National Rural Utilities
Cooperative Finance Corporation

National Rural Utilities Cooperative Finance Corporation (CFC)

Implementation of Dodd-Frank Act 2011

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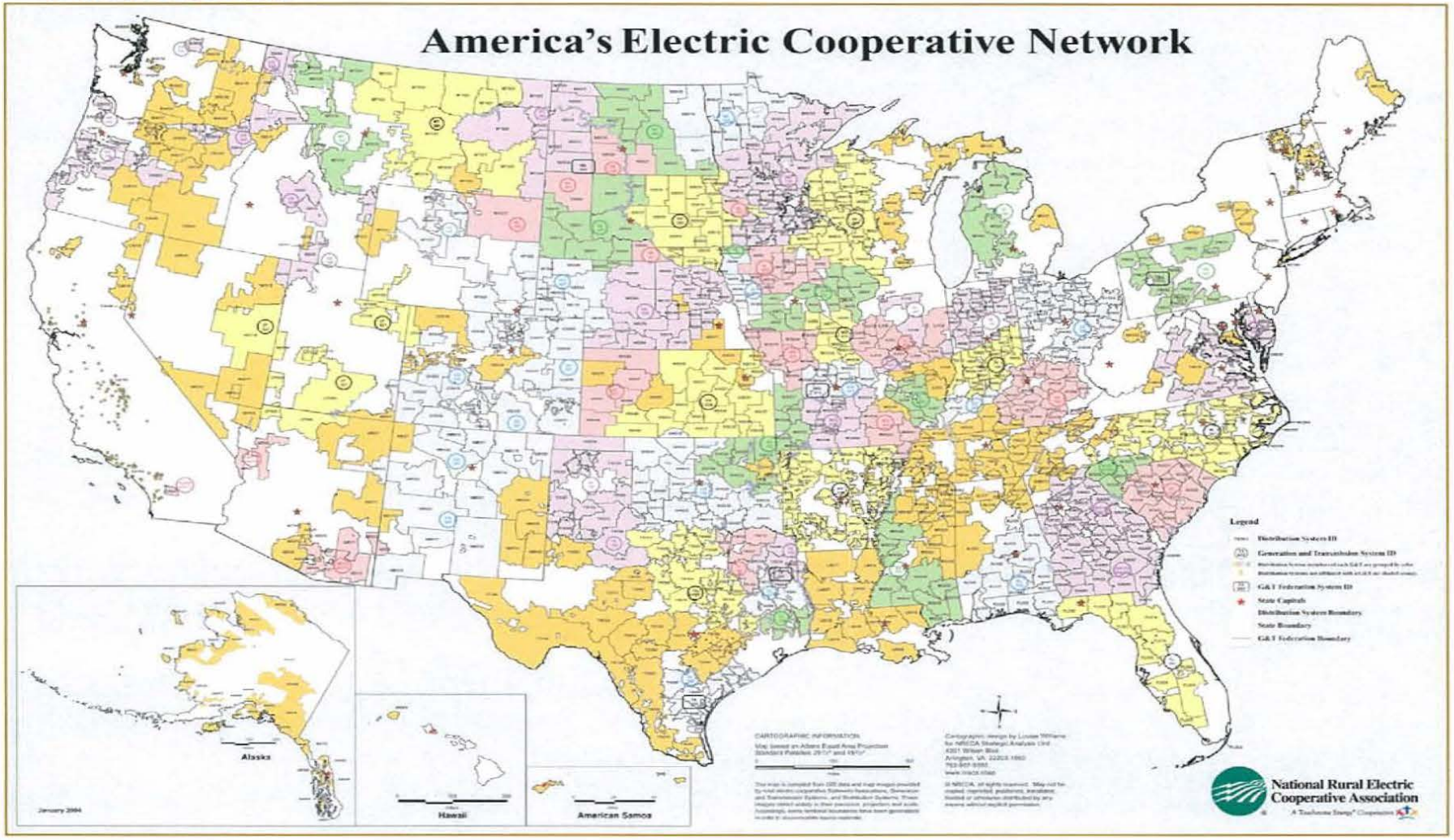
A. Introduction to CFC

CFC is an Important Source of Capital to Utilities in Rural America

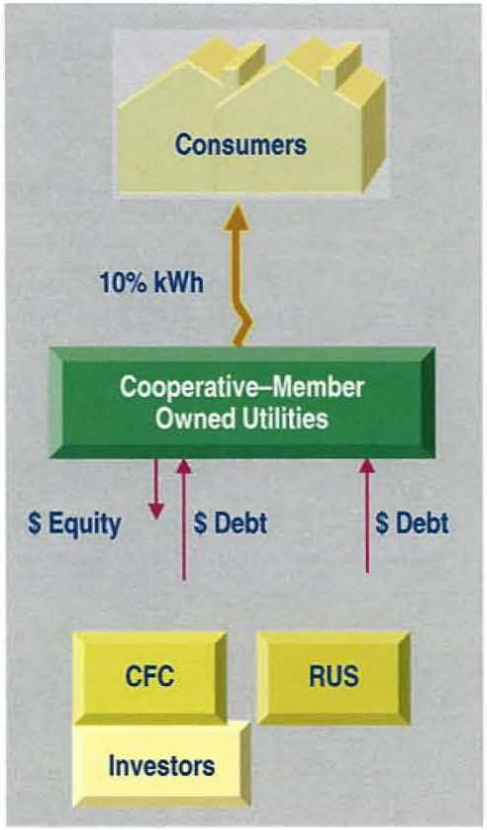
- **Member-owned cooperative association**
  - Established in 1969; owned by America's electric cooperatives
  - Private financing arm of America's rural utility systems
- **CFC's owners can qualify as commercial end users under DFA.**

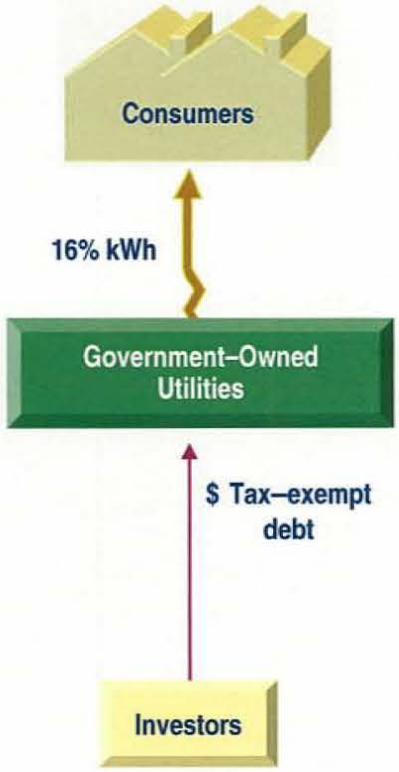
CFC's Purpose is to Provide Financing so that Electric Cooperatives can Provide Electric Power to Rural America.



Electric Cooperatives: A Small But Important Segment of the Industry

- Generation primarily built to meet native load requirements of member distribution systems only — no merchant or independent power producer risk; limited nuclear plant investment.
- Access to federal power on a preferential basis.
- Distribution companies have defined service territories — largely residential and small commercial customers.
- Generally, co-ops are able to opt out of deregulation in applicable states.
- Low cost (T+12 bps) long-term funding from USDA/ RUS, treasury rate funding.
- Stable operations and industry outlook.





Data Source: NRECA, Strategic Analysis, February 2007.

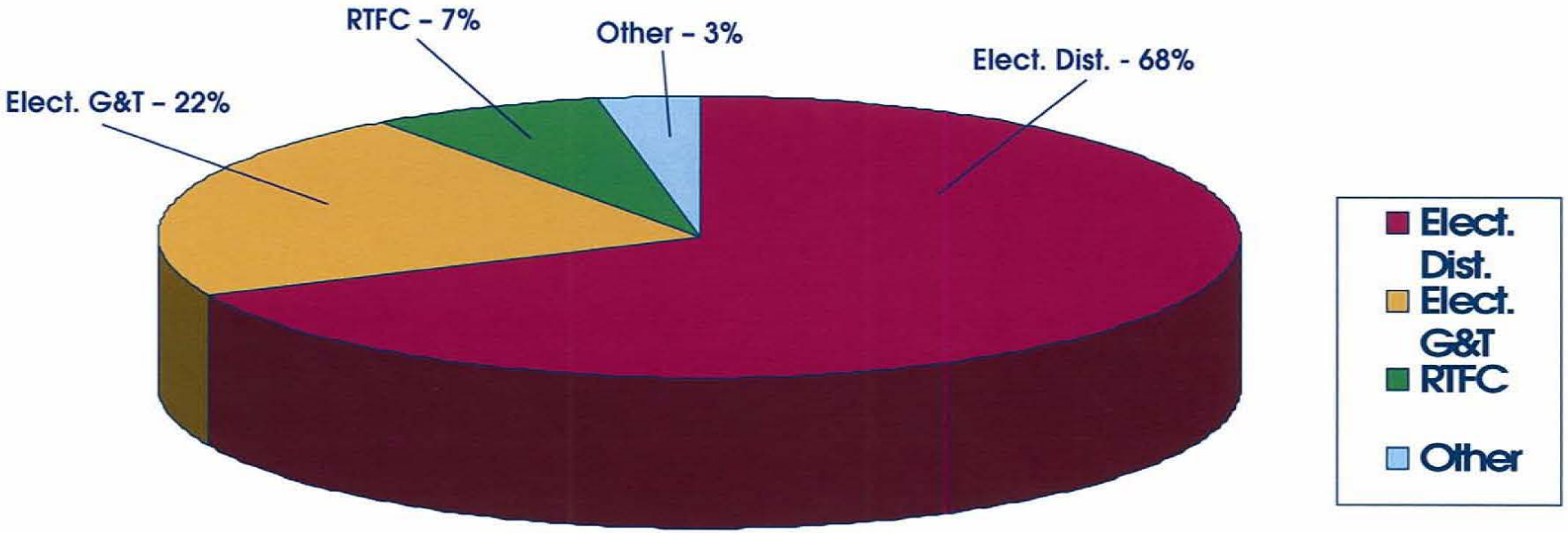
Rural Electric Cooperatives – Principles & Values

1. Voluntary and open membership – Are open to all persons able to use their services and willing to accept the responsibilities of membership.
2. Democratic member control – Cooperatives are democratic organizations controlled by their members, who participate in setting their policies and making decisions.
3. Member economic participation – Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative.
4. Autonomy and independence – Cooperatives are autonomous corporations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by members and maintain their cooperative autonomy.
5. Consumer education to members – Cooperatives provide education, training and information for their members so they can contribute effectively to the development of their cooperatives.
6. Cooperation among cooperatives – Serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.
7. Concern for community – While focusing on member needs cooperatives work for the sustainable development of their communities through policies accepted by members.

As a Cooperative CFC is Owned by and Exclusively Serves its Members

Members	System Functions
Distribution Cooperatives	Most electric cooperatives are distribution utilities purchasing wholesale power from others to distribute it, over their own distribution lines, to the ultimate customer.
Power Supply (Generation & Transmission) Cooperatives	Generation and transmission cooperatives carry high voltage electricity from generation facilities over long distances. G&Ts provide both generation and transmission functions.
Statewide and Associate Members	Most states have statewide associations supported by local cooperatives in that state. Provides a variety of services and legislative representation for members.
Rural Telephone Finance Cooperative (RTFC)	Affiliated business line for lending to rural telephone companies and their affiliates.
National Cooperative Services Corporation (NCSC)	Affiliated business line for providing financing to the for-profit or non-profit entities that are owned, operated or controlled by or provide substantial benefit to, members of CFC.

Loan and Guarantee Portfolio Overview



As of August 31, 2010

CFC's Public Purpose

- **CFC is different from traditional financial service organizations.**
- **CFC focuses exclusively on providing capital to the rural utility industry.**
  - Management incentives are designed to reinforce its long-term mission and credit ratings
  - Cooperative structure and nonprofit tax-exempt status influences capital structure
  - High asset portfolio quality with low delinquency rate and high recovery rate
- **Electric cooperatives provide affordable and reliable electric power in the most rural areas of the USA.**
  - Provide essential service
  - Are managed in a conservative manner
  - For the most part, are not rate regulated
  - Consistently report strong metrics
  - Do not have motivation for speculative investments

CFC's Objective is to offer Cost-Based Financial Products, not to Maximize its Net Income.

Loan Options	
Lines of Credit	unsecured credit loans for short–term working capital needs.
Long–term Concurrent Financing	long–term financing of up to 35 years to supplement Rural Utilities Service (RUS) loans.
100% Long–term Financing	lending to independent borrowers (members that have chosen to leave the RUS program).
Letters of Credit	short–term lending that enhance the credit to trading partners and other suppliers.
PowerVision™	financing with a draw period of five years for electric plant or other approved purposes.
Associate Member Financing	lending to not–for–profit cooperative organizations that are owned, operated, or controlled by a National Rural distribution, G&T, statewide, or regional owner and that are providing non–electric services for the benefit of their consumers.
RUS Guaranteed Loans	available funding for electric facilities, with the RUS repayment guarantee helping to keep interest rates down.
Joint CFC–RUS Combustion Turbine Financing	provide funds to meet cash requirements prior to permanent financing from RUS.
Clean Renewable Energy Bonds (CREBs)	provides electric cooperatives and other not–for–profit utilities incentives to invest in renewable generation resources.

CFC Is Committed to Strong Corporate Governance

- Board of Directors consists of twenty-three persons elected from general membership:
  - Twenty general managers or directors from member systems.
  - Two from the industry's trade association, National Rural Electric Cooperative Association (NRECA).
  - One at-large position that meets the requirements of the audit committee financial expert (as defined by Section 407 of the Sarbanes-Oxley Act of 2002).
- No members of CFC management hold board seats.
- Elected member serves a 3-year term; limited to a maximum of 2 consecutive terms.
- Regularly meets in executive sessions; management may not attend.
- Maintains audit, finance advisory, executive, loan, and corporate relations committees.
- Audit committee consists of no less than seven board members. Meetings held up to 5 times a year with external and internal auditors in executive session without CFC management present.
- Board members affiliated with a cooperative requesting a loan or guarantee are not allowed to attend or participate in the decision-making process.

Background of NRUCFC

- National Rural Utilities Cooperative Finance Corporation is a member–owned, non–governmental organization that provides financial products to 1,526 member systems consolidated across the United States of America.
  - The Company offers full–service financing, investment, and related services to its members, and offers a wide range of flexible, low–cost financing programs and interest rate options.
  - Headquartered in Herndon, Virginia, outside of Washington, D.C., the Company raises funds for loan programs with support of its owners' equity and investments through the sale of multiple financing vehicles in the private and public financial markets.
  - The Company is governed by a 23–member board made up of cooperative utility directors and managers. It has approximately 231 employees, including well seasoned regional credit portfolio managers.
- Points to Remember:
  - Primary objective is to provide its utility members/owners with an assured source of capital at the lowest reasonable loan and guarantee rates consistent with sound financial performance.
  - Has no exposure to residential mortgages, mortgage–backed securities, collateralized loan or debt obligations, or structured investment vehicles. Financial derivatives only utilized for interest rate and currency hedging.
  - NRUCFC is a member–owned finance company. CFC is not a bond insurance company.
  - Largest non–governmental lender to rural utility industry in the U.S.A with over $20 billion of gross loans outstanding, and its owners have invested over $4 billion in a wide array of securities at November 30, 2008.
  - NRUCFC has securities listed on NYSE and is a "Well-Known and Seasoned Issuer" in the public markets. The company is subject to the Sarbanes-Oxley law and is in compliance with all applicable requirements.

B. How and Why CFC Uses Derivatives

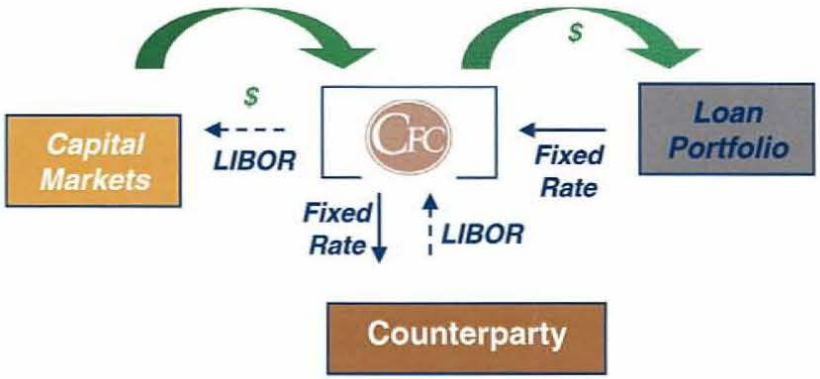
How & Why CFC Uses Derivatives

- **Derivative use is limited to plain vanilla interest rate exchange agreements. Since 1983, CFC has executed derivatives for the following reasons:**
  - To practice good risk management
  - To match-fund its fixed and variable loan pools and manage the size of its warehouse/prefund position
  - To provide flexibility in loan structuring and match cash-flows that may have deferral periods, accretions and other types of amortizations
  - To mitigate interest rate risk on forward starting loans
  - To create lower cost synthetic fixed/floating liabilities vs. issuance in the cash market
  - To limit exposure to exchange rate fluctuations when foreign currency denominated debt is issued. (None currently outstanding.)

CFC uses Derivatives to Hedge Market Interest Rate Risk

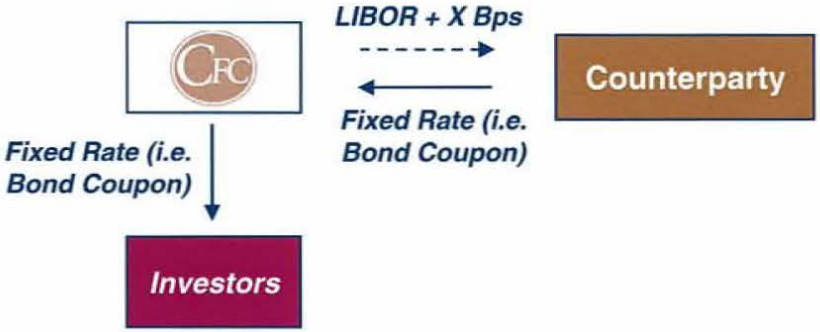
- In this example, CFC receives fixed interest from an aggregate loan portfolio but pays floating LIBOR to capital market investors. This mismatch in interest rate creates exposure, prompting CFC to swap the fixed rate from its loan portfolio to floating.

Pay-Fixed Swap



- In this example, CFC issues fixed rate notes and uses the proceeds to pay down Commercial Paper. CFC then swaps the fixed notes to floating so as to maintain its floating exposure and achieve a lower cost of funds.

Pay-Floating Swap



Interest Rate Management

- **Credit and market risk associated with the derivatives portfolios is offset and managed through the following:**

  -Highly rated, diverse counterparties consisting of participants in CFC's revolving credit facilities

  -Transactions are awarded on multi-tranche basis to ensure competitive pricing and to allow benchmark comparison when calculating fair values

  -Notional limits per counterparty

  -Offsetting trades executed with individual counterparties to reduce overall net credit exposure

  -Counterparty rating triggers embedded for long-dated swap tenors

  -Netting/resetting provisions

  -CFC has fully executed ISDAs with every swap counterparty

  -Complete legal review of all swap confirms on executed trades

  -Thorough external and internal audit review of overall swap portfolio management and supporting documentation

CFC Enters into Swaps with Highly Rated Counterparties

SWAP PORTFOLIO BY RATING 5.31.2010

S&P RATINGS				MOODY'S RATINGS			
Range	Number of Banks	Notional	% of Portfolio	Range	Number of Banks	Notional	% of Portfolio
AAA to AA-	5	2,435,992,325	22%	Aaa to Aa3	13	7,885,335,946	70%
A+ to A	12	8,069,939,046	72%	A1 to A2	5	2,800,005,425	25%
BBB to BBB+	2	508,346,000	5%	Baa1	2	508,346,000	5%
NR	1	179,410,000	2%				
	20	**11,193,687,371**	**100%**		**20**	**11,193,687,371**	**100%**

CFC Enters into a Limited Number of Swaps Each Year.

Deal Count	Year	Notional
42	1998	1,334,710,896
11	1999	974,350,000
32	2000	3,998,853,500
40	2001	7,617,378,573
21	2002	6,514,500,000
45	2003	4,433,402,643
14	2004	1,058,531,800
35	2005	3,247,134,500
20	2006	1,451,878,525
31	2007	2,945,218,401
25	2008	2,203,708,000
17	2009	1,558,201,100
14	2010	1,091,684,925
347		**38,429,552,863**

C. CFC Should be Exempt from DFA's Margining & Clearing Requirements

CFC Should be Exempt from the Margining and Clearing Requirements of DFA.

- **CFC is owned by and functions as a private financing arm for entities that are commercial end users eligible for exemption.**
- **Transferring Risk to a Clearing Organization is not needed**
  - CFC effectively manages its derivatives portfolio
  - CFC has the financial strength to meet obligations associated with non-cleared Swaps:
    - CFC is rated at A+ level for senior secured debt
    - CFC has never missed any payment on an obligation
    - CFC has substantial liquidity
    - CFC's portfolio strength is due to the nature of its membership

CFC's Credit Rating History

Senior Secured Debt		
Year	Moody's Investors Service	Standard & Poor's Corporation
1972-1973	A	A
1974	A	A+
1975-1978	A	AA
1979-1984	Aa	AA
1985-1989	Aa2	AA
1990	Aa3	A+
1991-1993	Aa3	A+
1994-2000	Aa3	AA
2001	Aa3	AA-
2002-2010	A1	A+

Liquidity Management

- At August 31, 2010, CFC had the following projected liquidity sources available:

Liquidity Source	Amount ($Millions)
Cash and Cash Equivalents	$451
Scheduled Loan Amortization & Prepayments [1]	$1,267
Farmer Mac Revolving Funding Availability [2]	$913
Excess CP and Daily Liquidity Fund ("DLF") [3]	$459
Bank Bid Note Capacity [4]	$470
Total	$3,560

[1] Scheduled loan amortization and expected prepayments over the next twelve months

[2] The amount available was reduced to $513 million due to the issuance of notes totaling $400 million under these note purchase agreements in September and October 2010.

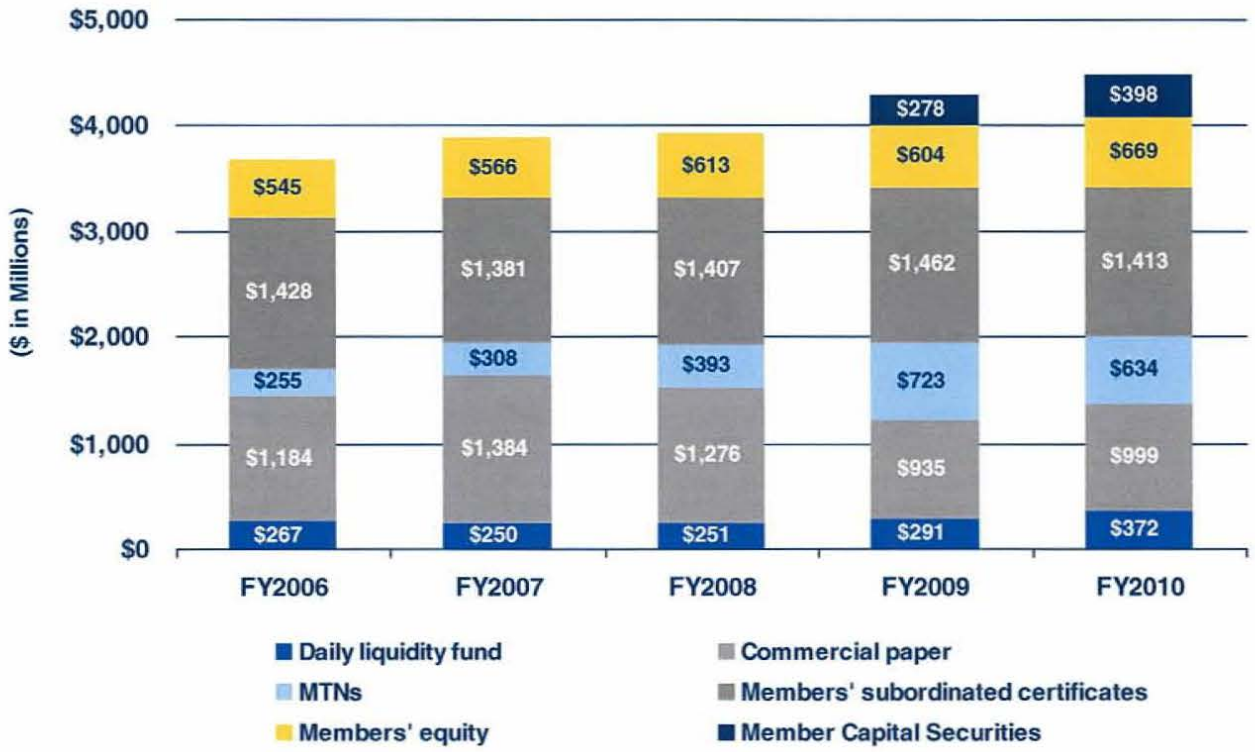
[3] CFC limits the amount of CP and DLF to the amount of backup liquidity available under our bank lines.

[4] Unadvanced portion subject to market conditions

- Rural Economic Development Loan & Grant (REDLG) program: $500 million available commitment in November 2010.
- CFC is a well-known seasoned issuer and believes it has adequate access to both long-term and short-term global funding options.

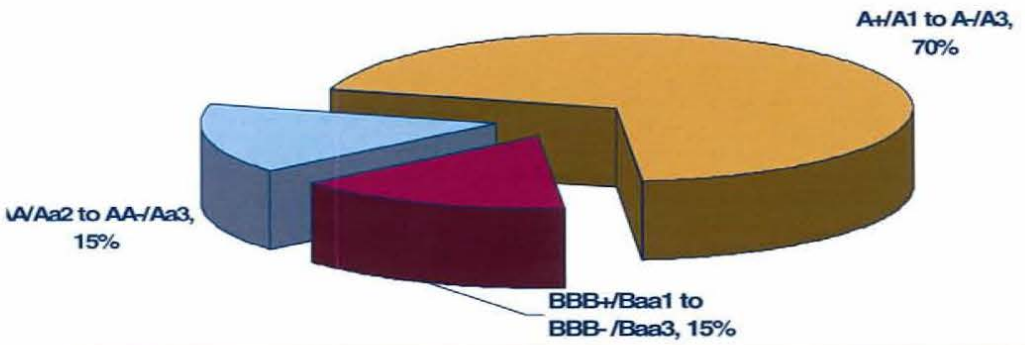
Strong Member Support

- **At May 31, 2010, CFC's members provided more than $4.4 billion in capital to CFC.**
- **CFC's members have consistently increased their financial commitment to CFC over the years.**

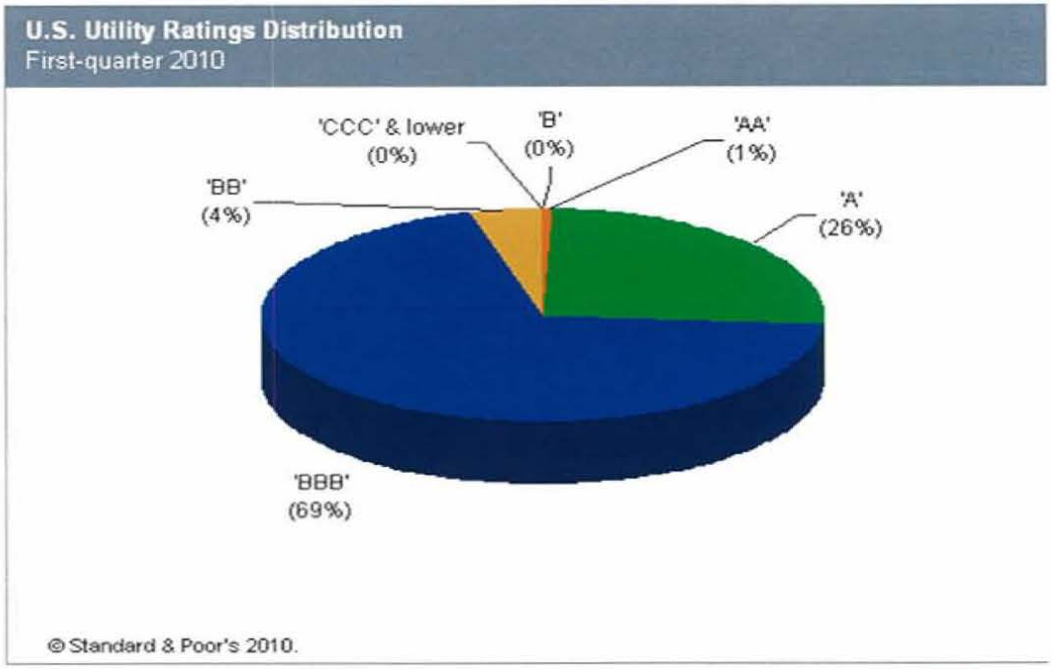


Electric Cooperatives Have Higher Credit Ratings than Investor Owned Electric Utilities

U.S. Publicly Rated Electric Cooperatives [1]



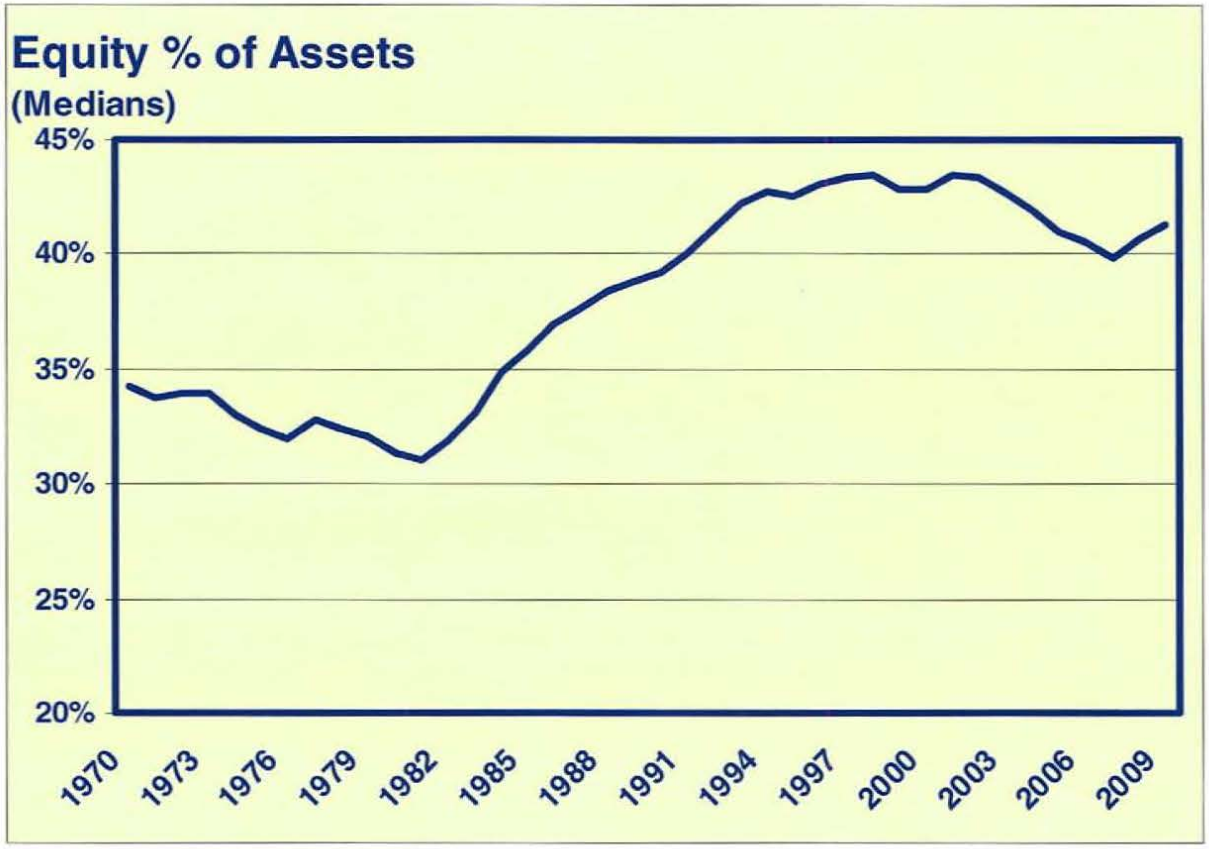
U.S. Shareholder-Owned Electric Utilities [2]



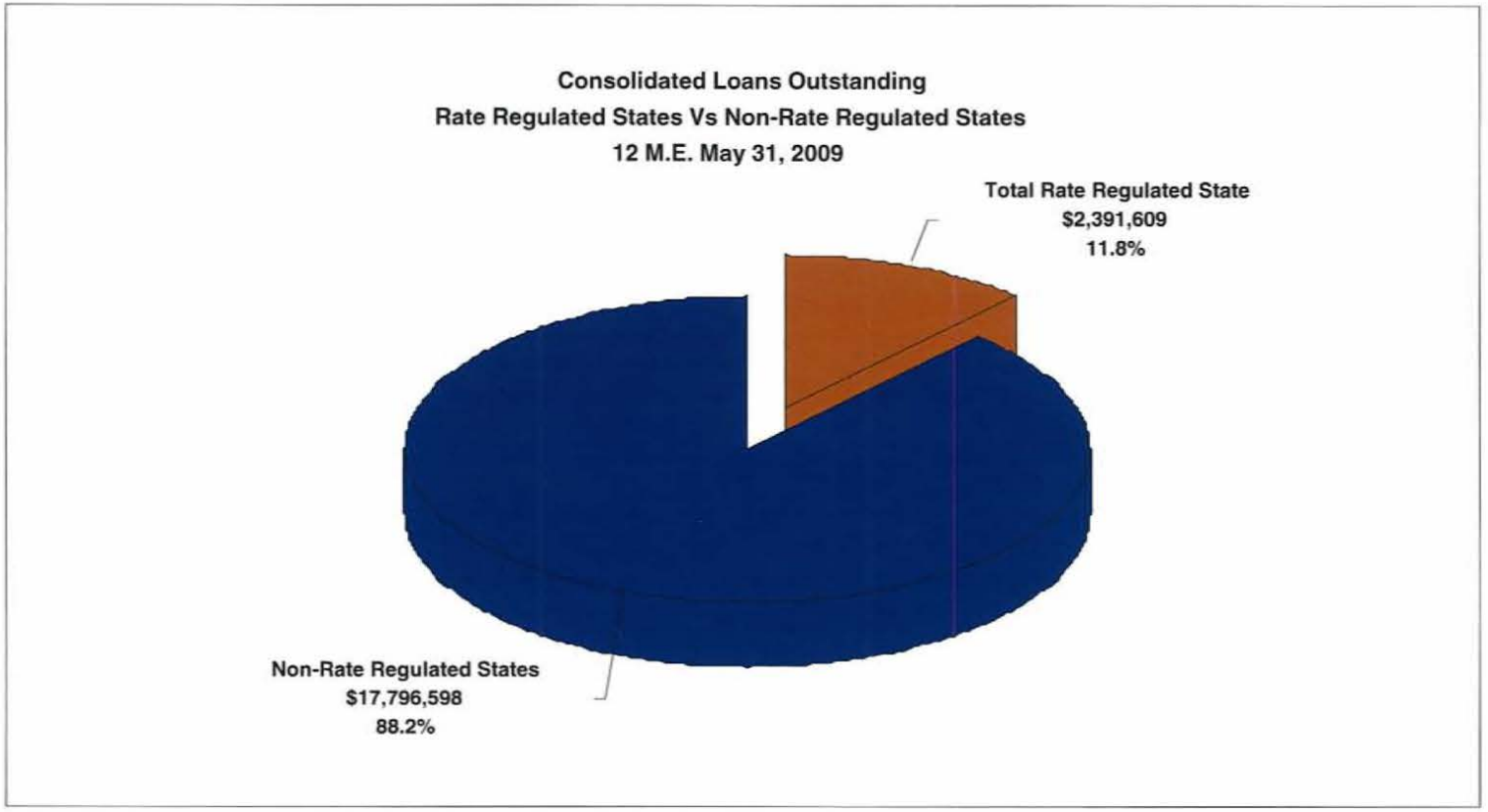
Source: [1] Moody's Investor Service, Standard & Poor's & Fitch Ratings, May 2010
[2] Standard & Poor's, First Quarter 2010
Note: Only about 33 electric co-ops have a public rating.

Co-op Ratepayers Have a Strong History of Reliable and Timely Payments of Electric Bills

Equity of Rural Electric Distribution Systems



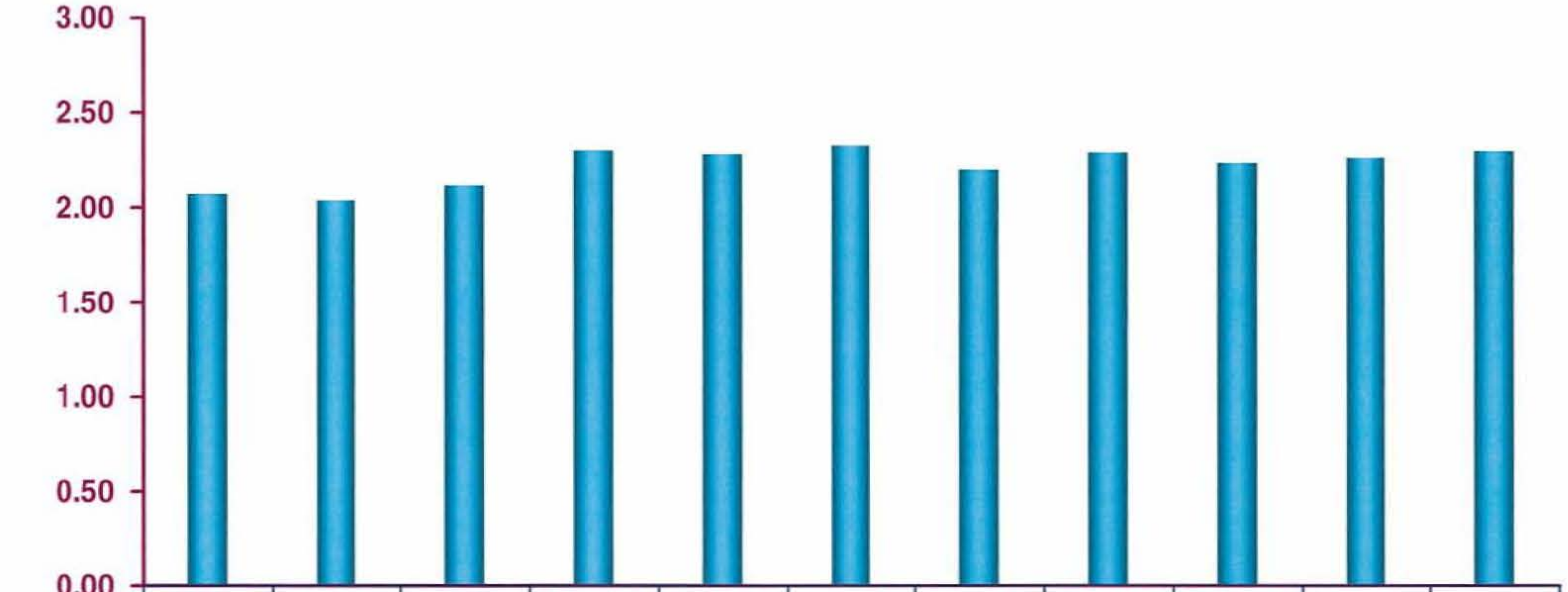
Electric Co-op and CFC Exposure to Adverse Regulatory Orders is Limited



Source: CFC

Times Interest Earned Ratio (TIER) for Electric Distribution Co-ops

Medians



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
TIER	2.07	2.03	2.11	2.30	2.28	2.33	2.20	2.29	2.24	2.27	2.30

RUS requires a 1.25 TIER, high 2 of most recent 3 years. CFC requires a 1.35 MDSC, high 2 of most recent 3 years.

D. Specific Requests for Consideration

1) CFC should not be considered a "Financial Entity" subject to mandatory clearing and Collateral Requirements

- CFC was created and is controlled by nonprofit entities for which it serves as a non-governmental financing arm – essentially an extension of its nonprofit member-owners, which are not "financial entities" themselves.
- The Rural Electric Cooperatives that own CFC qualify for the commercial end user exemption.

CFC should not be considered a "Financial Entity"

- CFC does not engage in the business of banking in a manner akin to depository institutions or other for profit financial entities.
- CFC lends only to its members, not to the general public.

CFC should not be considered a "Financial Entity"

We suggest language such as the following to clarify that CFC should not be swept up in the definition of "financial entity":

- " 'Financial entity' does not include: a nonprofit tax-exempt cooperative that is not a depository institution and a majority of whose members are nonprofit tax-exempt cooperatives that are not financial entities."
- "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt cooperative structure, and its associated public purpose."

2) CFC should qualify for the End-User Clearing exemption as an Affiliate of End Users

- DFA: "An affiliate of a person that qualifies for (the end-user exemption) may qualify for the exemption only if the affiliate, acting on behalf of the person and as an agent, uses the swap to hedge or mitigate the commercial risk of the person or other affiliate of the person that is not a financial entity."
- CFC's members own CFC and control CFC on a "one member, one vote" basis.
- CFC's use of derivatives is done "on behalf of" its members. CFC is owned by its members and exists only to serve them.

CFC should qualify for the Affiliate Exemption

- CFC's members qualify for the end-user exemption.
- The majority of CFC's members are small entities that do not execute standalone derivatives themselves. CFC fills this void and thereby offers smaller cooperatives the same pricing and flexibility that larger utilities can obtain.

CFC should qualify for the Affiliate Exemption

We suggest language such as the following to clarify the application of the affiliate exception:

- "For purposes of this section, an 'affiliate' of a person includes a nonprofit, tax-exempt cooperative (i) of which the person is a member, and (ii) which is not a depository institution."
- "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt cooperative structure, and its associated public purpose."
- "For purposes of this section, 'acting on behalf of the person and as an agent' includes: (a) hedging or mitigating a risk that arises from financing provided to the person by an affiliate of that person; or (b) acting for the benefit of that person."

3) CFC should qualify for the "Parent Company" exemption of DFA

- This exemption excludes from the definition of "financial entity":
  - "An entity whose primary business is providing financing and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company."

CFC should qualify for the Parent Company Exemption

- More than 90% of CFC business consists of providing financing to its rural electric system member-owners and their related organizations.
- CFC uses derivatives to hedge interest rate risk related to its financing business, never to speculate.
- Collectively, CFC's member-owners are analogous to "parent companies" of CFC. While CFC is not a subsidiary of any other entity, it is a cooperative formed and sustained by the collective efforts of its members. CFC exists to serve those members by providing them with financing.
- CFC's member-owners distribute, transmit and generate electricity. Thus, CFC's use of derivatives arises from the financing of facilities needed to create and deliver a product – electricity.

CFC should qualify for the Parent Company Exemption

We suggest language such as the following:

- "For purposes of this section, 'Financing that facilitates the purchase or lease of products' shall include financing that facilitates the provision of electric service."
- "For purposes of this section, 'manufacturing' includes the generation, transmission, and/or distribution of energy, such as electricity."
- "For purposes of the section, 'parent company' shall include the members of a nonprofit tax-exempt cooperative that is not a depository institution."
- "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt cooperative structure, and its associated public purpose."

4) Definition of "Highly Leveraged" should consider the Unique Capital Structure of CFC

- CFC's metrics and capital structure differ from for-profit banks and savings and loan institutions.
- Because of its nonprofit cooperative and tax exempt status, CFC is unable to issue equity securities.
- Instead of Equity Securities, CFC issues long-dated subordinated debt (Capital Term Certificates) to its members. These securities and retained earnings provide "equity like" comfort to investors in CFC securities.
- The subordinated certificates held by our member owners are available to absorb losses and CFC has offset rights against any amounts owned by the member to CFC.
- There is precedent for treating similar securities as the functional equivalent of regulatory capital.

Definition of "Highly Leveraged" should consider CFC's Unique Capital Structure

- CFC's Capital Structure and use of "Adjusted Equity" and other metrics has been well accepted for 40 years by rating agencies and creditors.
- Since CFC's inception in 1969 all of its debt indentures have treated member subordinated certificates as equity for purposes of covenant compliance, and rating agencies have given equity credit for these securities.
- Since implementing SFAS 133 (Accounting for Derivative Investments and Hedging Activities in 2001) CFC has reported adjusted measures that include its member subordinated certificates in calculating adjusted equity.
- CFC requests that the CFTC not rely solely on GAAP or for-profit banking standards to determine whether an entity is "highly leveraged."

CFC's Non-GAAP Measures of Adjusted Leverage and Adjusted Debt to Equity

(dollar amounts in thousands)	May 31, 2010	2009	2008	2007	2006
Liabilities	$19,556,448	$20,463,605	$ 18,699,169	$17,843,151	$18,373,319
Less:					
Derivative liabilities	(482,825)	(493,002)	(171,390)	(71,934)	(85,198)
Foreign currency valuation account	-	-	-	-	(244,955)
Debt used to fund loans guaranteed by RUS	(237,356)	(243,997)	(250,169)	(255,903)	(261,330)
Subordinated deferrable debt (1)	(311,440)	(311,440)	(311,440)	(486,440)	(636,440)
Subordinated certificates	(1,810,715)	(1,740,054)	(1,406,779)	(1,381,447)	(1,427,960)
Adjusted liabilities	$16,714,112	$17,675,112	$ 16,559,391	$15,647,427	$15,717,436
Total equity	$ 586,767	$ 519,100	$ 680,212	$ 732,030	$ 806,302
Less:					
Prior year cumulative derivative forward value and foreign currency adjustments	121,560	(38,457)	(137,200)	(231,035)	(224,824)
Year-to-date derivative forward value (income) loss	(2,696)	160,017	98,743	79,281	(28,805)
Current period foreign currency adjustments	-	-	-	14,554	22,594
Accumulated other comprehensive income (2)	(7,489)	(8,115)	(8,827)	(12,204)	(13,208)
Plus:					
Subordinated certificates	1,810,715	1,740,054	1,406,779	1,381,447	1,427,960
Subordinated deferrable debt (1)	311,440	311,440	311,440	486,440	636,440
Adjusted equity	$ 2,820,297	$ 2,684,039	$ 2,351,147	$ 2,450,513	$ 2,626,459
Guarantees	$ 1,171,109	$ 1,275,455	$ 1,037,140	$ 1,074,374	$ 1,078,980

(1) At May 31, 2007 and 2006, includes $175 million and $150 million, respectively, of subordinated deferrable debt classified in short-term debt.
(2) Represents the accumulated other comprehensive income related to derivatives.

Source: CFC's Form 10-K, May 31, 2010

CFC's Non-GAAP Measures of Adjusted Leverage and Adjusted Debt to Equity (cont.)

The leverage and debt to equity ratios using GAAP financial measures are calculated as follows:

$$\text{Leverage ratio} = \frac{\text{Liabilities + guarantees outstanding}}{\text{Total equity}}$$

$$\text{Debt to equity ratio} = \frac{\text{Liabilities}}{\text{Total equity}}$$

The adjusted leverage and debt to equity ratios are calculated as follows:

$$\text{Adjusted leverage ratio} = \frac{\text{Adjusted liabilities + guarantees outstanding}}{\text{Adjusted equity}}$$

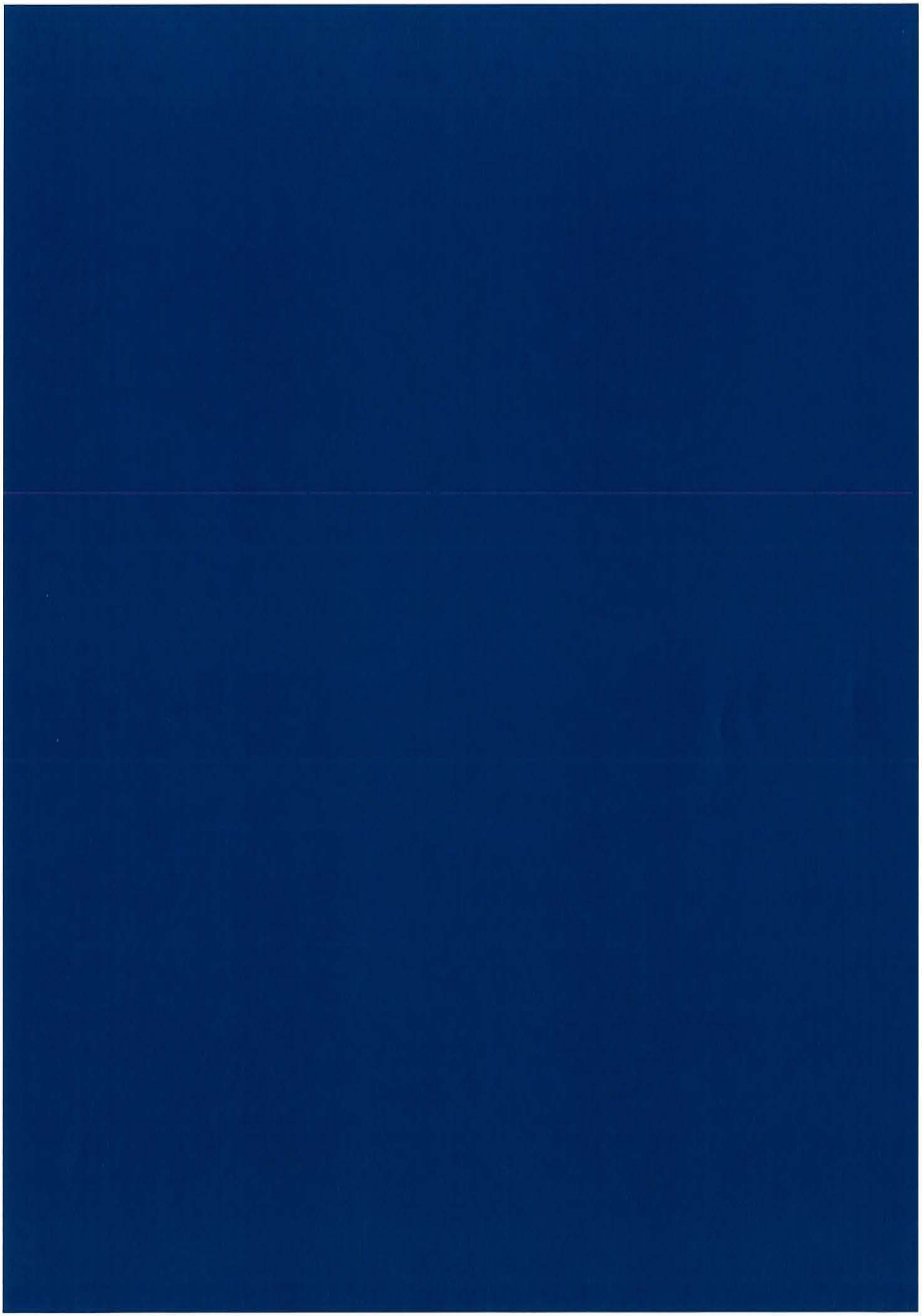
$$\text{Adjusted debt to equity ratio} = \frac{\text{Adjusted liabilities}}{\text{Adjusted equity}}$$

The following table provides the calculated ratio for leverage and debt to equity, as well as the adjusted ratio calculations, as of the five years ended May 31, 2010.

	May 31,				
	2010	2009	2008	2007	2006
Leverage ratio	35.33	41.88	29.01	25.84	24.13
Adjusted leverage ratio	6.34	7.06	7.48	6.82	6.40
Debt to equity ratio	33.33	39.42	27.49	24.37	22.79
Adjusted debt to equity ratio	5.93	6.59	7.04	6.39	5.98

Source: CFC's Form 10-K, May 31, 2010

Definition of "Highly Leveraged" should consider CFC's Unique Capital Structure

We suggest language such as the following to clarify the definition of "highly leveraged":

- "In case of a nonprofit tax-exempt cooperative that is not a depository institution, 'equity' shall be calculated to include subordinated debt issued by such cooperative and held by the member-owners of such cooperative."
- "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt, cooperative structure, and its associated public purpose and the amounts and characteristics of its subordinated debt."