



Management Challenges

**Farm Credit Administration
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MANAGEMENT CHALLENGES

As part of the Farm Credit Administration's (FCA or Agency) annual Performance and Accountability Report, the Reports Consolidation Act of 2000 requires Inspectors General to provide a summary perspective on the most serious management and performance challenges facing the Agency. These challenges reflect ongoing vulnerabilities identified by the OIG over recent years as well as new and emerging issues that the FCA faces. The chart below summarizes the top management challenges. The pages following the chart provide more depth regarding each challenge and the Agency's progress in addressing them.

Examination and Supervision Program

- Identifying and addressing risks in the Farm Credit System through effective examination and supervision to ensure it remains safe and sound.

Information Technology

- Leveraging investments in information technology while maintaining a secure environment.

Data Quality and Analysis

- Obtaining consistent, quality data vital to the Farm Credit Administration's mission to ensure the Farm Credit System remains a dependable source of credit for agriculture and rural America.

Human Capital

- Maintaining a well-trained, sustainable workforce while facing challenges in retirement eligibilties, workforce retention, and diversity.

Secondary Market Oversight

- Providing effective and impartial oversight of the Federal Agricultural Mortgage Corporation through the Farm Credit Administration's Office of Secondary Market Oversight.

CHALLENGE ONE: *EXAMINATION AND SUPERVISION PROGRAM*

A significant challenge for FCA lies in identifying and addressing risks in the Farm Credit System (FCS or System) through effective examination and supervision to ensure the System remains safe and sound.

Although the System remains financially sound and strongly capitalized, the System continues to be impacted by changing risk conditions. Macroeconomic factors, such as changing interest rates, slowing global economic growth, and low margins will likely impact risk in the System. Additionally, changing trade policies (including revised trade agreements and potential new tariffs) with several key U.S. partners will likely cause more volatility for agricultural products in the near future. FCS institutions must continue to be proactive and responsive to these risks. Working with borrowers and adapting to increasing risks while maintaining financial capacity will further increase the complexity of the System.

FCA's examination and supervision program must align with evolving threats, risks, and conditions. FCA uses a risk-based approach for oversight of the System. The Agency will require more sophisticated risk evaluation techniques to align with existing and emerging risk factors and identify and deter consequences with the greatest potential impact. Effective oversight will require using new technologies and developing new skill sets within the Agency. The control environment must also evolve to address increasing expectations associated with internal controls.

From time to time, more serious or persistent weaknesses require additional oversight activities. FCA must respond and intervene, when necessary, to protect the System. Effective examination and supervision require prompt identification of unacceptable risks. Both internal and external factors can cause significant changes in condition in a short period of time. Corrective actions and follow-up are critical to preventing the escalation of issues that impact safety and soundness. The Agency must be agile to monitor and prevent such conditions to protect the System.

Agency Progress

FCA continuously works to address the challenges of its examination and supervision roles and responsibilities. The Office of Examination (OE) has issued Informational Memoranda with guidance for institutions.

An Informational Memorandum (IM) titled, *Guidelines for Requesting Certificates of Good Standing, Authenticity, and Merger or Consolidation* (October 26, 2018), provides guidance on requesting certificates of good standing, authenticity, and merger or consolidation for System institutions. OE issued an IM concerning Regulation Z and Regulation M requirements, *2019 Threshold Adjustments Under Regulation Z and Regulation M* (December 13, 2018). Another IM titled, *Statutory Limit on Maximum Farm Credit System Bank Director Compensation Repealed* (January 22, 2019), informs System institutions that FCA will no longer calculate the maximum annual compensation adjustment, but will continue to review System bank director compensation to ensure that pay levels do not adversely affect the safety and soundness of System institutions. Another IM titled, *2019 Threshold Adjustment for Escrow Requirements, Protections for Tenants at Foreclosure, and Compliance-Related Resources* (April 23, 2019), provides updates and resources from the Consumer Financial Protection Bureau. On September 10, 2019, FCA notified System Institutions that it issued a *Notice of Prohibition* to a former employee of a System institution.

The Agency issued a Bookletter on *Revised Capital Treatment for Certain Water and Wastewater Exposures* (November 8, 2018) that provides guidance on the capital treatment for rural water and wastewater exposures.

Each year, OE identifies National Oversight Plan risk topics that are emphasized in ongoing examinations and

oversight activities. For Fiscal Year 2019, OE identified two risk topics: to concentrate on portfolio risk and how institutions are “navigating rough waters” and maintaining “three lines of defense” of internal controls (risk owners, risk management, and independent assurance).

Relevant OIG Work

FCA’s Office of Inspector General (OIG) completed a benchmarking study on the organizational structure of OE as compared to the other federal financial regulatory agencies. FCA was the smallest of the benchmarked agencies in size and in the number of institutions it examines. The benchmarking study found that the agencies surveyed varied in size, location, and organizational structure. The study found similar supervisor ratios and that most agencies surveyed were not using resident examiners. Each agency had unique responses on the location of examination staff and whether examiners were located in the same duty stations as their supervisors.

The OIG also completed an audit on FCA’s Stress Testing Guidance, and Use of Data and Analytical and Examination Tools. The objective of this audit was to evaluate FCA’s progress in updating stress testing guidance and related data, and analytical and examination tools. FCA made some progress in updating stress testing guidance since completing a stress testing project in March 2018. As a result of this audit, the Office of the Chief Operating Officer agreed to develop a project plan to ensure the timely completion of tasks related to stress testing.

The OIG also plans to address other challenges faced by the examination and supervision program, including a review of the Agency’s criminal referral process and the Agency’s Risk Project.

CHALLENGE TWO: *INFORMATION TECHNOLOGY*

A significant management challenge for FCA is the ability to leverage investments in information technology (IT) while maintaining a secure environment.

Evolving cybersecurity threats and vulnerabilities present significant challenges across the federal government. These challenges require an IT security program that is both agile and forward-looking. The prevalence of cybersecurity threats and risks have been highlighted by security incidents and data breaches across the public and private sector. Because FCA relies on various IT systems, security challenges can directly impact the Agency’s ability to achieve its mission. As such, FCA must continuously identify and respond to complex IT risks to effectively manage this challenge area.

As IT challenges grow, it is imperative that FCA has the necessary tools and staff to operate more efficiently and effectively. At the same time, the Agency must be prudent and responsible with its spending. To stay current and address the Agency’s IT requirements, FCA needs well-trained personnel that can successfully maintain IT systems and integrate new tools to improve operations. This challenge becomes increasingly difficult as new IT requirements are developed and implemented across federal systems.

The successful implementation of IT provides FCA staff with the tools and skills that enable the Agency to continue to:

- Analyze risks and implement an effective examination program across the System;
- Streamline business processes and build business intelligence to provide decision-makers with timely information and allow coordination with staff from multiple offices;

- Develop electronic recordkeeping and management capabilities for capturing, maintaining, and sharing institutional knowledge; and
- Protect and secure FCA information systems and data from ever-increasing external and internal threats.

Agency Progress

Over the past few years, FCA has invested in various IT tools to increase efficiency and effectiveness. FCA invested in analytical tools with the goal of improving risk identification in the System by analyzing System loan data. FCA's risk-based information security program continues to mature as it continuously identifies areas to strengthen and improve security. OIT supplemented its staff with a privacy officer to address privacy requirements, including compliance with the Privacy Act.

Relevant OIG Work

The OIG performs an annual evaluation of FCA's compliance with the Federal Information Security Modernization Act of 2014. The OIG conducted a benchmarking study of the OIT and its use of contractors. When compared to the IT budgets of the other federal financial regulators, FCA's IT budget, as a percentage of the Agency budget, falls in the middle of the benchmarked agencies, and FCA's use of contractors was the lowest of the other agencies. Looking ahead, the OIG will continue to focus on OIT operations and implementation of IT systems.

CHALLENGE THREE: DATA QUALITY AND ANALYSIS

Obtaining consistent, quality data is vital to FCA's mission of ensuring that the System remains a dependable source of credit for agriculture and rural America.

System data allows FCA to better monitor the System's condition and identify current and emerging risks, enhancing the development of a risk-based examination agenda and the promulgation of evidence-based policies and regulations. FCA is not an exception to the challenge of leveraging data to carry out its mission. The January 14, 2019 enactment of the Foundations of Evidence-Based Policymaking Act of 2018 (Evidence Act) emphasizes the better use of data governmentwide.

Collecting useful data from the System is no simple task, as varying practices and technical capabilities among its 69 institutions can result in inconsistent data, inhibiting FCA's ability to perform robust data analysis. Notwithstanding the inconsistency in System data, the Agency must consider the burdens to these 69 institutions when imposing reporting requirements. Further, FCA must ensure that data is collected and maintained in a manner comporting with legal requirements, and that sensitive information is safeguarded against unauthorized access or use. By identifying the gaps and critical data necessary to efficiently and effectively perform its mission, the Agency can better ensure the safety and soundness of the System.

Agency Progress

The Agency's Strategic Plan underscores that effective data analysis is critical to its oversight of the FCS. In the interest of improving its data analytics, FCA has made investments in related IT. The Agency is also in the process of developing and implementing analytical and examination tools that will enhance its ability to perform systemic risk and data analysis. FCA continues to work with the System to prioritize the most critical data fields for the overall improvement of data quality and consistency.

In June 2018, FCA created a new position to coordinate data and analytics at FCA and elevate the importance of obtaining consistent quality data from the FCS. In accordance with the Evidence Act and implementing U.S. Office of Management and Budget guidance, this position was subsequently designated as the Chief Data Officer. Going forward, the Chief Data Officer will be responsible for coordinating Agencywide data governance and lifecycle data management.

Relevant OIG Work

Recent OIG reviews relevant to this subject include a 2019 audit on the Agency's implementation of stress testing guidance and use of data and analytical and examination tools; a 2016 audit on FCA's oversight of young, beginning, and small farmer and rancher programs; and a 2016 audit on FCA's risk project. The OIG will continue monitoring the Agency's progress in obtaining and analyzing data in furtherance of its oversight mission.

CHALLENGE FOUR: *HUMAN CAPITAL*

A significant management challenge for FCA is maintaining a well-trained, sustainable workforce while facing challenges in retirement eligibilities, succession planning and training, and diversity.

Employees are FCA's most valuable asset. The Agency's success depends greatly on its ability to recruit, retain, and develop a capable workforce. Because FCA is a relatively small agency with nationwide responsibilities, changes in the workforce—such as the retirement of management and senior employees—must be accounted and planned for to avoid undue disruption to Agency functions.

The need for succession and human capital planning was highlighted in the past year by the retirement of multiple senior Agency leaders. Planning ensures that institutional knowledge and experience are passed on, and the Agency is less dependent on specific individuals.

Workforce training and developing takes a significant investment of resources, but the use of several tools can ensure that FCA maintains a vital, experienced staff. For example, data analytics can help the Agency identify training gaps. Job sharing, rotational details, and micro-assignment opportunities can be used to promote career development. Mentoring programs can prepare employees for management positions.

Diversity is another important aspect of human capital. A diverse staff brings different perspectives to problem-solving, enriching the Agency's ability to regulate and supervise the System. The Agency must continually assess and deploy strategies to reach its goals for diversity and inclusion. It can do this by using various tools that identify and reduce potential barriers to diversity and inclusion, enhance outreach, evaluate the Agency's recruitment data, and heighten awareness through programs that support diversity and inclusion.

Agency Progress

The Agency's Strategic Plan evidences a commitment to maintaining a diverse and capable workforce. Strategic objectives address maintaining a skilled, motivated workforce; ensuring adequate succession planning and knowledge transfer; and encouraging an engaged, diverse, and ethical workforce. FCA measures its success towards human capital goals based on employee outreach efforts and the results of the annual employee satisfaction surveys. The Agency also provides benefits and employee programs to attract and maintain a talented diverse workforce. In 2019, FCA accepted applications for its Student Loan Repayment Program. FCA's learning office also provides numerous online and in-person training resources to support technical skills, work/life balance, and managerial competencies.

Relevant OIG Work

The OIG has performed several reviews that have touched upon the subject of human capital in recent years, including, most recently, an audit concerning the effectiveness of FCA's process of obtaining background investigations for contractor personnel. Other reviews include a benchmarking evaluation comparing the structure and organization of FCA's Office of Examination with comparable offices of other financial regulatory agencies, an inspection of FCA's travel compensation program, and an audit of the Agency's human capital planning.

CHALLENGE FIVE: *SECONDARY MARKET OVERSIGHT*

A significant management challenge for FCA is to ensure that it effectively and impartially regulates the Federal Agricultural Mortgage Corporation (Farmer Mac) through the Office of Secondary Market Oversight (OSMO).

Farmer Mac is a stockholder-owned, federally-chartered corporation. Farmer Mac was established by the federal government in 1988 to provide a secondary market for agricultural credit by increasing access to, and reducing the cost of, capital to American agriculture and rural communities. Although Farmer Mac is part of the FCS, its secondary market mission is unique among FCS institutions. Farmer Mac's customer base is diverse, nationwide, and includes commercial and community banks, insurance companies, non-bank lenders, agricultural funds, rural utilities and other FCS institutions.

FCA, acting through OSMO, examines, regulates, and supervises the activities of Farmer Mac to ensure its safety and soundness and the accomplishment of its public policy purpose as authorized by Congress. It also ensures that Farmer Mac complies with applicable laws and regulations, and it manages FCA's enforcement activities with respect to Farmer Mac. Under the Farm Credit Act of 1971, as amended (Act), the OSMO Director reports directly to the FCA Chairman rather than the Chief Operating Officer. The Act also provides that the supervision of the powers, functions, and duties of Farmer Mac is performed, to the extent practicable, by personnel who are not responsible for the supervision of the banks and associations of the FCS. To fulfill its duties, OSMO uses examiners who also examine FCS banks and associations. Therefore, OSMO is continually challenged to ensure that it fulfills its oversight role free of conflicts of interest or undue influence from those also responsible for the supervision and regulation of the FCS banks and associations.

It is a challenge for OSMO to conduct its oversight and examination activities with a relatively small staff (approximately 5 employees, with additional rotational staff), while balancing resources sourced from FCA's Office of Examination responsible for supervision of FCS banks and associations. OSMO staff must have the necessary knowledge, skills, and training to understand the unique and complex mission, secondary market activities, and business model and capitalization of Farmer Mac. Further, because Farmer Mac is a publicly-traded company, OSMO staff must understand the market forces and reputational risks that can potentially affect Farmer Mac's safety and soundness. Advancements in data gathering, technology, and analytics that aid OSMO with risk measurement, management, and assessment, coupled with appropriate specialized training, can enhance FCA's ability to oversee Farmer Mac as it grows in scale and complexity. This will be particularly important in an environment that may present more challenges to farmers, ranchers, rural communities and their lenders. As the complexity of Farmer Mac increases, OSMO will need to ensure it maintains appropriate readiness to evaluate safety and soundness. To achieve its mission, OSMO may require increased resources and technical skills, which will present additional challenges for the Agency.

OSMO is further challenged by Farmer Mac's corporate governance structure and changes in leadership. The Farmer Mac board of directors is made up of 15 directors, including five Presidential appointees and ten

directors representing the different classes of stockholders. Over the last decade, Farmer Mac has experienced many changes among members of its executive management team that result in disruptions in Farmer Mac operations. OSMO's oversight role is made more difficult in ensuring the continued safety and soundness of Farmer Mac in the face of its large board representing diverse interests and the changes to its executive management.

Agency Progress

In its oversight role, OSMO provided guidance and implemented regulatory and other changes related to Farmer Mac. These changes were made in addition to OSMO's supervision and safety and soundness reviews of Farmer Mac. In February 2019, OSMO issued an IM outlining the 2019 examination focus areas as: emerging credit risks, capital stress testing and planning, earnings adequacy under less favorable agricultural economic conditions coupled with a rising interest rate environment, follow-up of recommendations, and Farmer Mac's new operating structure. In March 2019, FCA issued a Bookletter on Interest Rate Risk Management Guidance for Farmer Mac. The Bookletter described the policies, procedures, and internal controls that Farmer Mac should have in place to manage its exposure to interest rate risk and covered necessary risk measurement, monitoring, and reporting systems. In April 2019, OSMO provided guidance to Farmer Mac on providing a secondary market for mortgage loans and related participation interests secured by first liens on agricultural real estate that is used for the production or processing of hemp.

In October 2018, OSMO issued an IM providing guidance to Farmer Mac on planning and preparing for the expected phase out of the London Interbank Offered Rate. OSMO also revised its Risk Based Capital Stress Test for Farmer Mac to reflect changes to the corporate tax code, and FCA revised regulations that define the criteria that a nonprogram investment must meet for Farmer Mac investment.

In response to Section 5414 of the Agriculture Improvement Act of 2018,¹ FCA issued a study to Congress in June 2019 comparing loan risk and capital requirements for the FCS and Farmer Mac. The study was a collaborative effort of an interoffice workgroup comprised of members from the OE, OSMO, Office of General Counsel, and Office of Regulatory Policy. OSMO staff stated the study established a clear position on the fundamental differences between the two agricultural government-sponsored enterprises and the different risk profiles that translate into support for differing approaches to capital oversight and minimum requirement metrics. OSMO staff also stated the study may be used for internal training purposes to promote a convergence of opinions among FCA oversight functional offices on key differences.

Relevant OIG Work

In 2018, the OIG completed an audit to assess staffing arrangements and the reporting process for OSMO. Our review included recommendations to improve OSMO's processes and increase transparency. Because of our review, OSMO revised a directive to address conflicts of interest. In addition, OSMO developed a conflict of interest questionnaire and added a conflict of interest statement to rotational assignment agreements. OSMO also created a directive on the Farmer Mac assessment procedures. FCA's Office of the Chief Financial Officer documented methodologies used to calculate Farmer Mac's assessments. Lastly, based on our review,

¹ Section 5414 of the Agriculture Improvement Act of 2018 stated the Farm Credit Administration shall conduct a study that (1) analyzes and compares the financial risks inherent in loans made, held, securitized, or purchased by Farm Credit banks, associations, and the Federal Agricultural Mortgage Corporation and how such risks are required to be capitalized under statute and regulations in effect as of the date of the enactment of this Act; and (2) assesses the feasibility of increasing the acreage exception provided in section 8.8(c)(2) of the Farm Credit Act of 1971 to 2,000 acres.

the FCA Board created a delegation addressing the OSMO Director's reporting relationship with the FCA Board. Going forward, the OIG will review other aspects of OSMO oversight.