
INFORMATIONAL MEMORANDUM



October 5, 2020

To: Chair, Board of Directors
Chief Executive Officer
Each Farm Credit System Institution

From: Roger Paulsen, Director and Chief Examiner
Office of Examination

Subject: National Oversight Plan for Fiscal Year 2021

The Farm Credit Administration's Office of Examination annually establishes a National Oversight Plan (NOP) as part of its planning processes. The NOP identifies risk topics FCA examiners will emphasize in examination and oversight activities for the new fiscal year (FY). We issue this informational memorandum each year to notify Farm Credit System (System) institutions about our concerns and priorities. Please consider them in your risk assessment and planning processes.

First, we would like to recognize your efforts over the past few months to manage the unprecedented challenges of the COVID-19 pandemic. Many of you have made significant operational adjustments and modifications to continue meeting customer needs while also maintaining the health and safety of your personnel. FCA has faced similar challenges during this time, and we've made adjustments in how we conduct our examinations. We appreciate your efforts to accommodate these changes as we continue to meet our mission, while also ensuring we maintain the health and safety of your staff as well as our own.

Through the NOP, we identify the risk topics we're emphasizing in our examination and oversight of System institutions. The emergence of the COVID-19 pandemic intensified the credit and operational risks facing many System institutions and borrowers — the full extent of which still remains unknown. Given the challenges of the pandemic and adverse conditions in significant parts of the agricultural economy, we anticipate that the effect of the credit stress will become clearer with borrowers and institutions in 2021. Also, many of you have made changes to business activities and processes in response to the pandemic. These changes may have impacted operational risks, necessitating changes to your plans and controls.

Based on these conditions, we identified two NOP risk topics for fiscal year 2021:

- Credit – Risk management and loan servicing
- Operational risk – Management's actions in response to risk and the pandemic

Credit – Risk management and loan servicing

Pressure on commodity prices due to ample supplies and weak trade, as well as the pandemic, will continue impacting agriculture, the System, and its borrowers. Despite increased risk, credit quality has remained well within the System's risk-bearing capacity. Furthermore, borrowers continue to benefit from government assistance, stable real estate values, and low interest rates.

Nonetheless, we expect System institutions to continue to face credit stress because of ongoing challenges in the livestock and dairy sectors caused by supply chain and processing disruptions at the onset of the pandemic. The grain sector also remains under considerable stress because of reduced ethanol demand, projected large crop inventories, and continued low price forecasts.

Timely and effective risk identification, risk management, and loan servicing are increasingly important. Our FY 2021 examination program will emphasize these areas, particularly for portfolios with commodity concentrations in stressed industries.

Where appropriate, we will focus on ensuring timely and accurate risk identification, effective internal credit reviews, robust stress testing, and well-supported allowances for loan losses. We will also examine the effectiveness of loan servicing, including servicing related to deferral programs and borrower rights. Finally, we will evaluate the adequacy of institutions' processes to identify, report, and manage affiliated exposures related to large borrowers and processors. We will give special attention to the most stressed industries.

Operational risk – Management's actions in response to risk and the pandemic

The pandemic will continue impacting institutions' business operations. Many institutions materially modified operational processes to continue providing products and services while adhering to stay-at-home and social distancing guidelines. Operational modifications, including extensive use of work-at-home strategies and the need to quickly implement various stimulus programs, may have stressed change management processes. Also, government programs and policies aimed at supporting and helping customers affected by the pandemic may have impacted your institution's economic and regulatory landscape.

Furthermore, the potential for fraud likely increased. Persons committing fraud often take advantage of opportunities created by new or expanded government programs designed to provide relief in emergency situations, such as the Coronavirus Aid, Relief, and Economic Security Act. The predominately virtual work environment and the significant shift towards remote access have likely increased the potential for fraud involving new lending programs and funds transfer activities.

Your institution's plans and controls should evolve as risks and operations change. Our FY 2021 examinations will focus on adjustments to operations, strategic business plans, controls, and internal audit risk assessments in response to the pandemic and other risks.

We will assess how you responded to the effects of the pandemic and other material factors impacting the current business environment in your 2021 business plan. We also will evaluate your internal audit risk assessments and plans, and review adjustments to audit

scopes and completion resulting from the pandemic's wide-ranging operational impact. Finally, we will evaluate the adequacy of your initial and ongoing fraud risk assessment and changes you've made to your controls following the onset of the pandemic.

In addition, we will begin applying our new [model risk management guidance](#) in 2021 examination activities. System institutions rely on models in many decision-making aspects, which presents model risk. The pandemic may have increased model risk by introducing more uncertainty to the inputs and assumptions used, thus impacting some models' predictability and reliability. We will focus on examining policies, procedures, and processes for model development, implementation, and validation, as well as change controls, internal controls, and board reporting.

LIBOR phaseout – An area of continuing focus

Preparing for the phaseout of the London Interbank Offered Rate (LIBOR) at year-end 2021 is critical, especially if your institution has material LIBOR exposures. We communicated our expectations in a [September 11, 2018, informational memorandum](#). Since then, System institutions have taken significant actions to prepare for the phaseout by developing transition plans, revising fallback provisions in loan documents, and forming workgroups to direct and coordinate actions at the institution, district, and System levels.

As we approach the phaseout date, your institution's transition plan should reflect increased urgency and identify actions to implement all remaining transition requirements within established timeframes. In the new fiscal year, we will continue examining these plans and actions as part of our oversight and examination activities.

We will ensure that your transition plan has detailed action steps with timeframes for key objectives, such as stopping the inflow of new LIBOR volume, reducing exposures, revising fallback provisions in legacy contracts, and adjusting operational processes and accounting systems. We also will evaluate the frequency and adequacy of board reporting, particularly on the topics of LIBOR exposure trends, implementation of the transition plan, and analyses of the impact the phaseout will have on your institution.

Young, beginning, and small farmers and ranchers

As you know, the future of agriculture depends in large part on the success of young, beginning, and small producers. Because of this, the agency is exploring additional opportunities to share ideas with System institutions in FY 2021 to enhance service to these producers.

Please consider the priorities we've discussed in this informational memorandum in your 2021 planning. Please distribute this document to your board members and discuss it with your Audit Committee chair, other board committees, and executive management team. Your examiner-in-charge will discuss the priorities we've identified here with your board in an upcoming videoconference or phone call.

Please contact your designated examiner-in-charge or me at (703) 883-4265 (paulsenr@fca.gov) if you have any questions.