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Overview

Title IV of the Farm Credit Act of 1971, as amended (the Act), extends certain protections to applicants and borrowers of the Farm Credit System (System). These protections are known as borrower rights. Borrower rights are loan and collateral notices and actions that applicants and borrowers are entitled to receive as part of either applying for or having been granted an extension of credit. Borrower rights include protections in the following general areas: release and disclosure of information, protection of borrower stock, notice and review of credit decisions, distressed loan restructuring, mediation, protection for current loans, and reacquiring property through the right of first refusal. Refer to Farm Credit Administration (FCA) Regulation [617.7000](#) for definitions of several important terms relating to borrower rights.

Significant portions of these rights are only available to bona fide farmers, ranchers, and producers or harvesters of aquatic products, as defined in FCA Regulation [613.3000](#), including financing for basic processing and marketing needs. As a result, many borrower rights do not extend to rural home loans originated under FCA Regulation [613.3030](#), farm-related service business loans originated under FCA Regulation [613.3020](#), or loan participations purchased from non-System institutions. There are some exceptions. For example, the interest rate disclosure requirements apply to borrowers of all loans originated by System institutions that are not subject to the Truth in Lending Act, such as farm-related service business loans. Refer to FCA's [FAQs About Borrower Rights](#) for additional guidance on loan situations that qualify for borrower rights protections, including circumstances that allow for waiver of those rights under FCA Regulation [617.7010](#).

Institutions that do not appropriately provide borrower rights may be exposed to paying fines and damages, receiving a distressed loan restructuring directive, voiding of contracts, and incurring reputation risk. As such, effective internal controls are important to ensure compliance with borrower rights regulations. Controls expected of all institutions include policies, procedures, and training or other staff communications. Other internal controls should also be considered, including designating a compliance officer and having documented guidance, standardized forms, checklists, and centralized processing.

Note: Most borrower rights apply to qualified lenders, which is defined in FCA Regulation [617.7000](#). System institutions, except banks for cooperatives, that make loans (as defined in this regulation) are qualified lenders. Qualified lenders also include other financing institutions (OFIs), but only with respect to loans discounted or pledged under section [1.7\(b\)\(1\)](#) of the Act (refer to FCA Regulation [614.4560\(d\)](#)). In this Examination Manual section, we focus on examining borrower rights at System institutions, rather than at OFIs, which is reflected in references to *institutions* rather than *qualified lenders* throughout this guidance.

Examination Procedures and Guidance

General

1. Release & Disclosure of Information:

Evaluate the adequacy of guidance and controls to ensure compliance with FCA Regulations on releasing and disclosing information (Part 618, subpart G).

Guidance:

FCA Regulations in Part 618, subpart G contain most of the requirements for protecting and releasing information on borrowers, stockholders, and loan applicants, along with some specific disclosure requirements. These regulations cover what information can be released, to whom, and for what purpose. In particular, loan documents must remain confidential and institutions must protect borrower information. The regulatory requirements for releasing and disclosing information are summarized below (refer to the regulations for details):

- FCA Regulation [618.8300](#) generally provides that no director or employee may disclose any information about the institution or its borrowers or members unless otherwise authorized.
- FCA Regulation [618.8310](#) and question 28 in FCA's [FAQs About Governance Changes in 2006](#) address the release of borrower or stockholder lists. This includes time frames and restrictions on when an institution may release a list to a stockholder and how the list should be provided.
- FCA Regulation [618.8320](#) sets requirements for confidentiality and release of borrower and loan applicant documents and data.
- FCA Regulation [618.8325](#) requires institutions to provide a copy of loan documents to the borrower or the borrower's legal representative at loan closing and upon subsequent request (refer to the *Collateral Evaluation* section in FCA's [FAQs About Borrower Rights](#) for guidance on providing copies of collateral evaluations). Additionally, institutions must make their articles of incorporation, charter, and bylaws available for inspection and provide copies upon request by any owner of stock or participation certificates.
- FCA Regulation [618.8330](#) sets requirements for disclosure of confidential borrower information in the event of litigation.

Evaluative questions and items to consider when examining processes for releasing and disclosing information include:

- ***Policies and Procedures:*** Are policies and procedures sufficient to ensure regulatory compliance? Effective policies and procedures should address the items in Part 618, subpart G and include guidance on what information can be released, to whom, and for what purposes. They should also cover processes for ensuring compliance with the regulations. In addition, FCA Regulation [614.4595](#) requires each bank to have policies and procedures for requesting, obtaining, and maintaining the consent of its other financing institutions (OFIs) to disclose certain information.
- ***Training and Communications:*** Does the institution have sufficient processes to enable its directors, employees, and agents to understand and apply the regulatory requirements on

releasing and disclosing information? Periodic training or other communications should reinforce policy and procedure expectations as well as relevant regulations.

- **Other Internal Controls: Are internal controls sufficient to ensure the release and disclosure of information are handled in compliance with policies, procedures, and regulatory requirements?** The board and management should implement effective internal control processes to ensure proper handling of loan documents and confidential information. Examples include documented guidance, standardized forms, checklists, centralized processing, internal audit or review coverage, and designating a compliance officer.

2. Interest Rate Disclosures:

Evaluate the adequacy of guidance and controls to ensure compliance with FCA Regulations on the disclosure of effective and differential interest rates (Part 617, subparts B and C).

Guidance:

FCA Regulations require institutions to provide effective interest rate (EIR) disclosures for loans not subject to the Truth in Lending Act (TILA). Part 617, subparts B and C cover when and how institutions must disclose EIR, differential interest rate, and other loan information to borrowers, including the cost of borrower stock and loan origination charges. Regulatory requirements are summarized below (refer to the regulations for details):

- FCA Regulation [615.5250](#) requires institutions to provide prospective borrowers with certain disclosures related to equities purchased as a condition for obtaining a loan.
- FCA Regulations [617.7100](#), [617.7105](#), [617.7120](#), [617.7130](#), and [617.7135](#) identify general requirements for providing interest rate disclosures on all loans not subject to TILA. As such, this borrower rights area applies to some loans, such as farm-related service business loans originated under FCA Regulation [613.3020](#), that may not otherwise be entitled to most borrower rights contained in part 617. Also, FCA Regulation [617.7120\(b\)](#) requires that all EIR disclosures be made in a written form that is easy to read and separate from other loan information (unless directly related to the EIR).
- FCA Regulations [617.7110](#), [617.7115](#), and [617.7125](#) provide information on when and how to include stock purchases and loan origination charges in the EIR calculation. Institutions are also required to establish policies and procedures to ensure EIR disclosures clearly show the effect that stock purchases and loan origination charges have on the interest rate, as well as setting procedures for the major assumptions used in calculating the EIR. FCA's Informational Memorandum on [Effective Interest Rate Disclosure](#) dated December 17, 2004, further explains that FCA Regulations allow for supplemental disclosures to explain the effect of borrower stock on the EIR calculation.
- FCA Regulation [617.7200](#) identifies notice and review requirements on loans offered with more than one rate of interest (i.e., differential rates as defined in FCA Regulation [619.9130](#)).

The *Effective Interest Rate Disclosure* section in FCA's [FAQs About Borrower Rights](#) provides guidance on applying the interest rate disclosure regulations. Borrowers must receive meaningful and timely disclosures so they can make informed decisions.

Evaluative questions and items to consider when examining interest rate disclosures include:

- ***Policies and Procedures:*** Are policies and procedures sufficient to ensure regulatory compliance? Policies and procedures must include those items noted in FCA Regulation [617.7125\(c\)](#). Effective policies and procedures should also address items in the other regulations listed above, and include guidance on when disclosures should be made, to whom they should be made, and that they should be made in writing. In addition, they should cover processes for ensuring compliance with the regulations.
- ***Training and Communications:*** Does the institution have sufficient processes to enable its employees to understand and apply the regulatory requirements on interest rate disclosures? Periodic training or other communications should reinforce policy and procedure expectations as well as relevant regulations.
- ***Other Internal Controls:*** Are internal controls sufficient to ensure interest rate disclosures are handled in compliance with policies, procedures, and regulatory requirements? The board and management should implement effective internal control processes to ensure proper handling of interest rate disclosures. This includes maintaining appropriate controls to ensure EIR calculations are accurate and EIR disclosures comply with regulatory guidance. Examples include documented guidance, standardized forms, checklists, centralized processing, internal audit or review coverage, and designating a compliance officer. In addition, if templates are used for preparing disclosures, management should ensure they encompass all applicable regulatory requirements they are intended to address. They should also be updated, as needed, and used consistently throughout the institution.

3. Notice of Action & Review:

Evaluate the adequacy of guidance and controls to ensure compliance with FCA Regulations on taking actions on loan applications and reviewing credit decisions (Part 617, subpart D).

Guidance:

FCA Regulations at Part 617, subpart D require institutions to provide applicants prompt written notice of decisions made on loan applications for credit to bona fide farmers and ranchers (i.e., all loan applications except for rural home loans originated under FCA Regulation [613.3030](#) and farm-related service business loans originated under FCA Regulation [613.3020](#)). When the decision is adverse to the applicant (e.g., credit denial or approval of an amount less than requested), institutions must provide the applicant the specific reasons for the decision. Additionally, the notice must make clear the applicant has the right to ask for a review of the decision. Institutions must use a Credit Review Committee (CRC) to review adverse credit decisions. The regulatory requirements for notification of credit decisions and review rights are summarized below (refer to the regulations for details):

- FCA Regulation [617.7300](#) requires written notification to applicants of the decision on their loan application as quickly as possible (within 30 days per the Equal Credit Opportunity Act (ECOA) rules). This regulation also specifies to whom the notice should be sent and what is to be included. FCA Regulation [614.4200\(a\)\(3\)](#) and ECOA also discuss the need to provide written notice when an application is incomplete, before using that as a reason to deny a loan request.
- FCA Regulations [617.7305](#), [617.7310](#), and [617.7315](#) address CRC operations. Note: FCA Regulation [617.7420](#) outlines additional aspects of the CRC process relating specifically to

review of distressed loan restructuring denials.

The *General*, *Loan Applications*, and *Credit Review Committees* sections in FCA's [FAQs About Borrower Rights](#) provide additional guidance on applying the notice of action on loan requests and credit review regulations.

Evaluative questions and items to consider when examining actions on loan applications and review of adverse credit decisions include:

- ***Policies and Procedures:*** Are policies and procedures sufficient to ensure regulatory compliance? Effective policies and procedures should address the items in the regulations listed above and include guidance on notice requirements, review rights, and record retention. They should also cover processes for ensuring compliance with the regulations.
- ***Training and Communications:*** Does the institution have sufficient processes to enable its directors and employees to understand and apply the regulatory requirements on loan applicant notifications and CRC activities? Periodic training or other communications should reinforce expectations established by the regulations and the institution's guidance.
- ***Other Internal Controls:*** Are internal controls sufficient to ensure notices of actions and review rights are handled in compliance with policies, procedures, and regulatory requirements? The board and management should implement effective internal control processes to ensure proper handling of notifications to applicants and CRC activities. Examples include documented guidance, standardized forms, checklists, centralized processing, internal audit or review coverage, and designating a compliance officer. In addition, if templates are used for notices, management should ensure they encompass all applicable regulatory requirements they are intended to address. They should also be updated, as needed, and used consistently throughout the institution.

4. Distressed Loan Restructuring:

Evaluate the adequacy of guidance and controls to ensure compliance with FCA Regulations on distressed loan restructuring (Part 617, subpart E).

Guidance:

FCA Regulations in Part 617, subpart E contain provisions for notifying and offering restructuring to borrowers with distressed loans. Institutions are required to notify borrowers in writing of the right to seek restructuring as soon as the institution identifies the loan as distressed. When a distressed loan restructuring request is received, the institution is required to assess the cost of restructuring against the cost of liquidating the loan (i.e., least-cost analysis). If the cost of restructuring is equal to or less than the cost of liquidation, the institution must restructure the loan.

Distressed loan restructuring rights generally apply to all loans originated by an institution under the lending authorities of Titles I and II of the Act when those loans are made to bona fide farmers and ranchers. Neither the loans made under the lending authority of the banks for cooperatives (i.e., Title III lending) or rural home loans made under FCA Regulation [613.3030](#) receive distressed loan restructuring rights.

The regulatory requirements for distressed loan identification and restructuring are summarized below (refer to the regulations for details):

- FCA Regulation [617.7000](#) defines a distressed loan.

- FCA Regulation [617.7010](#) prohibits institutions from obtaining a waiver of borrower rights as part of a distressed loan restructuring, except under very limited circumstances. As discussed in question 50 in FCA's [FAQs About Borrower Rights](#), institutions may not ask for or accept a waiver of future borrower rights as part of a restructuring decision.
- FCA Regulation [617.7400](#) identifies certain protections for borrowers who meet all loan obligations.
- FCA Regulation [617.7405](#) requires that loan restructurings be made in accordance with the policy adopted by the funding bank.
- FCA Regulations [617.7410](#), [617.7420](#), and [617.7425](#) address written notices on the right to seek loan restructuring and the institution's decision whether to restructure.
- FCA Regulation [617.7415](#) discusses the least-cost analysis, which must be used to evaluate an application for restructuring. This analysis must be completed before any decision is made on a restructuring application. An institution must restructure the loan if the cost to restructure is less than or equal to the cost of foreclosure by implementing the restructure plan used in the least-cost analysis. In no case may the cost of foreclosure be less than zero. Also, if the institution believes the borrower will not be able to repay the entire debt under the restructuring plan, only that portion that is deemed uncollectible (rather than the entire debt) should be included in the cost of restructuring analysis.
- FCA Regulation [617.7430](#) covers participation in state mediation programs and the institution's responsibilities. The *State Mediation* section in FCA's [FAQs About Borrower Rights](#) provides additional guidance on mediation programs.
- FCA Regulations [615.5280](#) and [615.5290](#) discuss borrower stock retirement upon default and in the event of restructuring.

The *Distressed Loans*, *Distressed Loan Notices*, *Distressed Loan Restructuring*, and *Least-Cost Analysis* sections in FCA's [FAQs About Borrower Rights](#) provide additional guidance on applying the regulations. Also, note that denial of a distressed loan restructuring application may result in the borrower requesting a review by the Credit Review Committee (CRC). Refer to the *Notice of Action & Review* procedure for guidance on examining CRC processes.

Evaluative questions and items to consider when examining distressed loan restructuring include:

- ***Policies and Procedures:*** Are policies and procedures sufficient to ensure regulatory compliance? Each Farm Credit bank must maintain a policy on restructuring of distressed loans that is used by associations funded by the bank. The bank policy must meet the requirements in Section [4.14A\(g\)](#) of the Act and FCA Regulation [617.7405](#). An association can either formally adopt the policy of its funding bank or adopt its own policy, so long as the content of the association's policy does not conflict with the bank policy. Effective policies and procedures should address the identification of distressed loans, notice requirements, least-cost analyses, review rights, and record retention. In addition, they should cover processes for ensuring compliance with the regulations.
- ***Training and Communications:*** Does the institution have sufficient processes to enable its employees to understand and apply the regulatory requirements on distressed loan restructuring? Periodic training or other communications should reinforce policy and

procedure expectations as well as relevant regulations.

- **Other Internal Controls: Are internal controls sufficient to ensure that distressed loan restructuring is handled in compliance with policies, procedures, and regulatory requirements?** The board and management should implement effective internal control processes to ensure proper handling of distressed loans. Examples include documented guidance, standardized forms, checklists, centralized processing, internal audit or review coverage, and designating a compliance officer. In addition, if templates are used for notices, management should ensure they encompass all applicable regulatory requirements they are intended to address. They should also be updated, as needed, and used consistently throughout the institution.

5. Right of First Refusal:

Evaluate the adequacy of guidance and controls to ensure compliance with FCA Regulations on providing right of first refusal to previous owners of agricultural real estate acquired by System institutions (Part 617, subpart G).

Guidance:

FCA Regulations in Part 617, subpart G list the requirements for providing the right of first refusal (ROFR) in purchasing or leasing agricultural real estate acquired by a System institution. The prior owner of the real estate, which may not always be the borrower, must be given the first opportunity to purchase or lease it before the institution sells or leases it to another party.

ROFR applies only to the previous owner of agricultural real estate acquired by a System institution. Agricultural real estate is defined as improved or unimproved land, including any buildings constructed on land, which is devoted to or available for the production of crops and other products such as, but not limited to, fruits and timber or for the raising of livestock. ROFR does not apply to rural home loans originated under the authority in FCA Regulation [613.3030](#) because such loans cannot involve agricultural real estate. The regulatory requirements for ROFR are summarized below (refer to the regulations for details.):

- FCA Regulation [617.7600](#) provides additional definitions specific to the ROFR regulations.
- FCA Regulation [617.7605](#) limits offering the ROFR to situations where borrowers did not have the financial resources to avoid loss of the collateral to the institution.
- FCA Regulations [617.7610](#) and [617.7615](#) explain notice and decision requirements an institution must follow when selling or leasing acquired agricultural real estate.
- FCA Regulation [617.7620](#) addresses the notice and decision requirements an institution must follow when selling acquired property through a public auction, competitive bidding process, or other similar public offering.
- FCA Regulation [617.7625](#) addresses the certified mail process for notifying the previous owner or owners of the property.
- FCA Regulation [617.7630](#) explains that ROFR regulations do not replace any state-provided right of refusal (i.e., both co-exist).

The *Right of First Refusal* section in FCA's [FAQs About Borrower Rights](#) provides additional guidance on applying the ROFR regulations.

Evaluative questions and items to consider when examining ROFR include:

- ***Policies and Procedures:*** Are policies and procedures sufficient to ensure regulatory compliance? Effective policies and procedures should address the items in the regulations listed above, and include guidance on notifying prior property owners, finding the former owners, using public auctions, and accepting or rejecting offers from prior owners. They should also cover processes for ensuring compliance with the regulations.
- ***Training and Communications:*** Does the institution have sufficient processes to enable its directors and employees to understand and apply the regulatory requirements on ROFR? Periodic training or other communications should reinforce policy and procedure expectations as well as relevant regulations.
- ***Other Internal Controls:*** Are internal controls sufficient to ensure ROFR is handled in compliance with policies, procedures, and regulatory requirements? The board and management should implement effective internal control processes to ensure proper handling of ROFR requirements. Examples include documented guidance, standardized forms, checklists, centralized processing, internal audit or review coverage, and designating a compliance officer. In addition, if templates are used for notices, management should ensure they encompass all applicable regulatory requirements they are intended to address. They should also be updated, as needed, and used consistently throughout the institution.

6. Audit:

Determine if the institution conducts an effective audit (scope, reporting, and followup) of compliance with borrower rights regulations.

Guidance:

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

Evaluative questions and items to consider when examining the audit function regarding borrower rights include:

- ***Audit Coverage:*** Is there periodic audit or review coverage of borrower rights? 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.
- ***Scope and Depth:*** Are audit or review scope and depth sufficient to conclude on the adequacy, completeness, and timeliness of borrower rights processes? The scope should

cover key processes and controls within the area being audited or reviewed. The depth of work should be sufficient to determine if internal controls are functioning as intended and regulatory requirements are met. The scope and depth of coverage should be consistent with the approved audit or review plan and engagement contract (if applicable). If audit or review work deviated materially from the original planned scope, the board (or Audit Committee, if so delegated) should be notified of the reasons for the change. Specific items that should be considered in the audit or review scope include:

- Borrower rights processes and controls. Internal audits or reviews should address all the major borrower rights areas, including release of information, interest rate disclosures, notice of action and review, distressed loan restructuring, and right of first refusal.
 - Borrower rights policies, procedures, templates, and other guidance.
 - Compliance with borrower rights-related regulations, bylaws, policies, and procedures. Audits or reviews should include sufficient transaction testing to detect noncompliance with established criteria.
 - Fraud-related threats and vulnerabilities, as well as anti-fraud controls.
- **Reliability of Results: Did FCA identify any concerns with audit and review reliability?** 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 of 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. Often, auditors and reviewers will complete line sheets, flowcharts, control matrices, standard work programs, workpaper forms, or other relevant documents when conducting work. Workpapers should adequately document the work performed and support the final report. In addition, any proforma work programs, workpapers, or other tools should be accurate and sufficiently thorough. If there are material weaknesses identified by examiners that are not identified by internal audits or reviews, examiners should assess the underlying reasons.
 - **Reports: Do internal audit reports sufficiently communicate borrower rights review results and recommendations, if applicable?** Examiners should consider the following when evaluating the audit or review report:
 - Is the report prepared 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?
 - 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)?
- 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 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. In some cases, management commitments and agreements or any areas of disagreement are documented in the report or in a separate memo or tracking system. If corrective actions are not resolving the issues or concerns (based on repetitive audit findings, FCA findings, etc.), 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.

7. Transaction Testing:

Examine individual loans and applications to assess compliance with borrower rights regulations and the effectiveness of institution control processes.

Guidance:

The examination of borrower rights should be supplemented as necessary with transaction testing conducted as part of FCA's loan review or as a separate examination activity. This testing should ensure that borrower rights are being offered as required and that related policies, procedures, and internal controls are working as intended. Effectively administering borrower rights on individual transactions is an important part of managing reputation risk. Loans considered for borrower rights transaction testing should include, but are not limited to, the following:

- New loans with effective interest rate (EIR) disclosures to determine whether the institution disclosed all required information within appropriate time frames and to verify the accuracy of EIR calculations.
- Loans where the borrowers requested a review of their differential interest rate to ensure proper disclosures were made.
- Loans on which the interest rate changed to ensure proper disclosures were made.
- Denied loan applications to determine if appropriate and timely notices of action were provided.
- Delinquent loans and loans that were recently downgraded to an adverse classification to assess if the institution appropriately and timely evaluated the loans to determine if they were distressed and provided the proper disclosures.

- Loans recently foreclosed upon, restructured, or where the borrower applied for restructuring to assess distressed loan notices, least-cost analyses, and notification of decisions.
- Loans transferred to nonaccrual to check compliance with applicable borrower protections.
- Loan or restructuring applications where the borrower or applicant requested a meeting with the Credit Review Committee to determine whether the committee composition, activities, and decision were appropriate, minutes were adequate, and notification of its decision was timely and sufficient.
- Agricultural property owned that was recently acquired or sold to assess right of first refusal compliance.