

**First Quarter FY 2007 OIG Report on the Survey of FCS Institutions
Regarding the Agency's Examination Function
for the Period
October 1 - December 31, 2006**

Introduction

Based on the nature and degree of interface FCS institutions had with the Agency's examination function in the months leading up to December 31, 2006, OE identified 30 FCS institutions that were felt to be in a position to provide meaningful survey responses. (Institutions will be surveyed no less frequently than every 18 months and, generally, no more frequently than every 12 months.)

The OIG sent surveys to those 30 institutions on February 1, 2007. A follow-up e-mail was sent to nonresponding institutions on March 5. Of the 30 institutions surveyed for the quarter ended December 31, 2006, there were 21 completed surveys received as of March 19. Some of the nonresponding institutions will likely yet send a completed survey. If so, they will be included in the next quarterly report.

The OIG will provide an e-mail report to you at each fiscal year quarter-end, i.e., December 31, March 31, and June 30, so that you may timely take whatever action you deem necessary to address the responses. A detailed summary report will be issued to you covering aggregate survey results for each fiscal year ended September 30.

The survey asked respondents to rate each survey statement 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

There is also an available response of "Does Not Apply" for each survey statement.

Narrative responses are provided verbatim, except that any identifying information has been removed.

Survey Results - First Quarter FY 2007

- Average numerical responses to survey statements 1 - 10 range from 1.7 to 2.2.
- The average response for all survey statements is 1.9.

Two institutions responded to one or more survey statements with "Does Not Apply." One so responded to survey statements 7 [The examiners were organized and efficiently conducted examination activities.] and 8 [Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.]. I spoke to the CEO regarding their responses. He indicated that they had relatively little interface with the examiners

and did not feel capable of providing a rating for either survey statement. The other institution so responded to survey statement 10 [FCS-wide guidance from the Office of Examination (e.g., bookletters, informational memoranda, etc.) was timely, proactive and helpful.]. Their accompanying comment is the last bullet under "Comments" for survey statement 10.

Two institutions rated a survey statement below a "3" (Neither Agree nor Disagree). One institution rated survey statement 8 [Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.] as a "4" (Disagree). I called the CEO to inquire as to the reason(s). He indicated that over the examination cycles for 2005 and 2006, he and his board felt the examiners, particularly the lead examiner, were not listening effectively and, as a result, formulated conclusions based on incomplete information. The other institution rated survey statement 9 [The results and recommendations of the Office of Examination's national examination activities (e.g., information technology, finance, credit, etc.) and its reports on identified best practices have assisted your institution.] as a "4" (Disagree). The explanatory comment is listed as the last bullet under "Comments" for survey statement 9.

Nevertheless, positive narrative responses predominate in the comments on survey statements. This would appear to reinforce the methodology that OE is applying to the examination of institutions. However, there are some comments in response to survey statements 5 through 10, 11b, and 12 that may provide opportunities for you to reassess or refine examination methodology and communications.

Additionally, there are two comments in response to survey item 12 that are of particular interest. The first has to do with the respondent's concern that a "best practice" resulting from a national examination activity may evolve into a regulatory requirement, which in the view of the respondent, may not be cost effective for a small institution.

The other comment, which has primary import for the Office of Regulatory Policy, has to do with the same respondent's perspective that "...sometimes important distinctions between the System and other regulated companies are ignored when FCA considers new regulations and policies. Case in point was the "insider" designation that was included in the proposed governance regulations. The System has no directors that would be classified as "insiders" as they are all independent from management."

Responses to Survey Statements 1–10

Risk-Based Examination Process

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

Average Response: 1.8

Comments:

- This has been adjusted somewhat in recent years by FCA and is much more appropriate now.
- Farm incomes have been good and are increasing. Our institution is profitable and our loan risk is low.

Survey Statement 2: The examination process helped the institution understand its authorities and comply with laws and regulations.

Average Response: 2.0

Comments:

- The institution has processes in place to understand and review our regulatory compliance.
- Our past two lead examiners have done a good job of assisting us to know what was expected and be prepared for compliance.

Survey Statement 3: The results and recommendations of the examination process covered matters of safety and soundness, and compliance with laws and regulations.

Average Response: 1.8

Comments: None

Survey Statement 4: Examiners were knowledgeable and appropriately applied laws, regulations, and other regulatory criteria.

Average Response: 1.9

Comments:

- To our knowledge, the examiners that produced our streamlined document were knowledgeable and appropriately applied laws.
- We've worked with two lead examiners in the recent past and both have been good in this area.

Communications and Professionalism

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

Average Response: 1.7

Comments:

- It was difficult to determine from the generalized nature of the exam findings across the streamlined group as to whether they applied to our institution or not.
- No problems, the use of electronic communication has helped significantly.
- More proactive communication to the appropriate levels of the institution, especially where FCA is not getting needed information or analysis, would greatly benefit the efficiency of the exam process for both examiners and the institution.

- Thorough communications before the exam provided clarity of exam focus, which resulted in better preparation by our institution, and a more fruitful onsite exchange.

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: 1.8

Comments:

- It may have been beneficial to note those issues our institution should be addressing specifically vs. wondering if the general comments applied.
- The Audit Committee had a very informative meeting with the examiners as well as an executive session without management.

Survey Statement 7: The examiners were organized and efficiently conducted examination activities.

Average Response: 1.7

Comments:

- Received letter day of call—no time to review prior to call.
- Most of the work has been done on a quarterly basis instead of all at one time. This has been a benefit to the institution.
- We do not have “trainees” which require more time to interact with. Primary examiner continued relationship with the organization and provided continuity even after the FCA reorganization. Auditors saved organization time by reviewing loan folders in the branch offices which was appreciated.
- Given the short time onsite, the communications before and after onsite was organized and did not disrupt the institution.

Survey Statement 8: Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

Average Response: 2.0

Comments:

- The two lead examiners we have been working with excelled in this area.
- Agree at the most senior levels of the exam team. At lower levels, examiners don't always seem to consider our responses.

Best Practices and Regulatory Guidance

Survey Statement 9: The results and recommendations of the Office of Examination's national examination activities (e.g., information technology, finance, credit, etc.) and its reports on identified best practices have assisted your institution.

Average Response: 2.2

Comments:

- The information included in the report was helpful, except we did not know for certain if it applied to us.
- We very much support the cross-institution exam approach and the recommendations and observations that result.
- The recently received National Examination Business Continuity and Information Security report based its findings (suggested enhancements) on dated information. FCA examiners were aware our policies and practices were being upgraded, but did not inquire about current status prior to report release. Communication could have been improved, and resulted in an inaccurate message being conveyed to our Board.

Survey Statement 10: FCS-wide guidance from the Office of Examination (e.g., bookletters, informational memoranda, etc.) was timely, proactive and helpful.

Average Response: 1.9

Comments:

- The latest group of bookletters and informational memorandum have been very helpful in establishing direction.
- The information received is typically useful; however, many areas aren't addressed.
- There was no guidance issued by the Office of Examination during the exam period that applied to our institution.

Responses to Additional Survey Items 11a, 11b, and 12

Survey Item 11a: What aspects of the examination process did you find **most** beneficial?

- Discussion, interpretation, information exchange, on regulations, laws, and policies.
- Capital adequacy discussion.
- The fact the exam teams were not on-site and did not disrupt staff was very beneficial. Also the process was completed efficiently.
- The cooperative attitude and approach by the examiners. There was not a feeling of looking for something wrong. Good discussion on governance issues.
- Minimal staff disruption by the offsite examination process.

- We haven't had a normal full examination since the fall of 2005. We have been working since that time on an "on going" process of providing information and getting feedback. That seems to work very well for us.
- Communication of results.
- The dialogue with examiner on technical aspects of regulatory issues.
- The look across institutions and the opportunity to share best practices.
- All
- Extended audit timeframe. Less frequent onsite exams unless business conditions warrant.
- As an Audit Committee, meeting with the examiners was very informative.
- The new scope seems more appropriate for a safety and soundness regulator.
- FCA's examination team made some suggestions on management reports that the institution's management felt were helpful.
- Dialog of examiners and officers and directors resulted in mutual respect and understanding.
- We were given the opportunity to respond to issues before the final report was prepared.
- More offsite work, which allows for an ongoing exam process with better communication and no surprises.
- Our lead examiner's tone and approach to the exam was clear, constructive and open, which effectively eliminated the possibility of frustrations caused by misunderstandings.

Survey Item 11b: What aspects of the examination process did you find **least** beneficial?

- Nothing material.
- The lack of specificity in the exam results and wondering if they applied to us or not.
- None.
- Cost to our stockholders.
- We've just changed lead examiners again due to an unexpected retirement.
- Actually with more offsite work being done the interference with daily routine is drastically reduced.
- Nothing.
- N/A
- N/A
- This was an offsite exam and we believe it worked very well as disruption to the office was minimal and lowered the cost of the exam.

Survey Item 12: Please provide any additional comments about the examination process and related communications.

- When clean examinations occur, final presentation of results could be held by conference call with board or audit committees.
- Our experience over the past few years has been good, significantly due to the quality and willingness of the Lead Examiners to work with us and try to understand our situation, processes and approaches to problem solving. They have also been very willing to offer guidance and input in a constructive manner instead of just looking for ways to criticize.
- Have noticed the gradual increase in overall talent within the examination teams.

- Am concerned that “best practices” recommendations made today will translate into future regulatory requirements. Some “Best Practices” may not be necessary or cost effective for a small institution. Reasonableness must also be considered. It seems that sometimes important distinctions between the System and other regulated companies are ignored when FCA considers new regulations and policies. Case in point was the “insider” designation that was included in the proposed governance regulations. The System has no directors that would be classified as “insiders” as they are all independent from management.
- Ongoing discussions with the EIC during the year are beneficial to the institution and we hope the ongoing dialogue enables the examiners to complete the examination of the institution in a timely manner.
- The examination team obtained and reviewed some information prior to coming to and after leaving the institution thus reducing the amount of time spent at the institution. The institution management felt this was an efficient and effective use of time for both the examination team and the institution.
- Examiners conducted the examination in an efficient, courteous and professional manner.
- We think the examination process has evolved from a very hands on process to a more review process which is good in our opinion. We feel that communication between the institution and FCA has evolved to one that is more timely and constructive.
- N/A
- FCA's focus on risk rather than procedures is very positive. Our lead examiner's communications prior to, during, and after the exam were very good.