POLICY STATEMENT

Farm Credit System Insurance Corporation

FARM CREDIT SYSTEM INSURANCE CORPORATION
POLICY STATEMENT CONCERNING ASSISTANCE
(BM 11-APR-13-02)

Effective Date: April 11, 2013

Effect on Previous Action: Replaces "Policy Statement Concerning Stand-Alone Assistance" [BM-28-MAR-96-02]

Source of Authority: Part E of Title V of the Farm Credit Act of 1971, as Amended (Act); 12 U.S.C. §§ 2277a-2277a-14. Bylaws of the Farm Credit System Insurance Corporation [BM-12-SEP-06-05].

Background

The Farm Credit System Insurance Corporation (Corporation), in its sole discretion, is authorized under section 5.61(a) of the Farm Credit Act of 1971, as amended (Act), 12 U.S.C. 2277a–10(a), to provide, on such terms and conditions as the Corporation's Board of Directors may prescribe: (1) Stand-alone assistance in the form of loans, asset or debt security purchases, assumption of liabilities, or contributions: (a) To prevent the placing of the institution[1] into receivership, (b) to restore the institution to normal operation, or (c) to reduce the risk to the Corporation posed by the institution when severe financial conditions threaten the stability of a significant number of other System institutions or System institutions possessing significant financial resources; or (2) Assistance to facilitate a merger or consolidation of a "qualifying"[2] troubled System institution with another System institution through loans, loan guarantees, asset or debt security purchases, assumption of liabilities, contributions, or any combination thereof.[3]

If the Corporation receives a request for assistance, it must compare the cost of liquidation to the cost of providing assistance to determine the least costly alternative to the Insurance Fund.[4] In making this discretionary determination, the Corporation is authorized to gather any information necessary to perform the least-cost test.[5] After gathering all pertinent information, the Corporation must: (1) Evaluate alternatives on a present-value basis, using a reasonable discount rate, (2) document the evaluation and the assumptions on which the evaluation is based, and (3) retain the documentation for not less than 5 years.[6]

Policy Statement

The Corporation will consider a request for assistance to a troubled System institution under section 5.61(a) of the Act, 12 U.S.C. 2277a–10(a), upon receipt of an assistance proposal. An assistance proposal can be submitted either directly from a troubled System institution, from other System institutions seeking to acquire or assist a troubled System institution, or from the System banks to stem a liquidity crisis. Upon receipt of an assistance proposal, if the Corporation determines it is appropriate based on the facts and circumstances surrounding the request, the Corporation will provide System institutions the opportunity to submit any information, including information on the cost to the Farm Credit Insurance Fund (Insurance Fund) of a liquidation.[7] The Corporation will then conduct a least-cost test to determine whether the cost of providing assistance is less costly to the Insurance Fund than the cost of liquidating a System institution. If the cost of providing assistance is less than the cost of liquidation to the Insurance Fund, and the Corporation, in its sole discretion, approves assistance, the Corporation will enter into an agreement with the System institution receiving assistance.

Assistance Proposals

A System institution requesting assistance must submit a proposal to the Corporation. If the proposal is for stand-alone assistance, the proposal must provide justification for the assistance, including a detailed analysis of how such assistance will return the troubled System institution to a financially viable, self-sustaining operation. If the proposed assistance is to facilitate a merger, the proposal must demonstrate that the continuing System institution can safely and soundly absorb the financial and operational impact that will result from the merger. Moreover, the Corporation would consider FCA's preliminary approval of the proposed merger, pending the least-cost determination to provide assistance. If a System institution or group of System institutions submits an assistance proposal to resolve a troubled System institution or stem a liquidity crisis or financial contagion within the System, the proposal must contain sufficient information to demonstrate how the Corporation's assistance would be less costly to the Insurance Fund than liquidating the troubled System institution(s).

Assistance proposals must contain information to help the Corporation compare the cost of providing assistance to the cost of liquidating the troubled System institution as part of its least-cost determination. Assistance proposals can include requests for loans, loan guarantees, loss-sharing arrangements, asset or debt security purchases, assumption of liabilities, or cash contributions. The Corporation will consider the nature of the financial assistance requested on a case-by-case basis and may alter the form or amount of assistance as part of its determination. The Corporation has identified the following minimum criteria to be included in a request for assistance and assistance proposals:

1) Financial condition and performance criteria to better understand the problem that caused the need for assistance, including the rationale for seeking assistance;

2) The type and amount of assistance needed, as well as a reasonable repayment plan. Assistance proposals must include fee arrangements with attorneys, accountants, consultants, and other parties incident to the request for assistance (or projected costs for these arrangements). The Corporation would not acquire or service assets without a strong justification;

3) Reasonable projections to assess the future viability of the institution after assistance has been provided. This would include earnings projections and a capital restoration plan to achieve adequate capitalization. Earnings projections and the capital restoration plan must include the impact of repayment of assistance;

4) A business plan that would implement written policies and procedures designed to guide operations safely and soundly and to correct the problems that caused the need for assistance. The plan must include an internal control system to monitor ongoing performance with measurable criteria. The plan must also include an operating budget, including compensation arrangements covering directors and senior officers. Plans to continue the service and compensation of directors and senior officers must be pre-approved by the Corporation before it provides assistance and until assistance is repaid; and

5) Analysis of the effect of assistance on shareholders, uninsured creditors (e.g., impairment on subordinated debt), other System institutions and the financial markets. If the troubled System institution is an association, the analysis must include the impact on its funding bank's ability to continue meeting its insured obligations.

The Corporation reserves the right to request additional information as needed to conduct the least-cost test.

The Least-Cost Test

The Corporation will conduct a least-cost test to determine whether providing assistance to a troubled System institution is less costly to the Insurance Fund than liquidating the institution. The first step of the least-cost test is to determine the estimated liquidation value of the troubled System institution.[8] In making this determination, the Corporation shall use its examination authority under section 5.59(b) of the Act, 12 U.S.C. 2277a–8(b), to collect information from the troubled System institution to calculate the estimated liquidation value of the troubled System institution.[9] This information shall, at a minimum, include specific data elements as determined by Corporation staff to conduct a present-value analysis of the troubled System institution's assets, using a reasonable discount rate. As required by the Act, the troubled System institution must provide the Corporation all information necessary to perform a least-cost determination.

The second step of the least-cost test is for the Corporation to reasonably estimate whether the liquidation of the troubled System institution(s) creates a loss to the Insurance Fund. Since the Insurance Fund has been primarily established to insure the timely payment of principal and interest on System bank insured debt obligations,[10] a loss to the Insurance Fund occurs when a System bank defaults on an insured obligation, and the Corporation must use the Insurance Fund to pay the obligation.[11] Accordingly, to meet the least-cost test, the Corporation must be able to reasonably estimate whether the troubled System institution's failure will impair a bank's ability to pay its insured debt obligations.

A loss to the Insurance Fund may result from direct and/or indirect losses. Direct losses include the estimated losses to the Insurance Fund from the liquidation of a troubled System institution. Indirect losses to the Insurance Fund include the consequent effects of liquidating a troubled System institution. For example, if the troubled System institution is a bank, there is a direct loss to the Insurance Fund if the Corporation reasonably estimates that the net present value of the bank's assets[12] is less than its insured debt obligations.[13] If the Corporation can reasonably estimate that the liquidation of a troubled System bank subsequently causes one or more of the remaining System banks to default on insured debt obligations, there is an indirect loss to the Insurance Fund. Direct losses to the Insurance Fund can be reasonably estimated by the Corporation, but indirect losses to the Insurance Fund may be difficult for the Corporation to reasonably estimate. Consequently, it will be incumbent upon the remaining System banks to provide the Corporation with sufficient information and analysis to demonstrate that indirect losses to the Insurance Fund will result from the bank liquidation. For example, when a severe financial crisis exists, a System bank liquidation might cause the remaining System banks to be shut out of the debt market.[14] In a less extreme scenario, a System bank liquidation might substantially increase the cost of funds to the remaining System banks. In either scenario, for indirect costs to be considered, the Corporation must have sufficient information so that it can reasonably estimate the indirect loss associated with the bank liquidation. If indirect losses can be reasonably estimated, the Corporation may consider such losses in its least-cost test and assistance determination.

If the troubled System institution is an association, the Corporation must be able to reasonably estimate that the troubled System association's failure causes a loss to the Insurance Fund for there to be a basis for providing assistance. The funding bank would need to provide the Corporation with information to support the association request for assistance. If the Corporation reasonably estimates that the net present value of the association's assets[15] is less than the amount of its direct note with its funding bank, there would be a loss to the bank. If the Corporation reasonably estimates that the funding bank can sufficiently absorb this loss, there would be no loss to the Insurance Fund and, consequently, no basis for the Corporation to provide assistance to the troubled System association. However, if the Corporation reasonably estimates that the loss on the direct note is significant enough that the funding bank may default on its insured debt obligations, the Corporation may provide assistance to the troubled System association.

Moreover, if a sizable System association fails, or several smaller System associations fail, it is also possible that indirect losses to the Insurance Fund may result from association liquidations. For example, the liquidation of a considerable amount of agricultural loans in a relatively short period of time may cause a general decline in loan and collateral values throughout the district, creating higher levels of risk in the remaining association direct notes. Moreover, because the bank loses a significant source of revenue and capital, it might not be able to increase the cost of funds to the remaining associations to make up for lost revenue while simultaneously increasing their investment requirement to remain adequately capitalized. Without providing assistance to the sizable troubled association to prevent financial contagion, other associations could fail or the bank itself could fail, potentially creating losses to the Insurance Fund. A similar scenario could result with the failure of several smaller associations during a period of severe stress in agriculture. A temporary cash infusion to the bank could counteract the effects of financial contagion, stabilize the district, and help avoid a bank failure. The Corporation would consider structuring assistance so that it would recoup the cost associated with providing assistance. Therefore, if indirect losses can be reasonably estimated, the Corporation may consider such losses in its least-cost test and assistance determination.

The third step of the least-cost test is to determine the type and amount of assistance. The cost of providing assistance will depend upon the structure of the assistance. For example, the Corporation's purchase of distressed assets from a troubled System institution may cost the Insurance Fund more than providing the institution a loan with a repayment plan.[16] Moreover, if other System institutions are willing to contribute some of their funds to the troubled System institution to reduce the cost of providing assistance, the Corporation will factor this amount into its least-cost test and assistance determination.

The final step in the least-cost test is to compare the cost of liquidation to the cost of providing assistance. If the cost of providing assistance from the Insurance Fund is less than the cost of liquidating a troubled System institution (to the Insurance Fund), the Corporation's Board of Directors, in its discretion, may approve assistance to the troubled System institution. As required by statute, the Corporation shall use the information it receives during its least-cost determination to evaluate the alternatives, document the evaluation and the assumptions on which the evaluation is based, and retain the documentation for not less than 5 years.

Assistance Agreements

If the Corporation provides assistance, it will enter into an agreement with the System institution receiving assistance. The terms and conditions of the agreement will be determined on a case-by-case basis and may include limits on (or prior approval of) the types or amounts of activities the institution can engage in while assistance is outstanding. For example, assistance agreements might include repayment terms and limits on concentration risk, patronage and dividend payments, executive compensation, and certain types of expenses. Assistance agreements may also provide the Corporation the right to have a representative attend the institution's board meetings. Each assistance agreement will be subject to the Corporation's

Board of Directors' approval. While assistance agreements are outstanding, the Corporation will use its examination authority to ensure compliance with the agreement. Moreover, the Corporation will require the System institution receiving assistance to certify and publicly disclose compliance with the agreement requirements, including the disclosure of any instances of material noncompliance with the agreement.

DATED THIS 11TH DAY OF APRIL, 2013

BY ORDER OF THE BOARD

Dale L. Aultman
Secretary to the Board,
Farm Credit System Insurance Corporation.

[1]Section 5.61(a) of the Act uses the terms "insured System bank" and "bank" but the Act also specifies under section 5.61(e), 12 U.S.C. 2277a–10(e), that such terms also include production credit associations and other associations making direct loans under the authority provided under section 7.6 of the Act, 12 U.S.C. 2279b. Consequently, the terms "troubled System institution," "troubled System bank," or "troubled System association" are used to refer to those institutions specified in sections 5.61(a) and 5.61(e) of the Act, 12 U.S.C. 2277a–10(a) and 2277a-10(e).

[2]"Qualifying" means the troubled System institution is: (1) In receivership, (2) in danger of being placed in receivership, or (3) an institution that, when severe financial conditions exist that threaten the stability of a significant number of System institutions or of System institutions possessing significant financial resources, requires assistance to lessen the risk to the Corporation posed by such System institution under such threat of instability. See Act, section 5.61(a)(2)(B), 12 U.S.C. 2277a–10(a)(2)(B).

[3]The Corporation is not authorized to purchase voting stock from the troubled System institution. See Act, section 5.61(a)(3)(F), 12 U.S.C. 2277a–10(a)(3)(F).

[4]The cost of liquidation shall be made as of the earliest of: (I) The date on which a conservator is appointed for the institution, (II) the date on which a receiver is appointed for the institution, or (III) the date on which the Corporation makes any determination to provide assistance to the institution. See Act, section 5.61(a)(3)(C), 12 U.S.C. 2277a–10(a)(3)(C).

[5]See Act, sections 5.58(8) and 5.59, 12 U.S.C. 2277a–7(8) and 2277a–8. The Corporation will accord such other System institutions as the Corporation determines to be appropriate the opportunity to submit information relating to the determination. See Act, section 5.61(a)(3)(A), 12 U.S.C. 2277a–10(a)(3)(A).

[6]See Act, section 5.61(a)(3)(B), 12 U.S.C. 2277a–10(a)(3)(B). In addition, in regards to requests for stand-alone assistance, the Corporation must evaluate the adequacy of managerial resources of the troubled System institution. The Corporation is authorized to determine the continued service of any director or

senior ranking officer who serves in a policymaking role for the assisted System institution as a condition of approving assistance. See Act, section 5.61(a)(3)(D), 12 U.S.C. 2277a–10(a)(3)(D).

[7]The Corporation will determine which System institutions will provide this information.

[8]This value is computed by subtracting the present-value of the institution's liabilities from its assets. Liabilities include estimated resolution expenses.

[9]The Corporation will request that FCA examiners collect the information.

[10] See section 5.60(c)(1) of the Act, 12 U.S.C. 2277a-9(c)(1), which states, in part, "The Corporation shall expend amounts in the Insurance Fund to the extent necessary to insure the timely payment of interest and principal on insured obligations."

[11]This assumes that no other System institution is willing to voluntarily assist the defaulting bank to avoid a payout from the Insurance Fund.

[12]The net present value of bank assets is the estimated present value of bank assets at liquidation less estimated payments to creditors with a higher priority of claims than insured debt obligations and estimated resolution expenses.

[13]Conversely, there is no direct loss to the Insurance Fund if the Corporation reasonably estimates that the net present value of the bank's assets at liquidation is greater than its insured debt obligations.

[14]In a liquidity crisis situation, the Corporation would work with the System banks to ensure the Insurance Fund was used to protect investors in insured debt obligations.

[15]The net present value of association assets is the estimated present value of association assets at liquidation less estimated payments to creditors with higher priority of claims than the funding bank and estimated resolution expenses. In most cases, receivership expenses will be paid out of the receivership estate, so there would be no administrative cost to the Insurance Fund from the liquidation of the association.

[16]In the event the Corporation exercises its discretion to provide assistance, in most cases assistance would be provided to the funding bank, regardless of whether the troubled System institution is a bank or an association. For example, the Corporation may provide the funding bank a collateralized loan, purchase subordinated debt from the funding bank, or enter into a loss-sharing agreement with the funding bank to either restore the funding bank or its affiliated association (or both) to normal operations. If the assistance can be structured with a repayment feature, it is likely to be the least costly means of providing assistance of all possible alternatives available to the Corporation.