



Can Our Association Do That? FCA Adopts New Rule for Farm Credit Subsidiaries

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The Farm Credit Administration has adopted a new final rule governing the ownership and use of unincorporated business entities (UBEs) by Farm Credit System institutions. It applies to investments by System institutions in limited partnerships, limited liability partnerships, limited liability companies and other unincorporated business entities allowed under state law.

Unusual and Complex Collateral

Prior to the adoption of the new UBE Rule, member institutions looked to FCA Book Letter BL-057 for guidance in using state-chartered business entities for lending related purposes, such as holding title to real estate owned property. That Book Letter was limited to instances in which a member institution was foreclosing on real estate collateral and did not want to take title directly due to complex and unusual situations which may expose the institution to risks beyond those commonly associated with loans, or to administering the liquidation of collateral for syndicated loans involving multiple lending institutions.

Holding title to industrial and manufacturing properties was the primary use of such subsidiary entities under the Book Letter. The risks associated with owning environmentally contaminated property far outweigh the administrative burdens of forming and managing a subsidiary entity. Although the secured creditor exemption under the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) provides some protection against environmental clean-up liability, it is not viewed as a sufficient shield for lending institutions in many cases.

Expansion of Allowable Use

The new Rule addresses the same primary concerns as the Book Letter - protecting member institutions from liability associated with owning "unusual and complex collateral" and to assist in the administration of liquidation of collateral in syndicated loans - but expands the allowable use of UBEs for other purposes.

The Rule also allows member institutions to own single member UBEs for the purpose of providing limited services such as electronic transaction, holding fixed assets, or to provide trustee or other services that are integral to the daily internal operations of a System institution. As a result, UBEs could be used to own and operate office buildings housing member institutions. They can also be used in cooperation with other System institutions outside

of the service corporation structure to provide crop and hail insurance to Association customers.



In forming a new UBE, an institution must provide notice to the FCA, and in certain instances, obtain its approval prior to making its initial investment in the enterprise. For UBEs formed for the limited purpose of owning unusual or complex collateral associated with loans, to

provide hail or multi-peril crop insurance in collaboration with another System institution, or for any other business activity that FCA determines to be appropriate for notices only, the investing institution is only required to provide written notice to the FCA of the investment in a UBE. The notice must be received by FCA at least ten business days prior to making the investment and, at a minimum, include the following:

- The Articles of Formation
- The dollar amount of the institutions equity investment
- A certified copy of the board resolution authorizing the investment (with specific additional information if formed for purposes beyond holding complex collateral)
- A letter from the institution's funding bank stating that it has approved the investment
- Any additional information the institution wishes to submit

If the UBE is being established only to hold unusual or complex collateral associated with loans, the resolution adopted by the institution's board may be a blanket resolution to cover all such UBEs that the System institution will organize. In addition, the funding bank may provide a blanket approval of such UBEs. FCA approval is not required for UBEs formed for the limited purpose of holding unusual and complex collateral or to provide crop insurance products to its customers (or for any other UBE business activity that FCA determines to be appropriate for notice only). However, the FCA reserves the right to object to the forming of any such UBE within the 10-business day notice period.



Under the new UBE Rule, "unusual and complex collateral" means acquired property that may expose the owner to risks beyond those commonly associated with loans, including, but not limited to, acquired industrial or manufacturing properties where there is increased risk of incurring potential environmental or other liabilities that may accrue to the owners of such properties.

Beyond Holding Collateral and Insurance

For investments in UBEs that are formed for purposes beyond the holding of complex loan collateral or providing crop and related insurance, the System institution must obtain FCA's prior approval before making the investment.

The request for approval must include:

- A detailed statement of the risk characterizations of the investment
- A detailed statement of the purpose and objectives of the UBE
- A copy of the articles of formation (which must contain specific provisions limiting the business activities of the UBE, voting, distribution of profits and other provisions)
- The board resolutions approving the investment
- An approval letter from the institution's funding bank

The board resolution must address specific issues, including:

- A detailed statement as to the necessity of the investment in the UBE
- Requirements that it will operate with transparency and conduct its business activities in a manner designed to prevent conflicts of interest
- Restrictions prohibiting the use of the UBE to make direct loans or perform any activity that the System institution is not otherwise authorized to perform

Although the new Rule does not provide a time frame for FCA approval of requests to form non-collateral/crop insurance UBEs, it is FCA's practice to respond to requests from System institutions within 60 business days from receipt of the request.

Transparency and Other Requirements

The new Rule also contains transparency and reporting requirements for member institutions forming or investing in any UBE. The FCA can also require an institution to divest its interest in any UBE which activities violate the new Rule or the Farm Credit Act of 1971 as amended. It also contains grandfather provisions allowing for the continued use of UBEs formed prior to the effective date of the new Rule, as well as limitations on the co-ownership of UBEs by non-System institutions, such as commercial banks.

The new Rule was published in the Federal Register on May 28, 2013 and can be [found here](#). It becomes effective 30 days after publication in the Federal Register during which either Houses of Congress are in session. (Notice of the official effective date will also be published in the Federal Register.)

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