $3.4 million and $3.3 million for the years ended December 31, 2012, 2011 and 2010, respectively. Additionally, certain qualified individuals may participate in separate nonqualified supplemental 401(k) plans managed by their employer.

The bank and associations also provide certain health care benefits to eligible retired employees, beneficiaries and directors (retiree medical plan).

The following table reflects the benefit obligation, cost and actuarial assumptions for the district's pension and other postretirement benefit plans:

| | Pension Benefits | | | Other Postretirement Benefits | | |
|---|---|---|---|---|---|---|
| | **2012** | 2011 | 2010 | **2012** | 2011 | 2010 |
| **Accumulated benefit obligation, end of year** | **$ 331,264** | $ 288,707 | $ 256,263 | | | |
| Change in projected benefit obligation | | | | | | |
| Benefit obligation, beginning of year | **$ 322,549** | $ 282,007 | $ 278,678 | **$ 52,678** | $ 49,442 | $ 41,607 |
| Service cost | **5,446** | 5,147 | 5,967 | **1,383** | 1,377 | 1,226 |
| Interest cost | **15,643** | 15,173 | 16,145 | **2,645** | 2,774 | 2,478 |
| Plan participants' contributions | **—** | — | — | **527** | 526 | 476 |
| Plan amendments | **—** | — | — | **—** | — | — |
| Curtailment loss | **—** | 1,108 | — | **—** | — | — |
| Actuarial loss (gain) | **42,894** | 31,414 | (2,375) | **6,754** | 730 | 5,642 |
| Benefits paid | **(15,958)** | (12,301) | (16,408) | **(2,122)** | (2,170) | (1,987) |
| Projected benefit obligation, end of year | **$ 370,574** | $ 322,548 | $ 282,007 | **$ 61,865** | $ 52,679 | $ 49,442 |
| **Change in plan assets** | | | | | | |
| Plan assets at fair value, beginning of year | **$ 207,495** | $ 200,592 | $ 167,382 | **$ —** | $ — | $ — |
| Actual return on plan assets | **30,552** | (3,740) | 24,472 | **—** | — | — |
| Company contributions | **18,625** | 22,944 | 25,146 | **1,595** | 1,644 | 1,511 |
| Plan participants' contributions | **—** | — | — | **527** | 526 | 476 |
| Benefits paid | **(15,958)** | (12,301) | (16,408) | **(2,122)** | (2,170) | (1,987) |
| Plan assets at fair value, end of year | **$ 240,714** | $ 207,495 | $ 200,592 | **$ —** | $ — | $ — |
| **Funded status** | **$ (129,860)** | $ (115,053) | $ (81,415) | **$ (61,865)** | $ (52,679) | $ (49,442) |
| **Amounts recognized in the combined balanced sheets consist of:** | | | | | | |
| Retirement plan liability | **$ (129,860)** | (115,053) | (81,415) | **$ (61,865)** | (52,679) | (49,442) |
| Accumulated other comprehensive loss (income) | **132,126** | 117,400 | 74,919 | **6,686** | (1,155) | (3,278) |
| **Amounts recognized in accumulated other comprehensive income** | | | | | | |
| Net actuarial loss (gain) | **$ 132,050** | $ 117,288 | $ 73,269 | **$ 13,261** | $ 6,847 | $ 6,405 |
| Prior service cost (credit) | **76** | 112 | 1,650 | **(6,575)** | (8,002) | (9,683) |
| Total | **$ 132,126** | $ 117,400 | $ 74,919 | **$ 6,686** | $ (1,155) | $ (3,278) |

The funding policy establishes contribution requirements for the district's DB plan if plan assets are less than the accumulated benefit obligation at year end. The policy calls for contributions equal to the value of the additional benefits expected to be earned by employees during the year plus a payment on the shortfall between the accumulated benefit obligation and the plan assets. The additional payments for any shortfall are intended to increase the funded status by two percent. The plan sponsor is the board of directors of the Farm Credit Bank of Texas. In accordance with this policy, contributions of $15,781, $22,867 and $20,000 were made to the plan in January 2012, January 2011 and January 2010, respectively. The supplemental (nonqualified) pension plan was not funded.

| | Pension Benefits | | | Other Postretirement Benefits | | |
|---|---|---|---|---|---|---|
| | **2012** | 2011 | 2010 | **2012** | 2011 | 2010 |
| The following table discloses the excess of the DB plan's accumulated benefit obligation over its plan assets at December 31: | | | | | | |
| District DB plan projected benefit obligation | **$ 370,574** | $ 319,705 | $ 280,102 | | | |
| District DB plan assets at fair value | **240,714** | 207,495 | 200,592 | | | |
| Accumulated benefit obligation (ABO) of district DB plan | **331,264** | 285,863 | 254,653 | | | |
| Funding shortfall (Plan Assets to ABO) | **(90,550)** | (78,368) | (54,061) | | | |
| Supplemental (nonqualified) projected benefit obligation | **$ —** | $ 2,844 | $ 1,905 | | | |
| Supplemental (nonqualified) accumulated benefit obligation | **—** | 2,844 | 1,610 | | | |
| Supplemental (nonqualified) fair value of plan assets | **—** | — | — | | | |
| **Net periodic benefit cost** | | | | | | |
| Service cost | **$ 5,446** | $ 5,147 | $ 5,967 | **$ 1,383** | $ 1,377 | $ 1,226 |
| Interest cost | **15,643** | 15,173 | 16,144 | **2,645** | 2,774 | 2,478 |
| Expected return on plan assets | **(16,226)** | (16,300) | (13,638) | **—** | — | — |
| Amortization of: | | | | | | |
| Prior service cost | **36** | 36 | 390 | **(1,426)** | (1,682) | (1,732) |
| Net actuarial loss | **13,805** | 6,996 | 9,775 | **340** | 288 | 125 |
| Net periodic benefit cost | **$ 18,704** | $ 11,052 | $ 18,638 | **$ 2,942** | $ 2,757 | $ 2,097 |
| Curtailment expense | **—** | 3,049 | — | **—** | — | — |
| Settlement expense | **—** | — | 1,871 | **—** | — | — |
| Special termination benefits | **—** | — | — | **—** | — | — |
| Total benefit cost | **$ 18,704** | $ 14,101 | $ 20,509 | **$ 2,942** | $ 2,727 | $ 2,097 |
| **Other changes to plan assets and projected benefit obligations recognized in other comprehensive income** | | | | | | |
| Net actuarial (gain) loss in the current period | **$ 28,568** | $ 51,453 | (13,209) | **$ 6,754** | $ 730 | 5,642 |
| Settlement expense | **—** | — | — | **—** | — | — |
| Prior service costs | **—** | — | — | **—** | — | — |
| Amortization of prior service costs | **(36)** | (1,537) | (390) | **1,426** | 1,682 | 1,732 |
| Amortization of net actuarial (gain) loss | **(13,805)** | (7,435) | (11,645) | **(340)** | (288) | (125) |
| Net change | **$ 14,727** | $ 42,481 | (25,244) | **$ 7,840** | $ 2,124 | $ 7,249 |
| **AOCI amounts expected to be amortized in 2013** | | | | | | |
| Prior service cost (credit) | **$ 36** | | | **$ (1,228)** | | |
| Net actuarial loss (gain) | **16,435** | | | **765** | | |
| Total | **$ 16,471** | | | **$ (463)** | | |
| **Weighted-average assumptions used to determine benefit obligation as of December 31** | | | | | | |
| Measurement date | **12/31/2012** | 12/31/2011 | 12/31/2010 | **12/31/2012** | 12/31/2011 | 12/31/2010 |
| Discount rate | **4.15%** | 5.00% | 5.50% | **4.40%** | 5.10% | 5.70% |
| Expected long-term rate of return | **7.50%** | 7.50 | 7.50 | **N/A** | N/A | N/A |
| Rate of compensation increase | **5.50%** | 5.50 | 3% in 2011 down to 3.5% in 2012 | | | |
| Health care cost trend rate assumed for next year (pre/post-65) — medical | | | | **7.25%/6.50%** | 8.5%/6.75% | 7.5%/6.5% |
| Health care cost trend rate assumed for next year (pre/post-65) — prescriptions | | | | **7.75%** | 8.00% | 10.50% |
| Ultimate health care cost trend rate | | | | **5.00%** | 5.00% | 5.00% |
| Year that the rate reaches the ultimate trend rate | | | | **2023** | 2018 | 2017 |
| **Weighted-average assumptions used to determine net periodic cost for year ended December 31** | | | | | | |
| Measurement date | **12/31/2011** | 12/31/2010 | 12/31/2009 | **12/31/2011** | 12/31/2010 | 12/31/2009 |
| Discount rate | **5.00%** | 5.50% | 5.95% | **5.10%** | 5.70% | 6.05% |
| Expected return on plan assets | **7.50%** | 7.50% | 7.50% | **N/A** | N/A | N/A |
| Rate of compensation increase | **5.50%** | 3% in 2011 down to 3.5% in 2012 | 6% in 2010 down to 4% in 2012 | | | |
| Health care cost trend rate assumed for next year (pre/post-65) — medical | | | | **8.5%/6.75%** | 7.5%/6.5% | 8.0%/7.0% |
| Health care cost trend rate assumed for next year (pre/post-65) — prescriptions | | | | **8.00%** | 10.00% | 10.00% |
| Ultimate health care cost trend rate | | | | **5.00%** | 5.00% | 5.00% |
| Year that the rate reaches the ultimate trend rate | | | | **2018** | 2017 | 2017 |

## Effect of Change in Assumed Health Care Cost Trend Rates

| | |
|---|---|
| **Effect on total service cost and interest cost components** | |
| One-percentage-point increase | **$ 844** |
| One-percentage-point decrease | **(667)** |
| **Effect on year-end postretirement benefit obligation** | |
| One-percentage-point increase | **$ 10,503** |
| One-percentage-point decrease | **(8,470)** |

### Plan Assets

The trustees of the district DB 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 DB plan are to achieve and maintain plan assets in accordance with the funding policy mentioned above 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. District postretirement health care plans have no plan assets and are funded on a current basis by employer contributions and retiree premium payments.

| | Fair Value Measurement at December 31, 2012 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Asset Category: | | | | |
| Commingled trust funds: | | | | |
| Russell Multi-Manager Bond Fund | **$ 92,553** | $ — | $ 92,553 | $ — |
| Russell All International Markets Fund | **51,278** | — | 51,278 | — |
| Russell World Equity Fund | **29,710** | — | 29,710 | — |
| Russell Commingled Enhanced Fund | **27,400** | — | 27,400 | — |
| Russell Small Cap Fund | **12,158** | — | 12,158 | — |
| Russell U.S. Value Fund | **18,784** | — | 18,784 | — |
| Russell Emerging Markets Fund | **8,831** | — | 8,831 | — |
| Total assets | **$ 240,714** | $ — | $ 240,714 | $ — |

| | Pension Benefits | Other Postretirement Benefits |
|---|---|---|
| **Expected Future Cash Flow Information** | | |
| **Expected Benefit Payments** | | |
| Fiscal 2013 | **$ 14,886** | **$ 2,092** |
| Fiscal 2014 | **16,159** | **2,327** |
| Fiscal 2015 | **17,453** | **2,518** |
| Fiscal 2016 | **18,686** | **2,717** |
| Fiscal 2017 | **19,949** | **2,931** |
| Fiscal 2018 – 2022 | **114,911** | **17,613** |
| **Expected Contributions** | | |
| Fiscal 2013 | **$ 16,494** | **$ 2,092** |

| **Plan Assets** | Pension Benefits | | | | Other Postretirement Benefits | | | |
|---|---|---|---|---|---|---|---|---|
| Asset Category | Target | **2012** | 2011 | 2010 | Target | **2012** | 2011 | 2010 |
| Equity securities | 60% | **60%** | 60% | 60% | —% | **—%** | —% | —% |
| Debt securities | 40 | **40** | 40 | 40 | — | **—** | — | — |
| Cash/other | — | **—** | — | — | 100 | **100** | 100 | 100 |
| Total | 100% | **100%** | 100% | 100% | 100% | **100%** | 100% | 100% |

As disclosed in the preceding table, the expected total contribution for pension benefits for 2013 is $16.5 million.

Notwithstanding current investment market conditions, 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.

## Note 12 — Related Party Transactions

In the ordinary course of business, the associations have entered into loan transactions with directors, officers and other employees of associations and other organizations with which such persons may be associated. Total loans to such persons at December 31, 2012, 2011 and 2010 amounted to $158.4 million, $136.9 million and $158.6 million, respectively. In the opinion of management, such loans outstanding to directors, officers and other employees at December 31, 2012, did not involve more than a normal risk of collectibility, were subject to approval requirements contained in FCA regulations, and were made on the same terms, including interest rates, amortization schedules and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers. Disclosures on individual associations' officers and directors are found in the associations' individual annual reports.

## Note 13 — Commitments and Contingencies

The district has various outstanding commitments and contingent liabilities as discussed elsewhere in these notes.

The bank is primarily liable for its portion of Systemwide debt obligations. Additionally, the bank is jointly and severally liable for the consolidated Systemwide bonds and notes of other System banks.

The total bank and consolidated Systemwide debt obligations of the System at December 31, 2012, were approximately $198.0 billion.

In the normal course of business, district entities incur a certain amount of claims, litigation, and other legal and administrative proceedings, all of which are considered incidental to the normal conduct of business. The bank and district associations believe they have meritorious defenses to the claims currently asserted against it, and, with respect to such legal proceedings, intend to defend themselves vigorously, litigating or settling cases according to management's judgment as to what is in the best interest of the entity and its shareholders.

On a regular basis, district entities assess their liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. For those matters where it is probable that the entity would incur a loss and the amount of the loss could be reasonably estimated, the entity would record a liability in its financial statements. These liabilities would be increased or decreased to reflect any relevant developments on a quarterly basis. For other matters, where a loss is not probable or the amount of the loss is not estimable, the district entities do not record a liability.

Currently, other actions are pending against the district in which claims for monetary damages are asserted. Upon the basis of current information, management and legal counsel are of the opinion that any resulting losses are not probable, and that the ultimate liability, if any, resulting from a lawsuit and other pending actions will not be material in relation to the financial position, results of operations or cash flows of the district.

## Note 14 — Financial Instruments With Off-Balance-Sheet Risk

The bank 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. In the normal course of business, various commitments are made to customers, including commitments to extend credit and standby letters of credit, which represent credit-related financial instruments with off-balance-sheet risk.

At any time, the bank and associations have outstanding a significant number of commitments to extend credit. The bank and associations also provide standby letters of credit to guarantee the performance of customers to third parties. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. Credit-related financial instruments have off-balance-sheet credit risk, because only origination fees (if any) are recognized in the combined balance sheets (as other liabilities) for these instruments until the commitments are fulfilled or expire. Since many of the commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. The district's commitments to extend credit totaled $4.431 billion, $4.284 billion and $3.067 billion at December 31, 2012, 2011 and 2010, respectively. At December 31, 2012, the district had $112.3 million in outstanding standby letters of credit, issued primarily in conjunction with participation loans. Outstanding standby letters of credit generally have expiration dates ranging from 2013 to 2017.

The credit risk involved in issuing commitments and letters of credit is essentially the same as that involved in extending loans to customers, and the same credit policies are applied by management. In the event of funding, the credit risk amounts are equal to the contract amounts, assuming that counterparties 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 counterparty.

## Note 15 — Fair Value Measurements

Authoritative accounting guidance 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 advantageous market for the asset or liability. See Note 2, "Summary of Significant Accounting Policies," for additional information.

Assets and liabilities measured at fair value on a recurring basis at December 31, 2012, for each of the fair value hierarchy values are summarized below:

| | Fair Value Measurement at December 31, 2012 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Federal funds | **$ 24,137** | $ — | $ 24,137 | $ — |
| Investments available-for-sale: | | | | |
| Corporate debt | **208,622** | — | 148,664 | 59,958 |
| Agency-guaranteed debt | **65,766** | — | 50,649 | 15,117 |
| Mortgage-backed securities | **2,939,481** | — | 2,912,543 | 26,938 |
| Asset-backed securities | **17,131** | — | 14,035 | 3,096 |
| Mission-related and other available-for-sale investments | **115,479** | — | — | 115,479 |
| Loans valued under the fair value option | **65,074** | — | 60,310 | 4,764 |
| Derivative assets | **756** | — | 756 | — |
| Assets held in nonqualified benefit trusts | **3,577** | 3,577 | — | — |
| Total assets | **$ 3,440,023** | $ 3,577 | $ 3,211,094 | $ 225,352 |
| Liabilities: | | | | |
| Standby letters of credit | **$ 2,018** | $ — | $ 2,018 | $ — |
| Total liabilities | **$ 2,018** | $ — | $ 2,018 | $ — |

The table below represents a reconciliation of all Level 3 assets and liabilities measured at fair value on a recurring basis for the year ended December 31, 2012:

| | Corporate Debt Securities | U.S. Agency Securities | Mortgage-Backed Securities | Agricultural Mortgage-Backed Securities | Asset-Backed Securities | Loans Under Fair Value Option | Total |
|---|---|---|---|---|---|---|---|
| Available-for-sale investment securities: | | | | | | | |
| Balance at January 1, 2012 | $ 82,464 | $ — | $ 40,872 | $ 110,921 | $ 3,450 | — | $ 237,707 |
| Net gains (losses) included in other comprehensive income | 175 | 117 | 6,922 | (412) | 577 | — | 7,379 |
| Net gains (losses) included in earnings | — | — | (76) | — | (1) | 59 | (18) |
| Purchases, issuances and settlements | 60,000 | 15,000 | 145,656 | 4,970 | 11,070 | 4,705 | 241,401 |
| Transfers out of Level 3 | (82,681) | — | (166,436) | — | (12,000) | — | (261,117) |
| Balance at December 31, 2012 | $ 59,958 | $ 15,117 | $ 26,938 | $ 115,479 | $ 3,096 | $ 4,764 | $ 225,352 |
| 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, 2012 | $ — | $ — | $ — | $ — | $ 1 | $ — | $ 1 |

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the year ended December 31, 2012. Agricultural mortgage-backed securities are included in Level 3 due to limited activity or less transparency around inputs to their valuation. The net purchases and settlements in agricultural mortgage-backed securities include the bank's purchase of additional AMBS from a district association during the quarter ended March 31, 2012. At December 31, 2012, Level 3 investments included one agency MBS and three corporate debt instruments due to the fact that their valuations were based on Level 3 criteria (broker quotes) and certain non-agency MBS and non-agency ABS backed by home equity. In 2012, corporate debt and an agency MBS which had previously been included in Level 3 were valued using independent third-party valuation services using Level 2 criteria and were, accordingly, transferred from Level 3 to Level 2.

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2012, for each of the fair value hierarchy values are summarized below:

| | Fair Value Measurement at December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) |
| Assets: | | | | | |
| Loans | **$ 241,252** | $ — | $ — | $ 241,252 | $ (43,121) |
| Other property owned | **109,124** | | | 109,124 | (13,850) |
| Total assets | **$ 350,376** | $ — | $ — | $ 350,376 | $ (56,971) |

Assets and liabilities measured at fair value on a recurring basis at December 31, 2011, for each of the fair value hierarchy values are summarized below:

| | Fair Value Measurement at December 31, 2011 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Federal funds | **$ 20,687** | $ — | $ 20,687 | $ — |
| Investments available-for-sale | **3,160,683** | — | 2,922,977 | 237,706 |
| Derivative assets | **1,726** | — | 1,726 | — |
| Assets held in nonqualified benefit trusts | **2,691** | 2,691 | — | — |
| Total assets | **$ 3,185,787** | $ 2,691 | $ 2,945,390 | $ 237,706 |
| Liabilities: | | | | |
| Derivative liabilities | **$ 486** | $ — | $ 486 | $ — |
| Standby letters of credit | **3,093** | — | 3,093 | — |
| Total liabilities | **$ 3,579** | $ — | $ 3,579 | $ — |

The table below represents a reconciliation of Level 3 assets and liabilities measured at fair value on a recurring basis for the year ended December 31, 2011:

| | Corporate Debt | Mortgage-Backed Securities | Agricultural Mortgage-Backed Securities | Asset-Backed Securities | Total |
|---|---|---|---|---|---|
| Available-for-sale investment securities: | | | | | |
| Balance at January 1, 2011 | $ — | $ 100,385 | $ 140,503 | $ 6,760 | $ 247,648 |
| Net gains included in other comprehensive income | (842) | (2,286) | 2,943 | 131 | (54) |
| Net losses included in earnings | — | (1,934) | — | (153) | (2,087) |
| Purchases, issuances and settlements | 83,306 | 85,440 | (32,525) | (3,288) | 132,933 |
| Transfers out of Level 3 | — | (140,734) | — | — | (140,734) |
| Balance at December 31, 2011 | $ 82,464 | $ 40,871 | $ 110,921 | $ 3,450 | $ 237,706 |
| 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, 2011 | $ — | $ 1,934 | $ — | $ 153 | $ 2,087 |

There were no transfers of assets or liabilities into or out of Level 1 from other levels during 2011. At December 31, 2010, Level 3 investments included two agency mortgage-backed securities due to the fact that their valuations were based on Level 3 criteria (broker quotes) and certain non-agency mortgage-backed securities, asset-backed securities and certain nonguaranteed, noncollateralized corporate debt. In 2011, the two agency mortgage-backed securities, totaling $35,468, were valued using independent third-party valuation services using Level 2 criteria and were, accordingly, transferred from Level 3 to Level 2. In addition, four agency mortgage-backed securities purchased in 2011 and originally valued using independent third-party valuations using Level 3 criteria were subsequently valued at $105,265 using independent third-party valuation services using Level 2 criteria and transferred to Level 2.

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2011, for each of the fair value hierarchy values are summarized below:

| | Fair Value Measurement at December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) |
| Assets: | | | | | |
| Loans | **$ 534,460** | $ — | $ — | $ 534,460 | $(102,586) |
| Other property owned | **94,534** | | | 94,534 | (18,740) |
| Total assets | **$ 628,994** | $ — | $ — | $ 628,994 | $(121,326) |

Assets and liabilities measured at fair value on a recurring basis at December 31, 2010, for each of the fair value hierarchy values are summarized below:

| | Fair Value Measurement at December 31, 2010 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Federal funds | **$ 20,439** | $ — | $ 20,439 | $ — |
| Investments available-for-sale | **3,076,946** | — | 2,829,298 | 247,648 |
| Derivative assets | **6,512** | — | 6,512 | — |
| Assets held in nonqualified benefit trusts | **2,247** | 2,247 | — | — |
| Total assets | **$ 3,106,144** | $ 2,247 | $ 2,856,249 | $ 247,648 |
| Liabilities: | | | | |
| Derivative liabilities | **$ 5** | $ — | $ 5 | $ — |
| Standby letters of credit | **2,843** | — | 2,843 | — |
| Total liabilities | **$ 2,848** | $ — | $ 2,848 | $ — |

The table below represents a reconciliation of all Level 3 assets and liabilities measured at fair value on a recurring basis for the year ended December 31, 2010:

| | Corporate Debt | Mortgage-Backed Securities | Asset-Backed Securities | Total |
|---|---|---|---|---|
| Available-for-sale investment securities: | | | | |
| Balance at January 1, 2010 | $ — | $ — | $ — | $ — |
| Net losses included in other comprehensive income | — | (4,619) | — | (4,619) |
| Net losses included in earnings | — | — | — | — |
| Purchases, issuances and settlements | — | 145,122 | — | 145,122 |
| Transfers into Level 3 | — | 100,385 | 6,760 | 107,145 |
| Balance at December 31, 2010 | $ — | $ 240,888 | $ 6,760 | $ 247,648 |
| 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, 2010 | $ — | $ 1,438 | $ 392 | $ 1,830 |

In December 2010, the bank transferred certain non-agency mortgage-backed and asset-backed securities totaling $107,145 from Level 2 to Level 3. The decision to move these investments to Level 3 was based on the relatively illiquid current market for these investments, which were valued by independent third-party valuation services which used Level 2 and Level 3 criteria in their valuations. The significant inputs included volatility, prepayment rates, market spreads and dealer quotes.

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2010, for each of the fair value hierarchy values are summarized below:

| | Fair Value Measurement at December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) |
| Assets: | | | | | |
| Loans | $ 199,999 | $ — | $ — | $ 199,999 | $(129,101) |
| Other property owned | 86,490 | | | 86,490 | (15,151) |
| Total assets | $ 286,489 | $ — | $ — | $ 286,489 | $(144,252) |

Financial assets and financial liabilities measured at carrying amounts and not measured at fair value on the Balance Sheet for each of the fair value hierarchy values are summarized as follows:

| | December 31, 2012 | | | | | December 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|---|---|---|---|---|
| | | Fair Value Measurements Using | | | | | | | |
| | Total Carrying Amount | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value | Total Carrying Amount | Total Fair Value | Total Carrying Amount | Total Fair Value |
| **Assets:** | | | | | | | | | |
| Cash | **$ 512,842** | $ 512,842 | $ — | $ — | $ 512,842 | $ 432,719 | $ 432,719 | $ 453,322 | $ 453,322 |
| Mission-related and other held-to-maturity investments | **69,075** | — | — | 68,752 | 68,752 | 127,245 | 127,039 | 154,616 | 153,876 |
| Net loans | **16,453,564** | — | — | 16,686,810 | 16,686,810 | 14,975,436 | 15,343,847 | 15,265,746 | 15,197,041 |
| Total assets | **$ 17,035,481** | $ 512,842 | $ — | $ 16,755,562 | $ 17,268,404 | $ 15,535,400 | $ 15,903,605 | $ 15,873,684 | $ 15,804,239 |
| **Liabilities:** | | | | | | | | | |
| Systemwide debt securities and other notes | **$ 17,310,860** | $ — | $ — | $ 17,528,575 | $ 17,528,575 | $ 16,045,541 | $16,268,118 | $ 16,179,932 | $ 16,273,642 |
| Subordinated debt | **50,000** | — | — | 56,945 | 56,945 | 50,000 | 56,963 | 50,000 | 52,851 |
| | **$ 17,360,860** | $ — | $ — | $ 17,585,520 | $ 17,585,520 | $ 16,095,541 | $ 16,325,081 | $ 16,229,932 | $ 16,326,493 |

## Valuation Techniques

As more fully discussed in Note 2, "Summary of Significant Accounting Policies," authoritative accounting guidance 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. The following represent a brief summary of the valuation techniques used by the bank and associations for assets and liabilities:

*Investment Securities*

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. Among other securities, this would include certain mortgage-backed securities and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. At December 31, 2012, Level 3 securities included primarily the bank's AMBS portfolio which is valued by the bank using a model that incorporates underlying rates and current yield curves. Level 3 assets at December 31, 2012, also include certain non-agency mortgage-backed and asset-backed securities valued using independent third-party valuation services.

As permitted under Farm Credit Administration regulations, the banks are authorized to hold eligible investments. The regulations define eligible investments by specifying credit rating criteria, final maturity limit and percentage of portfolio limit for each investment type. At the time of purchase, mortgage-backed and asset-backed securities must be triple-A rated by at least one Nationally Recognized Statistical Rating Organization. The triple-A rating requirement puts the banks in a position to hold the senior tranches of securitizations. The underlying loans for mortgage-backed securities are residential mortgages, while the underlying loans for asset-backed securities are home equity lines of credit, small business loans, equipment loans or student loans.

To estimate the fair value of the majority of the investments held, the bank obtains prices from third-party pricing services.

*Assets Held in Nonqualified 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.

*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 and are classified within Level 2 of the valuation hierarchy. Such derivatives include basic interest rate swaps and cash flow derivatives.

The models used to determine the fair value of derivative assets and liabilities use an income approach based on observable market inputs, primarily the LIBOR swap curve and volatility assumptions about future interest rate movements.

*Standby Letters of Credit*

The fair value of letters of credit approximate the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations.

*Loans*

For certain loans evaluated for impairment under accounting impairment guidance, the fair value is based upon the underlying collateral since the loans are 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. At December 31, 2012, impaired loans with a fair value of $241,252 were included in loans.

*Other Property Owned*

Other property owned is generally classified as Level 3. The process for measuring the fair value of other property owned involves the use of appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

In accordance with authoritative accounting guidance, assets acquired in loan foreclosures are recorded at fair value, less estimated costs of sale. At December 31, 2012, foreclosed assets with a fair value of $109,124 are included in other property owned.

***Quantitative Information About Recurring and Nonrecurring Level 3 Fair Value Measurement***

| | Valuation Technique(s) | Unobservable Input |
|---|---|---|
| Mortgage-backed securities | Discounted cash flow | Prepayment rate<br>Probability of default<br>Loss severity |
| Asset-backed securities | Discounted cash flow | Prepayment rate<br>Probability of default<br>Loss severity |
| Mission-related investments | Discounted cash flow | Prepayment rates |

With regard to impaired loans and other property owned, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

***Information About Recurring and Nonrecurring Level 2 Fair Value Measurements***

| | Valuation Technique(s) | Input |
|---|---|---|
| Federal funds sold | Carrying value | Par/principal |
| Investment securities available for sale | Quoted prices<br>Discounted cash flow | Price for similar security<br>Constant prepayment rate<br>Appropriate interest rate yield curve |
| Loans held under the fair value option | Quoted prices<br>Discounted cash flow | Price for similar security<br>Constant prepayment rate<br>Appropriate interest rate yield curve |
| Interest rate swaps | Discounted cash flow | Appropriate interest rate yield curve |
| Interest rate swaps | Discounted cash flow | Appropriate interest rate yield curve<br>Annualized volatility |

***Information About Other Financial Instrument Fair Value Measurements***

| | Valuation Technique(s) | Input |
|---|---|---|
| Cash | Carrying value | Actual balance |
| Loans | Discounted cash flow | Prepayment forcasts<br>Appropriate interest rate yield curve |
| Systemwide debt securities, subordinated debt and other bonds | Discounted cash flow | Benchmark yield curve<br>Derived yield spread<br>Own credit risk |

## Note 16 — Derivative Instruments and Hedging Activity

The bank maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The bank's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet liabilities so that the net interest margin is not adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the district's gains or losses on the derivative instruments that are linked to these hedged liabilities. Another result of interest rate fluctuations is that the interest expense of hedged variable-rate liabilities will increase or decrease. The effect of this variability in earnings is expected to be substantially offset by the bank's gains and losses on the derivative instruments that are linked to these hedged liabilities. The bank considers its 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 bank enters into derivatives, particularly fair value and cash flow interest rate swaps, primarily to lower interest rate risk. The bank substantially offsets this risk by concurrently entering into offsetting agreements with non-System counterparties. Fair value hedges allow the bank 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 fair value hedge arrangements, the bank agrees 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. At December 31, 2012, the bank had two fair value hedges with a total notional amount of $100.0 million.

The bank's interest-earning assets (principally loans and investments) 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, fair value hedges in which the bank pays the floating rate and receives the fixed rate (receive fixed swaps) are used to reduce the impact of market fluctuations on the bank's net interest income. Because the size of swap positions needed to reduce the impact of market fluctuations varies over time, the 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 bank has interest rate caps to reduce the impact of rising interest rates on their floating-rate assets. At December 31, 2012, the bank held interest rate caps with a notional amount of $695.0 million and a fair value of $665. The primary types of derivative instruments used and the amount of activity (notional amount of derivatives) during the year ended December 31, 2012, is summarized in the following table:

| | Receive Fixed Swaps | Pay Fixed Swaps | Interest Rate Caps | Total |
|---|---|---|---|---|
| Balance at January 1, 2012 | $ 175,000 | $ — | $ 645,000 | $ 820,000 |
| Additions | — | — | 50,000 | 50,000 |
| Maturities/Amortizations | (75,000) | — | — | (75,000) |
| Balance at December 31, 2012 | **$ 100,000** | **$ —** | **$ 695,000** | **$ 795,000** |

By using derivative instruments, the bank exposes itself 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 of the derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the bank, thus creating a repayment risk for the bank. When the fair value of the derivative contract is negative, the bank owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the bank maintains collateral agreements to limit exposure to agreed-upon thresholds; the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency; and the bank also monitors the credit standing of, and levels of exposure to, individual counterparties. The bank typically enters into master agreements that contain netting provisions. These provisions allow the bank 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. However, derivative contracts must be reflected in the financial statements on a gross basis regardless of the netting agreement. At December 31, 2012, the bank had credit exposure to counterparties totaling $0.8 million, as compared with $1.7 million at December 31, 2011.

The table below presents the credit ratings of counterparties to whom the bank has credit exposure at December 31, 2012:

| | Remaining Years to Maturity | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| *(dollars in millions)* | Less Than One Year | More Than One to Five Years | More Than Five Years | Total | Maturity Distribution Netting | Exposure | Collateral Held | Exposure Net of Collateral |
| Moody's Credit Rating | | | | | | | | |
| A1 | $ — | $ 0.2 | $ — | $ 0.2 | $ — | $ 0.2 | $ — | $ 0.2 |
| A2 | — | — | — | — | — | — | — | — |
| Aa3 | 0.2 | — | 0.4 | 0.6 | — | 0.6 | — | 0.6 |

The bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the ALCO's oversight of the bank's asset/liability and treasury functions. The ALCO is responsible for approving hedging strategies that are developed through its analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the district's overall interest rate risk-management strategies. The bank enters into interest rate swaps classified as fair value hedges primarily to convert a portion of its non-prepayable fixed-rate long-term debt to floating-rate debt.

*Fair Value Hedges:*

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedge item (principally, debt securities) attributable to the hedged risk are recognized in current earnings. The bank includes the gain or loss on the hedged items in the same line item (interest expense) as the offsetting loss or gain on the related interest rate swaps. Accordingly, no gain or loss is recognized in earnings.

*Cash Flow Hedges:*

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. At December 31, 2012, the bank held interest rate caps with a notional amount of $695.0 million and a fair value of $665, but held no cash flow interest rate swaps.

*Derivatives not Designated as Hedges:*

For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings in "gains (losses) on derivative transactions" in the statement of income. The bank does not possess any derivatives not classified as hedges.

*Fair Value of Derivative Instruments:*

The following table represents the fair value of derivative instruments as of:

| | Balance Sheet Location | Fair Value 12/31/2012 | Fair Value 12/31/2011 | Fair Value 12/31/2010 | Balance Sheet Location | Fair Value 12/31/2012 | Fair Value 12/31/2011 | Fair Value 12/31/2010 |
|---|---|---|---|---|---|---|---|---|
| Receive fixed | Other assets | $ 91 | $ 499 | $ 1,848 | Other liabilities | $ — | $ 486 | $ — |
| Pay fixed | Other assets | — | — | — | Other liabilities | — | — | 5 |
| Interest rate caps | Other assets | 665 | 1,227 | 4,664 | Other liabilities | — | — | — |

The following table sets forth the amount of gain (loss) recognized in the Other Comprehensive Income (OCI) for the years ended December 31, 2012 and 2011:

| | (Loss) Recognized in OCI on Derivatives (Effective Portion) at December 31, | |
|---|---|---|
| | **2012** | 2011 |
| Interest rate caps | **$ (1,072)** | $ (3,437) |
| Cash flow derivatives | **—** | 5 |

| | Amount of Gain Reclassified From AOCI Into Income (Effective Portion) at December 31, | |
|---|---|---|
| | **2012** | 2011 |
| Interest expense | **$ 539** | $ 56 |

The following table provides information about derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including debt obligations and interest rate swaps. The debt information in the table presents the principal cash flows and related weighted average interest rates by expected maturity dates. The derivative information in the table represents the notional amounts and weighted average interest rates by expected maturity dates.

| **December 31, 2012** *(dollars in millions)* | Maturities of 2012 Derivative Products and Other Financial Instruments | | | | | | | **Fair Value** |
|---|---|---|---|---|---|---|---|---|
| | **2013** | **2014** | **2015** | **2016** | **2017** | **Subsequent Years** | **Total** | |
| Total debt obligations: | | | | | | | | |
| Fixed rate | $ 2,949 | $ 2,022 | $ 1,507 | $ 1,344 | $ 1,445 | $ 2,004 | $ 11,271 | $ 11,481 |
| Weighted average interest rate | 0.59% | 0.79% | 0.93% | 1.11% | 1.50% | 2.41% | 1.17% | |
| Variable rate | $ 5,315 | $ 575 | $ 150 | $ — | $ — | $ — | $ 6,040 | $ 6,043 |
| Weighted average interest rate | 0.54% | 0.19% | 0.21% | — | — | — | 0.50% | |
| Total debt obligations | $ 8,264 | $ 2,597 | $ 1,657 | $ 1,344 | $ 1,445 | $ 2,004 | $ 17,311 | $ 17,524 |
| Weighted average interest rate | 0.56% | 0.66% | 0.86% | 1.11% | 1.50% | 2.41% | 0.94% | |
| Derivative instruments: | | | | | | | | |
| Receive fixed swaps | | | | | | | | |
| Notional value | $ 100 | $ — | $ — | $ — | $ — | $ — | $ 100 | $ — |
| Weighted average receive rate | 0.28% | — | — | — | — | — | 0.28% | |
| Weighted average pay rate | <0.01% | — | — | — | — | — | <0.01% | |
| Pay fixed swaps | | | | | | | | |
| Notional value | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Weighted average receive rate | — | — | — | — | — | — | — | |
| Weighted average pay rate | — | — | — | — | — | — | — | |
| Interest rate caps | | | | | | | | |
| Notional value | $ — | $ 130 | $ 325 | $ 140 | $ 50 | $ 50 | $ 695 | $ 1 |
| Weighted average receive rate | — | — | — | — | — | — | — | |
| Weighted average pay rate | — | — | — | — | — | — | — | |

## Note 17 — Selected Quarterly Financial Information (Unaudited)

Quarterly results of operations are shown below for the years ended December 31:

| | 2012 | | | | |
|---|---|---|---|---|---|
| | **First** | **Second** | **Third** | **Fourth** | **Total** |
| **Net interest income** | **$ 151,520** | **$ 153,753** | **$ 153,480** | **$ 156,410** | **$ 615,163** |
| **Provision for loan losses** | **15,139** | **5,875** | **11,818** | **799** | **33,631** |
| **Noninterest expense, net** | **40,404** | **21,275** | **43,498** | **66,940** | **172,117** |
| **Net income** | **$ 95,977** | **$ 126,603** | **$ 98,164** | **$ 88,671** | **$ 409,415** |

| | 2011 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 153,927 | $ 151,021 | $ 148,266 | $ 154,842 | $ 608,056 |
| Provision for loan losses | 20,983 | 4,290 | 12,837 | 6,938 | 45,048 |
| Noninterest expense, net | 42,299 | 46,864 | 39,524 | 65,655 | 194,342 |
| Net income | $ 90,645 | $ 99,867 | $ 95,905 | $ 82,249 | $ 368,666 |

| | 2010 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 138,246 | $ 142,137 | $ 144,350 | $ 155,437 | $ 580,170 |
| Provision for loan losses | 22,883 | 25,585 | 60,781 | 32,208 | 141,457 |
| Noninterest expense, net | 27,283 | 41,788 | 34,298 | 60,027 | 163,396 |
| Net income | $ 88,080 | $ 74,764 | $ 49,271 | $ 63,202 | $ 275,317 |

## Note 18 — Bank-Only Financial Data

Condensed financial information for the bank follows. All significant transactions and balances between the bank and associations are eliminated in combination. The multiemployer structure of the district's defined benefit plan results in the recording of this plan only upon combination.

| | Year Ended December 31, | | |
|---|---|---|---|
| **Balance Sheet Data** | **2012** | 2011 | 2010 |
| Cash and federal funds sold | **$ 526,379** | $ 445,354 | $ 457,304 |
| Investment securities | **3,346,479** | 3,160,683 | 3,076,946 |
| Loans | | | |
| To associations | **7,250,641** | 6,972,663 | 7,530,019 |
| To others | **4,088,189** | 3,314,714 | 2,934,015 |
| Less allowance for loan losses | **17,258** | 15,659 | 28,678 |
| Net loans | **11,321,572** | 10,271,718 | 10,435,356 |
| Accrued interest receivable | **35,635** | 41,314 | 45,298 |
| Other property owned, net | **30,739** | 28,748 | 2,838 |
| Other assets | **114,865** | 101,417 | 90,461 |
| Total assets | **$ 15,375,669** | $14,049,234 | $ 14,108,203 |
| | | | |
| Bonds and notes | **$ 13,910,860** | $ 12,645,541 | $ 12,779,932 |
| Subordinated debt | **50,000** | 50,000 | 50,000 |
| Other liabilities | **140,966** | 143,337 | 127,413 |
| Total liabilities | **14,101,826** | 12,838,878 | 12,957,345 |
| Preferred stock | **482,000** | 482,000 | 482,000 |
| Capital stock | **212,588** | 216,839 | 228,399 |
| Allocated retained earnings | **16,984** | 14,438 | 11,144 |
| Unallocated retained earnings | **534,438** | 471,933 | 407,821 |
| Accumulated other comprehensive income | **27,833** | 25,146 | 21,494 |
| Total members' equity | **1,273,843** | 1,210,356 | 1,150,858 |
| Total liabilities and members' equity | **$ 15,375,669** | $ 14,049,234 | $14,108,203 |

| | Year Ended December 31, | | |
|---|---|---|---|
| **Income Statement** | **2012** | 2011 | 2010 |
| Interest income | **$ 390,364** | $ 422,479 | $ 483,257 |
| Interest expense | **169,540** | 195,650 | 270,737 |
| Net interest income | **220,824** | 226,829 | 212,520 |
| Provision for credit losses | **27,121** | 16,465 | 28,523 |
| Net interest income after provision for credit losses | **193,703** | 210,364 | 183,997 |
| Noninterest income | **49,397** | 28,685 | 44,746 |
| Other expense | **68,520** | 64,853 | 60,293 |
| Net income | **$ 174,580** | $ 174,196 | $ 168,450 |

## Note 19 — Association Mergers

Effective July 1, 2010, AgCredit of South Texas, ACA headquartered in Weslaco, Texas, was acquired by Texas AgFinance, FCS headquartered in Robstown, Texas. The continuing association uses the Texas AgFinance, FCS name and is headquartered in Robstown, Texas. Effective December 1, 2010, Louisiana Ag Credit, ACA headquartered in Arcadia, Louisiana, was acquired by Southern AgCredit, ACA headquartered in Ridgeland, Mississippi. The continuing association uses the Southern AgCredit, ACA name and is headquartered in Ridgeland, Mississippi. The primary reason to merge was based on a determination that the combined organization should be financially and operationally stronger than either association on a stand-alone basis.

According to authoritative accounting guidance, the acquisition method of accounting is required for mergers of cooperatives occurring after January 1, 2009. As the accounting acquirers, Texas AgFinance and Southern AgCredit accounted for the transaction by using their historical information and accounting policies and recording the identifiable assets and liabilities of AgCredit of South Texas and Louisiana Ag Credit as of the acquisition date of July 1, 2010, and December 1, 2010, at their respective fair values. The associations operate for the mutual benefit of their borrowers and other customers and not for the benefit of any other equity investors. As such, their capital stock provides no significant interest in corporate earnings or growth. Specifically, due to restrictions in applicable regulations and their bylaws, the associations can issue stock only at its par value of $5 per share, the stock is not tradable, and the stock can be retired only for the lesser of par value or book value. In these and other respects, the shares of AgCredit of South Texas that were converted into shares of Texas AgFinance and the shares of Louisiana Ag Credit that were converted into shares of Southern AgCredit had identical rights and attributes. For this reason, the conversion of stock pursuant to the merger occurred at a one-for-one exchange ratio. Management believes that because the stock in each association is fixed in value, the stock issued pursuant to the merger provides no basis for estimating the fair value of the consideration transferred pursuant to the merger. In the absence of a purchase price determination, Texas AgFinance and Southern AgCredit identified and estimated the acquisition date fair value of the equity interest of AgCredit of South Texas and Louisiana Ag Credit instead of the acquisition date fair value of the equity interests transferred as consideration. The fair values of the assets acquired, including specific intangible assets and liabilities assumed from AgCredit of South Texas and Louisiana Ag Credit, were measured based on various estimates using assumptions that Texas AgFinance management and Southern AgCredit management believe are reasonable utilizing information available at the merger date. Use of different estimates and judgments could yield materially different results. This evaluation produced a fair value of identifiable assets acquired and liabilities assumed that was substantially equal to the fair value of the member interests transferred in the merger. As a result, Texas AgFinance management and Southern AgCredit management determined goodwill was immaterial and therefore recorded no goodwill. The excess value received by Texas AgFinance from AgCredit of South Texas and the excess value received by Southern AgCredit from Louisiana Ag Credit over par value of capital stock and participation certificates issued in the merger is considered to be additional paid-in-capital.

The following table summarizes the fair values of the identifiable assets acquired and liabilities Texas AgFinance assumed from AgCredit of South Texas and Southern AgCredit assumed from Louisiana Ag Credit upon acquisition:

| | Fair Value | Contractual Amount | Contractual Amounts not Expected to be Collected |
|---|---|---|---|
| Loans | $ 172,293 | $ 177,797 | $ 2,726 |
| Total assets | 181,357 | — | — |
| Notes payable | 153,011 | 153,065 | — |
| Total liabilities | 156,905 | — | — |
| Net assets acquired | 24,452 | — | — |

As AgCredit of South Texas (the acquired entity) and Louisiana Ag Credit (the acquired entity) were affiliated associations of the district prior to the business combination with Texas AgFinance and Southern AgCredit, AgCredit of South Texas's and Louisiana Ag Credit's financial position and results of operations are included in the combined district financial statements for 2010 through the merger date. AgCredit of South Texas's and Louisiana Ag Credit's results of operations for the pre-merger periods were as follows:

| | 2010 |
|---|---|
| Net interest income | $ 3,635 |
| Provision for loan losses | 979 |
| Noninterest income | 823 |
| Noninterest expense | 3,251 |
| (Benefit from) provision for income taxes | (216) |
| Net income (loss) | $ 444 |

## Note 20 — Subsequent Events

The district has evaluated subsequent events through March 1, 2013, which is the date the financial statements were issued. There are no other significant subsequent events requiring disclosure as of March 1, 2013.

# Disclosure Information and Index

*Disclosures Required by Farm Credit Administration Regulations*

## Description of Business

The Farm Credit Bank of Texas (FCBT or bank), Agricultural Credit Associations (ACAs) and a Federal Land Credit Association (FLCA), collectively referred to as the district, are member-owned cooperatives which provide credit and credit-related services to or for the benefit of eligible borrower-shareholders for qualified agricultural purposes in the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. The district's ACA parent associations, which each contain wholly-owned FLCA and Production Credit Association (PCA) subsidiaries, and the FLCA are collectively referred to as associations. A further description of territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations required to be disclosed in this section are incorporated herein by reference to Note 1, "Organization and Operations," to the accompanying financial statements.

The description of significant developments that had or could have a material impact on results of operations or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting business, seasonal characteristics and concentrations of assets, if any, required to be disclosed in this section are incorporated herein by reference to "Management's Discussion and Analysis" of the bank included in this annual report to shareholders.

## Board of Directors and Senior Officers

FCBT is governed by a seven-member board of directors. Five directors are farmers or ranchers, who are elected by the customers of the 17 associations that own the bank. Two directors, who are not stockholders of any of the associations, are appointed by the elected board members. The board of directors is responsible for directing the operations of the bank. The bank's senior officers, through the bank's chief executive officer, are accountable to the board of directors and work with the board of directors to set the bank's direction, goals and strategies.

The following represents certain information regarding the board of directors and senior officers of the bank as of March 1, 2013, including business experience during the past five years:

## Directors

**James F. Dodson, 59**, joined the board of directors in 2003, and his current term expires December 31, 2014. He served as vice chairman from 2009 through 2011, and was elected chairman in January 2012. He is a past chairman of the Texas AgFinance, FCS Board of Directors and a former member of the Texas Farm Credit District's Stockholders Advisory Committee. He is chairman of the Tenth District Farm Credit Council board and serves on the bank's audit and compensation committees. He is a member of the Texas Agricultural Cooperative Council Board of Directors. Dodson grows cotton, corn and milo, and operates a seed sales business with his family in Robstown, Texas. He is the president of Dodson Farms, Inc. and Dodson Ag, Inc., both family-owned cotton and milo operations; and is a partner in Legacy Farms and 3-D Farms, which are farming operations. He is also a partner in Weber Greene Ltd. and managing partner in Weber Station LLC, both of which are farm real estate management companies. Dodson is chairman of the board of the National Cotton Council of America, a trade organization, and serves on the boards of Gulf Coast Cooperative, an agricultural retail cooperative, and the South Texas Cotton and Grain Association, a trade organization. He is also past chairman of the American Cotton Producers of the National Cotton Council of America, a trade organization; formerly served on the board of Cotton Incorporated and is former chairman of the Cotton Foundation, both trade organizations.

**Lester Little, 62**, joined the board of directors in 2009 and his term will expire December 31, 2014. He was elected vice chairman in January 2012. Prior to joining the bank board, Little was chairman of the Capital Farm Credit Board of Directors and previously served as vice chairman of the Texas Farm Credit District's Stockholders Advisory Committee. He also was a member of the district's Association Business Advisory Committee. Little is a member of the bank's audit and compensation committees. He is from Hallettsville, Texas, and owns and operates a farm headquartered in Lavaca County, Texas, with operations in Jackson and Bexar counties. His principal crops include corn, milo, hay and wheat. Little also offers custom-farming services, primarily reclaiming farms and handling land preparation. He serves on the Lavaca Regional Water Planning Group, a regional water planning authority in Texas. Little previously was a board member of the Lavaca Central Appraisal District, a county organization in Texas that hires the chief appraiser for the county for purposes of assigning real estate values for tax assessments, and was board chairman of Hallettsville Independent School District.

**Brad C. Bean, 52**, was elected to his first term on the board of directors effective January 1, 2013, and his current term expires December 31, 2015. He serves as vice chairman of the bank's audit committee and is a member of the bank's compensation committee. Bean is a dairy farmer from Gillsburg, Mississippi, with other farming interests, including corn, sorghum and timber. He serves on the boards of Amite County Farm Bureau and the Amite County Cooperative, both of which are trade organizations. Bean is a former vice chairman of the Texas Farm Credit District's Stockholders Advisory Committee and former chairman of the Southern AgCredit, ACA board of directors.

**Ralph W. Cortese, 66**, joined the board of directors in 1995, and his current term expires December 31, 2013. Cortese served as chairman from 2000 through 2011. Prior to joining the bank board, Cortese was chairman of the PCA of Eastern New Mexico Board of Directors. Early in his career, he was employed by the Federal Intermediate Credit Bank of Wichita and was vice president of Roswell PCA. He is president of Cortese Farm and Ranch Inc., a farming and ranching operation, and is from Fort Sumner, New Mexico. He is vice chairman of the Tenth District Farm Credit Council board. He is a member of the Texas Agricultural

Cooperative Council Board of Directors. Cortese is chairman of the bank's compensation committee and a member of the bank's audit committee. Currently, he serves on the board of the Federal Farm Credit Banks Funding Corporation. He is also a board member of the Texas Agricultural Cooperative Council, an industry association. From 2003 to 2008, Cortese served on the board of the Federal Agricultural Mortgage Corporation (Farmer Mac), a government agency chartered to create a secondary market for agricultural loans. He is a former board member of the American Land Foundation, a property rights organization.

**Joe R. Crawford, 75**, began his first term on the board of directors in 1998, and his current term expired December 31, 2012. Previously, he was a member of the FLBA of North Alabama Board of Directors. He also served on the Tenth District FLBA Legislative Advisory Committee. Crawford was a member of the bank's audit and compensation committees. He was a director on the board and an audit committee member of the Federal Farm Credit Banks Funding Corporation, and his term expired March 14, 2012. He is also 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, all of which are agriculture trade organizations. Crawford, who lives near Baileyton, Alabama, has owned and operated a cattle business since 1968. He retired from the bank's board of directors upon the expiration of his term.

**Elizabeth G. Flores, 68**, joined the board of directors in August 2006 as an outside director, and her current term expires December 31, 2015. She was mayor of Laredo, Texas, where she resides, from 1998 to 2006. Previously, she was senior vice president of Laredo National Bank. Flores is a member of the bank's audit and compensation committees. She also serves on the boards of the Texas Agricultural Cooperative Council, an industry association, and the TMF Health Quality Institute, a nonprofit consulting company. In 2012, Flores was appointed to a three-year term on the Institute of Mexicans in the Exterior, a council that is supported by the Mexican Secretary of State Department and serves to advise the Mexican Government on ways to improve the lives of Mexicans Living Abroad. She is a graduate of Leadership Texas 1995, a leadership program for women professional and community leaders for the state of Texas, and Leadership America 2008, a national leadership program for women professional and community leaders. Flores received the 2006 Cathy Bonner Leadership Award from the Leadership Texas Alumnae Association. In 2010, Flores was appointed to serve as a member of the Farm Credit System Diversity Workgroup. She is a partner in a ranching and real estate limited partnership, E.G. Ranch, Ltd. She is a former member of the Federal Reserve Board Consumer Advisory Council.

**Jon M. Garnett, 68**, began his first term on the board of directors in 1999, and his current term expires December 31, 2013. He was board vice chairman from 2000 through 2008. Prior to joining the bank board, he was chairman of the Panhandle-Plains Land Bank, FLCA Board of Directors from 1995 to 1998. He is a former member of the Farm Credit Bank of Texas Retirement Committee. In January 2003, he joined the national Farm Credit Council (FCC) Board of Directors as a district representative, became vice chairman in 2009 and served as chairman from 2011 to 2013. In addition, he is vice chairman of the FCC board's compensation and benefits committee, and a member of the executive, governance and coordinating committees. He is vice chairman of the bank's compensation committee and is a member of the bank's audit committee. Garnett is a member of the State Technical Committee for the Natural Resources Conservation Service, an agency of the United States Department of Agriculture. He raises grain and forage and runs stocker cattle near Spearman, Texas, and is president of Garnett Farms, Inc., a farming operation. Garnett is a former consumer cooperative director, Spearman Chamber of Commerce director, a trade organization, and former Spearman Independent School District board member.

**William F. Staats, 75**, joined the board of directors in 1997 as an outside director, and his current term expires December 31, 2014. Staats is a professor emeritus of finance at Louisiana State University, where he held the Louisiana Bankers Association Chair of Banking and the Hermann Moyse Jr. Distinguished Professorship. Previously, he was vice president and corporate secretary of the Federal Reserve Bank of Philadelphia. Staats also serves on the boards of the Money Management International Financial Education Foundation and Money Management International, both of which are credit counseling agencies. He also serves on the boards of SevenOaks Capital Associates, LLC, a diversified financial services company providing working capital to trucking firms, and Lakeside Bank, a community bank in Lake Charles, Louisiana. He is vice chairman of the Farm Credit System audit committee, is chairman of the bank's audit committee, serves on the bank's compensation committee, and is the bank's designated financial expert. He is also a member of the Texas Lutheran University Board of Regents.

## Committees

The board of directors has established an audit committee and a compensation committee. All members of the board serve on both the audit committee and the compensation committee. As the need arises, a member of the board of directors will also participate in the functions of the bank's credit review committee. The responsibilities of each board committee are set forth in its respective approved charter.

The disclosure of director and senior officer information included in this disclosure information and index was reviewed by the compensation committee prior to the annual report's issuance (including the disclosure information and index) on March 1, 2013.

## Compensation of Directors

Directors of the bank are compensated in cash for service on the bank's board. An annual compensation amount is considered as a retainer for all services performed by the director in an official capacity during the year except for extraordinary services for which additional compensation may be paid. The annual retainer fee is to be paid in equal monthly installments. Compensation for 2012 was paid at the rate of $54,467 per year, payable at $4,539 per month. In addition to days served at board meetings, directors may serve additional days on other official assignments and under exceptional circumstances where extraordinary time and effort are involved, the board may approve additional compensation, not to exceed 30 percent of the annual maximum allowable by FCA regulations. Additional compensation was approved by the board during 2011 to Ms. Flores for participation as faculty in a panel discussion at a Farm Credit Council Director Leadership Conference held in December 2011. The additional compensation of $3,000 was paid in January 2012 and is reflected in the table below. No director received non-cash compensation exceeding $5,000 in 2012. Total cash compensation paid to all directors as a group during 2012 was $384,269. Information for each director for the year ended December 31, 2012, is provided below:

| Board Member | Days Served at Board Meetings* | Days Served on Other Assignments** | Total Paid |
|---|---|---|---|
| James F. Dodson | 30.0 | 35.5 | $ 54,467 |
| Lester Little | 30.0 | 32.5 | 54,467 |
| Ralph W. Cortese | 30.0 | 29.5 | 54,467 |
| Joe R. Crawford | 27.5 | 26.5 | 54,467 |
| Elizabeth G. Flores | 30.0 | 39.0 | 57,467 |
| Jon M. Garnett | 30.0 | 34.5 | 54,467 |
| William F. Staats | 30.0 | 27.0 | 54,467 |
| | | | $ 384,269 |

* Includes travel time, but does not include time required to prepare for board meetings.

** Includes audit committee meetings, compensation committee meetings, credit review committee meetings, special assignments, training and travel time.

Directors are reimbursed for reasonable travel, subsistence and other related expenses while conducting bank business. The aggregate amount of expenses reimbursed to directors in 2012, 2011 and 2010 totaled $136,352, $144,376 and $120,413, respectively. A copy of the bank's travel policy is available to shareholders upon request.

### Senior Officers of the Bank

| Name and Title | Time in Position | Experience – Past Five Years | Other Business Interests – Past Five Years |
|---|---|---|---|
| Larry R. Doyle,<br>*Chief Executive Officer* | 9.5 years | Chief Executive Officer, FCBT | He served as a member of the board of directors for the Federal Farm Credit Banks Funding Corporation, with his term expiring in 2011. |
| Kurt Thomas,<br>Senior Vice President,<br>*Chief Credit Officer* | 2.6 years | Vice President and Unit Manager Association Direct Lending Group, FCBT | He served as a member of the board of governors for the Farm Credit System Captive Insurance Corporation with his term expiring in February 2011. |
| Kyle Pankonien,<br>*Senior Vice President,*<br>*Corporate Affairs, General Counsel and Corporate Secretary* | 5 years | Vice President, Corporate Affairs, Deputy General Counsel, FCBT | |
| Amie Pala,<br>*Chief Financial Officer* | 2.4 years | Vice President of Financial Management, FCBT | |
| Allen Buckner,<br>*Chief Operations Officer* | 2.5 years | Vice President of Lending Systems 2007-2010, FCBT; Vice President, Credit Operations and Risk Management 2006-2007, FCBT.<br>Chief Executive Officer, Heritage Land Bank, ACA, January 2006 - December 2006 | |
| Stan Ray,<br>*Chief Administrative Officer* | 2.4 years | Vice President of Marketing and Corporate Relations, FCBT | He serves on the AgFirst/FCBT Plan Sponsor Committee and the Texas District Benefits Administration Committee, and is president of the Texas District Farm Credit Council, a trade organization. He is a member of the board of directors for the following organizations: Texas Agriculture Finance Authority, a service providing arm of the Texas Department of Agriculture; Texas FFA Foundation, a nonprofit organization promoting youth in agriculture; Grow Texas Foundation, a nonprofit organization advocating the agriculture industry; Texas Agricultural Cooperative Council, an industry association; and the Star of Texas Fair and Rodeo, a nonprofit organization promoting youth education and western heritage. |
| Susan Wallar,<br>*Chief Audit Executive* | Appointed January 2012 | Vice President of Internal Audit, FCBT | She serves as a member of the board of governors for the Farm Credit System Captive Insurance Corporation. |

## Compensation Discussion and Analysis — Senior Officers

### Overview

The board of directors of the Farm Credit Bank of Texas, through its compensation committee, has pursued a compensation philosophy for the bank that promotes leadership in the adoption and administration of a comprehensive compensation program so that:

- Competent senior officers can be attracted, developed and retained for the delivery of performance that will result in the execution of the bank's strategic business plan;
- Operational activities that produce bank efficiencies and produce financial results that maximize the principles of a cooperative organization will be rewarded;
- Consistent application of compensation programs will link compensation to bank performance and levels of accountability for the achievement of the bank's strategies and programs; and,
- Market-based base salaries, benefits and bonus compensation will position the bank to be a competitive employer in the financial services marketplace.

With data derived from an independent third-party compensation consultant, the compensation committee considers market salary data of peers in the financial services sector to ensure that base salaries and bonus plan structures are in line with market-comparable positions with similarly situated financial institutions. This study provides the basis for actions by the compensation committee to approve the compensation level and bonus plan structure of the bank's chief executive officer (CEO) annually. Additionally, the compensation committee reviews the compensation policies and plans for the other senior officers of the bank and other employees, and approves the overall compensation program for the senior officers. The bank's compensation program encompasses four primary elements: (1) base salary, (2) discretionary bonus compensation, (3) bank-paid retirement benefits and (4) perquisites such as bank-provided vehicles, executive physicals, insurance benefits and education and fitness reimbursements.

### Chief Executive Officer (CEO) Compensation Table and Policy

In December 2010, a memorandum of understanding between the bank and the CEO was executed with an effective date of January 2, 2011. The memorandum of understanding was effective for a term of three years, until December 31, 2013. The base salary for each year of the three-year term for the CEO will be $1,250,000. Bonus payments, if any, are at the sole discretion of the compensation committee. With the execution and effective date of the memorandum of understanding, the CEO received a signing bonus of $500,000 paid in January 2011, with certain claw-back provisions should the CEO resign without good reason or employment is terminated by the bank for cause. The employment relationship between the bank and CEO remains at-will, meaning the bank may terminate the CEO's employment at any time, and the CEO may choose to leave at any time but may be subject to the claw-back provision discussed above.

The following table summarizes the compensation paid to the CEO of the bank during 2012, 2011 and 2010.

**Summary Compensation Table for the CEO**

| | | Annual | | | | | |
|---|---|---|---|---|---|---|---|
| Name of Chief Executive Officer | Year | Salary (a) | Bonus (b) | Change in Pension Value (c) | Deferred/Perquisites (d) | Other (e) | Total |
| Larry R. Doyle | 2012 | $ 1,250,048 | $ 1,000,000 | $ 178,046 | $ 21,063 | $ — | $ 2,449,157 |
| Larry R. Doyle | 2011 | 1,250,048 | 1,250,000 | 116,660 | 20,868 | — | 2,637,576 |
| Larry R. Doyle | 2010 | 750,029 | — | 82,331 | 20,486 | — | 852,846 |

(a) Gross salary for year presented.

(b) Bonus compensation is presented in the year earned, and bonuses are paid within the first 30 days of the subsequent calendar year. For 2012, bonus compensation was paid in January 2013 of $1,000,000 for the performance of the bank during 2012. For 2011, a signing bonus of $500,000 was paid in January 2011 for the execution and effective date of the memorandum of understanding previously discussed. Also included in the 2011 bonus compensation is a bonus paid in January 2012 of $750,000 for the performance of the bank during 2011. For 2010, no bonus for performance was paid to the CEO in accordance with the Compensation Agreement entered into in November 2008 between the bank and the CEO.

(c) For 2012, 2011 and 2010, disclosure of the change in pension value represents the change in the actuarial present value of the accumulated benefit under the defined benefit pension plan, the Farm Credit Bank of Texas Pension Plan, from the pension measurement date used for financial statement reporting purposes with respect to the audited financial statements for the prior completed fiscal year to the pension measurement date used for financial statement reporting purposes with respect to the audited financial statements for the covered fiscal year.

(d) Deferred/Perquisites include contributions to a 401(k) plan, automobile benefits and premiums paid for life insurance.

(e) No values to disclose.

### Pension Benefits Table for the CEO

The following table presents the total annual benefit provided from the defined benefit pension plan applicable to the CEO for the year ended December 31, 2012:

| Name | Plan Name | Number of Years Credited Service | Present Value of Accumulated Benefit | Payments During 2012 |
|---|---|---|---|---|
| Larry R. Doyle | Farm Credit Bank of Texas Pension Plan | 38.933 | $ 1,425,214 | $ — |

### Pension Benefits Table Narrative Disclosure for the CEO

The CEO participates in the Farm Credit Bank of Texas Pension Plan (the "Pension Plan"), which is a qualified defined benefit retirement 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 and bonus 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 percent of FAC60 times "Years of Benefit Service" and (b) 0.50 percent 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 benefit is calculated assuming retirement had occurred at the measurement date used for financial statement reporting purposes with retirement at age 60. 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, (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, or (d) by a service period of greater than 35 years. 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.

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 paid to the CEO in January 2010, and (iii) annual base salary of $750,000 for 2009 and 2010. In exchange for those benefits, the Compensation Agreement provided that the CEO would not (1) participate in the Supplemental Pension Plan after 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. The Compensation Agreement was not an employment contract. The deferred compensation provisions of the Compensation Agreement were intended to be an unfunded nonqualified deferred compensation plan for tax purposes, were 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. The Compensation Agreement was superseded by the memorandum of understanding executed with an effective date of January 2, 2011.

## Compensation of Other Senior Officers

The following table summarizes the compensation paid to the aggregate number of senior officers of the bank during 2012, 2011 and 2010. Amounts reflected in the table are presented in the year the compensation is earned.

**Summary Compensation Table**

| | | Annual | | | | |
|---|---|---|---|---|---|---|
| Name of Individual or Group | Year | Salary (a) | Bonus (b) | Deferred/Perquisites (c) | Other (d) | Total |
| Aggregate number of senior officers: (excludes Chief Executive Officer) | | | | | | |
| 6 | 2012 | $ 1,423,966 | $ 569,564 | $ 166,040 | $ — | $ 2,159,570 |
| 6 | 2011 | 1,534,398 | 479,813 | 1,632,082 | — | 3,646,293 |
| 7 | 2010 | 2,379,479 | 409,876 | 5,223,633 | 28,512 | 8,041,500 |

(a) Gross salary, including retention plan compensation for certain senior officers.

(b) Bonuses paid within the first 30 days of the subsequent calendar year.

(c) Deferred/Perquisites include contributions to 401(k) and defined contribution plans, supplemental 401(k) discretionary contributions, automobile benefits and premiums paid for life insurance. For 2012, Deferred/Perquisites also include educational assistance paid on behalf of a senior officer. For 2011, Deferred/Perquisites also includes payments of $1,478,241 to certain senior officers from the discontinuation of the Supplemental Pension Plan effective January 16, 2011, with payment to the respective individuals on January 31, 2012, and educational assistance paid on behalf of a senior officer. For 2010, Deferred/Perquisites also includes payments of $5,078,396 to certain senior officers that withdrew from the Supplemental Pension Plan in 2010.

(d) Other for 2010 reflects an amount paid to one senior officer for their remaining annual leave hours at retirement. No such amounts were paid or earned in 2012 or 2011.

For 2010, the aggregate number of senior officers includes two senior officers that ended their employment with the bank during 2010.

Other senior officers of the bank are eligible for deferred compensation plans and can participate in a retention plan, at the discretion and approval of the bank board's compensation committee. Amounts paid in 2012, 2011 and 2010 to any senior officer associated with the retention plan are reflected in the salary column in the above table. Senior officers, other than the CEO, participate in a bank discretionary bonus program, whose terms and conditions are detailed in writing as a Success Sharing Plan, with awards annually approved by the board's compensation committee. Neither the CEO nor any other senior officer received non-cash compensation exceeding $5,000 in 2012.

Disclosure of the compensation paid during 2012 to any senior officer or officer included in the table is available and will be disclosed to shareholders of the institution and stockholders of the district's associations upon written request.

Senior officers, including the CEO, are reimbursed for reasonable travel, subsistence and other related expenses while conducting bank business. A copy of the bank's travel policy is available to shareholders upon request.

Bank employees, other than the CEO, can earn compensation above base salary through an annual Success Sharing Plan, which the bank adopted in 2001. The Success Sharing Plan is based upon the achievement of bank performance, which is approved by the bank board's compensation committee, annually, and payment is determined by the compensation committee in its discretion. The compensation committee typically evaluates for purposes of the Success Sharing Plan several key financial indicators, the bank's list of accomplishments as it relates to the bank's strategic objectives and operational projects for that respective year. The compensation committee has the discretion to determine the amount of the Success Sharing Plan awarded and the percentage of the award target that will be funded. In addition, the bank maintains a retention plan, which is determined at the discretion and approval of the bank board's compensation committee. The Farm Credit Bank of Texas Employee Retention Plan (Retention Plan) is an unfunded nonqualified deferred compensation plan that was created and approved by the bank's board of directors in 2007 as a means to induce specific employees to accomplish certain activities and remain with the bank for a defined period of time. Participants are nominated by the CEO and approved by the bank board's compensation committee. The Retention Plan is constructed to be flexible as to the length of the retention period and the amounts paid for each year of successful participation in the Retention Plan. Certain senior officers and other bank employees, other than the CEO, have participated in the Retention Plan with individual three-year plans that paid a fixed percentage of their salary as long as they were still employed on the anniversary or ending date coincident with the effective date of each participant's plan year. As of December 31, 2011, the certain bank senior officers and other bank employees had met the conditions of the plan, and the respective cash payments occurred according to the three-year plans. The compensation committee in its discretion has also approved shorter term retention plans to assist in succession in key positions. One employee, who is not a senior officer, is currently actively participating in such a Retention Plan, with a minimal cash payment expected in the latter part of 2013.

Effective January 16, 2011, the bank's board of directors approved the termination and liquidation of the Farm Credit Bank of Texas Supplemental Pension Plan (the "Supplemental Pension Plan"), a nonqualified deferred compensation plan. As previously noted, 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, (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, or (d) by a service period of greater than 35 years. By terminating the Supplemental Pension Plan, no further vesting or benefit accrual occurred under the Supplemental Pension Plan following January 16, 2011, for the respective participants. All remaining unpaid vested benefits were distributed in a cash lump-sum payment to the participating bank employees after the one-year deferral period as required by Section 409A of the Internal Revenue Code. The impact of the termination and liquidation of the Supplemental Pension Plan was not material to the bank's financial results and was reflected in the December 31, 2011, financial results of the bank. The cash lump-sum payment to the participating bank employees occurred on January 31, 2012.

## Description of Property

On September 30, 2003, the bank entered into a lease for approximately 102,500 square feet of office space to house its headquarters facility located at 4801 Plaza on the Lake Drive, Austin, Texas. The lease was effective September 30, 2003, and its term was from September 1, 2003, to August 31, 2013. On November 16, 2010, the bank entered into a lease amendment which extended the term of the lease to August 31, 2024. In addition, the lease amendment included expansion of the leased space to approximately 111,500 square feet of office space and an "early out" option to terminate the lease in 2020. The district associations own 15 headquarter locations and lease two. There are 121 owned and 72 leased association branch locations. The bank's and associations' investment in property is further detailed in Note 5, "Premises and Equipment," to the accompanying combined financial statements.

## Legal Proceedings

There were no matters that came to the attention of the board of directors or management regarding the involvement of current directors or senior officers in specified legal proceedings which are required to be disclosed.

There are no legal proceedings pending against the bank and associations, the outcome of which, in the opinion of legal counsel and management, would materially affect the financial position of the bank and associations. Note 13, "Commitments and Contingencies," to the accompanying financial statements outlines the bank's position with regard to possible contingencies at December 31, 2012.

## Description of Capital Structure

The bank and associations are authorized to issue and retire certain classes of capital stock and retained earnings in the management of their capital structures. Details of the capital structures are described in Note 9, "Members' Equity," to the accompanying combined financial statements, and in the "Management's Discussion and Analysis" of the district included in this annual report to stockholders.

## Description of Liabilities

The district's debt outstanding is described in Note 8, "Bonds and Notes," to the accompanying financial statements. The district's contingent liabilities are described in Note 13, "Commitments and Contingencies," to the accompanying financial statements.

## Selected Financial Data

The selected financial data for the five years ended December 31, 2012, required to be disclosed, is incorporated herein by reference to the "Five-Year Summary of Selected Combined Financial Data" included in this annual report to stockholders.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

"Management's Discussion and Analysis," which precedes the combined financial statements in this annual report, is incorporated herein by reference.

## Transactions With Senior Officers and Directors

The policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference to Note 12, "Related Party Transactions," to the accompanying financial statements.

## Related Party Transactions

As discussed in Note 1, "Organization and Operations," the bank lends funds to the district associations to fund their loan portfolios. Interest income recognized on direct notes receivable from district associations was $194,211, $244,215 and $305,160 for 2012, 2011 and 2010, respectively. Further disclosure regarding these related party transactions is found in Note 4, "Loans and Allowance for Loan Losses," and Note 9, "Members' Equity."

In addition to providing loan funds to district associations, the bank also provides banking and support services to them, such as accounting, information systems, marketing and other services. Income derived by the bank from these activities was $2,686, $4,245 and $8,557 for 2012, 2011 and 2010, respectively, and was included in the bank's noninterest income. Effective in April 2011, the bank will only bill associations for direct pass-through expenses and no longer bill for allocated expenses.

The bank had no transactions with nor loans to directors or senior officers, their immediate family members, or any organizations with which such senior officers or directors are affiliated, during 2012, 2011 or 2010.

## Relationship With Public Accountants

The district's auditors are PricewaterhouseCoopers LLP. There were no changes in independent public accountants since the prior annual report to stockholders, and there were no material disagreements with our independent public accountants on any matter of accounting principles or financial statement disclosure during this period.

During 2012, district entities engaged PricewaterhouseCoopers LLP for fees of $1.2 million for audit services, $98 thousand for an Agreed Upon Procedures review on specific policies and procedures, and $18 thousand for audit-related services relating to consultation on various accounting matters. During 2012, district entities engaged PricewaterhouseCoopers LLP for non-audit-related services of $144 thousand. The non-audit services provided for the bank and combined district include tax return preparation.

## Financial Statements

The combined financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 1, 2013, and the report of management in this annual report to stockholders, are incorporated herein by reference.

The Farm Credit Bank of Texas and its affiliated associations' (district) annual and quarterly reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720 or by calling (512) 483-9204. Copies of the district's quarterly and annual stockholder reports can be requested by e-mailing fcb@farmcreditbank.com. The district's quarterly reports are available approximately 40 days after the end of each fiscal quarter. The district's annual report will be posted on the bank's website (at www.farmcreditbank.com), within 75 calendar days of the end of the district fiscal year. This posting coincides with an electronic version of the report being provided to its regulator, the Farm Credit Administration. Within 90 calendar days of the end of the district fiscal year, a copy of the district's annual report will be provided to its stockholders.

## Borrower Information Regulations

Farm Credit Administration (FCA) regulations require that borrower information be held in strict confidence by Farm Credit institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA board adopted a policy that requires Farm Credit institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the annual report to shareholders. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

## Credit and Services to Young, Beginning and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products (YBS)

In line with our mission, we have policies and programs for making credit available to young, beginning and small farmers and ranchers.

The definitions for YBS, as prescribed by FCA regulations, are provided below.

Young Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.

Beginning Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who had 10 years or less of experience at farming, ranching or producing or harvesting aquatic products as of the date the loan was originally made.

Small Farmer or Rancher – A farmer, rancher or producer or harvester of aquatic products who normally generated less than $250,000 in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

For the purposes of YBS, the term "loan" means an extension of, or a commitment to extend, credit authorized under the Farm Credit Act, whether it results from direct negotiations between a lender and a borrower or is purchased from, or discounted for, another lender, including participation interests. A farmer/rancher may be included in multiple categories as they are included in each category in which the definition is met.

The bank and associations' efforts to respond to the credit and related needs of YBS borrowers are evidenced by the following table:

| | At December 31, 2012 | |
|---|---|---|
| *(dollars in thousands)* | Number of Loans | Volume |
| Total loans and commitments | 66,770 | $ 21,010,652 |
| Loans and commitments to young farmers and ranchers | 11,879 | $ 1,846,857 |
| Percent of loans and commitments to young farmers and ranchers | 17.8% | 8.8% |
| Loans and commitments to beginning farmers and ranchers | 34,075 | $ 6,867,794 |
| Percent of loans and commitments to beginning farmers and ranchers | 51.0% | 32.7% |

The following table summarizes information regarding new loans to young and beginning farmers and ranchers:

| | For the Year Ended December 31, 2012 | |
|---|---|---|
| *(dollars in thousands)* | Number of Loans | Volume |
| Total new loans and commitments | 14,482 | $ 7,353,431 |
| New loans and commitments to young farmers and ranchers | 2,308 | $ 614,611 |
| Percent of new loans and commitments to young farmers and ranchers | 15.9% | 8.4% |
| New loans and commitments to beginning farmers and ranchers | 5,882 | $ 1,904,883 |
| Percent of new loans and commitments to beginning farmers and ranchers | 40.6% | 25.9% |

The following table summarizes information regarding loans to small farmers and ranchers:

| | At December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Annual Gross Sales | | | | |
| *(dollars in thousands)* | $50 Thousand or Less | $50 to $100 Thousand | $100 to $250 Thousand | More Than $250 Thousand | Total |
| Total number of loans and commitments | 15,193 | 16,563 | 19,843 | 15,171 | 66,770 |
| Number of loans and commitments to small farmers and ranchers | 11,360 | 13,029 | 15,173 | 8,535 | 48,097 |
| Percent of loans and commitments to small farmers and ranchers | 74.8% | 78.7% | 76.5% | 56.3% | 72.0% |
| Total loans and commitments volume | $ 1,945,292 | $ 998,349 | $ 2,615,241 | $ 15,451,770 | $ 21,010,652 |
| Total loans and commitments to small farmers and ranchers volume | $ 273,617 | $ 724,219 | $ 1,962,402 | $ 4,978,579 | $ 7,938,817 |
| Percent of loans and commitments volume to small farmers and ranchers | 14.1% | 72.5% | 75.0% | 32.2% | 37.8% |

The following table summarizes information regarding new loans made to small farmers and ranchers:

| | For the Year Ended December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Annual Gross Sales | | | | |
| *(dollars in thousands)* | $50 Thousand or Less | $50 to $100 Thousand | $100 to $250 Thousand | More Than $250 Thousand | Total |
| Total number of new loans and commitments | 3,393 | 2,654 | 3,813 | 4,622 | 14,482 |
| Number of new loans and commitments to small farmers and ranchers | 2,375 | 1,973 | 2,591 | 1,762 | 8,701 |
| Percent of new loans and commitments to small farmers and ranchers | 70.0% | 74.3% | 68.0% | 38.1% | 60.1% |
| Total new loans and commitments volume | $ 88,312 | $ 194,236 | $ 628,864 | $ 6,442,019 | $ 7,353,431 |
| Total new loans and commitments to small farmers and ranchers volume | $ 65,433 | $ 148,465 | $ 424,316 | $ 1,316,391 | $ 1,954,605 |
| Percent of loan and commitment volume to small farmers and ranchers | 74.1% | 76.4% | 67.5% | 20.4% | 26.6% |