

**Second Quarter Fiscal Year (FY) 2010
(January 1 – March 31, 2010)**

**Office of Inspector General's (OIG) Survey of Farm Credit System (FCS) Institutions
Regarding the Agency's Examination Function**

Introduction

Based on the interface FCS institutions had with the Agency's examination function during the period January 1 – March 31, 2010, the Office of Examination (OE) identified 20 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 20 institutions on April 20. A follow-up email was sent to nonresponding institutions on May 17. Of the 20 institutions surveyed, 18 submitted completed surveys. If the nonresponding institutions subsequently send a completed survey, it will be included in the next quarterly report.

One response to the survey issued for the fourth quarter of FY 2009 was received subsequent to the fourth quarter report and is included in this report. As a result, this report covers 19 responding institutions.

The OIG will continue to provide an email report to you based on each FY quarter-end, i.e., December 31, March 31, June 30, and September 30, so that you may timely take whatever action you deem necessary to address the responses. The fourth quarter report as of September 30 will continue to include FY summary data.

The survey asks respondents to rate the nine 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

There is also an available response of "6" (Does Not Apply) for each survey statement.

Narrative responses are provided verbatim, except that any identifying information has been removed and any grammatical or punctuation errors may have been corrected. Any narrative in "brackets" is explanatory information provided by the OIG based on communication with the institution.

Survey Results – Second Quarter FY 2010

Average numerical responses to survey statements 1 - 9 ranged from 1.8 to 2.4. (For the first quarter FY 2010, the range averaged 1.8 to 2.1.)

The average response for all survey statements was 2.1. (For the first quarter FY 2010, the average response was 1.9.)

While the above represents only a slight decline in the average numerical ratings this quarter, two banks and eight associations provided “3” (Neither Agree nor Disagree) ratings to survey statements 21 times, and five associations provided “4” (Somewhat Disagree) ratings to survey statements eight times and “5” (Completely Disagree) ratings to survey statements five times. While the “3” ratings to survey statements are neither negative nor positive, they do reduce the average numerical response and may essentially reflect a less than positive commentary on the survey statement.

While normally the majority of comments on the examiners and the examination process are positive, this quarter 60 percent of narrative comments to survey statements 1 - 9 were negative. Several were very negative. All negative comments of any degree are **color coded in red** and should provide opportunities for you to refine examination methodology and communications, and examiner training.

Survey item 10a asks for feedback on the most beneficial aspects 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 10b asks for feedback on the least beneficial aspects of the examination process. There were a number of comments that were more negative than normally received to this question. These comments should also provide opportunities for you to refine examination methodology and communications, and examiner training.

Survey item 11 asks for any other comments. Normally comments provided to this question are positive. However, this survey contains several very negative comments to this question.

While there was only a slight downturn in the average numerical scores, the number and depth of negative comments was spread among many institutions. Eleven associations provided a range of from one to eight negative comments each, and two banks provided two and four negative comments, respectively.

Responses to Survey Statements 1–9

Examination Process

Survey Statement 1: The scope and frequency 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:

- The focus and quality of examination has been much better since our institution was transferred to the large Association/Bank group of examiners. Our EIC was very refreshing to work with – his candor, openness and straight forward approach were both refreshing and greatly appreciated. He and his examiners were a pleasure to work with.
- **We thought their credit risk review was appropriate, but non-credit risk items seemed to have far more focus.**
- The scope and frequency were fine.

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

Average Response: 2.2

Comments:

- This was already occurring. Exam did not elevate or reduce this.
- This review team had a different interpretation of the regulations than we have had before in other exams.
- Comments were very general and critical, with little clear explanation of reported weaknesses. These distracted from real safety and soundness issues. We know our authorities, laws, in most cases regulations.
- We were already aware of all FCA Regulations and laws prior to the FCA review team completing their work.
- The board is helped the more it understands what FCA expects from it.

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: 1.9

Comments:

- Examinations are much more thorough and bring more value than at times in the past.
- They focused on material issues much more than past examinations – a fact that was greatly appreciated.
- Their views of matters of safety and soundness differ from ours on non-credit issues.
- Yes, in general, it did.
- The review team struggled with materiality when identifying deficiencies.

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

Average Response: 2.1

Comments:

- Experienced examiners are key for FCA. Must keep your experienced and knowledgeable staff.
- Very professional staff.
- Due to the variations in the years of reviewers' experience, some were put in situations that they were not prepared to handle.
- Some were very experienced, some were not. Opinions, conclusions, of both impacted report.
- The EIC was fine, but the rest of the team was inexperienced.
- We agree that examiners are knowledgeable. However, the application of that knowledgeable is different from different examiners. We have been told

to have certain policies that others have never been told to create or the guidance given to our institution for dealing with participation loans was not the same guidance given to other institutions. The inconsistency does create problems.

Communications and Professionalism

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

Average Response: 2.3

Comments:

- EIC was very candid and straight forward – that made him a pleasure to work with. We may not have always agreed, but we always knew where each other stood.
- Clear and mostly accurate but could have been more timely.
- While overall communications were thorough and professional, management expressed concerns over report presentation and expectations from FCA examiners. The message at times seemed to be inconsistent.
- Conflicts between our EIC and his boss put us in the middle of an uncomfortable situation. In the end, we didn't know who wrote the exam.
- The review timing extended for several months. We discussed the same topics multiple times with multiple reviewers.

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: 2.1

Comments:

- Conversation with the Board was candid and insightful.
- Senior members of examination division and audit team met with the Audit committee and later the full board. During those meetings, there was a frank exchange of ideas and observations regarding risks, operations, safety and soundness.
- Good communication and follow-up on issues raised by board and management.
- Brief and incomplete. Not much listening, not enough detail.
- The Institution really didn't learn anything as a result of the review.
- Close-out comments were concise, informative, and provided appropriate insight.

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

Average Response: 2.4

Comments:

- We believe this group that focuses on the larger Associations and Banks was much more organized and efficient than the group of examiners that we had previously worked with.
- FCA is in the process of transition of exam responsibilities. The new plan is to better match skill and experience of examiner with the complexity of the business units. During the transition, on occasion, there was redundancy and lack of clarity on responsibilities of their staff.
- Production of the final written report seemed to take much longer than previous reports have taken. This may be due to the multiple levels of review that reports must go through prior to issuance. Management and the Board do believe that thorough discussion of complex issues is helpful when balancing the reporting deadlines for system institutions.
- The exam was completed in two separate trips; due to what I understand was scheduling and timing difficulties. This problem is understandable, but is still two separate disruptions to the normal activities of the institution. Completing the review during one trip is much preferred.
- We had two on-site reviews in 6 months with a moving review date. Then we started again with another reviewer answering the same questions that we answered on the two on-site reviews.
- A disjointed team. Came from all over the country. The report seemed to be written that way.
- As mentioned earlier, the review dragged on for several months. We had to keep addressing the same topics that were resolved days earlier.

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

Average Response: 2.2

Comments:

- Candor and fairness was their hallmark. We may not always have agreed, but we knew where each other was coming from and had respect for each other's views.
- The FCA and system institutions are facing issues related to credit quality that have not been experienced in over 25 years. These credit quality issues will require a significant period of time to demonstrate marked improvement. Additional discussion is needed between FCA and the institutions to reach consensus as to a reasonable time frame needed to demonstrate credit quality.
- One of the reviewers onsite seemed to have a much different tone of behavior than the rest of the group. This examiner was very condescending, argumentative and opinionated with little willingness to consider other view points. He was not a good representative for FCA with this approach. Our

EIC was very understanding of our differences with the other reviewer. This issue was even commented on by the EIC in the close-out.

- The EIC's boss was not interested in our opinions.
- Examiners did not, during the course of the review, or since, clearly define their basis for criticism or weaknesses to enable the board or staff to properly address weaknesses or recommendations. Comments in the ROE suggest some of the examiners did not understand institution processes. And, based on input from institution staff little detail was provided by examiners.
- The reviewers did listed[n] to the Board and staff. The team was inexperienced.
- A mutual respect is demonstrated from both sides and we appreciate the opportunity to always provide our views.

Survey Statement 9: FCS-wide examination guidance from the Office of Examination (e.g., examination bulletins, informational memoranda, etc.) was timely, proactive and helpful.

Average Response: 2.2

Comments:

- Some bulletins too general in nature. Raises more questions than answers.
- Could be more anticipatory and proactive. For example, guidance on "Lands in Transition" came after the market collapsed.
- IM's and informational correspondence allows us to stay abreast of related issues in the system and ensure that we understand and address in an appropriate and sound manner. Please continue the communication.
- Board members expressed appreciation to FCA informational memoranda.
- This guidance is good; FCA must remember however that one size does not fit all. FCA must ensure that the institutions currently not having issues are not treated exactly like those that are having problems. It may be luck or timing or it could be the management of the institutions and its willingness to not take undue risks.
- The guidance provides some input into what FCA will be reviewing, but overall there was little benefit to the publication.

Responses to Additional Survey Items 10a, 10b, and 11

Survey Item 10a: What aspects of the examination process did you find **most** beneficial?

- Our EIC and tenured members of the exam team were professional and did listen to management's concerns. Their experience resulted in a rational approach to the regulatory process by not over reacting to a downturn in credit quality in a few industry segments and loans.
- Working with knowledgeable examiners and EIC was refreshing!
- Suggestions from Portfolio Review process.
- Professional and well trained examination team.

- The exam teams and their examiner in charge had frequent contact with Bank staff and CEO. They were effective and thorough but were understanding and flexible with staff demands. They maintained an open dialogue and discussed findings openly and fairly. They made appropriate and fair consideration to board and management comments.
- EIC, examiners and supervisors were open to understand our point of view and the direction/thought process we held in the various functions. Communication and common goals were the most beneficial.
- The ongoing communications with the Examiner-in-Charge were very beneficial.
- We had two on-site exams reviewing credit, capital, and earnings and found no issues.
- Some comments, suggestions from different examiners.
- FCA helping the board to understand its role and ways to improve its effectiveness.
- Comments during close-out with the board.
- Open dialogue.
- Open communication with Special Supervision.

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

- YBS.
- We had in depth discussion with our examination team around vaguely worded requirements and recommendations that, in our opinion, added little to the institution's management of risk. We would encourage future requirements be more specific in order for the institution's board and management to ensure compliance.
- We believe that there was some inconsistency in our discussions and agreements regarding oversight of institutions and our actions regarding those institutions.
- Exam(s) were relatively easy and undisturbing of institution function. Can not think of anything of issue or least beneficial.
- FCA examiners met with management to discuss the examination report prior to their meeting with the Board of Directors. The message communicated to management in the initial meeting seemed to indicate that the FCA felt management was well aware of the risks and was already implementing the proper actions in response. However, when examiners met in executive session with the Board, it appears that the examiners expressed a much higher level of concern. This type of mixed message is confusing and misleading to both management and the board.
- The time period that it took for the final report to be written. Nine months of constant exam answering the same questions to the same or different reviewers left the staff totally exhausted and frustrated with the exam process. We also had a conference call with the board chairman and the audit chairman concerning our internal reviews. We received the information to be reviewed 40 minutes before our conference call. The treatment of our audit chairman was totally unprofessional. As a result of that call, he almost resigned.

- Very little detailed communication during the examination. No details of credit administration weaknesses make it difficult to properly address, correct, or track improvement. The way the ROE was written distracted attention from the real concern, the financial condition of the institution and its future. What happened to our ability to constructively address issues?
- The inconsistency in communication that occurs from one exam team to another.
- Areas regarding compliance of technical areas that have little impact on the business, the risk associated with our loans, or the way in which we serve our customers (i.e., the income producing capability of the collateral.)

Survey Item 11: Please provide any additional comments about the examination process and related communications.

- Good communication, knowledgeable staff is appreciated.
- Tone of the report and lack of urgency to meet with the board did not correlate. Exam started in September 2009, as of date was December 31, 2009, report letter dated March 22, 2010, and meeting to present report was April 26, 2010.
- Timely receipt of the report by the board prior to meeting with FCA examiners is vital to a clear understanding of the issues. The report was sent to board members less than one week prior to the meeting with FCA and not all board members received the report in time to adequately review it.
- During the last week of the review, the Institution Board Chairman, Audit Chairman and staff also met with the EIC and his supervisor to visit about the review and the just issued Informational Memorandum – National Oversight Plan for Fiscal Year 2010. This was a good meeting with good dialog between the parties.
- We felt like we were caught in the middle between our EIC and his boss and there was no way to satisfy either. We witnessed a conflict starting when they were first on-site. It became an unprofessional exam. We were thankful that (name removed) took the time to come to the review closeout with our directors and intervened between the individuals. We have always enjoyed an open discussion with our EIC about institution issue and trusted his opinions. We do not see that relationship going forward. Our board and management will correct the exam deficiencies in a proactive and timely manner. We recognize some things need our attention.
- Our board is made up of very astute, successful, and dedicated businessmen. Our management team is experienced and dedicated. Both the board and management understand the difficult conditions we are in, and take our responsibilities very seriously. We know the buck stops here. We would welcome difficult questions, opinions, good exchanges of ideas, and action plans to protect the integrity of our institution and our System. This ROE did none of that.