



EM-1.2

Category: General Information

Topic: Overview of FCA Examination Process

Published: 9/27/2023

Introduction

The Farm Credit Administration's (FCA) mission is to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. FCA's Office of Examination (OE) is responsible for programs of examination and supervision of each Farm Credit System (System) institution, in accordance with the Farm Credit Act of 1971, as amended (the Act), and applicable regulations. FCA's Office of Secondary Market Oversight is responsible for programs of examination and supervision of the Federal Agricultural Mortgage Corporation (Farmer Mac).

FCA Examination Objectives

The overall objective of the examination process is to ensure each System institution operates safely and soundly, complies with laws and regulations, and is financially positioned to meet the needs of agriculture and rural America. To conduct examinations consistently and effectively, FCA focuses on the following objectives:

- Evaluate the institution's condition and performance in each CAMELS area (i.e., Capital, Assets, Management, Earnings, Liquidity, and Sensitivity).
- Determine the overall level of institution risk, and identify factors contributing to the risk.
- Require the institution's board to take corrective action as needed to strengthen the institution and ensure compliance with applicable laws and regulations.

Risk-Based Examination Concept

The risk-based examination concept provides the framework for FCA's examination process, as summarized in [FCA Board Policy Statement 53](#). In accordance with this policy, examination efforts and resources are focused in areas that could materially influence the safety and soundness of the System. FCA uses information from a wide range of sources to identify circumstances and events posing significant risk to the System. Through the strategic and annual planning processes, examiner resources are directed towards institutions and activities that pose the greatest risk.

FCA tailors examination activities to each institution. When establishing the scope and depth of examination activities, the Examiner-In-Charge considers various factors and information, such as prior examination scope and results, Financial Institution Rating System (FIRS) ratings, and information obtained during monitoring and oversight activities. The results of internal and external audits and reviews are another key consideration. Risk-based examinations require judgment in determining the scope and depth of examination work. Applying risk-based examination concepts may result in

considerable differences in scope and depth of examination between institutions, or from one examination cycle to the next.

Examination Frequency

The frequency of examination activities may vary based on risk, but each institution receives a summary of examination activities and a report on its overall condition at least every 18 months. Section [5.19](#) of the Act specifically outlines minimum examination frequency requirements, but allows FCA to establish the scope of an examination. In accordance with [FCA Board Policy Statement 53](#), examiners conduct ongoing, risk-based supervision and examination activities over the course of the examination cycle. Since FCA considers the examination process to be ongoing, the issuance of a Statutory Compliance Date (SCD) report is the mechanism for measuring compliance with the time frame requirements of the Act.

FCA Access to Institution Documents and Records

Examiners must have access to all documents and records of an institution during an examination. As a condition to funding from its Farm Credit Bank, Section [5.21](#) of the Act outlines that System institutions have consented to examination by FCA. Additionally, Section [4.12\(b\)\(5\)](#) of the Act outlines that FCA may place an institution into receivership or conservatorship if an institution conceals books, papers, records, or assets of the institution or refuses to submit books, papers, records, or other material relating to the affairs of the institution for inspection to any examiner or to any lawful agent of the FCA. FCA Regulation [618.8320\(b\)\(1\)](#) provides that examiners and other authorized representatives of the FCA and the bank concerned shall have free access to all information, records, and files relating to borrowers and loan applicants. It is important to note that by providing FCA documents and records pursuant to the supervisory or regulatory authorities of FCA, a System institution is not waiving its confidentiality of privileged communication with an attorney or accountant as outlined in Section [5.19\(e\)](#) of the Act.

Oversight and Examination Activities

The examination process ensures that each System institution receives the necessary regulatory oversight and examination activities on a timely basis so problems may be identified and addressed proactively. FCA strategic planning and OE's annual operating plans set the stage for oversight and examination activities, which include planning, monitoring, examination, reporting, and corrective action followup. As part of the annual planning process, OE establishes a National Oversight Plan to direct examiner oversight of areas that FCA wants to emphasize in the upcoming year. Although FCA's strategic and OE's annual operating planning processes are not addressed in this manual, they are important elements in the overall examination process. The following sections provide a description of key oversight and examination activities.

Planning

Planning is the process in which examination strategies are developed to guide the effective and efficient supervision of each institution. Effective planning is an ongoing process that should cover both onsite and offsite activities. The nature, extent, and timing of the activities will vary with the size and complexity of each institution and its risk profile. In the planning process, the risks in an institution are identified and prioritized, strategies are established to address areas of significant risk, and sufficient resources are allocated to accomplish the strategies. When changes in risk are identified during the examination cycle, plans and strategies are reassessed and updated as needed.

Monitoring

Monitoring consists of ongoing activities to assess emerging conditions and changes in risk. Typical activities include reading information from the institution (e.g., board packets, shareholder reports, business plans, management reports, etc.), having periodic discussions with management and board members, and completing FIRS analyses. Monitoring activities are part of a risk assessment process that enables examiners to assess risks proactively and plan risk-based examination activities effectively.

Examination

Examination involves analyzing the information obtained through planning and monitoring activities and gathering and analyzing additional information, as needed, to draw a conclusion on the level of risk or adequacy of risk management. This often includes testing or validating information that has been obtained. Risk-based concepts are applied to all examinations to allow flexibility in completing examination work. Examination activities may be conducted onsite and offsite, depending on the identified risk and strategies. For offsite activities, the findings may result in an onsite visit to review additional information or meet with management.

Reporting

FCA communicates with institutions as activities are completed or as concerns are identified. Any document provided to the institution that communicates oversight and examination results is an official report document. The following are the primary report documents used.

SCD Reports: FCA will issue a Report of Examination to each institution at least once every 18 months at the time of the SCD. The report will be distributed electronically in a secure manner to the institution's board chair, chief executive officer (CEO), and each board member, with a copy of association reports provided to the funding bank. The reports will typically include:

- A letter addressed to the board chair.
- An executive summary.
- Any matters requiring attention by the board and management.
- Conclusions on each CAMELS factor.
- A reference to the oversight and examination activities completed since the prior SCD.

Activity Letters: OE may conduct interim examination activities to ensure timely, risk-based regulatory oversight. Interim activities could be institution-specific or part of a horizontal activity involving all institutions or a sample of institutions. FCA typically sends an activity letter summarizing the interim examination activity conclusions to the institution, and forwards a copy of association activity letters to the funding bank, as needed.

FIRS Ratings Letters: OE communicates FIRS composite and component ratings to each institution's board of directors and CEO using a FIRS ratings letter. OE sends the FIRS ratings letter after issuance of an SCD report, after a FIRS rating change, or at other times as determined by OE. A copy of the associations' FIRS ratings letters, as well as a quarterly summary report of those ratings, is provided to the affiliated funding bank for its confidential use in oversight and servicing of the direct loans.

Internal Revenue Service Express Determination Letters: System institutions are responsible for requesting an express determination letter. The request must be sent to the examiner-in-charge prior to the beginning of a scheduled examination activity. OE will be more likely to accommodate the request when it is made early in the examination cycle. OE will provide institutions an express determination letter when the following conditions are met:

- Evaluation of loan loss classification standards and charge-offs are included in the scope of examination.
- Examination results indicate the institution maintains and applies loan loss classification standards and charge-offs consistent with the Uniform Classification System.

OE will not significantly alter its examination scope solely to provide the express determination letter.

Corrective Actions

Examination activities often identify matters requiring board and management attention. These may include issues or practices that could affect an institution's safety or soundness, regulatory violations, or other concerns. FCA reports and activity letters will include matters requiring attention (MRAs), as needed, to communicate expectations for resolving these areas of concern.

The following clarifies how examiners will determine if an issue should be considered an MRA, how MRAs are communicated to the board and management, and the expected board and management response:

- MRAs are necessary to address material issues or deficient practices that pertain to the institution's safety and soundness. The issues or deficient practices may have already affected the institution's condition or, if not corrected, could affect the institution's condition later. The goal is to identify and correct material issues and deficient practices **before** they affect the institution's condition.
- MRAs are necessary to address violations of laws and regulations or to address operational deficiencies that could lead to violations of laws or regulations if adequate controls are not established.
- MRAs may also be used to address other important, but less serious concerns. While corrective action is expected, FCA will typically provide the board and management more latitude in how to address these concerns. For example, we may require the board and management to evaluate or review these items to determine what, if any, changes are needed.
- MRAs will be specifically identified in FCA communications, usually within an activity letter or SCD report.
- The board and management will be typically expected to submit a formal corrective action plan for MRAs within a stated time frame.

FCA may also communicate other examination results to management in an exit conference or another communicate. These results may include issues that do not involve regulatory violations or rise to the level of concern that warrants an MRA, as discussed above, and thus would typically not be included in an SCD report or activity letter. FCA will not require a corrective action plan for these items, and will not formally track management's actions to address them.