

**Third Quarter Fiscal Year (FY) 2010  
(April 1 – June 30, 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 April 1 – June 30, 2010, the Office of Examination (OE) identified 12 FCS institutions that were in a position to provide meaningful survey responses.

The OIG sent surveys to those 12 institutions on July 23. A follow-up email was sent to nonresponding institutions on August 18. Of the 12 institutions surveyed, 11 submitted completed surveys. One institution respectfully declined to complete the survey.

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 – Third Quarter FY 2010**

Average numerical responses to survey statements 1 - 9 ranged from 1.5 to 2.0.

Average Numerical Responses to Survey Statements 1 – 9		
3 <sup>rd</sup> Qtr	2 <sup>nd</sup> Qtr	1 <sup>st</sup> Qtr
1.5 – 2.0	1.8 – 2.4	1.8 – 2.1

The average response for all survey statements was 1.8.

Average Response for all Survey Statements		
3 <sup>rd</sup> Qtr	2 <sup>nd</sup> Qtr	1 <sup>st</sup> Qtr
1.8	2.1	1.9

The above represents a slight improvement in the average numerical ratings this quarter. There were no “5” (Completely Disagree) ratings and only three ratings of “4” (Somewhat Disagree) with respect to the survey statements.

The majority of comments on the examiners and the examination process are positive. However, survey statement 9 received several very negative comments. The first bullet under question 10b, which asks what aspects of the examination process did responders find **least** beneficial, seemed particularly significant. 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 11 asks for any other comments. Most were positive with one being somewhat negative.

## **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:** 1.9 (second and first quarters were 1.8)

**Comments:**

- The frequency seemed a little more often than necessary in view of the institution’s current excellent credit quality and financial position.
- The institution has received an examination letter, its statutory examination report, and an interim activity examination. Throughout each of the various examinations, the focus has been upon safety and soundness and regulatory compliance. The reports that have been issued clearly and concisely conveyed the results of all findings in those areas, and the accompanying recommendations were appropriate, well reasoned, and fully supportable. In both the various written reports and personal interactions, examination staff displayed absolute professionalism and competence. The institution fully acknowledges the pivotal role played by FCA in illuminating the internal weaknesses which gave rise to the adverse conditions, and for the supportive environment it has adopted to facilitate the corrective measures necessary to repair the damage.

- Sampling of lease portfolio adequately addressed size, industry exposure, complexity, and credit risk.
- Examinations conducted in 2009 were limited examinations that generally focused on areas of greater risk but not necessarily our association's risk.
- The interim communications and the Report of Examination appropriately focused on the key risks of the institution.

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

**Average Response:** 1.7 (second quarter was 2.2, first quarter was 1.9)

**Comments:**

- From this exam it became apparent FCA had changed directions on a very confusing area – 'other credit needs.' Earlier FCA communications came out urging institutions to expand their lending in the other credit needs area, and in this exam we found FCA had not intended we go as far as what we thought was being suggested by earlier communications. The system needs to simplify this whole area, because as it is laid out today, loan officers have a very hard time early in a new lending relationship process determining whether the request is eligible for anyone who is not a full time farmer.
- The institution has received an examination letter, its statutory examination report, and an interim activity examination. Throughout each of the various examinations, the focus has been upon safety and soundness and regulatory compliance. The reports that have been issued clearly and concisely conveyed the results of all findings in those areas, and the accompanying recommendations were appropriate, well reasoned, and fully supportable. In both the various written reports and personal interactions, examination staff displayed absolute professionalism and competence. The institution fully acknowledges the pivotal role played by FCA in illuminating the internal weaknesses which gave rise to the adverse conditions, and for the supportive environment it has adopted to facilitate the corrective measures necessary to repair the damage.
- Appreciate the interaction and open dialogue as it relates to authorities and FCA regulations.
- The overall positive results of the examination appeared to support that the institution understands its authorities and complies with laws and regulations.
- Current compliance issues including areas where clarification was needed were discussed with FCA throughout the examination period.

**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 (second and first quarters were 1.9)

**Comments:**

- The institution has received an examination letter, its statutory examination report, and an interim activity examination. Throughout each of the various examinations, the focus has been upon safety and soundness and regulatory compliance. The reports that have been issued clearly and concisely conveyed the results of all findings in those areas, and the accompanying recommendations were appropriate, well reasoned, and fully supportable. In both the various written reports and personal interactions, examination staff displayed absolute professionalism and competence. The institution fully acknowledges the pivotal role played by FCA in illuminating the internal weaknesses which gave rise to the adverse conditions, and for the supportive environment it has adopted to facilitate the corrective measures necessary to repair the damage.
- The examination process appropriately included consideration of safety and soundness and compliance issues.

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

**Average Response:** 1.8 (second quarter was 2.1, first quarter was 1.9)

**Comments:**

- Due to the Institution's excellent credit quality and financial position, it has helped to train new FCA employees, so they understandably were not as knowledgeable. However some seasoned employees were not able to accurately understand a loan relationship.
- Additionally, and perhaps more importantly, the FCA staff with whom the institution interacted were cognizant of the operational realities and challenges ahead that proper remediation efforts would entail. This understanding afforded the institution the ability to undertake the more time consuming, but more permanent and lasting, task of focusing upon changes necessary to address the root causes of the deficiencies in the institution.
- However, while we are happy to provide space in our facility for the FCA to bring inexperienced examiners into our institution for training purposes, it appears that many if not all of the examinations were used as a training ground for new FCA examiners.
- Senior examiners had sufficient knowledge. This was "training" for several new-hire examiners.
- The examination team was experienced and professional. Team members had an understanding of the laws and regulations, but were less knowledgeable in finance areas.

## Communications and Professionalism

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

**Average Response:** 1.6 (second quarter was 2.3, first quarter was 1.9)

**Comments:**

- Very good communications throughout the year. Examination team was open to questions and responsive.
- The institution's board valued most highly the face-to-face interaction with examination staff. While the various examination reports and related correspondence were excellently written and comprehensive, the ability to meet personally with the examiners was of great benefit to the board and new management in order to benefit from the "context" as a necessary supplement for creation of accurately developed rehabilitation strategies. Additionally, the board found the interim communications between examination activity that it had with FCA staff to be particularly beneficial, and especially the pre-examination entrance conference and discussions.

Additionally, we compliment the immediate availability of all examination staff from RSD [Risk Supervision Division]. Regardless of their location or travel status, they could always be reached and never failed to respond to management or board members immediately whether by email or telephone.

- Coordination remains very good.
- Yes.
- Ongoing communication throughout the examination period was appropriate.

**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:** 1.5 (second quarter was 2.1, first quarter was 1.9)

**Comments:**

- The board valued most highly the face-to-face interaction with examination staff. While the various examination reports and related correspondence were excellently written and comprehensive, the ability to meet personally with the examiners was of great benefit to the board and new management in order to benefit from the "context" as a necessary supplement for creation of accurately developed rehabilitation strategies. Additionally, the board found the interim communications between examination activity that it had with FCA staff to be particularly beneficial, and especially the pre-examination entrance conference and discussions.
- In the areas reviewed, the FCA examination results verified that the board and the audit committee process fulfilled their oversight responsibilities.
- Communication with the Board and Audit Committee was timely and appropriate. Examination communications provide value to the governance of the institution.

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

**Average Response:** 1.8 (second quarter was 2.4, first quarter was 2.0)

**Comments:**

- Teams seemed well prepared.
- Efficiency seems to be lacking. A lot of time spent deeply analyzing risk rating 4 or 5 loans seems like an inefficient use of time. Seems more phone conferences vs. on-site visits would be adequate in some cases.
- All FCA staff, whether from the Risk Supervision Division or the Examination Division, were professional in the truest sense of that meaning. They conducted their activities with efficiency and effectiveness, with no disruption to daily operations.
- The EIC effectively conveyed the scope of the examination prior to the examination and the staff was generally prepared to conduct the review in a timely manner.
- The ongoing nature of examination activities involved frequent submission of information and materials to the examiners throughout the period and provided multiple feedback opportunities. One examiner lacked in professionalism.

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

**Average Response:** 1.5 (second quarter was 2.2, first quarter was 2.0)

**Comments:**

- Listened to our concerns. Adjusted conclusions when other facts were presented.
- Additionally, and perhaps more importantly, the FCA staff with whom we interacted were cognizant of the operational realities and challenges ahead that proper remediation efforts would entail. This understanding afforded us the ability to undertake the more time consuming, but more permanent and lasting, task of focusing upon changes necessary to address the root causes of the deficiencies in the institution.
- Relationship and communication remains very good.
- We appreciate the opportunities provided to share views and pursue mutual understanding of examination issues, conclusions, and recommendations.

**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:** 2.0 (second quarter was 2.2, first quarter was 2.1)

**Comments:**

- Agree. However, the regulator needs to consider the impact communications has on boards and management. Well intentioned

comments described as “suggestions” can lead to unnecessary work. There is a cost benefit to all of these ideas, and because risk profiles of each institution are quite different, what may be needed in one is excessive in the other.

- Sometimes guidance is for a few institutions but is broadcast over the entire System. Just like the differential analysis done in certain credit situations so could the guidance be.
- The number and detail of informational memoranda has increased significantly. While we recognize that the risk profile of the System has changed, as has the regulatory/political environment, we do encourage the agency to consider whether System wide proscriptive direction is always necessary, particularly when it is precipitated by the actions of one or a very few organizations.
- Effective sharing of information and insight on areas of concern focus of upcoming examinations.
- Examination bulletins and informational memorandums are generally beneficial and well received. However, the FCA tends to require/apply guidance to all institutions regardless of the size, complexity, operating structure and expertise respectively.
- Informational memorandums are being published very frequently with general information. Due to general nature of many, this may lead to overlooking the most important.
- Guidance regarding Office of Examination interpretations and current issues provides insight that is helpful. These communications provide an opportunity for institutions to assess their activities and possibly achieve compliance in a proactive manner. It is important that such guidance remains focused on regulatory compliance and safety and soundness issues. The stress study direction from FCA has been inconsistent and poorly handled.

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

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

- Interaction with the examiners on site. Also the ability to ask questions throughout the year. We also appreciate having most of the exam team being made up of examiners who know our institution. We have to spend less time educating new examiners on how we manage risk, when a majority of the exam team are familiar with our shop.
- FCA examinations help us to stay up to date with changes in regulations and FCA's interpretation of regulations. Offered some good ideas on how to manage risk in the Portfolio.
- The FCA examination staff appropriately and accurately identified the weaknesses in the operations of the institution. However, and more critically, the examination staff issued a report which identified the “root causes” which were giving rise to and creating the environment for those weaknesses. Because of that, we were able to treat the actual problem, as opposed to only the symptoms, thus enabling an actual deeper change as opposed to only “on the surface.”
- Quality of the team and their willingness to discuss different points of view.

- Interaction and dialogue with the examiners are always informative and appreciated.
- The examination process identified Best Practices which we generally find beneficial.
- Validation to the Board of internal review and controls.
- Risk identification, internal controls and more involvement of the board.
- The most beneficial aspects have been communication about areas of focus and issues identified by the agency. This avoids surprises and provides for timely consideration of these matters.

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

- We have a policy or a process which we have had in place for the past 15+ exams and it is never questioned by an examiner, and then out of the blue an examiner is saying this policy or this process is not acceptable. How can this be? The regulations did not change. The area has been examined in past exams. This out of the blue shift in how someone in the agency is now interpreting a regulation can have huge impacts back in the marketplace, or in the operations in an institution. We had one or two of these situations occur in this exam.
- Sometimes spent a lot of time discussing specific problems on excellent quality loans that, if viewed in context of the overall loan relationship, are not material.
- Given the circumstances of our institution, there was no part of the examination process that was not beneficial and meaningful to problem identification, assessment, and remediation.
- Although not an extreme hardship, having so many trainees takes more time.
- The exit conference was held with the audit committee and management, however, the audit committee was not informed that their physical presence was needed which became an issue after the meeting. The audit committee was involved in the exit conference via conference call except the chairman of the audit committee attended in person.

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

- I feel our institution has a good relationship with our EIC and examination team. Because we have worked with a number of the exam teams for 2-3 years we develop this type of relationship which is beneficial to our institution, and I also believe beneficial to the exam team. We both want a well run safe and sound lending institution.
- The board valued most highly the face-to-face interaction with examination staff. While the various examination reports and related correspondence were excellently written and comprehensive, the ability to meet personally with the examiners was of great benefit to the board and new management in order to benefit from the "context" as a necessary supplement for creation of accurately developed rehabilitation strategies. Additionally, the board found the interim communications between examination activity that it had

with FCA staff to be particularly beneficial, and especially the pre-examination entrance conference and discussions.

- We appreciate the professionalism, knowledge and understanding, and open communication that the staff exhibits.
- Well organized, Considerate. Willing to listen.
- There was some confusion that when the EIC requested an executive session and management left the meeting, the EIC later said the CEO was expected to remain in the meeting but did not express that desire until the examination report was given to the full board.
- Overall, most of the examination process was professionally conducted and communications have been clear and effective.