

Farm Credit Administration

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INFORMATIONAL MEMORANDUM



October 12, 2012

To: Chairman, Board of Directors
All Farm Credit System Institutions

From: Samuel R. Coleman, Director and Chief Examiner
Office of Examination

A handwritten signature in black ink that reads 'Samuel R. Coleman'.

Subject: National Oversight Plan for Fiscal Year 2013

The Office of Examination (OE) establishes a National Oversight Plan (NOP) to direct our oversight of areas that we want to emphasize in the upcoming year as a supplement to our ongoing examination and oversight activities. This memorandum summarizes those NOP focus areas. I believe the following information will be beneficial to your business planning activities for 2013.

Drought and Related Risks – The 2012 drought is having a material impact on agriculture. Grain farmers and related transportation, storage, and processing industries will see the impact of lower production levels. In addition, many livestock, poultry, dairy, and ethanol producers will suffer as a result of higher grain prices. While credit risk associated with crop production losses will be substantially offset by crop insurance, disaster programs, and higher grain prices; the grain processing, protein and ethanol sectors will very likely be impacted negatively. The full effects of the drought conditions and risk impact are not yet known, but it is reasonable to expect Farm Credit System (System) credit risk will increase. OE will continue to monitor the drought conditions, coordinate with other FCA Offices, and communicate with the System as appropriate. You should expect examiners to evaluate your response to drought conditions, including how your institution is working with borrowers, complying with applicable FCA Borrower Rights regulations, and managing the resulting portfolio risks through your Loan Portfolio Management (LPM) strategies.

Loan Portfolio Management – The LPM guidance and risk management remains an examination focus because of its importance to each institution's safety and soundness. We continue to refine and update our examination guidance and activities surrounding all LPM-related functions. This guidance will ultimately be published as the *Loan Portfolio Management Examination Guide*. These modules include:

- ✓ Managing Risk Concentrations (*implemented June 2010*);
- ✓ Loan Underwriting (*implemented June 2010*);

- ✓ Stress Testing (*implemented February 2011 and will be incorporated into Portfolio Planning and Analysis in 2013*);
- ✓ Collateral Risk Management (*implemented December 2011*);
- ✓ Portfolio Planning and Analysis (*target implementation 2013*);
- ✓ Credit Administration (*target implementation 2014*), and
- ✓ Risk Identification (*target implementation 2014*).

The System's Risk Management Workgroup provided insight as we developed this guidance, and we will continue to engage with this workgroup as we develop new modules.

Standards of Conduct – There have been several significant Standards of Conduct (SOC) breaches that have resulted from a breakdown in internal controls at some institutions. We have identified situations where institution SOC practices are insufficient and these practices have led to regulatory violations and supervisory actions against System institutions or individuals. We plan to revise our examination guidance and conduct SOC examination work in all System institutions in 2013. This evaluation will focus on SOC processes, disclosures, and program effectiveness. The FCA publication entitled *The Director's Role* provides additional information on SOC-related expectations. You should review your institution's SOC-related practices and provide additional SOC-related board and management training as appropriate. All directors have a fiduciary responsibility to maintain the highest standards of conduct and ethical behavior when governing their financial institution.

Diversity and Inclusion – The FCA made significant changes to *FCA Regulation 618.8440 (Planning)* which became final on May 1, 2012. This regulation requires the System to develop the necessary plans to achieve increased diversity and inclusion in its workforce, management, and directorship. The regulation also requires the FCS to be responsive to the credit needs of all eligible and creditworthy agricultural producers. We will be issuing new examination guidance and examining each institutions' 2013 Business, Marketing, and Human Capital Plans (plans) for compliance with the new regulatory requirements. These new requirements must be considered and addressed in each institution's 2013 plans (refer to *FCA Regulation 618.8440*). You and your management team should thoroughly review this regulation and work to promote its implementation.

Please use this information to better understand our priorities for the upcoming year. This memorandum should be distributed to your fellow board members and discussed with the Audit Committee chairman, other board committees, and your executive management team. Please contact your designated examiner-in-charge or me at (703) 883-4246 (colemanr@fca.gov) if you have any questions.

Copy to:

Chief Executive Officer, All Farm Credit System Institutions
 Chief Executive Officer, Farm Credit Council
 Chief Executive Officer, Farm Credit Council Services
 Chief Executive Officer, Federal Agricultural Mortgage Corporation