Module: Compliance
Section: Borrower Rights - Retirement of Equities
EM-626

Date Published: 06/94

Authority and Purpose

FCA Regulations 12 CFR Part 615, Subpart J, describes the requirements for Farm Credit System (System) institutions relative to the retirement of borrower equities.

Applicability and Exemptions

When a borrower is in default, the institution may, but is not required to, retire all or part of the equity owned by the borrower in total or partial liquidation of the debt. Eligible borrower stock shall be retired at par, and other stock shall be retired at book value not to exceed par. Bank for Cooperatives (BC) retirement of equities that are not eligible borrower stock must reflect their present value as determined by the BC. If the institution chooses to retire the borrower's equities, it must provide written notification to the borrower prior to retirement.

The written notice must be provided to the borrower at least 10 days prior to the retirement or by first class mail sent to the last known address of the borrower at least 13 days before the retirement of the equities. The notice must include the following information:

- The loan has been declared to be in default;
- All or part of the borrower's equities will be retired in full or partial liquidation of the loan;
- The effect of the retirement of equities on the borrower's relationship with the institution;
- The amount of outstanding debt after the retirement of the borrower's equities; and
- The date the borrower's equities will be retired.

A separate notice does not need to be provided to the borrower if, during the processes of notifying the borrower of restructuring or foreclosure, the institution provides the information listed above.

<u>Retention of Equities in the Event of Restructuring, § 615.5290</u>

When loans are restructured and principal is charged off, borrower stock is canceled in the same dollar amount up to the total amount of stock. However, the borrower is entitled to retain at least one share of stock for voting privileges. Regarding a Federal Land Bank Association's retirement of stock, the district bank must retire an equal amount of stock to the extent provided for in the bank's capitalization bylaws.

Examination Objectives

Determine whether adequate policies, procedures, and internal controls have been established to provide reasonable assurance of compliance with the regulatory requirements relating to notification of retirement of equities.

Obtain corrective action when violations are identified and deficiencies are noted.

Examination Procedures

The following procedures are provided to facilitate an evaluation of requirements relative to the retirement of equities. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution.

1. Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasis should be on identifying violations of law and regulation in other areas (e.g., eligibility, scope of financing, lending limits, etc.); integrating those findings with the examination of consumer protection, borrower rights, and financial reporting; and concluding on management's compliance with laws and regulations.

2. Review and evaluate the adequacy of policies, procedures, and internal controls that are in place to ensure compliance with the requirements of FCA Regulations 12 CFR Part 615, Subpart J.

3. Review loans in default and determine if notices provided to borrowers were timely and contained the required information.

4. Ensure borrowers' equities are retired at the value required by FCA Regulation 12 CFR § 615.5280.

5. Ensure borrowers whose loans are restructured are entitled to the retention of at least one share of stock.

6. Complete workpaper FCA 6060, if necessary, in conjunction with the evaluation of compliance with the requirements of this regulation.

7. Utilize discussions with institution managers as needed to gather information and discuss procedures and practices followed by institution personnel to ensure compliance with laws and regulations.

8. Conclude whether the institution is adequately complying with FCA Regulations 12 CFR Part 615, Subpart J. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.

9. Consider the possibility of issuing a borrower rights directive or imposing civil money penalties if significant, repeated, and uncorrected violations are surfaced.

10. Discuss tentative conclusions and examination findings with the examiner(s) responsible for evaluating management.

11. Discuss items of concern, scope of work performed, and conclusions with the EIC and with the appropriate institution manager. Obtain a response regarding the cause(s) of deficiencies or weaknesses and anticipated corrective actions.

12. Organize and compile, if necessary, violations of law and regulation into an appendix for the Report of Examination.

13. Prepare a leadsheet or other summary document to provide workpaper support for the work performed and the conclusions reached.