



FEDERAL RESERVE BANK *of* KANSAS CITY

January 10, 2017

Chief Executive Officer of Tenth District Agricultural State Member Bank

Subject: Supervision and Regulation (SR) Letter 11-14 *Supervisory Expectations for Risk Management of Agricultural Credit Risk*

On October 26, 2011, the Board of Governors of the Federal Reserve System issued SR Letter 11-14 *Supervisory Expectations for Risk Management of Agricultural Credit Risk* to remind banks of the supervisory expectations for agricultural credit risk management. While the guidance was issued nearly five years ago, the risk management principles contained in SR Letter 11-14 remain appropriate regardless of agricultural market conditions. Today, credit risk in the agricultural sector is increasing in general due to lower commodity prices, moderating farmland values, and persistently high production costs. As noted in the guidance, increasing risk in the agricultural sector heightens the importance of appropriate risk management. Accordingly, a bank's risk management and capital planning practices must be sufficiently robust to assess the level of agricultural-related credit risk, as well as the adequacy and ability of bank capital levels to withstand potential future market and economic stresses.

We are reminding banks that appropriate policies and controls must be in place to identify, segregate, and monitor agricultural carryover debt. When carryover debt arises, the bank should confirm the reasons for its existence (e.g., weaknesses in a borrower's financial condition or operations, a poor marketing plan, adverse weather conditions, or inappropriate credit administration on the bank's part) and confirm the viability of the borrower's operation so an informed decision can be made to determine whether debt restructuring is appropriate. The restructured debt should generally be written on a term basis with a reasonable amortization period; secured by clearly identified and verified collateral; and require payment amounts based on realistic cash flow expectations. Carryover debt resulting from the borrower's inability to generate sufficient cash flow from sales to repay the current cycle's production loans generally reflects a well-defined credit weakness and will receive close analysis by examiners. Decisions regarding the risk rating and adverse classifications of carryover debt should be based upon an assessment of the individual borrower's overall financial condition and trends. The identification of a troubled borrower does not prohibit representatives of the bank from working with that borrower.

A copy of SR Letter 11-14 is attached and is also available on the Board's public web site at <http://www.federalreserve.gov/bankinforeg/srletters/sr1114.htm>. You are also encouraged to refer to the FedLinks bulletin titled "Agricultural Credit Risk Management" available at <http://www.communitybankingconnections.org/fedlinks>. This bulletin provides additional examiner perspective on sound agricultural risk management. Please direct any questions concerning the guidance or policy statement to your Federal Reserve Bank of Kansas City Central Point of Contact.

Sincerely,

James H. Hunter