

OFFICE OF
INSPECTOR GENERAL

SURVEY REPORT

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

Third Quarter Fiscal Year 2018
(April 1 - June 30, 2018)

Issued September 28, 2018



FARM CREDIT ADMINISTRATION



Executive Summary

Survey of Farm Credit System Institutions Regarding the Agency's Examination Function Fiscal Year 2018 Third Quarter Report (April 1 – June 30, 2018)

The FCS institutions asked to respond to the survey are those institutions that:

1. Received a Report of Examination during the FY quarter; or
2. Had significant examination activity and interface with OE during the same period.

The survey asks respondents to rate eight survey statements as:

- | | |
|-------------------------------|---|
| Completely Agree | 1 |
| Agree | 2 |
| Neither Agree
nor Disagree | 3 |
| Disagree | 4 |
| Completely Disagree | 5 |
| Does Not Apply | 6 |

Each fiscal year (FY) quarter the Office of Examination (OE) identifies several Farm Credit System (FCS) institutions that are in a position to provide meaningful survey responses for that period. The OE identified 16 FCS institutions to survey for the period April 1 – June 30, 2018. The Office of Inspector General (OIG) sent surveys to those institutions in August 2018. Fourteen of the sixteen institutions completed the survey (an 88% response rate), with two institutions submitting a combined survey response because of a joint examination. The OIG received one response to the second quarter survey after the report was published and we included the narrative comments and numerical ratings in this report.

For the third quarter of FY 2018, average numerical ratings ranged from 1.3 to 2.0 (with "1" reflecting a positive rating and "5" reflecting a negative rating). The total average numerical rating for all survey statements was 1.7. For comparison, we provide data from the prior three quarters below.

FY Quarter	Average Numerical Rating Range	Total Average Numerical Rating
3 rd Quarter FY 2018	1.3 – 2.0	1.7
2 st Quarter FY 2018	1.9 – 2.2	2.0
1 st Quarter FY 2018	1.5 – 2.6	1.9
4 th Quarter FY 2017	1.6 – 2.4	2.1

Consistent with prior quarters' responses, we received more positive than negative comments about the examiners and the examination process.

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ACRONYMS

FCA	Farm Credit Administration
FCS	Farm Credit System
FY	Fiscal Year
OE	Office of Examination
OIG	Office of Inspector General

BACKGROUND AND METHODOLOGY

Each fiscal year (FY) quarter the Office of Examination (OE) identifies several Farm Credit System (FCS) institutions that are in a position to provide meaningful survey responses for that period. The criteria for including an FCS institution in the survey are:

1. The institution received a Report of Examination during the FY quarter; or
2. There was significant examination activity and interface with an institution during the same period.

The Office of Inspector General (OIG) provides a survey report for FY quarters ending December 31, March 31, June 30, and September 30. The fourth quarter report includes FY summary data.

When outstanding responses from prior quarters are received, they are included in the next quarterly report.

The survey asks respondents to rate eight survey statements from "1" (Completely Agree) to "5" (Completely Disagree), or "6" if the statement does not apply. The rating choices are:

Completely Agree	1
Agree	2
Neither Agree nor Disagree	3
Disagree	4
Completely Disagree	5
Does Not Apply*	6

*We do not include ratings of “6” in rating averages because a “6” will skew the numerical average negatively even though the statement is not applicable to the institution.

We provide the current FY quarter’s average numerical rating for survey statements 1-8 and, for comparison, the prior two FYs’ data.

Survey statements 1-4 pertain to the examination process and statements 5-8 pertain to communications during the examination. Statements 9-11 are general questions about the overall process. Respondents may submit comments for each of the 11 survey statements.

Narrative responses are provided verbatim, except any information identifying the institution or examiners has been removed and obvious spelling errors are corrected. Any bracketed text is for the purpose of removing information that identifies an institution or an examiner or providing clarification to a response. Perceived negative comments of any degree are color coded in red.

At the end of the survey we ask whether the respondent would like the OIG to contact the institution confidentially to discuss the submitted responses.

SURVEY RESULTS

EXAMINATION PROCESS

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 Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	1.8	1.9	1.7		1.8
FY 2017	1.8	1.6	1.8	2.1	1.8
FY 2016	1.6	1.8	1.9	1.7	1.8

Comments:

- The scope of examination focused on the institution's governance, performance, and operations appropriate for the institution's complexity and risk profile.
- Considered the focus areas of the exam to be in alignment with the overall key risks facing the institutions, particularly in balancing the credit risk in the current environment with being supportive and dependable in a more challenging agricultural environment. Much of our discussion was focused on how the institutions are managing a deteriorating credit quality position while continuing to maintain strong earnings and capital positions.
- The institution agrees that the scope of the examination was appropriate for the size of the entity and the nature of its operations. **We find that in some instances regulations have more meaningful application to System banks and institutions,** however the exam team demonstrates an understanding of our institution's unique structure.
- The scope of the most recent exam did match our institution's risk profile.
- The board is interested in risk around controls and loan portfolio. **The past examination focus seems to be on policy and procedures whether you had this one or that one.**
- The scope of examination activities 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.

Statement #2

Examiners appropriately applied laws, regulations, and other regulatory criteria to examination findings and conclusions.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	1.8	2.0	1.9		1.9
FY 2017	1.8	1.7	1.8	2.1	1.9
FY 2016	1.9	1.8	2.1	1.8	1.9

Comments:

- There were no issues related to applying and/or interpreting current regulations or laws. The FCA exam team has been an appropriate liaison in helping facilitate the flow of information to FCA regarding the changes that some institutions have (or are in the process of making) to their customer stock process. We look forward to FCA's final guidance on this issue to the rest of the System.
- The exam team provided useful guidance and clarification regarding regulation 630.20(g)(3)(i)(B). As a result, the institution made an enhancement to System level financial disclosure.
- To the largest extent, we agree with the above statement. **The one exception leading to our disagreement has to do with the exam review of our institution's Enterprise Risk Management (ERM) framework and processes.** We support the premise of continued improvement to our ERM program. **The exam findings included three 'Matters Requiring Attention' (MRA) relating to our ERM program which do not appear to be based on law, regulation or other regulatory criteria (e.g., FCA Bookletters, Informational Memorandums, or Exam Manual Guidance), but rather on an FCA perception of 'best practices'. We agree to address the MRAs because they are reasonably sound practices but we are not in agreement they are items appropriately noted as MRAs - reasonable as a discussion topic or guidance, not reasonable as 'required' action.**
- Examiners applied criteria appropriately.

Statement #3

The matters requiring attention and any supervisory agreement with FCA assisted the board and management in addressing the risks of the institution.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	2.6	2.1	1.9		2.2
FY 2017	1.8	1.8	2.2	2.4	2.1
FY 2016	2.1	2.2	2.1	2.0	2.1

Comments:

- The matters requiring attention were appropriate. They were clearly discussed and communicated prior to report issuance.
- **Matters requiring attention were better defined under the old rating system (Required and Recommended Actions).**

- There was clear communication between the exam team and leadership during the examination process.
- The areas highlighted by the exam team as "matters requiring attention" led to useful dialogue at the audit committee and board meetings.
- Agree, **with the exception as noted 2a.**
- Really did not identify risks in the last examination with the exception of IT and security. **The matters requiring attention centered more around policy and procedures – not financial or credit risk.**
- 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 2018 board meeting. We viewed the 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.

Statement #4

The examiners were professional and efficiently conducted examination activities.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	1.5	2.1	1.3		1.6
FY 2017	1.8	1.5	1.4	1.6	1.6
FY 2016	1.5	1.5	1.8	1.3	1.5

Comments:

- **Offsite access to institution information could be conducted more efficiently with a more collaborative and timely effort of FCA and institution technology teams.**
- The examination team provided frequent communication throughout the examination period and were efficient in carrying out their examination procedures. They remained professional throughout the engagement.
- The exam team was professional and efficient during the exam process. Examination leadership contacted the institution in advance of the exam work with a list of key areas needing information and discussion. The exam team was

encouraging of open dialogue and built an appropriate level of professional rapport while maintaining their independent view.

- The onsite exam took place in the course of one week and the exam team was efficient, professional and thorough.
- Our institution appreciates the open discussion and engagement between FCA staff and our staff on questions/issues that arose during the course of the exam process.
- Examiners conducted themselves in a professional manner.
- Examiner in Charge and his supervisor were very professional. The EIC with more time, will become really good in this role. He was assisted by a very mature and capable supervisor.
- Very professional staff.
- 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.

COMMUNICATIONS

Statement #5

Communications between the Office of Examination staff and the institution were clear, accurate, and timely.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	1.8	2.1	1.5		1.8
FY 2017	1.6	1.5	1.7	2.0	1.7
FY 2016	1.8	1.7	1.8	1.6	1.7

Comments:

- Communication with examination team was timely and clear, issues were thoroughly discussed and vetted.
- This is generally true. **Management has found that submission of required exam documents through the FCA portal is not always successful. Multiple submissions of documents were required, and hard copies of documents previously submitted through the portal were requested of management when the exam team arrived onsite.** Management will work more closely with the exam team on this issue during the next exam cycle.

- Per management, communication between staff and examiners was very good. Clear dialogue, discussion of any issues, and open two-way communication.
- Multiple members of our leadership team (CRO, Chief Reg. Legislative & Compliance Officer, SVP of Internal Audit and SRD) have scheduled recurring monthly update calls with the FCA examiners to ensure the flow of information is clear, accurate and timely. These timely communications have proved to be very effective. The quarterly meetings with the Management Executive Committee 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 noteworthy of discussion.

Statement #6

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

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	1.8	1.9	1.7		1.8
FY 2017	1.8	1.6	1.7	2.1	1.8
FY 2016	1.7	1.7	1.6	1.6	1.7

Comments:

- The board appreciated the in person discussion with FCA staff.
- The board and audit committee were satisfied with the level of communication from the exam team.
- Examiners are always willing to include comments in the exam report that management has responded and corrected any findings before the report is issued which is extremely beneficial to the audit committee.
- **The communications seemed excessive at times through the review process. Remember, institutions have other examinations going on - PwC, Internal Audit, External Credit review, Bank Validation review, Appraisal Review, Protiviti Review, ICFR etc.**
- 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 2018 board meeting, and through the written final report of examination.

Statement #7

Examiners fairly considered the views and responses of the board and management in formulating conclusions and matters requiring attention.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	1.9	2.2	1.7		1.9
FY 2017	1.6	1.8	2.1	2.1	1.9
FY 2016	1.9	1.8	1.9	1.8	1.9

Comments:

- The institution appreciates the examination team's genuine willingness to have fair and considerate dialogue prior to report issuance.
- As mentioned in question 4, the exam team was proactive in providing the institution a clear understanding of what to expect, and then ongoing communication on key areas of concern throughout the process. The exam team consistently provided the opportunity to discuss any findings and were open to considering additional information prior to making a final decision.
- The exam team was fair in their consideration of the institution's responses to noted exceptions.
- Agree **except for the issue on 'ERM' noted in question 2.**
- Yes.
- 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.

Statement #8

FCS-wide guidance from the Office of Examination was proactive and helpful.

Average Numerical Ratings by FY Quarter

FY	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY Average
FY 2018	1.9	2.0	2.0		2.0
FY 2017	2.0	2.0	1.9	2.3	2.1
FY 2016	1.7	2.2	2.2	1.8	2.0

Comments:

- The institution appreciates the FCA's efforts to provide greater transparency with examination procedures (through the posted Examination Manual) and continuation of agency guidance through IM's, Bookletters, and regulations.
- The key areas reviewed by the exam team were consistent with the direction sent from the FCA management team regarding the agency's focus areas for 2018. Each System entity has unique risks and challenges and we observe our exam team adjusting accordingly.
- The institution benefits from the FCA's view of "best practices" employed throughout the System.
- 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.

GENERAL QUESTIONS

Statement #9

What aspect of the examination process did you find most beneficial?

- Open and transparent communication.
- The exit conference.
- The open and fair dialogue between management and the examination team.
- The most beneficial time spent in the review process was around discussing the current ag environment and what actions the institutions are taking to balance the credit risk and maintaining an appropriate level of reputation risk. Key areas identified in the past exam were discussed and there was good dialogue around the progress of improvements and setting clear and agreed upon expectations for further enhancements.
- The board and management found conversations with the exam team productive. These conversations enabled management to more clearly understand the views of the exam team, and seek clarifications where necessary. The FCA's presentation to the board provided the directors with a clear understanding of the audit process and the exam conclusions.
- We appreciate the opportunity for general (non-attributed) discussion on comparative practices in key business areas seen by FCA staff through their experience working across the Farm Credit System.
- The institution's communication with the examiner in charge is always forthright and professional.

- Examinations that take a team approach instead of "I got you approach." Discussions on best practices that appear to work well with other FCS institutions. This could help your institution go from good to great.
- Thorough review of policies and procedures. Examiners were professional and were willing to listen to staff.
- Communication with the examiners. They provided us a lot of best practices to consider.
- The informal and formal close out meetings.
- 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.

Statement #10

What aspect of the examination process did you find least beneficial?

- Coordinating the access of institution information electronically for offsite portion of the examination was difficult and time consuming.
- Criticizing the out years in the Business Plan.
- Nothing specific.
- None.
- This FCA exam cycle included a change from a former process of noting issues of deficiency or weakness as 'Required' or 'Recommended' actions, depending on significance or materiality, to a new characterization of 'Matters Requiring Attention' (MRA). We are aware that other regulators have also moved to this approach; however as implemented with our exam, the board and management found this change to result in less clarity and more potential for confusion. The new language raises a concern of interpretation by future FCA staff who could have a different understanding or expectation as to the adequacy or sufficiency of an institution response to an MRA.
- Repeated requests for more information from examiners weeks after the initial examination.
- None.
- The large number of questions to our credit staff from examiners in the training program.
- Nothing to report.
- None to speak of.

Statement #11

Please provide any comments from the Board as a whole regarding the examination process not provided in the preceding responses.

- Associate Examiner should not be the Examiner in Charge.
- The board appreciates the examination team's efforts to build a healthy relationship with management. Additionally, the board is thankful for the supervisory EIC and institution EIC's continued opportunity to meet with the board in executive session and their honest candor and feedback.
- Nothing more to add.
- The board is satisfied with the exam scope, process and results.
- FCA's postponement of the exam due to Hurricane Irma was much appreciated by management.
- The board believes examinations are vital to the health of any organization – the institution however averages 5 per year which includes FCA. There is a lot of focus on policy and procedures from FCA. We as a board are interested in risk in controls and portfolio.
- As chair of the audit committee, I was a little surprised that I was not contacted or interviewed as part of the examination process. I believe the same is true for the board chair.
- Overall, I feel the examination was thorough, professional and focused on the appropriate risks facing our institution. Examination staff were knowledgeable and familiar.
- We felt the examination was appropriate and conducted very professionally.
- 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 possible. However, the survey will be appropriately discussed in the December 2018 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.

Request for OIG Contact

Would you like the Office of Inspector General to contact you confidentially to discuss your survey responses and/or the examination?

This quarter one institution indicated they would like a call from the OIG. However, when contacted, institution staff stated they had misinterpreted the question to mean that it was okay for the OIG to followup regarding their survey response.

**FARM CREDIT ADMINISTRATION
OFFICE OF INSPECTOR GENERAL**



REPORT

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