

**Second Quarter Fiscal Year (FY) 2011 Summary Report
(January 1 – March 31, 2011)**

**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, 2011, the Office of Examination (OE) identified 25 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 25 institutions on April 19, 2011. Of the 25 institutions surveyed, 22 submitted completed surveys. If the nonresponding institutions subsequently send a completed survey, they will be included in the next quarterly report.

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.

Survey Results – Second Quarter FY 2011

Average numerical responses to survey statements 1 - 9 were 2.0 to 2.2 (For the first quarter FY 2011, the range averaged 1.4 to 2.1.)

The average response for all survey statements was 2.1. (For the first quarter FY 2011, the average response was 1.7.)

There were four ratings of "4" (Disagree), i.e., one each for survey statements 2 and 3, and two for survey statement 9. There were six ratings of "5" (Completely Disagree), i.e., one each for

survey statements 1, 2, 5, and 7, and two for survey statement 4. Of the ten adverse (“4” or “5”) numerical ratings, one institution accounted for six.

In this quarter, unlike prior quarters’ survey results, there were more negative than positive narrative comments to survey statements 1-9. (Negative comments of any degree are color coded in red.)

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. As would be expected, most were negative. However, several comments do provide a perspective that should prove constructive.

Survey item 11 asks for any additional comments. There is a mix of negative and positive commentary.

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: 2.0 (1st Quarter 1.8)

Comments:

- The new risk based examination process provided reasonable focus to the exam activities.
- Appropriate focus.
- The re-interpretation of borrower rights by the Agency was more focused on over complying versus the intent of borrower rights. Although we disagreed with some of the interpretations we respect the Agency’s position.
- The scope of the examination was meaningless, and the frequency was overbearing and burdensome. Two of the examinations mainly focused on asset examination, despite our extremely high credit quality, and our conservative credit culture. Our institution had FCA staff on site for three separate times during the examination period totaling a three week period. This much onsite activity is extremely disruptive to staff and management and causes the institution to lose focus from its main goal of serving our customers. In addition to the 3 weeks of onsite examinations, the staff spent countless hours providing and copying information and answering clueless questions from the very inexperienced FCA staff. These questions also continued after the onsite visit. We received numerous questions for up to two weeks or more following the site visit from lower level staff who apparently were not seeking guidance from their superiors. This was highly disruptive during the onsite visit and the institution had to contract with

outside resources to ensure our business operations were handled timely and effectively during the examination visit.

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

Average Response: 2.1 (1st Quarter 1.9)

Comments:

- Our institution maintains a keen understanding of our authorities and the related laws and regulations.
- That's our responsibility and there were no issues to better understand.
- Our disagreements are more with the interpretation of the statute and regulations versus understanding our authority.
- The examination process did nothing to help our institution understand its authorities and comply with laws and regulations. The regulations are burdensome, outdated, and reactionary. They are not helpful at all in being proactive and providing assistance to institutions. While we are not perfect, and we have made mistakes, our institution has always abided as best we can by the regulations. FCA correspondence is reviewed as it is received and we share all correspondence with our Board at their monthly meetings. Our regulatory compliance was rated as generally satisfactory. This has been substantiated repeatedly by our internal audit examinations as well as FCA examinations.

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: 2.0 (1st Quarter 1.5)

Comments:

- The results and recommendations of the exam process were focused on minor issues that are trivial; and not helpful at all. After weeks in the audit process, FCA made minor recommendations. It appears as though since FCA could not find any issues relative to "safety and soundness" or "compliance" and therefore they focused on requesting further documentation.
- The recommendations sometimes do not align with actual audit findings.
- On a couple of issues FCA was unable to provide convincing arguments that linked an issue to a serious safety and soundness concern. Too much focus on one area versus considering the overall strength of the company.

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

Average Response: 2.2 (1st Quarter 1.9)

Comments:

- Pendulum is swinging in some areas as it always does with new board members.
- Generally we agree, as our disagreements were more with the interpretation and application of a regulation versus the examiners' knowledge.
- Some admitted they lacked complete understanding of borrowers' rights regulations. Demonstrated good knowledge of all other regulations.
- The examiners were rookies and for the most part clueless. Each examination was filled with 8-10 new staffers that wasted a great deal of our time. There is no experience level at FCA and no value added in regards to the examiners present at our examination. Some of the FCA staff exhibit difficult attitudes and are extremely impersonal and impede the exam process.
- Examiners were not consistent in the application of the scoring based on the actual results of the institution (i.e., credit quality, earnings, capital, financial position.)

Communications and Professionalism

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

Average Response: 2.0 (1st Quarter 1.4)

Comments:

- This area has improved significantly over the years.
- The communications between the Exam staff, particularly the new hires and FCA's "Second Career Specialists" and the institution were not clear or timely and, in the most extreme case, bordered on harassment.
- Information requests significantly increased after the examiners were no longer on-site. There were some complications regarding the sharing of information among examiners officed in different locations.
- Agree except as to timeliness of the final report.
- Communication and application of responses to requirements and recommendations was confusing and unclear. It was our understanding that we were only responsible to respond on requirements. We responded on both requirements and recommendation. However, we did not include the level of detail on recommendations which was challenged by FCA and created confusion.

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: 2.0 (1st Quarter 1.7)

Comments:

- Communication was good in both directions and allowed for a written report that was on point.
- Provided useful information.
- The written response is communicated well. FCA's verbal communications are very structured, seem to follow a checklist, and were not very well done. It was very clear to the Board that the newer examiners do not have the depth of knowledge or understanding of the business operations to provide the Board with meaningful conclusions or insight into the Board's oversight role.
- The inconsistency of the application of the FCA scoring criteria results in uncertainty for the Audit Committee.
- Yes, but "dense" (written like a lawyer would write).

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

Average Response: 2.0 (1st Quarter 1.5)

Comments:

- Those that could be conducted off site were effectively handled.
- Had a sound plan of action and they adhered to the plan well.
- Very professional.
- The examiners were clueless, asked ridiculous questions that no respectable auditor would ask and did not focus on the main risks of the company. An example of this criticism follows. When the examiners were on site we were visiting about a loan that is very complex. Our COO asked the examiner if she wanted to see the file and she said no. She simply relied on our conversation. While everything we told her was truthful, we would have thought that she at least would have verified the information by looking at the file. Examiners were not well educated in the fiscal area as well and we had comments from them stating they didn't understand or have knowledge about specific processes. They basically were asking questions from a checklist with no understanding of the information so they could respond with appropriate follow-up questions or research. Also refer to our response in question #1 relative to lack of organization and efficiency. This lack of efficiency and organization is driving higher regulatory costs and increased Institution time away from business activities that generate profits and allow us to serve our members; overall this impacts the institution's operating costs which directly impact our borrower-members. Also refer to our response in question #11.
- The on-site work for the examination team is always hurried. Most of the first and last day is cut short due to travel requirements. Many times there

are multiple questions concerning a particular issue or a particular loan/line of credit. While the exam team and our staff are readily available to discuss issues, many times these discussions are rushed and there is also the possibility of several unresolved issues that require follow up.

- We believe the information gathering organization could have improved and could have avoided many of the information requests after the on-site visit.

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

Average Response: 2.0 (1st Quarter 1.8)

Comments:

- Good dialogue resulted in agreement on the areas where findings indicated needed action by our institution.
- No real issues to discuss.
- The examiners listened to our views and responses, but we have no way of determining whether or not the institution's views were considered in the FCA exam conclusions.
- Once again, the FCA scoring criteria is heavily weighted toward the "subjective" versus the objective and actual results of the institution.
- In some areas we feel views and responses were fairly considered and in some other areas they were not.
- Overall we would agree, however FCA did not fairly represent our pricing survey in their final report.

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: 2.1 (1st Quarter 2.1)

Comments:

- The FCS-wide exam guidance (bulletins and information memoranda) is helpful. Additionally, FCA's attendance and presentations at specific CCO/CFO meetings was helpful in interpreting new guidance and FCA's intent and expectations.
- Some is, much is about giving everyone the same treatment. We realize difficult to differentiate, but some of it is going beyond regulation and safety and soundness in the past year.
- System wide guidance has certainly increased over the years; appropriately so.
- Appropriate for the current business environment.
- There has been a LOT of guidance, and it seems like it is sometimes more legalistic than necessary.
- The Loan Portfolio Management Examination Modules and the National Oversight Informational Memorandum are helpful; however, there is significant redundancy. Further, the overall quantity of guidance information

being sent, combined with the level/depth of management practices addressed, may in some instances go beyond a safety and soundness role.

- It would have been appreciated if the first two portfolio management modules had been sent to us prior to a few days before the examination.

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

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

- We have experienced much financial stress but our greatest challenge is with lack of human capital. FCA, by putting stronger pressure on Boards has helped us as a wholesale bank get more traction to get replacement of management teams we knew for some time needed to be upgraded.
- Our lead examiner took time and made an extra effort to explain FCA's position on most items and was most helpful in offering suggestions for ways for us to improve several areas of our operation and we appreciate this approach.
- Interaction with EIC on reg interpretation.
- The combination of on-site and off-site examination worked well for our staff.
- We appreciated the EIC sharing some of the "best practices" observed at other institutions.
- Board and management believe audits and examinations provide great value to the institution. We take seriously the responsibility to operate the institution in a safe and sound manner. Examinations provide insight into the quality and effectiveness of our operations, controls, and processes.
- Quality validation—assets observations.
- Confirms our institution is well managed with appropriate governance. The offsite exam results in less disruption of the institution staff.
- Examiners provided good information on many current issues.
- Good feedback on best practices.
- The examiner-in-charge did a fine job coordinating the expectations, and provided accurate feedback of the findings that were to be in our report.
- In-person meetings. The written report was more critical than previous reports. The in-person meetings both during and after the examination help put the report findings in context.
- Interaction with examination staff regarding borrower rights compliance.
- The close out dialog with FCA, Management, and our Audit Chairman.
- The face to face meeting with the Board was beneficial.
- Overall knowledge of the most recent exam team was very good and they did offer suggestions in some areas.
- The final close out was handled very professionally. The discussion of "safety and soundness" areas was also informative.
- They were very professional and helped us better understand risk management.
- We did not find any aspects of the exam process beneficial.

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

- There were several trainees in our group of examiners and that took extra time for us, but we didn't mind having them here and hopefully we were helpful in furthering their training.
- All was beneficial.
- We didn't have any negatives with the examination process.
- Initially the EIC was going to delay the meeting with the Board. A more timely meeting was deemed to be better.
- There still seems to be some overlap in the process where shared assets are concerned.
- The least beneficial aspect of the exam process is dealing with incompetent FCA staff.
- Financial
- Examination and FCA review and overview processes add nearly one full time staff person to our staffing requirements. Additional stress testing from what our institution does (given size of institution) appears unreasonable. Once again actual institution results or objective criteria appear not to be considered by the FCA examination process.
- The lack of explanation as where and why FCA came up [with] the top ten relationships not to exceed 75% of risk funds. When explaining change to staff it helps to have a full understanding as to why our regulator is making the change.
- Timeliness of the final report as to date of findings. Significant change had occurred in the interim time period.
- Recommendations that don't fully evaluate both sides of the issue or adequately consider the overall strength of the company.

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

- Professional, reasonable and fair.
- Well communicated, professional, and constructive; provided appropriate information and feedback for our Team to improve and strengthen our institution.
- Appreciated the professionalism of our EIC and his team.
- Overall, we are satisfied with the examination process and results.
- Considering the overall financial industry, the Ag segment continues to perform well. FCA needs to make sure they are not unduly influenced by the non-ag sector in their review process.
- Overall we believe the exam was professionally conducted. We would recommend that FCA consider completing a cost/benefit analysis in making their required and/or recommended actions.
- More off-site work prior to coming to the institution.
- No Value Added by FCA: There is absolutely no way that we can justify the expense that we pay FCA to our stockholders. There is no "value added" component that we can find that offsets their cost. In fact, there is a substantial negative impact on the institution due to the additional time that we spend preparing, cooperating and reporting before, during, and after their

audits. As the costs of FCA continue to escalate, the burden on the institutions has risen to the point that something needs to change. We strongly support a diligent, third party examination process for our institution and for all other FCS institutions; but FCA has proven for years that they are incapable and it is getting worse. FCA's Biggest Problem: The Agency has very few qualified people in the field; they fill our office with rookies during the audits that are clueless and completely inexperienced. We have had up to (10) new FCA staff members in our office at once. They waste a great deal of our time. Due to constant turnover at FCA, individuals that were too insecure to speak in their first audit become supervisors of our next audit! There is no wealth of experience remaining with FCA, that is apparent to the field and thus there is no value added. The Agency's attempt to shore up their ranks in the field with "Second Career Specialists" is completely ineffective, as these individuals are usually drop-outs from the commercial banking and other industries that can't find a job, and have little to add except a difficult attitude and frustrated egos. They have proven to be an impediment to the examination process. FCA is not fulfilling their role in risk assessment: FCA examines the results of the in-house institution reviews and "spot checks" random loans. The internal reviews are either conducted by in-house reviewers or independent contractors. We will not speak to the accuracy of the in-house reviewers except to point out that their independence and objectivity is suspect as the reviewers are employees of the institution that they review. In our view, this is a direct conflict of interest that will, in some cases result in assessment of loan classifications and risk that are inaccurate. The independent contractors reviewing institutions follow the age-old System practice wherein reviews are conducted based on the policies and procedures of each institution that they examine, some of which are very liberal and some are not; which completely discredits the roll up of credit quality, credit administration and System risk. This practice also misleads institution Boards who conclude that their performance results compare with other, well managed institutions, when they do not. While this process is politically expedient, it results in data that is not truly representative of the actual risk. We have not observed FCA staff in the field that are capable of interpreting the data from either in-house reviewers or independent contractors, or making value judgments relative to the work performed by the internal reviewers or the performance of the members. Most of the FCA staff is clueless relative to evaluating loan performance, structure or risk management. Bottom line, FCA is of no value to either the institution or the System in this critical area. The System would be much better served if the Office of the Controller reviewed and examined the institutions based on uniform standards that are generally acceptable in the banking industry. This would remove the internal Farm Credit System politics from the review and examination process and greatly improve the safety and soundness of the System.

- Final report was delivered four months after exit interview.