

OFFICE OF
INSPECTOR GENERAL

Survey Report

Survey of
Farm Credit System Institutions
Regarding the Agency's
Examination Function

Second Quarter
Fiscal Year 2017
(Jan. 1 - March 31, 2017)

Issued July 7, 2017



FARM CREDIT ADMINISTRATION

Office of Inspector General's Survey of Farm Credit System Institutions
Regarding the Agency's Examination Function
Second Quarter Fiscal Year 2017 Summary Report
(January 1 - March 31, 2017)

Introduction

During the period January 1 – March 31, 2017, the Office of Examination identified thirteen Farm Credit System (FCS) institutions that were in a position to provide meaningful survey responses.

The Office of Inspector General (OIG) sent surveys to those institutions on May 8, 2017. Eleven of the thirteen institutions surveyed submitted completed surveys (85% response rate). When outstanding responses from prior quarters are received, they are included in the next quarterly report. The OIG did not receive any responses to prior surveys; therefore, no additional responses are included in this report.

The OIG will continue to provide a report to you based on each Fiscal Year (FY) quarter-end, i.e., December 31, March 31, June 30, and September 30; we trust this will give you an opportunity to take timely action should you find it necessary. The fourth quarter report will include FY 2017 summary data.

The survey asks respondents to rate the eight survey statements from "1" (Completely Agree) to "5" (Completely Disagree). The rating options are as follows:

Completely Agree	1
Agree	2
Neither Agree nor Disagree	3
Disagree	4
Completely Disagree	5
Does Not Apply (not included in averages)	6

Narrative responses are provided verbatim, except identifying information has been removed and any grammatical, punctuation and spelling errors may have been corrected. Any narrative in “brackets” is explanatory information provided by the OIG based on conversations with institution management.

Survey Results – Second Quarter FY 2017

Average numerical responses to survey statements 1–8 ranged from 1.5 to 2.0 for the second quarter.

Average Numerical Response Range to Survey Statements 1–8

2 nd Quarter FY17	1 st Quarter FY17	4 th Quarter FY16	3 rd Quarter FY15
1.5 – 2.0	1.6 – 2.0	1.3 – 2.0	1.6 – 2.2

The average numerical response for all survey statements was 1.7 for the second quarter.

Average Numerical Response for all Survey Statements

2 nd Quarter FY17	1 st Quarter FY17	4 th Quarter FY16	3 rd Quarter FY15
1.7	1.8	1.7	1.9

In this quarter, there were more positive than negative narrative comments to survey statements 1–8. (Perceived negative comments of any degree are color coded in **maroon**.)

Survey item 9 asks for feedback on the most beneficial aspect of the examination process. Consistent with prior quarters’ responses to this survey item, many very positive comments were provided about the examiners and the examination process.

Survey item 10 asks for feedback on the least beneficial aspect of the examination process. While most were negative, as would be expected, several comments provide a perspective that should prove constructive.

Survey item 11 asks for any additional comments from the board as a whole. It elicited several thoughtful responses from full boards, which was the objective of the question.

EXAMINATION PROCESS

Survey Statement 1: The scope of examination activities was focused on areas of risk to the institution and appropriate for the size, complexity, and risk profile of the institution.

Average Response: 1.6

Statement 1	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 2017	1.8	1.6			1.7
FY 2016	1.6	1.8	1.9	1.7	1.8
FY 2015	2.4	1.8	1.9	1.9	2.0
FY 2014	2.0	2.2	2.4	1.9	2.1

Comments:

- They took into consideration past experience and size and impact on FCS Administration.
- In general, we agree that the examination activities were focused on the appropriate areas of risk to the institution and were appropriate for our size, complexity, and risk profile. **We do however continue to struggle with the examination team's focus on the institution's management of market value of equity.** The institution consistently has expressed its strategic view of managing IRR in a manner that supports stable net interest income in all rate environments. Our eleven consecutive years of increasing earnings has illustrated this strategy has resulted in an institution with solid earnings performance and the ability to build capital and pay patronage. The rating agencies have consistently rated the institution and the System very highly because earnings are the first line of defense when problems arise with capital being the second line of defense. The institution's board of directors has established limits on market value of equity, and the institution performs well within those limits. **Every examination of the finance/treasury area brings with it an element of the regulator's displeasure with our market value of equity sensitivity. Many times, this displeasure comes in the form of comments related to the institution's adopting of short funding to enhance earnings or to risk related to the institution's funds transfer pricing process. When discussions occur related to these issues the examination team always circles back to market value of equity sensitivity.**

The institution has had several productive meetings with the examination staff where we have invited the capital markets specialists to have a dialog about a single topic. For the last two years, we have met with agency staff in a non-examination environment to discuss the institution's pension strategy. FCA has participated in person and via video conference call. These meetings are very beneficial and generally take about a half day. In addition, we invited the FCA capital markets

specialist to come down and discuss our interest rate risk management process. The meeting included our CEO. The session was very informative and comfortable allowing participants to discuss concepts in detail. **Unfortunately, this did not translate back into an understanding of the institution's management of market value of equity risk when the examination cycle occurred.** We will continue to work with FCA staff and keep conducting these types of information sharing sessions. We appreciate their time and willingness to participate. With respect to the portion of the examination focused on the institution's IT operations, the scope of the examination findings was relevant and the recommendations were appropriate.

- The scope of examination activities at the institution appeared to be comprehensive and appropriately considered the risks within and facing the organization. The institution has made a considerable investment to develop and maintain a strong control environment which was appropriately considered by the FCA as part of their examination activities. Additionally, the examiners appeared to increase their leverage of the work performed by the institution's 2nd and 3rd lines of defense to better understand risks within the organization and the underlying control environments prior to developing their review plans and during their onsite review activities.
- **Larger score in mid-year examinations, anticipated crop and credit weaknesses that had not really materialized yet.**

Survey Statement 2: Examiners appropriately applied laws, regulations, and other regulatory criteria to examination findings and conclusions.

Average Response: 1.7

Statement 2	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 2017	1.8	1.7			1.8
FY 2016	1.9	1.8	2.1	1.8	1.9
FY 2015	2.0	1.7	1.5	1.8	1.8
FY 2014	1.8	2.1	1.9	1.8	1.9

Comments:

- We agree the examination team generally applied the appropriate laws, regulations and regulatory criteria to the current examination findings and conclusions. **Many times, however, we find that examiners look to other financial regulatory agencies for guidance, which, while it can be worthwhile, needs to be balanced with the unique attributes of the Farm Credit System's business model. Because System banks and associations are non-depository institutions with limited business lines, a more flexible and practical application of the other federal financial regulators' guidance to our business model is needed. One recent example is the recommendation by FCA examiners that the institution monitor the relationship of book capital to market value of capital and have the board establish a threshold limit for the variance. While this concept is important to an institution that has publicly traded stock, it provides little value to our business model. Instead, we believe that the appropriate course of action for examiners is to consider other financial regulatory agency guidance as a point of reference, but at the same time ensure that its application really addresses the real risks presented in a System institution.**
- As expected, the examination activity included a review of regulatory requirements and the institution's compliance with such requirements. In completing the compliance review, the examiners focused significantly on the technical and specific letter of the law reading to identify non-compliance issues. **In a handful of cases, the institution had trouble connecting these technical findings with the achievement of the intent and spirit of the regulations. In our view, the**

result in those cases was an application of the regulations that while technical in nature add limited value with respect to achieving the true public policy or safety and soundness outcomes intended by the regulatory requirements.

- Our examiners advised us that our institution has no discretion to conclude a person did not act with intent to defraud when considering a potential criminal referral, and directed our institution (as a required action) to make a criminal referral on a particular matter. We believe the regulations and related guidance make clear that institutions have discretion to determine whether there is a reasonable basis to believe a person acted with intent to defraud the institution. See FCA reg. 612.2300(d); 62 Fed. Reg. 24562, 24564 (at Section II.E. "Discretion to Make a Criminal Referral") (5/6/1997). "Agree" is still our rating, as all other exam findings were consistent in our opinion, with regulations and criteria.

Survey Statement 3: The recommendations, required actions, and any supervisory agreement with FCA assisted the board and management in addressing the risks of the institution.

Average Response: 1.8

Statement 3	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 2017	1.8	1.8			1.8
FY 2016	2.1	2.2	2.1	2.0	2.1
FY 2015	2.1	1.8	2.0	2.3	2.1
FY 2014	1.7	2.0	2.1	2.1	2.0

Comments:

- All recommendations provided were reasonable and added value to the day to day operations of our institution.
- As noted in the response to #1, we believe that the agency's recommendations concerning the institution's management of the market value of equity reflected a fundamental misunderstanding of the institution's business model and were not particularly helpful to address the institution's risks.
- The FCA appropriately interacted with various board members throughout the course of the examination cycle as they deemed necessary to support the individual reviews and presented their results in the May 2017 Board Meeting. We viewed the institution examination results as favorable and felt that the related discussions were valuable in the development of our understanding of the related risks. We continue to see increased collaboration between the institution and the FCA regarding the management of difficulties in the areas of internal control and standards of conduct across the System and view this as a very effective and efficient process to address the related risks and in the development of remediation plans and actions.
- Recommendations were fair and did point out areas of weakness that we have since improved on in our underwriting. See #2 for comments regarding opinions concerning the required action.
- Recommendations in the report are treated the same as Requirements. If the expectation is the institution is expected to complete the "recommended" action, then it should be listed as required.

Survey Statement 4: The examiners were professional and efficiently conducted examination activities.

Average Response: 1.5

Statement 4	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 2017	1.8	1.5			1.7
FY 2016	1.5	1.5	1.8	1.3	1.5
FY 2015	1.5	1.6	1.9	1.5	1.6
FY 2014	1.4	2.2	1.8	1.6	1.8

Comments:

- We appreciate the professionalism of everyone involved.
- For the most part, we agree. However, we did have one examiner who was not efficient. He asked for data to be produced, then when we produced it, he asked for it to be produced again in a different format and structure, then when we produced it that way, he asked for it to be produced again in a third, new format and structure. After about four iterations going back and forth like this, he was finally satisfied and ceased. This process created a lot of wasted time and effort. This was not a novice examiner, he was a seasoned examiner, who apparently was on a mission to prove something that wasn't there. We have nothing to hide and are very open. We provide everything the examiners ask for. This examiner was far too demanding.
- The examiners were very professional throughout the review. They were well prepared when delivering their report of examination to the Board and Management Team.
- Examiners were consistently professional and efficient in conducting examination activities. We are concerned that examiners may sometimes interpret our efforts to engage in substantive discussions with them as disrespectful when that is not our intent at all. We simply want to ensure that the agency evaluates our performance in light of a sound understanding of our business model, and strongly believe that both the regulator and the institution benefit from robust dialog.
- FCA staff were very professional and productive. Additionally, the FCA deployed skilled resources with a breadth of backgrounds (credit, technology, operations risk, assurance, management, etc.) that were able to effectively and efficiently evaluate the risks within the organization. The FCA utilized the 2016 examination cycle to transition a new Examiner In-Charge (EIC) onto the institution's exam who will be the point on the institution's examination in 2017.
- The exam consisted of 3 on-site visits over a 6-month period, plus some off-site examination of policies and procedures, which did seem to require more time and staff resources than in the past, but understand given the cycle we are in. Examiners were professional and interacted well with staff.
- During our exam cycle, the EIC assigned to our institution left the agency. I was impressed with how well FCA staff completed the exam.
- Efficient in the review/onsite aspect; however, post onsite and prior to report issuance, several new topics brought up that would have been more efficiently addressed while onsite. Following up on items discussed earlier is understandable but bringing up new topics at the very end of the review is not only disruptive but also inefficient for all parties involved.

COMMUNICATIONS

Survey Statement 5: Communications between the Office of Examination staff and the institution were clear, accurate, and timely.

Average Response: 1.5

Statement 5	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 2017	1.6	1.5			1.6
FY 2016	1.8	1.7	1.8	1.6	1.7
FY 2015	1.5	2.0	1.7	1.8	1.8
FY 2014	1.6	2.2	2.0	1.7	1.9

Comments:

- There was significant back and forth after the examination.
- For the most part, we agree. However, see our response to the previous question. **We had a particular seasoned examiner who changed the form of his request for particular information multiple times. In effect, he was not clear in what he was after, and created a timeliness problem.**
- Communications are generally clear, timely and accurate. The examination team allows the institution to give adequate input on examination findings. Where we do not agree with the findings, we have had the ability to document our disagreement and to seek alternative ways to address the issue. An example is our disagreement with FCA's recent finding on the institution's transfer pricing process and recommendation to change it. Institution management and the board disagreed with that finding and recommendation, and the agency agreed to the middle ground of allowing institution staff to develop a white paper addressing whether there was risk in the current process.
- Communications between the FCA and the institution's staff and board were clear, accurate and timely. Additionally, the Chief Risk Officer and the EIC have scheduled regular monthly update calls and the FCA examiners meet quarterly with the institution's Strategic Relations Division staff. These timely communications have proved to be very effective. The Quarterly meetings with the Executive team allow the institution to provide timely updates to the FCA regarding organization matters and for the FCA to provide the leadership updates on ongoing examination activities and other agency topics of discussion requiring discussion.
- Communications were timely and professional, both on-site and off. Willing to listen to our concerns and adjust findings when additional information was presented to them. Very good communication and cooperation with EIC, _____.

Survey Statement 6: Examination communications included the appropriate amount and type of information to help the board and audit committee fulfill their oversight responsibilities.

Average Response: 1.6

FY 2016	1.7	1.7	1.6	1.6	1.7
FY 2015	2.0	1.8	1.7	1.9	1.9
FY 2014	2.1	2.2	1.8	1.9	2.0

Comments:

- The FCA provided complete and detailed communications in the form of ongoing verbal updates, close-out meeting with the various management teams, a formal readout of institution results with the Executive team, presentation of Examination results in the May Board Meeting, and through the written final Report of Examination.

Survey Statement 7: Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

Average Response: 1.8

Statement 7	1 st Qtr	2 nd Qtr	3 rd Qtr	4 th Qtr	FY Average
FY 2017	1.6	1.8			1.7
FY 2016	1.9	1.8	1.9	1.8	1.9
FY 2015	1.8	1.6	1.9	2.1	1.9
FY 2014	1.8	2.2	1.9	2.1	2.0

Comments:

- The examiners effectively demonstrated an openness to discussion on topics prior to formalizing their conclusions and recommendations.
- We believe in general that our views are considered. **We do find, however, that examiners overly rely on written best practices and do not have enough practical experience to adapt best practices to our GSE business model.**
- Board of directors had minimal views or responses for the examiners to consider in formulating their conclusions and recommendations. However, conversations held between Examiners and certain board members throughout the Examination were effective. The Exam team and EIC had significant discussions with management as appropriate before finalizing recommendations.
- Yes, we found the end result of the examination to be fair, **with the exception of the required action concerning Criminal Referrals.**

Survey Statement 8: FCS-wide guidance from the Office of Examination was proactive and helpful.

Average Response: 2.0

FY 2016	1.7	2.2	2.2	1.8	2.0
FY 2015	1.9	1.9	2.0	2.2	2.0
FY 2014	2.0	2.2	2.0	2.1	2.1

Comments:

- Requirements for new capital calculations in the business plan were not clear and expectations was that we would be complying with projections.
- FCS-wide guidance was not a factor in the current examination. In general, FCS-wide guidance is helpful.
- FCS-wide guidance from the Office of Examination in the form of the annual National Oversight Plan, various information memorandums, and other non-formal communication are all very helpful in the understanding of direction and requirements.
- The guidance is definitely helpful, but sometimes the application of that guidance from issuance to examination teams may vary which is difficult to implement.
- Agree guidance is helpful but two comments to mind. (1) When guidance is put out, examiners do not always seem to be fully knowledgeable of the new guidance and how to apply it when in the field. (2) As we looked to put in place the direction outlined in Bookletter O66, we ran a few things by FCA. The response we received back fell along a more conservative interpretation of FCA Regulations than what was presented in the Bookletter. The inconsistent interpretation is frustrating at the institution level.

GENERAL QUESTIONS

Survey Item 9: What aspect of the examination process did you find **most** beneficial?

Comments:

- Meeting with full Board was informative and collaborative. The discussion provided examples that could be acted on.
- The examination report was delivered in person to our board by the EIC and her supervisor. This was well received by our board.
- The recommendations from FCA were helpful for the Board in addressing matters that need attention.
- The examiners are knowledgeable and very well qualified.
- The Team's willingness to offer advice on the best practices they've identified throughout the System.
- The examination process is well coordinated and communicated with staff. This allows institution staff to provide adequate information to examiners ahead of time, which facilitates efficiency and the best use of time for the both the FCA and institution staff. In addition, FCA does a good job in close-out process by discussing issues and giving staff a chance to address/challenge issues and facilitate better communication.

- Opportunities to collaborate on the various risks facing the organization and the Farm Credit System as a whole. Greater integration in the handling of certain District and System matters.
- The examination of the Audit & Review process as well as the standard loan review examination. Interactions with the exam staff and getting a better understanding of their perspective.
- We always find the dialogue with FCA staff to be useful and informative.
- Exit conference in executive session.
- Continuity in the review team – provides more efficiency as FCA examiners know the institution better and institution personnel can better understand examiner point of view based on past experiences.

Survey Item 10: What aspect of the examination process did you find **least** beneficial?

Comments:

- At times the comment seems to be more form over substance.
- See our response to question number four, regarding an examiner who wasted our time by requesting the same information multiple times, in a different format and structure each time.
- Timing of the exam.
- At times it seems as though Districts are being compared without consideration of differences in funding mechanisms and other significant shared service arrangements.
- The least beneficial part of the examination process is the fact that many of the examiners have never actually had any practical business knowledge of running the operations of a financial institution. As a result, examiners have a tendency to focus on written best practices that have little relevance to our actual operations. Best practices are a good starting place but should lead to more in-depth discussions on the real risks in the organization.
- Similar to prior feedback provided, there is an ongoing opportunity for lesser experienced examiners to enhance their understanding and knowledge of assigned areas. This would accelerate the reviews and lessen the overall examination burden on the organization.
- Preparing for multiple site visits by the examination team; lengthy review during one of our busiest times of year.
- Approach on recommendations. The focus on how we handled/addressed the recommendations seems disproportionate. If it is expected for us to fully address/complete the recommendations, then call them what they really are: requirements. The way they are currently handled is not conducive to efficient communication.

Survey Item 11: Please provide any comments from the **Board as a whole** regarding the examination process not provided in the preceding responses.

Comments:

- Their process is on its way to being more than satisfactory and almost superior. They did genuinely appear to seek all our input as to how we are trying to improve. And their engagement was beyond just checking the boxes. **Only minor critique is their continued focus sometimes of form over substance.**
- The board looks at the examination team and the examination process as a way of supporting what we do right, and to comment on things that we need to do to improve.
- It would be beneficial for the board to meet and discuss the report prior to the FCA presentation.

- The board was satisfied with the results of the examination and receptive to the examiners' recommendations.
- This was my first report of the examiners as a Board member. I was impressed with their professionalism.
- Exceptionally conducted exit interview and presentation.
- The Chairman of the Board of Directors agreed to allow the Audit Committee to review and discuss this survey prior to its submission. Based on the timing of the survey release and the requested due date, a discussion on the responses amongst the full Board was not available. However, the survey will be appropriately discussed in the August Board Meeting with the Audit Committee and the Board as a whole. The Audit Committee concurs with management's responses to questions 1 to 10 and has no additional comments.
- **Again, the comments made by the different exam teams to different institutions may put one institution at a disadvantage versus another.** We know that is hard to do, but it is too important that FCA be consistent in its application and interpretation of regs and overall expectations.
- Excellent communication from the EIC and Senior Examiner to the Board. **Disappointed with a "2" rating for management and Board.**
- Our board of directors appreciates the opportunity to meet with FCA staff in executive session following their presentation of the ROE.