

of the System's YBS compliance. The proposed rule also requires System banks and direct lender associations to discuss their YBS programs and results in their annual reports to shareholders and investors. We believe these reporting and disclosure requirements will create more meaningful and transparent disclosure of the System's YBS program results than would the reporting of YBS examination results. Moreover, we believe such reporting and disclosure requirements will provide an added incentive to System banks and direct lender associations to focus on and enhance their YBS policies and programs.

Finally, the GAO recommended more consistent and complete YBS examination procedures. In response to this recommendation, FCA has made numerous changes to improve the YBS examination process. Such changes included implementing additional controls to provide assurance that examiners are fully completing the comprehensive YBS examination procedures. Before the GAO review, examiners had been completing YBS examination procedures using a "risk-based" approach, focusing attention on those areas deemed to be significant to that particular institution. Shortly after receiving the GAO report, the "risk-based" approach was discontinued and comprehensive scope examinations became mandatory in all association examinations, with full documentation of work performed and conclusions drawn. Senior examiners are now required to provide close supervision of the YBS examination program, and quality assurance examiners review the work completed and certify that the examiners followed all applicable guidance. After reviewing the agency's progress in this area, the GAO concluded that our corrective action plan satisfies the recommendation contained in the report regarding YBS examination activities.

The agency proposes to revise its YBS regulation by removing the current rule in its entirety and replacing it with the proposed rule discussed below.

V. Section-by-Section Analysis

Section 614.4165(a)—Definitions

We have added a definition section to clarify that the term "credit" includes all loans and interests in participations made by System banks and direct lender associations operating under title I or II of the Act. This section also clarifies that the term "services" as used in section 4.19(a) of the Act includes all leases made under title I or II authorities and all related services made by System

banks and direct lender associations operating under title I or II of the Act.

Section 614.4165(b)—Farm Credit Bank Policies

This section implements certain provisions of section 4.19 of the Act, which require each:

1. Direct lender association to adopt a YBS program under the policies of its funding¹⁹ Farm Credit bank board;
2. Direct lender association to coordinate with other System institutions in its territory, and other Governmental and private sources of credit in extending credit and services to YBS farmers and ranchers;
3. Direct lender association to report annually on its YBS programs and performance results to its funding bank; and
4. Farm Credit bank to report annually to the FCA, summarizing the YBS program operations and achievements of its affiliated direct lender associations.

Direct lender associations have gained more autonomy from their funding banks since 1980, when section 4.19 of the Act was added. In recognizing this autonomy, we are proposing that the Farm Credit bank policies be kept to a minimum. Instead, the proposed rule focuses on ensuring that the direct lender associations establish YBS programs that fulfill the provisions of section 4.19 of the Act.

Section 614.4165(c)—Direct Lender Association YBS Programs

This section sets forth the minimum components that each direct lender association must include in its YBS program. This section allows each direct lender association to design a YBS program unique to the needs of the YBS farmers and ranchers in its territory. Setting forth minimum components for YBS programs conveys FCA's expectations for specific activities and standards that constitute an acceptable YBS program.

The first component of this section requires each direct lender association to develop a mission statement for its YBS program. The exercise of developing a mission statement will compel each direct lender association to focus on the objectives of its YBS program and the steps it must take to accomplish such objectives.

The second and third components of this section require each direct lender association to develop annual

quantitative targets and qualitative goals to be incorporated into its operational and strategic business plan. Although the proposed regulation provides several suggestions on how to establish quantitative targets, these are suggestions only and are not mandatory. Each direct lender association has the flexibility to establish quantitative targets that best fit the needs of its territory. These targets must be established for each category of YBS borrowers. We note that no matter how direct lender associations establish their quantitative targets, the agency will continue to require annual YBS reports on loan volume and numbers.

The proposed rule requires that quantitative targets reasonably relate to the demographic data in each direct lender association's territory. We realize, based on the comments received, that the demographic data available to the System is not a perfect representation of the potential pool of eligible YBS borrowers in each direct lender association's territory. However, demographic data available from the *Census of Agriculture*, for example, is suitable as long as the direct lender association makes a reasonable effort to determine the reliability of the data. Moreover, quantitative targets must reasonably reflect the YBS demographics in each direct lender association's territory.

The quantitative targets and qualitative goals outlined in the proposed rule are similar to current FCA policy and reporting requirements for System YBS programs. Therefore, we do not believe these components impose significant new burdens for System direct lender associations.

The fourth component of this section requires each direct lender association to have methods to ensure that it conducts its YBS program in a safe and sound manner and within its risk-bearing capacity. It is possible that YBS farmers and ranchers pose a higher credit risk than other System borrowers. However, through the use of loan participations, capital pooling, guarantors such as the Farm Service Agency and state organizations that address specific YBS lending needs, a direct lender association can better manage its risk and increase opportunities for its YBS borrowers. The use of credit enhancements is one method to manage risk while providing more opportunities.

Section 614.4165(d)—YBS Advisory Committee

Under this section, each direct lender association may establish and maintain an advisory committee comprised of

¹⁹ Although section 4.19 of the Act refers to "district" and "supervising" Farm Credit bank, we use the term "funding" bank, which we believe more appropriately reflects the current relationship between a Farm Credit bank and its affiliated direct lender associations.