

OFFICE OF
INSPECTOR GENERAL

Report of Audit

Regulation and Policy
Development Process

A-10-01

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Auditor-in-Charge



August 30, 2010

FARM CREDIT ADMINISTRATION



August 30, 2010

The Honorable Leland A. Strom
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Chairman Strom:

The Office of Inspector General (OIG) completed an audit of the Farm Credit Administration's regulation and policy development process.

We found the regulation and policy development process is complying with Federal requirements and is operating effectively and efficiently. This is promoted through:

- ensuring transparency throughout the regulation and policy development process;
- a collaborative process that ensures communication between Board members and staff;
- a team approach and the assignment of staff to regulation and policy projects based on matching needs with staff skill levels; and
- the use of various methods to optimize internal and external input on regulation and policy decisions.

We conducted the audit in accordance with *Government Auditing Standards* issued by the Comptroller General for audits of Federal organizations, program activities, and functions. We conducted fieldwork from February 2010 through July 2010 and provided a discussion draft report to management on August 6, 2010. The Office of Regulatory Policy, Office of General Counsel, and Office of Secondary Market Oversight were given the opportunity to comment on the discussion draft report. The comments are included in the final report. The report contains no recommendations or agreed upon actions.

We appreciate the courtesies and professionalism extended to the audit staff. If you have any questions about this audit, I would be pleased to meet with you at your convenience.

Respectfully,

A handwritten signature in black ink that reads 'Carl A. Clinefelter'.

Carl A. Clinefelter
Inspector General

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BACKGROUND

The Agency's mission includes developing regulations and policies that govern how Farm Credit System (FCS or System) institutions and the Federal Agricultural Mortgage Corporation (Farmer Mac) conduct their business. The Farm Credit Administration's (FCA or Agency) regulation and policy development initiatives focus on, for example, implementing the Farm Credit Act; protecting System safety and soundness; providing requirements related to lending, related services, investments, capital, and mission; and ensuring adequate financial disclosure and governance.

The Director of the Office of Regulatory Policy (ORP) manages the FCS's institutions regulation and policy development program on behalf of the FCA Board. In carrying out the regulation and policy development function, ORP works with the Office of General Counsel (OGC) and coordinates with the Regulation and Policy Development Committee (RPDC), Chief Examiner, and Director of the Office of Congressional and Public Affairs to ensure the regulation and policy function is:

- a collaborative process that involves early discussion of regulatory and policy issues with other office directors, the RPDC, and Board members;
- an efficient process for determining the appropriate regulatory time frames and staff skill levels for regulatory and policy projects;
- a process that communicates effectively internally and externally, as appropriate, throughout the developmental cycle until full implementation;
- a process that encourages regulatory and policy solutions that are balanced, flexible, and supported by appropriate analyses; and
- a process that is conducted consistent will legal requirements.

Every two years internal control reviews are completed by ORP to assess the effectiveness and efficiency of the regulation and policy development function and determine compliance with applicable laws and regulations.

The Director of the Office of Secondary Market Oversight (OSMO) manages the regulation and policy development program regarding Farmer Mac on behalf of the FCA Board. OSMO's regulation and policy development process generally functions in the same manner as ORP's, except OSMO does not coordinate through the RPDC. However, OSMO does coordinate and communicate with the FCA Board members' Executive Assistants during the regulation and policy development process.

The Agency has developed several policies and procedures to assist with rulemaking operations. The report's appendix lists the Agency's major policies and procedures.

OBJECTIVE AND SCOPE

The objective of this audit was to assess whether the regulation and policy development process is operating efficiently and complies with applicable Federal requirements. The scope of the audit work included the following:

- interviews with staff from the ORP, OSMO, OGC, and various members of the RPDC;
- review of Federal and Agency guidance that pertains to regulation and policy development;
- review of RPDC charter and meeting notes;
- review of the regulation development process;
- review of regulation and policy files and the regulation and policy database; and
- review of regulation and policy team skill levels and size.

The audit was performed at FCA headquarters in McLean, Virginia, from February 2010 through July 2010, in accordance with generally accepted auditing standards for Federal audits.

CONCLUSION

The regulation and policy development process is operating effectively and efficiently, and in accordance with Federal requirements. This is being promoted through:

- ensuring transparency throughout the regulation or policy development process;
- a collaborative process that ensures communication between Board members and staff;
- a team approach and the assignment of staff to regulation and policy projects based on matching needs with staff skill levels; and
- the use of various methods to optimize internal and external input on regulation and policy decisions.

AUDIT ANALYSES

Federal Requirements Relating to Regulation Development

The Federal guidance the Agency follows for developing regulations and policies are the Administrative Procedure Act (APA) and Executive Order 12866 *Regulatory Planning and Review* (Order). The APA establishes the process by which Federal agencies propose and establish regulations. The APA generally requires agencies to provide public notice and seek comments prior to enacting new regulations. The Order's objective is to enhance planning and coordination with respect to both new and existing regulations.

Administrative Procedure Act - The APA is the principal law governing rulemaking. According to the APA, steps to be followed during the rule making process include:

- publishing proposal rule notices in the Federal Register;
- providing a way for interested parties to participate in the rulemaking process through submission of written data or arguments, with or without oral representation; and
- publishing the final rule in the Federal Register with a concise general statement of its basis and purpose.

Agency's Compliance with Administrative Procedure Act - We judgmentally selected the following six regulations to assess whether APA guidelines were being followed¹:

- Capital Adequacy-Preferred Stock (3052-AC21)
- Farmer Mac Risk-Based Capital Standards (3052-AC17)
- Farmer Mac Risk-Based Capital Requirements (3052-AC51)
- Investments in Farmers' Notes (3052-AC23)
- Priority of Claims-Subordinated Debt (3052-AC38)
- Investments in Rural America (3052-AB92)

For the rules reviewed, we found the Agency was complying with APA. Specifically:

- Proposed rules were published in the Federal Register and included background information, a summary of changes, the effects of changes, objectives, legal authority, and the process for sending comments with the final date for receiving comments.
- The process for receiving comments was outlined in the proposed rules and also stated on the Agency's website. Comments received were tracked through the regulation and policy database and also on the Agency's website.
- Final rules were published in the Federal Register. Included in the final rules were a summary of comments received, FCA's response to comments, and the rule's effective date. Further, a notice of the rule's effective date was also published in the Federal Register.
- Rulemaking files were appropriately maintained and included all notices published in the Federal Register as well as other information such as studies relied upon to formulate the rule.
- Prior to rules being published in the Federal Register, quality assurance assessments were completed by the Federal Register Liaison Officer (FRLO). In addition, the FRLO used a timeline checklist to ensure FCA regulations are published in the Federal Register at the appropriate time.

¹ We selected regulations developed during FY 2005-2009. Our selection was based on the following criteria: (1) number of comments received during the process ; (2) time to develop the regulation from start to finish; (3) mix of regulations to include FCA & OSMO and; (4) type of regulation, for example, direct final or withdrawn.

Executive Order 12866 - The Order was developed to enhance planning and coordination for new and existing regulations. According to the guidance, independent regulatory agencies are required to prepare a Unified Regulatory Agenda (Agenda). The Agenda is to list all regulations under development or review, at a time and in a manner specified by the Administrator of the Office of Information and Regulatory Affairs (OIRA). The description of each regulatory action shall contain, at a minimum, a regulation identifier number, a brief summary of the action intended, legal authority for the action, legal deadline for the action, and name and telephone number of knowledgeable agency official.

As part of the Agenda, each agency shall also prepare a regulatory plan of the most important significant regulatory actions that the agency reasonably expects to issue in proposed or final form that fiscal year or thereafter. Criteria to assess whether a regulatory action is significant are outlined in the Order².

Agency's Compliance with Executive Order 12866 - In accordance with the Order, the Agency publishes its Agenda, which includes OSMO, on the OIRA's website. The Agenda contains all the information required by the Administrator of OIRA. In addition, a summarized version of the Agenda is published on FCA's website.

Each fiscal year the Agency also completes a review to assess whether regulatory actions need a regulatory plan. To date, the Agency's regulatory actions have not been significant enough to require a regulatory plan based on the criteria. However, the Agency still forwards a letter to the OIRA stating a review was completed and includes a list of regulatory actions reviewed.

Transparency in Regulation and Policy Development

Internal and external transparency throughout the development of regulations and policies is important to affirm the integrity and legitimacy of the regulatory and policy process. In addition, an openly communicated process will lead to better informed comments as well as a better understanding of how to comply with regulatory changes. The Agency uses several methods to ensure the regulation and policy development process is transparent internally and externally.

Internal Transparency - Internal transparency is accomplished through several different avenues such as monthly status reports, database system, and staff meetings:

- ORP provides monthly status reports summarizing rulemaking activities to the Chief Executive Officer, Chief Operating Officer, Board members, and office directors. The reports discuss progress made to meet project goals and include dates when major

²Significant regulatory actions means any regulatory action that is likely to (1) have an annual effect on the economy of \$100 million or more; (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) materially alter the budgetary impact of entitlements, grants, user fees or loan programs or the rights and obligations of recipients thereof; or (4) raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

milestones were met. The reports also serve as a way for Board members and the Agency's senior management to monitor the status of rules and policies.

OSMO also provides the status of rulemaking activities as part of its monthly office report to the Chief Executive Officer, Chief Operating Officer, Board members and office directors.

- Regulation Development Team (RDT) project managers and OSMO staff are responsible for maintaining a current regulation project profile in the regulation and policy database. The regulation and policy database allows staff to share the status of regulation and policy efforts. Some of the information maintained in the database includes: the project status (pending, complete, or current), project plan, proposed rule, final rule, comment letters, Board packages, management reviews and clearance, legislative regulatory history, and explanation for any delays. Most ORP, OSMO, OGC, and Office of Examination (OE) staff have access to the information in the database.
- The RPDC meets throughout the year to discuss regulatory and policy projects. OSMO is not part of the RPDC, however, OSMO meets with Board members' Executive Assistants as needed during the regulation and policy development process. In addition, the various offices have regular staff meetings to discuss the status of rulemaking projects. Also, at weekly senior staff meetings, ORP and OSMO discuss the status of rulemaking projects.
- Per an August 2005 agreement between ORP, OSMO and the Office of Inspector General (OIG), ORP and OSMO staff ensures the OIG is apprised of significant regulatory and policy projects.

External Transparency - External transparency is mainly accomplished through FCA's website which includes the following:

- Regulatory Performance Plan - The Agency posts its Regulatory Performance Plan twice a year to coincide with its semiannual update of the Agenda. The plan lists the regulatory and policy projects that are active for a 15-month period and describes the types of regulation and policy actions planned for each quarter and their purpose.
- FCA Pending Regulations and Notices - The FCA Pending Regulations and Notices database provide a list of all pending regulations. Until the comment period expires, pending regulations are open to public comment. Also included in this database are notices issued by FCA to announce information, public meetings, an action or intended action, or to invite comment on issues of public interest.
- Public Comments - For the public comment section of the website one can:
 - Read submitted public comments - On the website, the public can read comments received on items that are still open for comment, items on which

the Board has not taken final action, or rules which are not yet effective. This website section also lists the process for reviewing comments on final regulations.

- Submit comments - Provides instruction on how to submit comments on proposed regulations via the website, e-mail or regular mail.
 - View pending regulations and notices.
 - View Federal Register Documents.
- Also, FCA, including OSMO, provides briefings to Congressional Staff members and the Farm Credit Insurance Corporation upon request.

Coordination Between Board Members and Staff

The Agency established the RPDC to foster communication and collaboration with Board members during the regulation and policy development process. The RPDC facilitates FCA Board early involvement in the regulation and policy process and provides a forum for exchanging information that is used to develop regulation and policy positions. Committee members include the Chief Operating Officer, office directors, and Board members' Executive Assistants. Board members' Executive Assistants brief their Board members about regulation and policy matters discussed during committee meetings. Agency staff such as policy analysts, attorneys, and examiners directly involved with the regulations and policies being discussed also attend committee meetings. Committee meetings are scheduled when needed, by the Director of the ORP, who serves as the committee coordinator.

Our review of committee meetings' notes showed meetings are being held throughout the year for various regulation and policy initiatives. Information discussed at the meetings includes topics such as:

- Comments received on proposed rules;
- Legal and political aspects of a regulatory or policy initiative;
- Reasons for a regulation or policy;
- Unified Agendas; and
- Status/update on regulation and policy development initiatives.

According to Agency staff, RPDC meetings assist in providing a clear perspective on regulation and policy development direction. In addition, with Board members early involvement, fewer changes are needed during the regulation development process.

OSMO primarily achieves this communication and collaboration through coordination with Executive Assistants and briefings with FCA Board members.

Staff Assignments to Regulation and Policy Projects

Regulation and policy development staff are assigned based on project need and staff expertise. With guidance from the Chief Executive Officer and Chief Operating Officer, the ORP Director establishes the priority and general timeframes for regulation and policy development projects. Regulatory projects are accomplished using a team approach. To facilitate staff assignment, ORP management uses an internal assignment tracking database to determine staff availability for projects.

Team Approach - The ORP Director works with ORP senior staff, OGC, and OE management to establish a RDT for regulation projects. The RDT usually consists of staff from ORP and OGC with participation from OE staff, as needed. The ORP analyst serves as the RDT project manager. To advise the RDT, ORP has associate directors who are subject matter experts in the areas of Credit and Mission; Finance and Capital Markets; Operations, Management and Accounting; and Agriculture and Economics. The subject matter experts provide further expertise for significant areas in the regulation and policy development process. By putting together staff with varying experience and viewpoints, tasks can be divided among team members according to their areas of expertise.

Assignment Tracking Database - ORP management uses an internal assignment tracking database to facilitate the timely assignment of staff to rulemaking projects. Some of the information captured in the database includes team member names, the project initiation date, the statutory due date, the target completion date, and date completed. A comment section allows additional information to be recorded on board briefing dates and RPDC meetings. The internal assignment tracking database allows ORP to determine at any given time, a rule's status and what staff have been assigned to a particular project. This allows ORP to assess staff availability for upcoming projects.

OSMO draws upon its own staff, OGC and OE personnel, and perhaps ORP staff to promulgate regulations pertaining to Farmer Mac. An outside contractor is also used for technical expertise in developing changes to the risk-based capital rule that pertains to Farmer Mac.

External Input on Regulatory Decisions

The Agency has used various methods to encourage input on regulatory decisions. These methods include meeting with interested parties to discuss rulemaking projects, soliciting input on regulations that may be burdensome; and using an optional rulemaking process to minimize the potential for unclear rule interpretation.

Town Hall Meetings - To promote fully informed regulatory decisions, the Agency has conducted town hall meetings in coordination with the Farm Credit Council. At the meetings, the Farm Credit Council representatives and Agency staff discuss regulation and policy issues. Through the discussions, Agency staff and stakeholders explored

external interest, considered options on how rules might be structured, and discussed diverse parties' concerns.

Regulation Burden Reviews - The Agency periodically conducts a regulation burden review. These reviews involve the Agency publishing a Regulatory Burden Solicitation in the Federal Register. The solicitation asks for comments from the public on regulations that may be duplicative, ineffective in achieving objectives, or impose a burden that is greater than the benefit received. After reviewing and analyzing comments received, the Agency publishes a summary of the comments and what actions the Agency will take.

Optional Rulemaking Process - As part of the rulemaking process, the Agency may use an Advance Notice of Proposed Rulemaking (ANPRM). The ANPRM is focused on a specific subject matter and is used when the Agency feels there is a need to adopt or change a regulation. With an ANPR, discussion can be held more openly with outside parties on their thoughts and ideas early on in the process.

Agency's Primary Policies and Procedures for Regulation and Policy Development

- FCA Policy Statement 59, *Regulatory Philosophy*, outlines the Board's regulatory philosophy.
- FCA Policy Statement 37, *Communications During Rulemaking*, governs the oral communication between the public and Board members staff.
- FCA Policy Statement 64, *Rules of the Transaction of Business of the Farm Credit Administration Board*, addresses how the Board operates including how the Board manages, administers, and establishes regulations and policies for the FCA.
- *Regulation and Policy Development Committee Charter*, states the mission, authorities, responsibilities, and performance expectation of the committee.
- Agency Administrative Procedures 601, *Regulation and Public Policy Development of the Farm Credit Administration*, discuss the operating procedures, authorities, and reporting of policies and regulations.
- ORP Office Directive 2, *Regulatory Policy Development*, addresses the process for:
 - initiating a regulation and policy project,
 - staffing a regulation development team,
 - reviews during the regulation and development process,
 - proposed, final rule and other policy comments
- OGC Office Directive 3, *Publication of FCA Documents in the Federal Register*, provides guidance on publication of FCA documents in the Federal Register.