EM-31.5

Category: **Board & Management Operations**
Topic: **Mission Compliance**
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Overview

The *Mission Compliance* topic provides guidance on evaluating compliance with mission-related regulations and effectiveness of programs to provide constructive credit and services. The Farm Credit System's (System) overall mission is to provide sound and dependable credit and related services to agriculture and rural America. This mission is derived primarily from Section 1.1 of the Farm Credit Act of 1971, as amended (the Act), which identifies the policy and objectives of Congress for the System. The Farm Credit Administration (FCA) has also emphasized the importance of mission, addressing it in FCA Board Policy Statement 59 on Regulatory Philosophy and in other regulatory documents. The credit and related service needs of agricultural producers and rural America are evolving, and meeting those needs in a safe and sound manner can be a challenge. Within the bounds of safety and soundness, FCA wants to ensure institutions fulfill their public mission as government-sponsored enterprises (GSEs).

While it is important for the System to be responsive to the needs of all types of agricultural producers having a basis for credit, institutions should use caution when expanding into new markets or products. Institutions should conduct appropriate due diligence and have the necessary resources and expertise to serve these markets and deliver their products in a safe and sound manner. As discussed in the procedures below, FCA will evaluate compliance with mission-related regulations and guidance by assessing the adequacy and administration of programs to provide constructive credit and services as a GSE, including efforts to strive for diversity and inclusion. This also includes ensuring institutions meet the needs of young, beginning, and small (YBS) farmers, and that investments for public mission purposes, if used, help agriculture and rural communities meet their ongoing debt and equity financing needs.

Examination Procedures and Guidance

General

1. Constructive Credit & Services:

Evaluate the adequacy and success of programs for meeting the System's public mission to provide credit and related services to all eligible, creditworthy customers.

Guidance:

Section 1.1 of the Act calls for the System to provide sound, adequate, and constructive credit and related services to farmers, ranchers, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations. It sets the congressional policy that System institutions be responsive to the credit needs of all types of agricultural producers having a basis for credit. Other provisions of the Act address eligibility and scope of financing, as well as providing sound and constructive credit to YBS farmers. Collectively, FCA views these objectives in the Act as key components of the System's public mission.

FCA Regulation 618.8440(b)(8) requires that business plans for agricultural credit banks (ACBs) and direct lender associations include a marketing plan. The marketing plan must strategically address how the institution will be responsive to the credit needs of all types of agricultural producers having a basis for credit, with specific outreach toward diversity and inclusion. In addition, FCA Bookletter BL-066 reinforces the need for lenders to look beyond traditionally served markets and customers, and towards other eligible customers. In a growing number of areas around the country, these new markets and potential customers are providing an increasing amount of food and fiber to consumers.

As set forth in the Act and regulations, institutions must understand their marketplace, reach out to potential eligible and creditworthy customers, and have board-adopted strategies and actions that clearly demonstrate efforts to fulfill their mission. Business plans, policies, lending standards, and risk appetite and tolerances should be structured and aligned in a manner that supports this mission, while balancing with the need to ensure credit and other risks remain within the institution's risk-bearing capacity.

Evaluative questions and items to consider when examining an institution's good faith efforts to provide constructive credit and services include:

- ***Market Analysis:*** **Does the market analysis include a description of the chartered territory by market segment? Does the analysis provide sufficient analytical support for identifying strategies to reach out to emerging or underserved market segments?** Business and marketing plans are key mechanisms for a board to guide management and staff in supporting mission-related objectives. To support the guidance contained in these plans, each institution should study and know its customer base and agricultural marketplace. FCA Regulation 618.8440(b)(8)(i) requires that ACB and direct lender association marketing plans include a description of the chartered territory by market segment, including the characteristics of demography, geography, and types of agriculture practiced. The institution should use this data to understand the characteristics of its chartered territory. With this knowledge, the institution can determine whether there may be potential, eligible customers it can reach through better marketing and outreach methods. The following are examples of best practices an institution should consider when completing a market analysis. While not required by regulations, these practices may help an institution develop meaningful strategies to carry out its mission.

    - When describing the characteristics of the territory and each market segment, include trend information on production units by size, type, or other characteristics that can help guide future marketing and outreach decisions.

    - Address eligible market segments such as producers, farm-related service businesses, processing or marketing operations, and rural homes. When analyzing these, management could consider factors such as how well the marketplace is already meeting customer needs in a particular segment, and the resources and expertise needed to serve that segment.

- Consider all types of creditworthy borrowers from the institution's-chartered territory including underserved populations.

- Consult with legal counsel to ensure that data gathering and analysis complies with applicable laws.

- ***Impediments to Fulfilling Public Mission:* Do values, culture, or practices pose any impediments to meeting the public mission, and if so, has the institution undertaken any strategies or actions to address these impediments?** The institution's mission statement, core values, and general organizational culture and practices should be consistent with the System's mission as outlined in Section 1.1 of the Act and the other criteria documents referenced in this guidance. This also includes items such as policies, processes, underwriting standards, lending approach, risk tolerances, staffing, and compensation systems that can influence behaviors or practices that may promote or impede the institution from achieving its mission. Management should analyze lending programs and practices, service delivery mechanisms, and staff skills to serve the various market segments and ensure there are no unnecessary barriers to providing credit to eligible, creditworthy customers. For example, such barriers could include a lack of employee training, appropriate loan products, appropriate creditworthiness standards, or outreach toward certain populations or geographic areas. When these barriers exist, management should take appropriate actions to address them. However, management should ensure they understand the inherent risks associated with such actions or any new initiatives, and that appropriate risk management practices and controls are in place.

- ***Lending Authorities:* Is the institution appropriately using its available lending authorities to carry out its mission? If not, was reasonable and thoughtful consideration given for not using certain authorities?** While the mission focus is on credit and services aimed at eligible agricultural producers, the institution's actual and intended use of authorities such as farm-related service businesses, processing or marketing operations, rural home, and similar entity should also be considered. While there are no specific requirements that the institution use these authorities, management should consider how these authorities may contribute to accomplishing the institution's mission. As a sound business practice, the institution should complete a thoughtful analysis as a basis for any business decisions to not actively use available lending authorities.

- ***Strategies and Actions:* Has the institution developed appropriate strategies and actions to market the institution's products and services to all eligible and creditworthy customers?** FCA Regulation 618.8440(b)(8)(ii) requires the business plan for each ACB and direct lender association to include a marketing plan. This marketing plan must include strategies and actions to market the institution's products and services to all eligible and creditworthy customers, with specific outreach toward diversity and inclusion within each market segment. The plan should reflect the chartered territory's geographic and demographic diversity, and address the accessibility of the institution's products and services to all potential customers. In developing strategies, the institution should make a good faith effort to identify how it can reach out to potential eligible and creditworthy customers who may not have previously had access to credit for various reasons. The approach to developing strategies should be thoughtful, deliberative, supported, and documented. Once strategies are established, the institution should develop actions that outline how the strategies will be implemented. Actions should have enough specificity to ensure they will reasonably accomplish the intended strategies. To ensure accountability, the institution should craft the strategies and actions in a way that will enable reporting on the progress made in accomplishing them. However, institutions are not expected to quantify results obtained from accomplishing the strategies and actions related to diversity and inclusion. Note: YBS programs have additional criteria related to establishing quantifiable goals that go beyond the expectations outlined in FCA Regulation 618.8440(b)(8). Refer to FCA Regulation 614.4165 and FCA Bookletters BL-040 REVISED and BL-066 for details.

- *Implementation:* **Are marketing plan strategies and actions effectively implemented?** Strategies and actions must be effectively implemented for the marketing plan to be successful. Management and staff should make a good faith effort to implement all strategies and actions. Any material deviation from the plan should be reported to the board. The board should hold management accountable for implementation and should approve any material deviation from the plan. While the institution is not expected to quantify results related to diversity and inclusion, a best practice would be to quantify results in meeting other aspects of the marketing plan. A review of the information discussed above, along with an analysis of loan portfolio composition and loan underwriting practices, should evidence that the institution is effectively meeting its public mission.

- *Internal Controls:* **Are internal controls sufficient to ensure programs for providing constructive credit and services are managed appropriately and in compliance with program guidance and regulatory requirements?** As a sound business practice, the institution should implement internal controls that establish clear lines of responsibility for approving and implementing programs to provide constructive credit and services. The board should ensure necessary controls are addressed when planning and approving new programs. Controls should ensure that programs are effectively carried out in accordance with program guidance and regulatory requirements, with appropriate delegations of authority and segregation of duties. The board should also ensure sufficient internal audit and review coverage of guidance and controls. Refer to the *Audit* and *Transaction Testing* procedures for information on examining audit coverage and conducting transaction testing to validate that controls are functioning as intended.

- *Board Reporting:* **Does the board receive sufficient reports on progress made in accomplishing marketing plan strategies and actions?** The reporting should inform the board of any significant problems, delays, or adjustments in implementing strategies and actions to market the institution's products and services to all eligible and creditworthy customers, with specific outreach toward diversity and inclusion within each market segment. Report content and frequency should be consistent with board policy or process requirements, and comply with FCA Regulation 618.8440(c)(2). While the regulation requires board reporting annually, the institution should consider more frequent reporting as discussed in the *Providing Business Planning and Strategic Direction* section of The Director's Role. More ongoing reporting will enable the board to ensure accountability and formulate new strategies and actions, if necessary.

Note: As specified in FCA Regulation 618.8440(b)(8), institutions may use other documents as part of meeting the marketing plan regulatory requirements. However, these documents must be approved by the board annually, and be summarized and incorporated by reference in the marketing plan. Also, it is important to remember the FCA business planning regulation does not require an institution to:

- Establish quotas. It does not require specific outcomes in lending; rather, the focus is on outreach efforts and strategies and actions.

- Complete redundant plans or actions. An institution may use existing documents to satisfy these planning requirements, provided the existing documents are approved annually by the board.

- Disclose confidential or sensitive information in public documents.

- Extend credit to any persons who are not eligible, creditworthy, or within the scope of financing rules.

- Favor any type or group of agricultural producers in its underwriting of credit.

- Gather or record data on customer characteristics not currently legally gathered or recorded.

- Implement strategies or actions that extend beyond its marketplace.

- Develop marketing plans unless it is exercising title III lending authorities or is a direct lender association.

- Implement strategies or actions inconsistent with existing lending laws and rules or with safety and soundness standards.

System institutions vary widely in their size, marketplace, agricultural types practiced, producer demographics, and other areas. A one-size-fits-all approach to compliance with FCA's business planning regulations is not appropriate and the regulation does not contemplate quotas or quantifiable metrics in marketplace service or any specific strategies or actions. Examiners should not expect specific outcomes or results in diversity and inclusion marketplace service, but will evaluate the institution's good faith efforts to implement well thought out strategies and actions identified in the marketing plan.

Refer to the following documents for additional guidance and information:

- Preamble to the 2012 Business Planning Regulation amendments
- Frequently Asked Questions on Business Planning for Diversity and Inclusion
- FCA procedures and guidance within the *Mission Compliance* topic for examining YBS, investments for public mission purposes, and related services programs.

2. YBS:

Examine the adequacy and administration of the YBS program, contribution to meeting the System's public mission, and compliance with FCA guidance.

Guidance:

Section 4.19 of the Act and FCA Regulation 614.4165 require each association to have a program for furnishing sound and constructive credit and related services to young, beginning, and small (YBS) farmers and ranchers. Each association's program must be developed under its funding bank's policy and is subject to the bank's annual review and approval. Each bank must adopt written policies that direct associations to develop a YBS program and to coordinate with other institutions and organizations. The banks are required to report annually to FCA summarizing its association's YBS program operations and achievements. YBS programs are intended to help ensure associations make conscious efforts to meet the unique credit and related services needs of eligible YBS producers. Associations should identify underserved communities and groups, so they are not overlooked or excluded from marketing, education, and outreach efforts. Underserved groups include those who, because of their identity as members of underserved groups, have been subjected to racial or ethnic prejudice without regard to their individual qualities. While YBS programs are mandated by regulatory requirements, providing credit and services to YBS farmers and ranchers makes good business sense and is important to association's long-term success. Institutions can refer to the YBS page on FCA's website for information and resources.

FCA's examination of a YBS program focuses on assessing guidance and controls established to extend credit and related services to all creditworthy YBS farmers and ranchers. Institutions must have internal controls in place to ensure compliance with regulatory requirements.

Evaluative questions and items to consider when examining the adequacy and administration of YBS programs, contribution to meeting the System's public mission, and compliance with FCA guidance include:

- ***YBS Program Guidance:*** **Does YBS program sufficiently evidence a commitment to meeting the association's public mission?** Program guidance should sufficiently evidence a commitment to fulfilling the mission of providing YBS farmers and ranchers the credit and related services they need to begin, grow, or remain in agricultural production. FCA Regulation 614.4165 establishes minimum YBS program components to ensure that associations can successfully fulfill their YBS mission. This includes a mission statement describing YBS program objectives and specific means for achieving such objectives. While associations would typically choose to adopt a board policy, they have latitude to use other means to enact and control their YBS program in lieu of a formal policy. FCA Bookletter BL-040 REVISED expands on the minimum requirements in FCA Regulation 614.4165 by recommending that the association develop YBS policies to address several topics. These topics could include the following:

    - Definitions for the three YBS categories as defined in FCA Bookletter BL-040 REVISED.

    - Criteria for treating a subset of part-time YBS farmers with certain attributes as bona fide, full-time farmers. For example, the subset could consist of those farmers with a high degree of commitment to begin, grow, or remain in production agriculture and a demonstrated intent to progress toward agricultural production as their primary business and vocation.

    - A reasonable definition of other credit needs that could apply to YBS farmers.

    - Risk parameters and criteria for new loans to YBS farmers that are classified less-than-acceptable.

    - Loan file documentation expectations to demonstrate the YBS farmer's commitment or intent to progress towards agricultural production as their primary business and vocation.

    - Internal controls, including audit coverage, to ensure the program is implemented for the benefit of YBS farmers and reporting is accurate.

- *Internal Controls:* **Are internal controls sufficient to ensure the YBS program is managed appropriately and in compliance with program guidance and regulatory requirements? Are controls sufficient to ensure accurate YBS coding on loans and leases?** FCA Regulation 614.4165(d)(1)(i)(B) requires direct lender association YBS programs to include internal controls that establish clear lines of responsibility for YBS strategic plan development and corresponding YBS program implementation, tracking YBS program performance, and quarterly reporting to the board. In addition to the program guidance discussed above, the association should maintain other controls as a sound business practice to ensure YBS programs are effectively carried out in accordance with program guidance and regulatory requirements, and loans and leases are accurately coded for tracking and reporting purposes. Examples of internal controls include the following:

    - *YBS Training Program* – Management should ensure staff are properly trained on the program, so they can recognize and effectively serve the current and future needs of YBS farmers and ranchers and ensure accurate YBS coding.

    - *Internal Audit and Review Coverage* – Management reviews and internal audit should include YBS program coverage, including YBS coding, to ensure compliance with regulations and accurate reporting. Refer to the *Audit* and *Transaction Testing* procedures for information on examining audit coverage and conducting transaction testing to validate that controls are functioning as intended and YBS coding is accurate.

    - *Performance and Compensation Programs* – Management could link performance evaluations and compensation and incentive programs to YBS program success. FCA Regulation 620.31(b)(3) requires the Compensation Committee to ensure that senior officer compensation, incentive, and benefits programs support the association's mission, which includes the YBS program.

- *Other Qualitative Factors:* **Has the association developed and implemented appropriate programs and strategies for marketing, outreach, education, and credit and related services for all eligible and creditworthy persons, including YBS farmers and ranchers?** When developing YBS programs, the association should identify opportunities to reach out and market to all eligible and creditworthy YBS customers. Underserved communities and groups can be overlooked or excluded from traditional marketing efforts and education outreach. Therefore, every effort should be made to reach the entire universe of creditworthy YBS borrowers in the association's territory. The approach to developing these programs and related strategies should be thoughtful, deliberative, supported, and documented. Once strategies are established, management should develop actions that outline how the strategies will be implemented. Actions should have enough specificity to ensure they will reasonably accomplish the intended strategies. Management needs to effectively implement strategies and actions for the YBS mission outreach to be successful. To ensure accountability, the strategies and actions should be designed in a way that will enable reporting on the progress made in accomplishing them. The board should hold management accountable for plan implementation and be informed of any material deviations from the plan. Accomplishment of the association's YBS goals is a good indicator of whether strategies and actions were adequate and appropriate. The following are additional requirements and considerations when examining qualitative factors and strategies:

- FCA Regulation 618.8440(b)(8)(ii) requires institutions to develop strategies and actions to market their products and services to all eligible and creditworthy persons, which would include YBS customers.
- FCA Regulation 614.4165(d)(1)(ii)(A) provides examples of credit and related services for this often less financially stable, yet crucial group of borrowers. Examples include customized loan underwriting standards, loan guarantee programs, fee waivers, or other credit enhancements commensurate with the credit risk approved by the board.
- FCA Regulation 614.4165(d)(1)(ii)(B) requires coordination with other System institutions in the territory and other governmental and private sources who offer credit and services to YBS farmers and ranchers.
- FCA Regulation 614.4165 (d)(1)(iii) requires associations to implement effective outreach programs to attract and retain YBS farmers and ranchers, which may include the use of advertising campaigns, educational programs, and advisory committees comprised of YBS farmers and ranchers and/or a YBS mentoring program to better serve and understand the needs of this lending segment.
- FCA Regulation 614.4165(c)(2) requires associations to analyze previous year performance; discuss variances and reasons for the results; and identify how the qualitive factors and quantitative goals in FCA Regulation 614.4165(d) assist and expand access to credit and education for YBS farmers and ranchers.
- FCA Bookletters BL-040 REVISED and BL-066 provide additional information and guidance on possible strategies, actions, and outreach to potential YBS customers.
- FCA Informational Memorandum on Lending, Training, and Outreach Opportunities with the Farm Service Agency dated November 25, 2014, provides information on specific lending, training, and outreach opportunities provided by the Farm Service Agency (FSA). Taking full advantage of these opportunities can benefit associations by reaching a broader lending segment and providing them with ways to coordinate YBS programs with other governmental sources of credit, as required by Section 4.19 of the Act. Farm loan programs such as government guarantees may also help mitigate credit risk when meeting the financing needs of YBS customers.

Refer to the *Regulatory Compliance* procedure in the *Business Strategy & Planning* Examination Manual topic for examining business plan compliance related to qualitative factors.

- ***Quantitative Goals:* Has the association developed and implemented appropriate goals to ensure the YBS program provides sound and constructive credit to YBS farmers and ranchers in its territory?** FCA Regulation 614.4165(d) requires associations to develop a YBS lending program that incorporates certain minimum components, including annual quantitative goals for credit to YBS farmers and ranchers based on an understanding of reliable demographic data. Direct lender associations must identify the sources of data used to establish the goals. The regulation also requires YBS goals be included in the association's operational and strategic business plan for at least the succeeding 3 years. Additionally, FCA Regulation 620.5(k) requires annual disclosure of certain YBS program elements in the annual report to shareholders. Refer to the *Regulatory Compliance* and *Annual Report* procedures in the *Business Strategy & Planning* and *Financial & Shareholder Reporting* Examination Manual topics, respectively, for examining business plan and annual report compliance. Management needs to quantify results in meeting YBS goals, as further discussed in the *Reporting* section below. Other important considerations include:

- Lending to some YBS farmers and ranchers, particularly new entrants into farming, may involve greater risk than lending to non-YBS customers. Despite the potential for added risk, YBS programs are important for fulfilling the System's mission and attracting new customers who may become life-long System members. When setting goals, the association should balance the credit needs of YBS farmers and ranchers with its risk-bearing capacity. As discussed in FCA Bookletter BL-040 REVISED, associations should consider if making less-than-acceptable new loans to a limited subset of YBS farmers is within its risk appetite.

- As discussed in FCA Bookletter BL-040 REVISED, the association should also consider credit enhancements and credit coordination programs to improve creditworthiness and to further support program goals. To provide these types of credit enhancements, the association should consider setting aside capital they are willing to risk in supporting YBS programs.

- ***Impediments to Fulfilling Public Mission:* Do values, culture, or practices pose any impediments to meeting the YBS mission, and if so, has the association undertaken any strategies or actions to address these impediments?** Effective YBS programs begin with the culture and tone at the top, as set by the board. Policies, procedures, processes, underwriting standards, lending philosophy, risk tolerances, staffing, and compensation systems should all be an outgrowth from this culture and tone. These elements influence behaviors and practices and can either promote or impede the association in achieving its YBS mission. Management should review lending programs and practices, marketing efforts, and staff skills to determine if they sufficiently facilitate serving all market segments in the association's lending territory. This review should ensure there are no unnecessary barriers to providing credit to all eligible, creditworthy YBS farmers and ranchers. Barriers could include inadequate employee training, lack of suitable loan products, inappropriate creditworthiness standards, or insufficient outreach toward certain populations or geographic areas. When these barriers exist, the board and management should address them while also ensuring appropriate risk management practices are in place. Associations should also work with their local FSA representatives to assist with the System's directive to serve all creditworthy YBS borrowers by breaking down bureaucratic barriers to entry.

- ***Reporting:* Does the board receive adequate reports on progress made in carrying out the YBS program?** FCA Regulation 614.4165(d)(1)(i)(B) requires quarterly board reporting, which enables the board to ensure accountability for program implementation and make adjustments as needed. Accurate quantitative and qualitative YBS reporting serves to help track and monitor program operations and achievements, including any program changes and progress towards achieving YBS goals. Report content and frequency should be consistent with board policy or process requirements, and comply with regulatory requirements. Board reporting should identify significant problems, delays, or needed adjustments in implementing strategies and actions to market products and services to all eligible and creditworthy YBS customers. To facilitate the bank's required annual report, and review and approval of each direct lender association's YBS program, associations must annually provide YBS program information to its funding bank. The banks report association

YBS quantitative data to FCA through the FCS call reports annually. Banks and associations report to FCA on YBS qualitative factors through the annual YBS Non-Lending report. YBS reporting must be accurate, as results are reported to Congress and other audiences.

- ***Bank Oversight of YBS Programs (banks only):*** **Does the bank adequately meet its responsibilities for policy guidance, annual review and approval, internal controls, and reporting related to YBS program operations and achievements?** Banks have a responsibility to provide effective oversight and reporting of affiliated association YBS program activities, as outlined in Section 4.19 of the Act. FCA Regulation 614.4165(b)(1) requires each bank to adopt written policies and outlines specific items the policies must address. Specifically, the bank's policy must direct each affiliated direct lender association to establish a program to provide sound and constructive credit and related services to YBS farmers and ranchers, and include in its YBS program provisions for ensuring coordination with other System institutions in the territory and other governmental and private sources of credit. The policy also must require the bank to provide the FCA a complete and accurate annual report summarizing the YBS program operations and achievements of its affiliated direct lender associations. FCA Regulation 614.4165(b)(2) requires each bank to annually review and approve the YBS program of each direct lender association. Review and approval shall solely be to determine whether the YBS program contains all required components as set forth in FCA Regulation 614.4165(d). Any conclusion by the bank that a YBS program is incomplete must be communicated in writing to the direct lender association and to the FCA within 30 days. Additionally, FCA Regulation 614.4165(b)(3) requires each bank to implement internal controls for requirements in FCA Regulations 614.4165(b)(1)(iii) and (b)(2). Specifically, the banks need to have internal controls over its reporting functions to FCA, and review and approval of association YBS programs.

In addition to the guidance above, please refer to FCA's *Annual Report to Shareholders* and *Business Planning Regulatory Compliance* workpapers (see Part 3 of the Examination Manual). These workpapers provide guidance on examining specific aspects of YBS related to shareholder disclosures and business planning.

3. Investments:

Evaluate the use of investments to meet the System's public mission.

<u>Guidance</u>:

In the Preamble and Section 1.1 of the Act, Congress identified providing an adequate and flexible flow of money into rural areas and improving the income and well-being of America's farmers and ranchers among the primary objectives of the Farm Credit System (System). Investments are one method institutions (System banks, associations, and service corporations) can use to accomplish these objectives when carrying out their mission. In addition to the types of investments institutions are specifically authorized to make, FCA has identified *other investments approved by FCA* (other investments) per FCA Regulation 615.5140(e) as a means to achieve these objectives. This regulation provides flexibility and opportunity for institutions to serve agriculture and rural communities through investments. For example, FCA has approved requests to invest in rural community facilities. Rural community facility investments, most often done in partnership with the United States Department of Agriculture (USDA) and community banks, are intended to support essential community facility projects such as hospitals, charter schools, other education facilities, nursing homes, and assisted living facilities. Investing in rural communities enables the System to fulfill its mission by helping sustain rural communities on which the System's borrowers are dependent for their livelihoods. System institutions can also purchase Federal Agricultural Mortgage Corporation (Farmer Mac) securities under FCA Regulation 615.5174 to further their mission to finance agriculture.

Another type of investment related to the System's mission is an equity investment in a rural business investment company (RBIC), as authorized by the Farm Security and Rural Investment Act of 2002. These investments are venture capital funds the USDA approves and oversees. These venture capital funds provide startup money to rural entrepreneurs and equity capital to existing rural businesses for growth opportunities.

Note: Using investments for public mission purposes is allowed under FCA Regulations but is not mandated. These procedures should not be construed to compel participation. Examiners should only use these procedures to evaluate institutions that voluntarily participate in such activities.

Evaluative questions and items to consider when examining the use of investments to further public mission include:

- ***Board Involvement:*** **Does the board provide sufficient guidance on using investments for public mission purposes?** Institutions that use investments for public mission purposes should address such investments in board policy or other guidance. This includes using their authority under FCA Regulation 615.5140(e) to make other investments to meet their public mission. Refer to the *Investments* Examination Manual topic for guidance on evaluating investment policy adequacy.

- ***Strategies and Actions:*** **Does the institution have effective strategies and action plans to help the flow of funds to agriculture and rural communities through the use of investments?** An institution that decides to use investments to meet public mission, and especially other investments under FCA Regulation 615.5140(e), should develop strategies and action plans linking these investments into its strategic and operational planning. Examples of potential strategies that could indicate an institution's further commitment to carrying out its public mission using investments include:

    - Evaluating its agricultural and rural communities' financial and service needs through such means as outreach and market analysis.

    - Collaborating with agricultural and rural community leaders.

    - Partnering with rural economic development and infrastructure projects at the federal, state, or local levels.

    - Evaluating projects and programs in rural communities that might have difficulty attracting financing at an affordable rate.

    - Considering non-financial benefits of using other investments, such as:

        - Having a positive impact on rural communities and the quality of life for rural residents.
        - Stimulating economic conditions in rural areas.
        - Funding critical infrastructure and facilities.
        - Creating jobs, sustaining economic growth, and retaining youth and talent in rural communities.

    - Creating a positive corporate image for the institution.
    - Promoting its status as a government-sponsored enterprise.

- ***Guidance and Controls:* Are guidance and controls sufficient to ensure adherence with FCA guidance on using investments for public mission purposes?** Guidance and controls should be commensurate with the extent of investments for public mission purposes. Institutions that only use these types of investments infrequently would not be expected to have the same level of guidance and controls as institutions that make more extensive use of these types of investments. The following include specific FCA guidance related to investments for public mission purposes:

    - Informational Memorandum on Guidance for Investments Requests under FCA Regulation 615.5140(e) dated September 4, 2014.

    - Informational Memorandum on Association Investments dated May 16, 2012.

    - Informational Memorandum on Investments in Rural America -- Pilot Investments Programs dated May January 11, 2005. (Note: These pilot programs were concluded effective December 31, 2014. However, institutions were permitted to continue holding these investments until maturity or divestiture provided the institution continues to meet all approved conditions.)

    - Informational Memorandum on Investments in Rural America dated June 25, 2004. (Note: Criteria regarding "If an FCS institution holds more than 15 percent of the shares of a RBIC, either alone or in conjunction with other FCS institutions (or affiliates), the RBIC shall not provide equity investments in, or provide other financial assistance to, entities that are not otherwise eligible to receive financing from the FCS under the Act" is no longer valid and was increased to 50 percent. The Agricultural Improvement Act of 2018 amended this area for the Rural Business Investment Program (RBIP) for the System to 50 percent, with a subsequent update to the governing regulation 7 CFR 4290.720(i), which became final and effective March 24, 2020.)

    - Informational Memorandum on Possible Effects of the Farm Security and Rural Investment Act on Farm Credit System Institution Authorities dated January 2, 2003.

    - Informational Memorandum on Prior Approval of New Investment Activities dated August 2, 1999.

- ***Rural Business Investment Companies (RBIC) Limitation:* Are any RBICs within the statutory limitation?** As required by the Farm Security and Rural Investment Act of 2002, SEC. 384J, Subsection (b), no bank, association, or institution described in Subsection (a) may make investments described in Subsection (a) that are greater than 5 percent of the capital and surplus (total regulatory capital [tier 1 + tier 2 capital] + any amounts of the allowance not included in tier 2 capital) of the bank, association, or institution. Examiners should monitor compliance with this requirement when an institution increases its investment in RBICs.

- ***Reporting to the Board:* Is reporting sufficient for the board to monitor how investments are contributing to meeting the System's mission?** Periodically, management should report to the board (or its designated committee) on how these investments are achieving their mission-related objectives. Effective reporting should include updates on carrying out any business plan strategies and actions.

4. Related Services:

Examine the adequacy and administration of related services programs, contribution to meeting the System's public mission, and compliance with FCA guidance.

Guidance:

Sections 1.1, 1.12, 2.5, 2.12(15), and 3.7 of the Act call for and authorize the System to provide related services to farmers, ranchers, producers of aquatic products, their cooperatives, and selected farm-related businesses necessary for efficient farm operations. As defined in FCA Regulation 618.8000(b), a related service is any service or type of activity that is appropriate to the recipient's operations, including control of financial matters. It includes, but is not limited to, technical assistance, financial assistance, financially related services, and insurance, but does not include lending or leasing activities. While there are no specific requirements that an institution use its related services authority, management should consider how such offerings may contribute to accomplishing the System's public mission. See FCA's Informational Memorandum on Serving the Members of Farm Credit System Institutions dated November 4, 2010, for additional guidance on providing value-added benefits to members. Note: Service corporations are allowed to provide related services, with the exception that Section 4.25 of the Act prohibits them from offering insurance services.

FCA's examination of related services programs at institutions that offer them focuses on evaluating the adequacy of guidance and controls to comply with regulatory requirements and meet the System's public mission. Business objectives, strategies, policies, and other guidance should be structured and aligned to promote the System's public mission of providing related services for eligible recipients. Institutions also need effective internal controls to uphold their policy and ensure satisfactory program implementation and compliance with regulatory requirements.

Note: FCA Regulations require institutions to disclose in the annual report to shareholders and address in the business plan certain information on related services. Compliance with these requirements is examined as part of the *Financial & Shareholder Reporting* topic (see the *Annual Report to Shareholders* workpaper) and *Business Strategy & Planning* topic (see the *Business Planning Regulatory Compliance* workpaper). Specific requirements in FCA Regulation 614.4165 for addressing related services to young, beginning, and small (YBS) farmers and ranchers as part of an institution's YBS program is examined in these two workpapers, as well as the *YBS* procedure earlier in this section. Also, the requirement for marketing plans to address strategies and actions to market the institution's products and services is examined in the *Constructive Credit & Services* procedure earlier in this section.

Evaluative questions and items to consider when examining the adequacy and administration of related services programs, contribution to meeting the System's public mission, and compliance with FCA guidance include:

- ***Policies:* Are board policies governing related services and member insurance programs adequate and in compliance with regulatory requirements?** Institutions that offer related services, including member insurance services, are required by FCA Regulations to adopt board policies. Effective policies should evidence a commitment by the board to fulfilling the public mission of providing eligible recipients with services they need to begin, grow, or remain in agricultural production. Specific policy requirements include:

- FCA Regulation 618.8015 requires a policy on related services. At a minimum, the policy must include the stated purposes, objectives, and operating parameters for offering related services, and include a requirement that each service offered be consistent with the institution's business plan and long-term strategic goals. The policy must also be subject to review under an appropriate internal control policy. Refer to the regulation for policy guidelines regarding fee disclosures and ensuring related services are offered to recipients on an optional basis.

- FCA Regulation 618.8040 requires a policy on member insurance programs. The regulation lists 12 general guidelines for insurance programs that should be addressed in this policy.

- ***Eligibility:*** **Is the institution only offering related services to eligible recipients?** Institutions can offer related services to most persons and entities who are eligible to borrow, as identified in FCA Regulation 618.8005. Exceptions include farm-related service businesses and rural homeowners who do not have farm or aquatic operations. An eligible recipient does not need to be a borrower or a member to be offered related services other than insurance; they only need to be eligible to borrow. For credit or term life or credit disability insurance, as addressed in FCA Regulation 618.8040, the recipient must be a member of and have a loan from any System institution. For all other types of insurance, the recipient must be a member of any System institution. Related services may also be requested by an eligible borrower as a part of a transaction between that borrower and a recipient of the service who would otherwise be ineligible. For example, a fee appraisal that is necessary to a transaction with an eligible borrower may be provided to any party to the transaction.

- ***Approval of Insurers (banks only):*** **Did the bank meet regulatory requirements for approving insurers? Is bank supervision of the insurance services offered by the approved insurers sufficient?** FCA Regulation 618.8040(b)(3) requires each bank to make a reasonable and good faith effort to attract and approve the insurance programs of more than two qualified insurers for each type of insurance offered in all states of the bank's chartered territory. When unable to approve at least two insurers, the bank must document its efforts to attract additional qualified insurers for the affected insurance program and state. Also, FCA Regulation 618.8040(b)(11) requires bank supervision to ensure that insurance services offered by approved insurers consistently provide members or borrowers with a high-quality and cost-effective service. This supervision must be without any coercion or suasion from the bank in favor of any agent or insurer.

- ***Insurance Services Requirements:*** **Has the institution met the requirements in FCA Regulation 618.8040(b)(4) for each insurance service offered?** Refer to the regulation for specific requirements the institution must meet to offer member insurance services. Among these is selecting only from the bank-approved insurers (see *Approval of Insurers* bullet above). If the institution selects less than two approved insurers for any insurance program, it must document the reasons why it is unable to offer members and borrowers additional insurers for the affected program.

- ***Out-of-Territory Requirements:*** **Has the institution met regulatory requirements for any out-of-territory related services?** Before offering a related service outside of its chartered territory, FCA Regulation 618.8030 requires the institution to obtain consent from all chartered institutions offering the same type of service within the desired territory. If the service is not currently being offered, it must obtain consent from at least one direct lender institution chartered in the territory. Consent must be in the form of a written agreement with specific terms and conditions, including timeframes. Service corporations must also follow the requirements of this regulation in offering related services out-of-territory. However, a service corporation cannot consent to an out-of-territory institution providing services in its chartered territory.

- ***Internal Controls:* Are internal controls sufficient to ensure related services programs are managed appropriately and in compliance with program guidance and regulatory requirements?** As a sound business practice, the institution should implement internal controls that establish clear lines of responsibility for related services program implementation, performance results, and reporting to the board. Controls should ensure related services programs are effectively carried out in accordance with program guidance and regulatory requirements, with appropriate delegations of authority and segregation of duties. Examples of other controls include:
  - Properly training staff on related services programs so they can recognize and effectively serve the needs of eligible recipients and comply with program guidance and regulatory requirements.
  - Tying performance evaluations and compensation and incentive programs to related services success to help effectively implement the related services programs. FCA Regulation 620.31(b)(3) requires the Compensation Committee to ensure senior officer compensation, incentive, and benefits programs support the System's public mission, which includes related services programs. Note: Refer to FCA Regulation 618.8040(b)(6), which restricts receipt of commissions or gifts from underwriting insurance companies and places limits on incentive compensation that may be earned for selling insurance.
  - Maintaining sufficient records, as required by FCA Regulation 618.8040(b)(12), to facilitate the review and supervision of insurance services.
  - Ensuring sufficient internal audit and review coverage of related services guidance and controls. Refer to the *Audit* and *Transaction Testing* procedures for information on examining audit coverage and conducting transaction testing to validate that controls are functioning as intended.
- ***Reporting*: Is reporting sufficient for the board to monitor and make informed decisions on related services programs?** Management should report to the board (or its designated committee) on related services activities and whether these services are achieving their intended objectives. Report content and frequency should be consistent with policy requirements and may include items such as activity, profitability, customer satisfaction, and periodic reviews of each related service for continued consistency with business plan and long-term strategic goals.

In addition to the above, the following are evaluative questions and items to consider when an institution offers a new service or one that it did not offer during the most recently completed business cycle:

- ***Authorization Process:* Has the institution appropriately notified FCA of each related service offering as required by FCA Regulation 618.8010?** Institutions can offer related services that have been authorized by FCA (see the Related Services List), or request approval from FCA for new service proposals. If an institution plans to offer a service already on the related services list, it must provide a written description of the service to FCA's Office of Examination 10 business days prior to implementation. For new services not on this list, the regulation identifies specific requirements for obtaining FCA approval. Examiners should verify that notifications were made, or approvals obtained, and the institution complied with any approval conditions.

- ***Feasibility Requirements:*** **Has the institution completed a sufficient feasibility analysis for every related service program it provides, as required by FCA Regulation 618.8020?** The feasibility analysis must include support for determining the proposed service is authorized and a cost-benefit analysis that demonstrates program feasibility. The cost-benefit analysis must take into consideration several factors specified in the regulation (e.g., market, pricing, training requirements, financial liability, consistency with business and capital plans, conflicts of interest). These requirements should not be interpreted as all-encompassing, and in many instances, there will be other issues the institution will need to address. The extent of the cost-benefit analysis should be appropriate to the level of financial and operational risks in a service. For example, a service that is low-priced or free to the recipient would still bear a cost to the institution and require an extensive analysis to justify offering it. The institution's board needs to approve related services and, by doing so, would approve the adequacy of the feasibility analysis. Note: Prior to offering a new related service program or one that it did not offer during the most recently completed business cycle, associations and service corporations must submit the feasibility analysis to the funding bank (or service corporation owners) for review (see FCA Regulation 618.8025).

- ***Feasibility Reviews (banks and service corporations only):*** **Did the bank (or service corporation owners) adequately meet its feasibility review responsibilities as required by FCA Regulation 618.8025?** Prior to an institution offering a new related service program or one that it did not offer during the most recently completed business cycle, the board of the funding bank (or service corporation owners) must verify the institution has performed a feasibility analysis pursuant to FCA Regulation 618.8020. Refer to the regulations for specific requirements. The funding bank (or service corporation) should have a documented process for completing feasibility reviews.

Refer to the following documents for additional criteria, guidance, and information on evaluating related services programs:

- FCA's Informational Memorandum on Foreign Currency Transactions dated September 18, 2008 – Addresses the permissible scope of foreign currency transactions.

- FCA's Informational Memorandum on Livestock Risk Protection and Other Insurance Products Offered by the Federal Crop Insurance Corporation dated January 25, 2006 – Communicates that all insurance products approved and administered by the Federal Crop Insurance Corporation (FCIC) and the Risk Management Agency (RMA) are considered to be an already approved multiple-peril crop insurance related service.

- FCA's Informational Memorandum on Revised Related Services List dated June 10, 2004 – Addresses farm credit bank authorization to offer certain financial risk management services.

- FCA Legal Opinion Summary 99-13 dated December 23, 1999 – Addresses contracting with a farm input buying service as a related service (farm business consulting).

- FCA Legal Opinion Summary 98-08 dated December 16, 1998 – Addresses offering related services to eligible farm-related businesses, non-farm rural homeowners, and former farmers.

5. Audit:

Determine if the institution conducts an effective audit (scope, reporting, and followup) of programs related to mission compliance.

Guidance:

The internal audit and review program is a key mechanism for ensuring mission compliance activities and processes are functioning effectively and in compliance with regulations and policies. The internal auditor or other qualified, independent party should review the adequacy of mission compliance practices to ensure compliance with applicable criteria. The audit risk assessment and scope should address mission compliance topics, and audit or review frequency should be commensurate with the complexity of the institution's operations and risk profile. A reliable audit program provides the board reasonable assurance that mission compliance activities are effective and that mission compliance reporting is complete and accurate.

Note: This procedure focuses on evaluating the reliability and effectiveness of internal audits and reviews in this topical area. Refer to the *Audit & Review Programs* topic in the Examination Manual for guidance on examining the overall internal audit and review program.

Evaluative questions and items to consider when examining the audit or review of mission compliance include:

- ***Audit Coverage:*** **Is there periodic audit or review coverage of mission compliance?** Audit or review coverage and frequency should be appropriate relative to risks, changes in the operating environment, regulatory requirements, and periodic testing needs. Coverage should also be consistent with the institution's risk assessment results and annual audit plan. FCA Bookletter BL-040 REVISED encourages YBS program coverage in the audit program.

- ***Scope and Depth:*** **Are audit or review scope and depth sufficient to conclude on the adequacy, completeness, and timeliness of mission compliance activities and processes?** The scope and depth of work, including transaction testing, should cover the primary processes and controls within the area being audited or reviewed and be sufficient to determine if internal controls are functioning as intended and regulatory requirements are met. The scope and depth of coverage should be documented and consistent with the approved audit or review plan and engagement contract (if applicable). Audit or review workpapers should be examined to verify the actual scope and depth of work performed. The workpapers may indicate the scope and depth deviated from what was identified (or implied) in the audit plan. For example, workpapers may indicate the work performed was limited to evaluating the existence of policies and procedures and didn't include reviewing other controls, such as training or reporting, or testing compliance with regulations or institution guidance. If the work deviated materially from the original planned scope, internal audit should notify the board (or Audit Committee, if so delegated) of the reasons for the change. Specific items that should be considered in the audit or review scope include:

- Policies and procedures for all major mission compliance areas (e.g., marketing and outreach, YBS program, public mission investments, related services programs).
- Compliance with mission-related policies, procedures, FCA Regulations, and other FCA guidance.
- Monitoring and control processes (e.g., reporting, management oversight, delegated authorities, separation of duties, management information systems and data).
- Marketing plans and outreach efforts towards diversity and inclusion.
- YBS program, including sufficient transaction testing to ensure established criteria are followed.
- Fraud-related threats and vulnerabilities, as well as anti-fraud controls.

- ***Reliability of Results:*** **Did FCA identify any concerns with audit or review reliability?** It is important to understand the scope and depth of the audit or review being examined, as discussed above, when evaluating audit or review reliability. With this understanding, the following are key considerations when evaluating the reliability of audit or review results:
  - *FCA Testing* – Evaluate the reliability of internal audit or review work by comparing the results to FCA's examination results in this area. This comparison often includes FCA testing transactions that were covered in the internal audit or review (transactions are often loans or loan applications, but may include other types of transactional activity, as well). In addition to the audit or review report, examiners should request and review the workpapers and hold discussions with the auditor to obtain a more thorough understanding of work completed. This can be especially important if the audit or review report is not sufficiently detailed or FCA's examination work and testing identifies potential concerns. Auditors and reviewers complete line sheets, flowcharts, control matrices, standard work programs, workpaper forms, or other relevant audit evidence when conducting and supporting their work. (IIA Standards 2240, 2300, 2310, and 2320) Workpapers should adequately document the work performed and support the final report. If FCA identifies weaknesses that were not identified in the audit or review, the cause for any discrepancy should be determined.
  - *Audit/Review Staffing* – Whether internal or outsourced, auditors and reviewers conducting the work need to be qualified, independent, and objective to ensure reliable results. They should have the right mix of knowledge, skills, and other competencies needed to perform the work. (IIA Standard 2230) Additionally, auditors and reviewers need to be independent of the activities they audit so they can carry out their work freely and objectively. (IIA Standards 1100, 1112, 1120, and 1130) For example, audit and review staff should not be involved in developing and installing procedures, preparing records, operating a system of internal controls, or engaging in any other activity that they would normally review. Examiners should evaluate the staffing on the individual audit or review being examined as part of determining the reliability of results.
  - *Institution Review of Work Performed* – The institution should complete an independent review of the workpapers to ensure audit or review objectives and

scope were met and the results and conclusions were reliable and supported. (IIA Standard 2340) Examples could include a supervisory review of in-house audit work by the Chief Audit Executive (CAE) or other audit staff, or a review of outsourced work by the CAE or audit coordinator. Examiners should consider whether the institution completed these reviews, and if any concerns were identified, when concluding on audit or review reliability.

- ***Reports:*** **Does the internal audit or review report sufficiently communicate mission compliance review results and recommendations, if applicable?** Examiners should consider the following when evaluating the audit or review report:
    - Is the report prepared and communicated in accordance with the institution's guidelines?
    - Is an executive summary or overview included to provide the board with a general conclusion on audit or review results?
    - Is the report accurate, concise, supported, and timely in communicating the audit or review objectives, scope, results, conclusions, and recommendations? (IIA Standards 2330, 2400, 2410, 2420, 2440, and 2450)
    - Are conclusions and recommendations realistic and reasonable, with material and higher risk issues clearly identified and prioritized?
    - Are conclusions and recommendations supported by convincing evidence and persuasive arguments (condition, criteria, cause, and effect)?
    - Do results in the workpapers align with report conclusions?
    - Does the report conclude whether the institution adheres to policies, procedures, and applicable laws or regulations, and whether operating processes and internal controls are effective?
    - Does the report address potential vulnerabilities to fraud, if applicable?
- ***Corrective Action:*** **Are management responses to audit or review findings in this area reasonable, complete, and timely? Have corrective actions been effective?** Audits and reviews are only effective if corrective action is taken to remedy the weaknesses identified. As such, there should be a reasonable, complete, and timely management response to the audit or review report. Management commitments and agreements or any areas of disagreement should be documented in the report or in a separate memo or tracking system. (IIA Standards 2500 and 2600) If corrective actions are not resolving the issues or concerns in a timely manner, examiners should further investigate the reasons. For example, this could indicate the audit or review did not sufficiently identify the underlying causes or materiality of weaknesses, sufficient resources are not being directed toward corrective actions, or weaknesses exist in the institution's corrective action process, including board oversight of the process.

6. Transaction Testing:

Examine individual assets, applications, or transactions to assess compliance with the institution's mission-related programs and applicable laws and regulations, and to evaluate effectiveness of internal controls and accuracy of data.

Guidance:

The examination of mission compliance should be supplemented as necessary with transaction testing. Testing should determine if policies, procedures, and internal controls are working as intended. Examiners should be attentive to any transactions or activity that may represent a potential concern with how the institution meets its public mission. For example, during the review of loans and loan applications to test areas such as credit administration and compliance with borrower rights regulations, examiners should note any concerns related to providing constructive credit and related services to all eligible, creditworthy customers. Transaction testing will primary be conducted as part of FCA's loan examination, but may include other testing activities, as well. Transactions to consider for mission compliance testing should include, but are not limited to, the following:

- Loans or transactions for any new programs established to provide constructive credit or services to a type of producer that the institution has not previously served.
- Agricultural loans for testing YBS coding and compliance with YBS policies and procedures, with an emphasis on recent transactions.
- Loans with potential YBS coding errors based on evaluation of information in the loan database.
- Denied loan applications to YBS applicants.
- Related services transactions, including sales of the different insurance products, to customers with and without a lending relationship at the institution.

Note: Transaction testing for investments is addressed in the Investments Examination Manual topic.

The following are items to consider when examining loans or transactions related to new programs:

- Did the loan or transaction comply with applicable regulations and the institution's policy and procedures, and was sound and constructive credit or service provided?
- Were internal audit or review testing and related conclusions accurate?

The following are items to consider when examining transactions to test YBS programs and coding:

- Was the loan made in compliance with the institution's YBS policy and procedures, and was sound and constructive credit provided (as outlined in FCA Bookletter BL-040 REVISED)?
- If it was a denied application to a YBS applicant, were YBS program criteria appropriately considered and applied in making the loan decision?
- Was the YBS data in the loan file and the loan database consistent and accurate?
- Were internal audit or review testing and related conclusions accurate?

The following are items to consider when examining related services transactions:

- Did the transaction comply with the eligibility requirements in FCA Regulation 618.8005?

- Was the service provided to the recipient on an optional basis (FCA Regulations 618.8015(b) and 618.8040(a) and (b)(9))? Refer to the regulations for additional requirements if the institution requires a related service as a condition to borrow.
- Were fees for related services separately identified from loan interest charges and disclosed to the recipient prior to providing or implementing the service (FCA Regulations 618.8015(c) and 618.8040(b)(5))?
- For insurance sales, did the recipient meet the applicable membership and lending relationship requirements (FCA Regulations 618.8040(b)(1) and (2))?
- Was term insurance, credit life insurance, or a combination of the two written in an amount that did not exceed the total loan commitments to the member or borrower (FCA Regulation 618.8040(b)(7))?
- Were internal audit or review testing and related conclusions accurate?