

Farm Credit Administration

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INFORMATIONAL MEMORANDUM



August 21, 2013

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

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

Subject: National Oversight Plan for Fiscal Year 2014

The Office of Examination (OE) establishes a National Oversight Plan (NOP) as part of our annual planning processes. This NOP identifies topics that we emphasize in our ongoing examination and oversight activities. This memorandum summarizes those risk topics and it provides an update on the *FCSLoans2 Database Project*. The following information highlights our priorities so they can be considered in your 2014 risk assessment and business planning processes. I hope you find this information beneficial.

NOP Risk Topics

OE's risk surveillance and planning processes identified four NOP risk topics for 2014. They include: Business Planning and Diversity and Inclusion; Underwriting in Volatile Times; Board Governance; and Standards of Conduct (Phase 2). These topics are further explained below:

- **Business Planning and Diversity and Inclusion** – This risk topic focuses on the quality and effectiveness of the board's strategic and operational plans and business results compared to plan, in addition to regulatory compliance. It emphasizes the need to address diversity and inclusion in your marketing plans and human capital plans, as well as compliance with annual reporting requirements established in *FCA Regulation 618.8440(c)*. I encourage you and your management team to review *FCA Regulation 618.8440* (including its Preamble) and ensure your planning documents appropriately emphasize diversity and inclusion in its lending activities, management and staffing, and board representation. The Preamble includes important perspective regarding these requirements. We plan to update our examination guidance and provide examiners with additional information to discuss expectations with you. I anticipate we will issue additional communications on this subject as we summarize the results of our review of 2013 business plans.

- **Underwriting in Volatile Times** – Underwriting conditions are changing. Agriculture has enjoyed several years of record profitability; however, several factors that drove this profitability are likely to change over the next 2 years. Agricultural commodity prices are forecasted to decline, interest rates are projected to increase, and government farm subsidies are anticipated to decrease. Moreover, changing world conditions – including increased production acres and slowing population or income growth in various regions – may cause increased supplies in relation to demand. Crop production (grains) appears particularly vulnerable to these conditions and borrower repayment capacity, liquidity, and ultimately solvency and collateral values could be strained. This scenario could challenge borrowers that invested in higher-priced real estate (owned or rented) and equipment during the past several years. This risk topic emphasizes proactive and diligent underwriting practices in efforts to navigate continued volatility in the agricultural sector.

- **Board Governance** – Effective and informed board governance is paramount in today's increasingly complex financial institutions and fast-changing business conditions. The directorate must keep pace with these changes and constantly renew and develop itself to ensure the board has the needed knowledge, skills, and abilities to govern today's financial institution. Expertise in one or more fields is necessary. Expectations from stakeholders (borrower-shareholders, investors, Congress, System funding banks, and FCA) are high, and each director is accountable for the institution. They must execute their governance responsibilities with "due care". FCA has emphasized governance enhancements in its regulatory initiatives, supervisory-related actions, Reports of Examination, and in presentations to System directors. This risk topic emphasizes governance enhancements in areas of board committees, governance assessments (self-assessments and third-party assessments), and Nominating Committees. We plan to update our examination guidance on this issue and provide examiners with additional information to discuss our expectations with you. Moreover, we plan to conduct a System-wide governance assessment in order to evaluate board governance conditions.

- **Standards of Conduct (Phase 2)** – FCS directors and employees are expected to maintain high ethics and standards to comply fully with the standards of conduct (SOC) regulations (*FCA Regulation 612, Subpart A*). We examined SOC disclosures and programs in 2013. Examiners identified some SOC administration weaknesses and regulatory violations; however, very few examples of willful misconduct were identified. Where corrective actions were necessary, they were implemented through the appropriate follow-up examination and supervision programs. The identified weaknesses are largely attributed to a lack of training and understanding or ineffective SOC processes. Given these conditions, we plan to continue our SOC evaluations in 2014, update examination guidance, and provide examiners additional information to discuss SOC expectations with you. We are also contemplating additional communications to you to further define FCA expectations, best practices, and common weaknesses identified through examination activities. I encourage the board and SOC Officer to evaluate their SOC programs closely and identify and address opportunities for improvement.

FCS Loan Database Project

The FCS improved loan data availability and quality in recent years and this effort continues into 2014. The *FCSLoans2* dataset is used during every loan examination and it is integrated into our examination processes, thereby improving examination efficiency. This information also aids identification and oversight of shared assets – something that continues to evolve. Moreover, the dataset provides us needed information to analyze systemic risks and conduct policy-related analyses and it is critical that this information is complete and accurate. I want to thank you for supporting this effort and for providing us the needed information to fulfill our mission. We plan to examine this area during 2013/14 and I encourage you to focus on the integrity of your data submissions through your internal audit and loan review programs.

Please use this information to 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