

**72 FR 10939, 03/12/2007**

**Handbook Mailing HM-07-2**

[6705-01-P]

**FARM CREDIT ADMINISTRATION**

**12 CFR Part 627**

RIN 3052-AC16

**Title IV Conservators, Receivers, and Voluntary Liquidations; Joint and Several Liability--Priority of Claims**

**AGENCY:** Farm Credit Administration.

**ACTION:** Proposed rule.

**SUMMARY:** The Farm Credit Administration (FCA, Agency, we), proposes to amend the priority of claims regulations to provide priority of claims rights to Farm Credit System (System, FCS, Farm Credit) banks if they make payments under a reallocation agreement to holders of consolidated and System-wide obligations on behalf of a defaulting System bank. We also propose to clarify that payments to a class of claims will be on a pro rata basis.

**DATES:** You may send comments on or before May 11, 2007.

**ADDRESSES:** We offer a variety of methods for you to submit comments. For accuracy and efficiency reasons, we encourage commenters to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. You may also send comments by mail or by facsimile transmission. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at [reg-comm@fca.gov](mailto:reg-comm@fca.gov).
- Agency Web site: <http://www.fca.gov>. Once you are at the Web site, select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses

to help reduce Internet spam.

**FOR FURTHER INFORMATION CONTACT:**

Christopher D. Wilson, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4414, TTY (703) 883-4434,

or

Rebecca S. Orlich, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

**SUPPLEMENTARY INFORMATION:**

**I. Objectives**

Our objectives in this proposed rule are to:

- Provide System banks that make payments under a reallocation agreement to holders of consolidated and System-wide obligations of a defaulting bank the same priority of claims rights they would have for payments made under statutory joint and several calls by the FCA.
- Clarify that claims in the same class will receive payments on a pro rata basis if there are insufficient assets in a receivership to pay the entire class in full.

**II. Background**

**A. Joint and Several Liability Under the Act**

System associations obtain funding by means of direct loans from their affiliated Farm Credit banks. The banks in turn obtain their funding primarily by issuing System-wide obligations to investors through the Federal Farm Credit Banks Funding Corporation (Funding Corporation).<sup>1</sup> The banks' authority to issue System-wide obligations is provided in section 4.2(d) of the Farm Credit Act of 1971, as amended (Act).<sup>2</sup> Section 4.2 (c) of the Act also authorizes the banks to obtain funding by issuing consolidated obligations with other banks operating under the same title of the Act, but all of the System's joint funding at the present time is through System-wide obligations.<sup>3</sup>

Investors in consolidated and System-wide obligations have three levels of repayment sources. Under section 4.4(a)(2)(A) of the Act, each bank is primarily liable for the portion of any consolidated or System-wide obligation made on its behalf.<sup>4</sup> If the bank that is primarily liable is unable to pay, payment must be made by the Farm Credit System Insurance Corporation (FCSIC), created in 1988. The FCSIC insures the timely payment of interest and principal on consolidated and System-wide obligations (these obligations are referred to as "insured obligations"). The source of payments by the FCSIC is the Farm Credit Insurance Fund (Insurance Fund), whose assets consist primarily of premiums paid by the System banks (as well as earnings on the premiums).<sup>5</sup> The Insurance Fund must be used to make payments on behalf of System banks defaulting on their insured obligations, but the FCSIC also has discretion to make other expenditures out of the Insurance Fund.<sup>6</sup>

If a System bank is unable to pay the portion of any insured obligations issued on its behalf and the Insurance Fund is exhausted, section 4.4(a)(2) of the Act provides that the other (nondefaulting)

System banks are jointly and severally liable for such timely payments as follows:

- The FCA will make calls on nondefaulting banks in proportion to each bank's proportionate share of the aggregate available collateral held by all nondefaulting banks.<sup>7</sup>
- If the aggregate available collateral does not fully satisfy the insured obligations of the defaulting bank, the FCA will make calls on all nondefaulting banks in proportion to each bank's remaining assets.

A bank's "available collateral" is defined in section 4.4(a)(2)(C) as "the amount (determined at the close of the last calendar quarter ending before such call) by which a bank's collateral . . . exceeds the collateral required to support the bank's outstanding notes, bonds, debentures, and other similar obligations."

Furthermore, the Act provides subrogation rights to both the banks and the FCSIC for payments of insured obligations made on behalf of a defaulting bank. With respect to FCSIC, section 5.61(c)(1) and (2) of the Act provides:

[O]n the payment to an owner of an insured obligation issued on behalf of an insured System bank in receivership, the [FCSIC] shall be subrogated to all rights of the owner against the bank to the extent of the payment. . . . Subrogation . . . shall include the right on the part of the [FCSIC] to receive the same dividends from the proceeds of the assets of the bank as would have been payable to the owner on a claim for the insured obligation.<sup>8</sup>

With respect to System banks, section 4.4(a)(2)(E) provides:

Any System bank that, pursuant to a call by the [FCA], makes a payment of principal or interest to the holder of any consolidated or System-wide obligations issued on behalf of another System bank shall be subrogated to the rights of the holder against such other bank to the extent of such payment.

## **B. FCA Priority of Claims Regulations**

Part 627 of our regulations governs the conduct of System institution conservatorships and receiverships. Section 627.2750 sets forth the priority of claims in the distribution of the assets of a bank in liquidation. After payment of certain receivership expenses and secured claims, paragraph (h) provides for the payment of "[a]ll claims of holders of consolidated and Systemwide bonds and claims of the other Farm Credit banks arising from their payments pursuant to [joint and several calls by the FCA under] 12 U.S.C. 2155" before payments are made to general creditors. Section 627.2755 requires the receiver to pay in full all the claims of a class of claims of the same priority (or make provision for such payment) before paying the claims of classes of lesser priority. That regulation further provides that the receiver must pay such claims on a pro rata basis if there are insufficient funds to pay in full any class of claims against a System association in receivership. However, the regulation does not address how the receiver must pay claims against a System bank or institution other than an association in the case of insufficient funds to pay a class of claims in full.

## **C. System Banks' Petition to Amend Regulations**

At the present time, the System banks and associations are well capitalized, and no bank or association has been placed in receivership since 1989. The FCA has never made joint and several calls on System banks to pay consolidated and System-wide bondholders, and monies from the Insurance Fund have never been used for that purpose. Nonetheless, the potential effect of a joint and several call based on banks' aggregate available collateral has caused System banks to consider possible alternative methodologies based on an agreement among the banks.

In recent years, the banks have discussed the benefits and feasibility of using a methodology for joint and several calls based on the proportion of total System-wide debt on which each nondefaulting bank is primarily liable. The banks have explored the possibility of entering into a reallocation agreement among themselves to pay a defaulting bank's maturing insured obligations as the Insurance Fund is nearing exhaustion but before statutory joint and several calls are triggered. The banks have informed us that, while they are in general agreement on the outlines of an agreement for payment based on individual banks' outstanding System-wide debt, a key to an agreement is that payments made under the banks' agreement would be entitled to the same payment rights as if the banks had made the payments under a statutory joint and several call.

The System banks have petitioned the FCA to amend our priority of claims regulations to provide the same subrogation rights to banks under a reallocation agreement to make joint and several payments on insured obligations that the banks would receive if they made payments under section 4.4(a)(2) of the Act. We have reviewed the banks' petition and believe there is merit in the banks' efforts to create an alternative methodology that they perceive has the potential benefit to increase funds available to pay a defaulting bank's insured obligations. Such an agreement would be subject to Agency approval. Therefore, we are proposing to amend our regulations to allow for such a reallocation agreement and to provide priority of claims rights equivalent to those granted to the banks for payments under section 4.4(a)(2) of the Act.

The proposed rule is described more fully below.

### **III. Description of Proposed Rule**

#### **Section 627.2750—Priority of Claims—Banks**

Section 627.2750 sets forth the priority of claims for banks in liquidation. Each paragraph describes a class of claims. Existing paragraph (h) provides for payment of claims of holders of consolidated and System-wide obligations and of other System banks arising from their payments made under statutory joint and several calls. We propose to add to this paragraph all claims of other System banks arising from their payments of consolidated and System-wide obligations under a reallocation agreement. The agreement must be in writing and approved by the FCA.

#### **Section 627.2755—Payment of Claims**

Existing § 627.2755 contains several provisions that apply to some or all types of System institutions that may be placed in receivership by the FCA under part 627 of our regulations.<sup>9</sup> We propose to amend paragraph (a) by deleting language limiting the pro rata requirement to association receiverships. This will clarify that, in all System institution receiverships, if there are insufficient funds to pay a class of claims in full, payments to such class must be on a pro rata basis.

### **IV. Regulatory Flexibility Act**

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

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<sup>1</sup>The Funding Corporation is the fiscal agent of the System established under section 4.9 of the Farm Credit Act of 1971, as amended (12 U.S.C. 2160).

<sup>2</sup>12 U.S.C. 2153(d).

<sup>3</sup>12 U.S.C. 2153(c).

<sup>4</sup>12 U.S.C. 2155(a)(2)(A).

<sup>5</sup>Section 5.55 of the Act (12 U.S.C. 2277a-4).

<sup>6</sup>Section 5.60(c) of the Act (12 U.S.C. 2277a-9).

<sup>7</sup>Section 4.4(a)(2)(F) of the Act requires the FCA to appoint a receiver upon making a joint and several call.

<sup>8</sup>12 U.S.C. 2277a-10(c).

<sup>9</sup>We note that part 627 of FCA's regulations does not apply to the Federal Agricultural Mortgage Corporation, also known as Farmer Mac. Regulations applicable to Farmer Mac are in part 650 of FCA's regulations.

**List of Subjects in 12 CFR Parts 627**

Agriculture, Banks, banking, Claims, Rural areas.

For the reasons stated in the preamble, we propose to amend part 627 of chapter VI, title 12 of the Code of Federal Regulations to read as follows:

**PART 627--TITLE IV CONSERVATORS, RECEIVERS, AND VOLUNTARY LIQUIDATIONS**

1. The authority citation for part 627 continues to read as follows:

**Authority:** Secs. 4.2, 5.9, 5.10, 5.17, 5.51, 5.58, 5.61 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2244, 2252, 2277a, 2277a-7, 2277a-10).

**Subpart B--Receivers and Receiverships**

2. Revise § 627.2750(h) to read as follows:

**§ 627.2750 Priority of claims--banks.**

\* \* \* \* \*

(h) All claims of holders of consolidated and System-wide bonds and all claims of the other Farm Credit banks arising from their payments on consolidated and System-wide bonds pursuant to 12 U.S.C. 2155 or pursuant to an agreement among the banks to reallocate the payments, provided the agreement is in writing and approved by the Farm Credit Administration.

\* \* \* \* \*

**§ 627.2755 [Amended]**

3. Amend § 627.2755(a) by removing the words "described in § 627.2745" in the last sentence.

**Dated: March 7, 2007**

**Roland E. Smith,  
Secretary,  
Farm Credit Administration Board.**