

Farm Credit Administration

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INFORMATIONAL MEMORANDUM



November 25, 2004

To: The Chief Executive Officer
All Farm Credit System Institutions

From: Thomas G. McKenzie, Director
Office of Examination

Subject: Compliance with Farm Credit Administration E-commerce Regulations in
Business Plans

What is the purpose and background of this Informational Memorandum (IM)?

This IM provides general guidance on complying with Farm Credit Administration (FCA) regulations concerning your 2005 Business Plans and future business plans addressing E-commerce. FCA regulation Section 609.935 provides: "When engaging in E-commerce, the business plan required under part 618 of this chapter, subpart J, must describe the E-commerce initiative, including intended objectives, business risks, security issues, relevant markets, and legal compliance." Let me begin by asking you to share this IM with those on your staff who are responsible for management or review of information technology and E-commerce.

FCA regulation Part 609, which pertains to E-commerce, became effective on May 8, 2002. We specifically included a requirement on business planning in this regulation because we wanted Farm Credit System (FCS or System) institutions to exercise good business judgment and assess costs and benefits before engaging in E-commerce. Your institution must conduct E-commerce in a safe and sound manner and in compliance with applicable regulatory requirements.

Your institution has completed two business planning cycles since the regulation became effective. Through our examinations, we have observed that many business plans do not adequately address or fully comply with FCA's regulatory requirements. A thoughtful business plan should pay for itself by addressing risks before there are costly mistakes.

Is your institution engaging in E-commerce?

You are engaging in E-commerce if you have a Web site, send e-mail, or transact business with your supervising bank or the FCA using the Internet or e-mail, among other things, which could include those listed below. FCA regulation Section 609.925(c) defines E-commerce as, "buying, selling, producing, or working in an electronic medium." This definition is quite broad and was intended to recognize and adjust for the changing nature of technology. Today, activities that occur in an electronic medium represent many of your institution's day-to-day business activities and fall into a variety of E-commerce categories from the very simple to the more complex. Although you know best the types of E-

commerce that your institution engages, you should review the following examples of various E-commerce initiatives:

Communications (Internet E-mail, Extranets, Value Added Networks);
Marketing/Advertising (Web sites, third party dealers);
Reporting (posting Shareholder Reports or other compliance-related issues on a Web site);
Employee Services (Human Resources, time tracking, 401(k), employee benefits, health care information);
Related Services (crop insurance filings, credit life insurance, tax information, collateral searches, UCC filings, credit reporting services);
Business-to-Business Activity (servicing of and reporting on loan participations, pricing/funds ordering, submission of loan data, file transfer protocol transmissions); and
Lending (on-line banking, on-line applications, automated telephone transactions).

Your institution may be conducting these E-commerce services either in-house or through a vendor relationship. In either case, your institution is responsible for complying with applicable regulatory requirements, including ensuring a full understanding of the related business risks and implementing the necessary internal controls.

Must you address both planned E-commerce initiatives and current E-commerce initiatives in your business plan?

Yes. The business planning requirement in FCA regulation Section 609.935 applies to both planned and current E-commerce initiatives. Some System institutions have interpreted the term "E-commerce initiatives" in FCA regulation Section 609.935 as only planned or proposed initiatives. Thus, some institutions are addressing only planned initiatives and not current E-commerce initiatives, such as on-line loan applications or a Web site, in their business plans. As explained herein, the term "E-commerce initiatives" should be read broadly to include both proposed and existing E-commerce initiatives.

The reference to "when engaging in E-commerce" in the regulation means that the business plan must address E-commerce initiatives that an institution is currently engaged, as well as those it plans to engage in the future. Like FCA regulation Section 618.8440, which is not limited to proposed initiatives, the business planning requirement of the E-commerce regulation must be read broadly. Hence, the term "initiative" should be read interchangeably with "activity."

Business planning is a good business practice that ensures the safety and soundness of FCS institutions and compliance with law and regulation. This broader reading of "initiatives" supports the goals of business planning.

What is the general guidance for addressing E-commerce in 2005 Business Plans and future business plans?

Many of you have asked for some additional guidance. We suggest you consider the following when drafting your business plan:

Define the scope of your E-commerce initiatives/activities (please see the seven categories illustrated above).
Prioritize your initiatives according to importance and risk as they pertain to your institution. For each initiative, address the intended objectives, business risks, security issues, relevant markets, and legal compliance, as identified in FCA regulation Section 609.935.

An effective business plan will include your written supporting analysis. The level of detail should hinge on the materiality of the initiative and the complexity of your institution's E-

commerce initiatives. If your institution is engaged in online transactions, which are more material by nature, your business plan would be expected to be more complex due to the greater E-commerce importance and greater risk. FCA examiners will look for a more detailed analysis of your intended objectives, the anticipated business risks, any security issues, your relevant markets, and legal compliance.

Do the FCA E-commerce regulations address areas other than business planning?

Yes, among other things, these regulations require any institution engaging in E-commerce activities to:

Adopt E-commerce policies and procedures (FCA regulation Section 609.930);
Assess E-commerce activities as part of the business planning process (FCA regulation Section 609.935);
Establish appropriate internal controls to monitor E-commerce activities (FCA regulation Section 609.940); and
Use good business practices when conducting electronic communications (FCA regulation Section 609.950).

Here again, you may expect FCA examiners to review compliance with the regulations and for safe and sound banking practices.

What are some additional sources for FCA guidance?

For general guidance on business planning, you should look to the FCA's Examination Manual. You can access the Examination Manual on our Web site (www.fca.gov) under Publications Resources for the FCS. The Examination Manual provides, in part, the following pertinent guidance:

In order to develop the most effective objectives and strategies, the present position of the institution and the environment within which it operates must be assessed. Business plans are based on assumptions about the institution's strengths and weaknesses, the needs of the customers, and the competitive environment. A situational analysis improves the accuracy of these assumptions. A situational analysis requires both an internal analysis to identify the strengths and weaknesses of the institution and an external analysis to identify the opportunities and threats to the institution.

For background information and guidance on E-commerce, you can go to the FCA's Web site which contains a useful link to E-commerce under Publications Resources for the FCS. Among other items in the "E-commerce" link are our proposed and final E-commerce rules that contain helpful insight in the preamble sections, which are not published in your FCA Handbook. Also, the "E-commerce" link contains many other FCA IMs that may be of assistance.

Should you have questions regarding this IM, please contact Eric Rodney, rodneye@fca.gov, Office of Examination at (703) 883-4451, Jane Virga, virgaj@fca.gov, Office of General Counsel at (703) 883-4371, or Dale Aultman, aultmand@fca.gov, Office of Policy and Analysis, at (703) 883-4381.