

Federal Housing Finance Board

Memorandum

June 14, 1991

To: J. Stephen Britt
Executive Director

From: Beth L. Climo
General Counsel

Subject: Stock Retention by and Dividend Payment to Receivers

We have been asked to address the following issues concerning the proper treatment of capital stock held by a receiver of a member institution.

ISSUES:

- A) Whether a Federal Home Loan Bank ("FHLBank") is required to allow a receiver of a member whose charter has been canceled to hold the capital stock until the end of the dividend period?
- B) If the stock is not held at the end of the dividend period, may the receiver be paid a dividend?

CONCLUSIONS:

- A) Unless the receiver maintains outstanding indebtedness to the FHLBank, the FHLBank may immediately redeem the capital stock when the member's charter is canceled and pay the receiver the cash paid subscription.
- B) If the stock is redeemed prior to the end of the dividend period, the FHLBank may not pay a dividend.

DISCUSSION:

- 1) THE FHLBANK IS NOT REQUIRED TO ALLOW RECEIVERS TO RETAIN CAPITAL STOCK UNTIL THE END OF A DIVIDEND PERIOD IF THERE ARE NO ADVANCES OUTSTANDING
 - A) The Federal Home Loan Bank Act limits a receiver's successorship rights to a member's FHLBank capital stock

The Federal Deposit Insurance Act ("FDI Act") generally sets

forth the rights of a receiver. Under section 11(d) of the PDI Act, a receiver by operation of law succeeds to all the rights, powers and privileges of an insured depository institution, including the FHLBank's capital stock owned by the insured depository institution.¹ The receiver simply steps into the shoes of the insolvent member and succeeds to the rights and obligations of that member.

Once having succeeded to those rights and obligations, the same law that governed the rights and obligations of the member would govern those of the receiver. The disposition or redemption of the FHLBank capital stock of a member whose membership is terminated -- and, thus, of a receiver as its successor -- is governed by section 6(e) of the Federal Home Loan Bank Act ("Bank Act"). Thus, the successorship rights to FHLBank capital stock are governed by the Bank Act.

- B) Unless a member maintains outstanding advances with the FHLBank, the FHLBank may immediately redeem the capital stock upon termination of FHLBank membership

Section 6(e) of the Bank Act governs the disposition of FHLBank capital stock in the event of membership termination. Section 6(e) provides in pertinent part:

If any member's membership in a Federal Home Loan Bank is terminated, the indebtedness of such member to the Federal Home Loan Bank shall be liquidated in an orderly manner (as determined by the Federal Home Loan Bank), and upon completion of such liquidation, the capital stock in the Federal Home Loan Bank owned by such member shall be surrendered and canceled Upon the liquidation of such indebtedness such member shall be entitled to the return of its collateral, and, upon surrender and cancellation of such capital stock, the member shall receive a sum equal to its cash paid subscriptions for the capital stock surrendered² (Emphasis added).

1. 12 U.S.C.A. § 1821(d)(2) (West 1990).

2. 12 U.S.C.A. § 1426(e) (West Supp. 1990). Section 6(e) was added to the Bank Act by section 706 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"). Pub. L. 101-73, Title VII, § 706, 103 Stat. 412 (August 9, 1989). It replaced former section 6(i) of the Bank Act. 12 U.S.C.A. § 1426(i) (West 1989). Section 6(i) provided in pertinent part:

... Upon liquidation of such indebtedness such member or nonmember borrower shall be entitled to

The statute clearly states that upon termination of FHLBank membership, a FHLBank must (1) liquidate all indebtedness in an orderly manner, and (2) upon completion of such liquidation; capital stock shall be surrendered and canceled. If a former member has no outstanding indebtedness, section 6(e) requires the FHLBank to cancel and surrender the capital stock.

Thus, the key issue is whether cancellation of an institution's charter and the appointment of a receiver constitutes a "termination of membership."

c) The cancellation of a member's charter and the appointment of a receiver constitute immediate termination of membership by operation of law.

Section 6(e) of the Bank Act prescribes two events that constitute termination of, or withdrawal from, membership in the Bank System: (1) voluntary withdrawal upon six-months written notice, and (2) involuntary withdrawal because of insolvency (i.e. liabilities exceed assets), or a member's failure to comply with any provision of the Bank Act or any Finance Board regulation.³ The latter requires 30-days notice and an opportunity for a hearing by the Finance Board.

In both instances, the charter of the member may remain intact. In the first instance, the institution is still a chartered institution eligible for membership under section 4(a) of the Bank Act.⁴ In the second instance, a removal proceeding is

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the return of its collateral, and, upon surrender and cancellation of such capital stock, the member shall receive a sum equal to its cash paid subscription. . . . id.

Former section 6(i) was not specific as to the timing of the stock surrender and cancellation. Section 6(e), as amended by FIRREA, specifically states that "upon completion of such liquidation, the capital stock shall be surrendered and canceled." Thus, a receiver of a member that owes no indebtedness to the FHLBank is required to surrender for cancellation the capital stock to the FHLBank.

3. 12 U.S.C.A. § 1426(e) (West Supp. 1990) See also 12 C.F.R. §§ 933.32 and 933.33 (1990).

4. Section 4(a) of the Bank Act provides:

Any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, or any insured depository institution . . .

required since continued eligibility requires a factual inquiry as to the solvency or compliance record -- as the case may be -- of the member. However, pending outcome of the hearing, the member remains eligible for membership since -- unless it is put into receivership as a result of its insolvency --- it continues to be eligible for membership under section 4(a).

When a member's charter is canceled and a receiver is appointed, there is no official removal proceeding by the Finance Board. Because the institution ceases to exist, it no longer meets the membership eligibility criteria under section 4(a) and, thus, its membership is automatically terminated. Section 4(a)(1)(A) requires an institution to be "duly organized under the laws of any State or of the United States."⁵ Once a member's charter is canceled and a receiver is appointed, it is no longer organized under any governing body. Thus, the institution's membership is terminated by operation of law.

Furthermore, the Resolution Trust Corporation ("RTC") is an instrumentality of the United States. It is not one of the types of institutions eligible for membership in the Bank System under section 4(a)(1)(A). Therefore, once the RTC as receiver succeeds to all the rights, powers and privileges of the former member and its shareholders, including the FHLBank capital stock, membership is terminated.

Finally, voluntary withdrawal and involuntary removal are not the exclusive means of withdrawal from or termination of membership. There are other ways to terminate membership which do not require written notice or a hearing. For example, the Finance Board considers a disappearing institution's membership in an

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shall be eligible to become a member of a
Federal Home Loan Bank if such institution---

- (A) is duly organized under the laws of any State or of the United States;
- (B) is subject to inspection and regulation under the banking laws, or under similar laws of the State or the United States; and
- (C) makes such home mortgages loans as, in the judgment of the Board, are long-term loans... .

12 U.S.C.A. § 1424(a) (West Supp. 1990).

5. 12 U.S.C.A. § 1424(a)(1)(A) (West Supp. 1990).

interdistrict merger as terminated automatically.⁶ This situation parallels that of a receivership in that the charter of the disappearing institution in the merger is canceled. Neither written notice of withdrawal nor a 30-day notice and a hearing are necessary.

In sum, once an institution's charter is canceled and a receiver is appointed, its membership in the Bank System is terminated automatically by operation of law. Upon termination of membership, the disposition of outstanding stock held by the receiver is governed by section 6(e) of the Bank Act, which requires cancellation of the stock if no advances are outstanding.

11) THE RECEIVER IS NOT ENTITLED TO A PARTIAL DIVIDEND UPON REDEMPTION OF CAPITAL STOCK.

Section 6(e) limits the redemption amount upon stock cancellation to the cash paid subscription. This does not appear to permit the payment of a dividend. The last sentence of section 6(e) provides in pertinent part:

[U]pon the surrender and cancellation of such capital stock, the member shall receive a sum equal to its cash paid subscriptions for the capital stock surrendered...'

Thus, upon redemption of the capital stock, the receiver is entitled only to the cash paid subscription.

Furthermore, section 932.3 of the Finance Board's regulations requires the FHLBank to pay a dividend to all stockholders of record on December 31 of each year or the record date set by the Finance Board? Thus, only stockholders of record are entitled to a dividend.⁹ If a member is placed in receivership and its

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6. Jerome Plapinger, former Special Counsel to the Federal Home Loan Bank Board ("FHLBB"), concluded that the merger of a member of one district into a member of another district terminates the membership in the first district by operation of law. Opin. Gen. Couns. FHLBB, Dec. 11, 1982.
 7. 12 U.S.C.A. 1426(e) (West Supp. 1990).
 8. 12 C.F.R. § 932.3 (1990).
 9. Section 932.3 of the Finance Board's regulations is consistent with general corporate law. The Model Business Corporation Act and general principles of corporate law state that "as soon as a dividend is lawfully and fully declared out of surplus profits, the corporation becomes indebted from that moment to each stockholder for the amount of his share,"
- 14 W. FLETCHER, ENCYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS

FHLBank stock canceled prior to the 'record date, it is not entitled to a dividend.¹⁰

III) CONCLUSION

The Bank Act governs the di'sposition and redemption of a withdrawing member's FHLBank capital stock. Upon termination of membership, unless the institution maintains any outstanding indebtedness with the FHLBank, the FHLBank may immediately redeem the capital stock and pay the institution or its successor the cash paid subscription. The cancellation of a member's charter and the appointment of a receiver constitute termination of membership by operation of law. Thus, if the receiver owes no indebtedness to the FHLBank, the FHLBank may immediately redeem the stock held by the receiver.

Furthermore, only stockholders of record are entitled to dividends. If a member is-placed in receivership and its FHLBank stock canceled prior to the record date, it is not entitled to a dividend.


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§ 5322 (rev. perm. ed. 1980).

10. The RTC cites section II(e)(12) of the FDI Act as authority for prohibiting the FHLBank from attempting to avoid the dividend payment based on the association's receivership. 12 U.S.C.A. § 1821(e)(12) (West 1990). Section II(e)(12) prohibits enforcement of ipso facto clauses in contracts which permit termination by one part-rights or obligations under the contract on the insolvency or receivership of the other party. However, the status of an institution's membership, the timing of the redemption of its FHLBank capital stock, and its right to receive dividends are not the result of an ipso facto clause (i.e., a contract right). Instead, they occur by operation of law. Once an institution's charter is canceled and a receiver is appointed, its membership is terminated automatically by operation of law. Upon termination of membership, the disposition of outstanding stock held by the receiver is governed by section 6(e) of the Bank Act, which requires cancellation of the stock if no advances are outstanding. Furthermore, section 6(e) of the Bank Act and section 923.3 of the Finance Beard's regulations do not permit payment of a dividend if an institution's FHLBank capital stock has been redeemed prior to the dividend record date.