Division of Supervision and Consumer Protection **MEMORANDUM SYSTEM**	
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	☐ Notice ☒ Memorandum

MEMORANDUM TO: Regional Directors

FROM: Michael J. Zamorski
Director

SUBJECT: Guidance on the Examination Treatment of Assets Related to the Tobacco Transition Payment Program

1. **Purpose**. To issue examination guidance regarding the proper treatment of assignments of tobacco transition payments and successor-in-interest contracts.

2. **Background**. The Fair and Equitable Tobacco Reform Act of 2004 (Reform Act) was passed on October 22, 2004, as part of the American Jobs Creation Act of 2004. The Reform Act established the Tobacco Transition Payment Program, commonly referred to as the "Tobacco Buyout," which is administered by the U.S. Department of Agriculture (USDA). The legislation terminates the federal tobacco marketing quota and price support loan programs. Therefore, beginning with the 2005 tobacco crop year, there will be no geographical planting restrictions, no marketing cards, and no price support loans.

   To ease the transition, the USDA's Commodity Credit Corporation (CCC) will make an estimated $9.6 billion in payments to eligible tobacco quota holders (land owners) and producers (farmers), payable in 10 annual installments in each of the 2005 through 2014 fiscal years. Quota holders will receive payments equal to $7 per pound based on 2002 marketing quotas, and producers will receive up to $3 per pound based on their share of the risk of producing quota tobacco between 2002 and 2004. Fiscal year 2005 buyout payments will be made between June and September of 2005, and subsequent payments will be made in January of each fiscal year. Tobacco producers and quota holders were required to sign up for the buyout program by June 17, 2005, to be eligible to receive a 2005 payment. Buyout payments and other related costs will be funded through quarterly assessments on domestic tobacco manufacturers and importers totaling no more than $10.14 billion over the 10-year period. The CCC is also authorized to borrow up to $30 billion from the Treasury, private agencies, and others, if assessment funds are insufficient to meet contract obligations.

   According to the USDA's Farm Service Agency (FSA), eligible tobacco types included in the buyout program are produced in the States of Alabama, Florida, Georgia, Indiana, Kentucky, Missouri, North Carolina, Ohio, South Carolina, Tennessee, Virginia, West Virginia, and Wisconsin.

3. **Discussion.** The CCC has no legal authority to make a lump sum payment to an individual tobacco quota holder or producer in lieu of annual payments. However, a financial institution may offer a lump sum payment to a quota holder or producer, in exchange for the stream of annual payments, through either an assignment of payments or a successor-in-interest contract. Assignments may begin with the fiscal year 2005 payment, while successor-in-interest contracts may not begin until the fiscal year 2006 payment. Under an assignment of payments arrangement, the quota holder or producer assigns the rights to receive one or more annual payments to the financial institution. However, the quota holder or producer continues to own the buyout contract and must abide by the terms of the contract with the CCC. Under the successor-in-interest arrangement, the quota holder or producer transfers all rights in his/her contract to the financial institution. The financial institution becomes the owner of the buyout contract and must abide by the terms of the contract with the CCC. Both financing arrangements must be approved by the CCC.

   An assignment or successor-in-interest contract will not be approved unless the amount the financial institution proposes to pay the quota holder or producer is greater than or equal to the discounted value of the remaining buyout payments due based on a discount rate set by statute. The maximum discount rate is the prime rate in effect on the first business day of the month plus two percentage points, rounded to the nearest whole number. The "discount rate" provision only applies to the original assignment or successor-in-interest contract. Subsequent assignments or purchases of the buyout payments can be based on market value.

   Upon approval of the assignee or successor contract, annual payments by the CCC will be made directly to the financial institution. Any payments to be made to the financial institution under an assignment of payments arrangement will be reduced if the quota holder or producer owes any debt to an agency of the United States at any time over the life of the contract, thereby exposing the institution to credit risk. On the other hand, the annual payments made to the financial institution cannot be reduced by any debt owed by the quota holder or producer to an agency of the United States subsequent to the CCC's approval of a successor-in-interest contract. Nevertheless, the CCC will reduce the payment made to the financial institution if the institution owes any debt to an agency of the United States. In addition, the CCC will not issue a payment to the financial institution that is the assignee or successor to a producer contract if either the producer (in an assignment of payments arrangement) or the institution (in a successor-in-interest contract) is not in compliance with wetlands and highly erodible land provisions of the USDA's regulations or is convicted of trafficking in controlled substances. That result is the same even if the failure to comply is associated with a property other than the one which generates the assigned payment.

   The attached table outlines the features of an assignment of payments and a successor-in-interest contract.

4. **Policy.** It is permissible for state nonmember banks to take an assignment of payments or successor-in-interest contract under the Tobacco Transition Payment Program without providing notice or obtaining prior approval under Part 362 of the FDIC's Rules and Regulations. Tobacco buyout assignments and successor-in-interest contracts do not appear to pose any greater risk than other credit enhancements when taken as collateral for loans. A financial institution that makes a loan secured by an assignment of tobacco buyout payments or successor-in-interest contract is essentially discounting a promissory note because the producer or quota holder receives a lump sum payment up-front, less a discount for all or a portion of the remaining stream of buyout payments. Examiners

should ensure that such financing arrangements are made in a prudent manner with proper risk controls and management oversight.

a. Call Report Treatment. The Supplemental Instructions for the June 30, 2005 Call Report state that banks that enter into CCC-approved assignments and successor-in-interest contracts and make lump-sum payments to tobacco quota holders or producers should report these financing arrangements as "Loans to finance agricultural production and other loans to farmers" in Schedule RC-C, part I, item 3. The discount reflected in these lump-sum payments should be recognized as interest income over the life of the assignment or contract using the interest method.

The Supplemental Instructions for the June 30, 2005 Call Report further state that for risk-based capital purposes, assignment of payments should be risk weighted at 100 percent because of the potential exposure to payment reductions for any debt owed by the quota holder or producer to an agency of the United States as outlined above. Successor-in-interest contracts from quota holders are, in essence, unconditionally guaranteed by the U.S. Government and should be risk weighted at zero percent. In contrast, successor-in-interest contracts from producers are considered conditionally guaranteed and should be risk weighted at 20 percent.

5. **Additional Resource.** Please visit the tobacco information web site at www.fsa.usda.gov/tobacco for additional information about the Tobacco Transition Payment Program, including sample contracts, and a lump sum conversion calculator.

6. **Effective Date.** This memorandum is effective immediately.

7. **Distribution.** This memorandum should be distributed to all DSC risk management personnel.

Attachment:

A. Features of Assignment of Payments and Successor-In-Interest Contract
B. Federal Register: April 4, 2005, (Volume 70, Number 63, Page 17150-17166)

Transmittal No: 2005-028

Attachment A

ASSIGNMENT OF PAYMENTS	SUCCESSOR-IN-INTEREST CONTRACT
• Assigns the right to a payment, or a portion thereof, to the financial institution. The quota holder/producer remains the buyout contract holder.	• Terminates and transfers all rights and obligations of the buyout contract to the financial institution.
• May begin with the fiscal year 2005 payment. However, limited to two assignees per year.	• May not begin until the fiscal year 2006 payment. Financial institution must execute contract by November 1st of the preceding year, in order to receive the subsequent January payment.
• Revocable at any time with the consent of the financial institution.	• May not be revoked.
• Quota holder/producer is subject to the offset of payment provisions of the Debt Collection Improvement Act of 1996.	• Quota holder/producer may not enter into a successor-in-interest contract if subject to an outstanding claim established by any agency of the United States at that time.
• Annual payments made to the financial institution will be reduced by the amount the quota holder or producer owes to any agency of the United States at any time over the life of the assignment.	• Annual payments made to the financial institution will be reduced by the amount the institution owes to any agency of the United States at any time over the life of the contract. Subsequent actions or debts of the quota holder/producer will not affect the annual payments received by the financial institution after the rights in the contract are transferred to the institution.
• The CCC will not make payments to the financial institution under an assignment if the producer is not in compliance with the wetlands and highly erodible land provisions and substance control provisions in federal law. This is the case even if the failure to comply is associated with a property other than the one which generates the assignment payments.	• The CCC will not make payments to a financial institution that is the successor-in-interest to a producer contract if the institution is not in compliance with the wetlands and highly erodible land provisions and substance control provisions found in federal law.
• All or part of the payment stream may be assigned.	• Must succeed to whole contract (partial successor-in-interest contracts are not allowed).
	• The CCC will allow the sale of a successor-in-interest contract to another party, but the number of successions has not yet been determined.