BANKING & FINANCE LAW

Program Materials 2012

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FOREWORD

The Institute is especially grateful to our outstanding Seminar Chairperson, Gerald L. Blanchard, for providing the necessary leadership, organization and supervision that has brought this program into a reality. Indeed a debt of gratitude is particularly due our articulate and knowledgeable faculty without whose untiring efforts and dedication in the preparation of papers and in appearing on the program as speakers, this program would not have been possible. Their names are listed on the program at page iv of this book and their contributions to the success of this seminar are immeasurable.

I would be remiss if I did not extend a special thanks to each of you who are attending this seminar and for whom the program was planned. All of us hope your attendance will be most beneficial as well as enjoyable. Your comments and suggestions are always welcome.

February, 2012

Lawrence F. Jones
Executive Director
Institute of Continuing Legal
Education in Georgia

PROGRAM

Presiding: *Gerald L. Blanchard*, Program Chair, Bryan Cave LLP, Atlanta

8:15 **REGISTRATION**
(All attendees must check in upon arrival. A jacket or sweater is recommended.)

9:00 **WELCOME AND PROGRAM OVERVIEW**
Gerald L. Blanchard

9:05 **FAIR LENDING AND OTHER COMPLIANCE ISSUES**
Moderator: *B. Knox Dobbins*, Sutherland Asbill & Brennan LLP, Atlanta
Panelists:
Judy Carter Newberry, Deputy Commissioner for Legal and Consumer Affairs, Georgia Department of Banking and Finance, Atlanta
Loretta Salzano, Franzén and Salzano, P.C., Norcross
Christopher J. Willis, Ballard Spahr LLP, Atlanta

10:00 **REGULATORY DEVELOPMENTS POST *DODD FRANK***
Paul S. Pilecki, Kilpatrick Townsend & Stockton LLP, Washington, DC
David T. Bloom, Deputy General Counsel, SunTrust, Atlanta

10:45 **BREAK**

11:00 **THE INTERSECTION OF ACCOUNTING AND BANKING LAW**
Robert D. Klingler, Bryan Cave LLP, Atlanta
Kris M. Trainor, Mauldin & Jenkins, Atlanta
Jamie Hood, Porter Keadle Moore, Atlanta

12:00 **RECENT BANKING LAW CASES**
Gerald L. Blanchard

12:30 **LUNCH**

1:30 **NEGOTIATING THE BANK M&A TRANSACTION IN THE POST MELT DOWN ENVIRONMENT**
Moderator:
Richard T. Hills, Womble Carlyle Sandridge & Rice, PLLC, Atlanta
Panelists:
David Black, Senior Vice President of Finance, State Bank & Trust Company, Atlanta
Brian D. Branson, Director, Investment Banking, Sterne Agee & Leach, Inc., Atlanta
Matthew Veneri, FIG Partners, LLC, Atlanta

2:15 **LAWYER AND REGULATOR PANEL DISCUSSION ON THE ROLE OF LAWYERS IN THE INTERACTION BETWEEN BANK CLIENTS AND THE GOVERNMENT**
Moderator:
Mark C. Kanaly, Alston & Bird LLP, Atlanta
Panelists:
James W. Stevens, II, Kilpatrick Townsend & Stockton LLP, Atlanta
Kevin Hagler, Georgia Department of Banking & Finance, Atlanta
John P. Henrie, Deputy Regional Director, FDIC, Atlanta
Tom Dujenski, Regional Director, FDIC, Atlanta

3:15 **BREAK**

3:30 **PAYMENT ISSUES—WHAT IS MONEY? CONTINUED DEVELOPMENT OF PAYMENT SYSTEMS INCLUDING RELOADABLE CARDS AND CELL PHONES**
Judith E. Rinearson, Bryan Cave LLP, New York, NY
Cherie M. Fuzzell, President, Firstview LLC, Atlanta

4:30 **ADJOURN**

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FAIR LENDING AND OTHER COMPLIANCE ISSUES

MODERATOR

Knox Dobbins
Sutherland Asbill & Brennan LLP
Atlanta, Georgia

PANELISTS

Judy Carter Newberry
Deputy Commissioner for Legal and Consumer Affairs
Georgia Department of Banking and Finance
Atlanta, Georgia

Loretta Salzano
Franzén and Salzano, P.C.
Norcross, Georgia

Christopher J. Willis
Ballard Spahr LLP
Atlanta, Georgia

Excerpts from *The Consumer Financial Protection Act of 2010: An Annotated Guide* by Knox Dobbins and Jason Stone

North Law Publishers, Inc. (http://www.northlawpublishers.com)

Sec. 1002. DEFINITIONS.

Except as otherwise provided in this title, for purposes of this title, the following definitions shall apply:

* * * *

(13) Fair lending.-- The term "fair lending" means fair, equitable, and nondiscriminatory access to credit for consumers.

* * * *

CROSS-REFERENCES

* * * *

(13) Fair Lending

Office of Fair Lending and Equal Opportunity, see § 1013(c).

Consumer Advisory Board, see § 1014.

Required reports to Congress, see § 1016.

Joint investigations of Bureau, HUD and/or Attorney General, see § 1052(a)(2).

Report regarding private education loans and private education lenders, see § 1077.

* * * *

COMMENTARY

* * * *

Perhaps the most significant definitional shift from existing federal consumer law lies in the definition of "fair lending" in ***Section 1002(13)***. That subsection provides: "The term 'fair lending' means fair, equitable, and nondiscriminatory access to credit for consumers."

Under current laws, particularly the Fair Housing Act and the Equal Credit Opportunity Act,[1] the fair lending focus lies on eliminating affirmative discrimination by lenders acting on a prohibited basis. Disparate treatment or impact, as well as overt discrimination, are prohibited, but they must be based on a personal characteristic of a consumer or service applicant.[2] ***Subsection 1002(13)*** seemingly addresses more.

First, the requirement of "fair" and "equitable" is not tied to unfairness occurring on the basis of bias tied to race, gender, color, religion or national origin. For instance, unfair pricing – charging any consumer, regardless of his demographic, more for one product than for a comparable product – would seem under the ***Section 1002(13)*** definition to be unfair lending.

Perhaps more importantly, including "access" in the definition of "fair lending" seems to extend the concept and requirement beyond fair dealing with a covered person's customers and applicants. To require that consumers upon application not be denied nondiscriminatory credit, which is the principle underlying current fair lending laws, is a much lesser requirement than mandating that consumers have access to "fair" (however defined) credit.

The Act may not provide the Bureau with the authority to make rules based on this definitional shift in the concept of "fair lending." The new "fair lending" definition in ***Section 1002*** applies only to the term as used in this Act itself. It does not amend ECOA or other federal statutes addressing fair lending or the definitions in those other statutes.

Section 1031, which sets out the goals of Bureau rulemaking, and ***Section 1036***, which lays out prohibitions, only address "acts or practices" or the offering or provision of products. They do not reach to the absence of credit access or credit transactions by a covered person. Subsection (c) of ***Section 1031***, moreover, imposes a high hurdle for the Bureau to declare an act or practice "unfair."[3]

Yet ***Section 1052*** authorizes the Bureau to join Justice or HUD with subpoenas, CIDs and required testimony in investigating "matters relating to fair lending."[4] It is not clear whether this authority can or will be used to implement the new definition of "fair lending" outside an allegation of a violation of existing federal consumer statutes, with their more limited definition of "fair lending."

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1 42 U.S.C.S. § 3601 *et seq.*; 15 U.S.C.S. § 1691 *et seq.*

2 *See* Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266 (Apr. 15, 1994).

3 Consumer Financial Protection Act of 2010, Pub. L. No. 111-203, tit. X, §§ 1031, 1036, 12 U.S.C.S. §§ 5531, 5536.

4 *Id.* at § 1052, 12 U.S.C.S. § 5562.

Georgia Department of Banking & Finance

Regulatory Overview

Judy Carter Newberry, Deputy Commissioner
Legal and Consumer Affairs Division
Georgia Department of Banking and Finance

Banking and Finance Law
February 17, 2012

Department of Banking & Finance
"Safeguarding Georgia's Financial Services"

GA Dept. of Banking and Finance

"Safeguarding Georgia's Financial Services"

- Our **Mission** is to promote safe, sound, competitive financial services in Georgia through innovative, responsive regulation and supervision.
- Divisions
  - Supervision
  - Non-Depository Financial Institutions
  - Legal and Consumer Affairs

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Regulatory Framework

- Dual Banking System
  - Banks, Credit Unions and Savings Banks may choose to be state or federally chartered.
- Mortgage Industry
  - Mortgage Brokers, Mortgage Lenders (if not a subsidiary of a bank or credit union) and Mortgage Loan Originators are state licensed.
  - Residential lending is federally governed by the Real Estate Settlement Procedures Act (RESPA).

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Department Regulated Entities

- Depository*
  - State Chartered Banks (197)
  - Bank Holding Companies (226)
  - Credit Unions (59)
  - International Bank Organizations (4)
  - Trust Companies (1)
- Non-Depository*
  - Mortgage Brokers & Lenders (773)
  - Check Cashers (1035)
  - Money Transmitters (81)
  - Check Sellers (27)
  - Mortgage Loan Originators (4800)

*As of January 25, 2012

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Mortgage Industry Regulation

- Georgia Residential Mortgage Act (GRMA)
- Georgia Fair Lending Act (GaFLA)
- Mortgage Fraud Act

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Types of Disciplinary Actions

- Fines
- Cease and Desist Orders (C&D)
- Intent to Revoke License (ITR)

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Administrative Actions

Mortgage Brokers and Lenders and Mortgage Loan Originators Volume of Administrative Actions

	Cease & Desist Orders O.C.G.A. § 7-1-1018	Intent to Revoke License O.C.G.A. § 7-1-1017	Consent Orders
2010	54	106	26
2011	12	82	30

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Georgia Fair Lending Act
(O.C.G.A. § 7-6A-1 through 7-6A-13)

- Points and Fees Test (High Cost Loans)
  - Exceeds threshold where total points and fees payable in connection with the loan, excluding not more than two bona fide discount points exceed 5 percent of the total loan amount if the total loan amount is $20,000 or more. O.C.G.A. § 7-6A-2(17)(B).

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Georgia Fair Lending Act
(O.C.G.A. § 7-6A-1 through 7-6A-13)

- “Flipping” a Home Loan
  - the consummating of a high-cost home loan to a borrower that refinances an existing home loan that was consummated within the prior five years when the new loan does not provide reasonable, tangible net benefit to the borrower considering all of the circumstances…O.C.G.A. § 7-6A-4(a).

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Fair Lending

- Term is also used to describe examination process by which bank examiners test compliance with nondiscrimination laws and regulations

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Fair Lending

- At a minimum, a Fair Lending examination will include a comprehensive review of the Lender’s underwriting and pricing policies to ensure they are not discriminatory “on their face” = overt discrimination.

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Unlawful Discrimination

- Overt Discrimination
  - Blatant discrimination on a prohibited basis

Unlawful Discrimination

- Disparate Treatment
  - When Lender treats applications differently based on one or more prohibited factors

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Enforcement & Penalties

- Government Action
  - Federal and state banking agencies, along with the DOJ have several options when fair lending is violated. Some examples are. . .

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Enforcement & Penalties

- Regulatory Agencies
  - Cease & desist order
  - Civil money penalties
  - CRA rating of “Needs to Improve” or “Substantial Noncompliance”
  - Referral to DOJ or HUD for additional investigation

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Enforcement & Penalties

- U.S. Attorney General
  - Permanent/Temporary Injunction or restraining order
  - Civil Penalties not to exceed:
    - $50,000 for 1st violation or
    - $100,000 for each subsequent violation

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Enforcement & Penalties

- Both Fair Housing Act and Equal Credit Opportunity Act Provide for specific damages as follows. . .

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Damages Awarded

- Fair Housing Act
  - Actual damages
  - Punitive damages
  - Permanent/temporary injunction, temporary restraining order or other appropriate affirmative order
  - Attorney's fees and court costs

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Damages Awarded

- Equal Credit Opportunity Act
  - Actual damages
  - For individual lawsuits, civil penalties no greater than $10,000
  - For class action lawsuits, civil penalties no greater than the lesser of $500,000 or 1% or creditor's net worth
  - Reasonable attorney's fees

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Questions & Answers

Department of Banking & Finance
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7 Deadly Sins

(Based on Recent Enforcement Actions)

1. Unfair Lending and Servicing
   - Disparate impact
   - Denials
   - Pricing
   - Access
   - Steering
   - Ads
   - NCRC/HUD actions
     - Underwriting practices
     - Investor guidelines
   - Loss mitigation
   - Modifications
   - Short sales
   - Collection practices
2. Licensing Violations
   - Loan purchasers and servicers
   - LOs
   - Loss mitigation, short sale and foreclosure rescue services
3. Unfair and Deceptive Acts and Practices
   - Direct mail and advertisements
   - Improper use of government logos and seals
   - HELOCs
4. Quality Control Voids
   - Policies and procedures
   - Audits
   - Oversight
   - Corrective Action
5. Lack of Third Party Oversight
6. Disclosure Errors
7. Lack of Documentation
   - Policies and procedures
   - Training
   - Testing
   - Regulator reporting and communications
   - Management reports
   - Corrective action

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An Overview of New Mortgage Rules

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OVERVIEW

- Dodd-Frank amended existing provisions, created new regulations, added new sections to RESPA, TILA and more.
- Fed proposed and issued regulations to implement some of these changes.
- CFPB is busy issuing regs, but not on mortgage-specific issues.

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Dodd-Frank Act
Title X

- Creation of Consumer Financial Protection Bureau
- HMDA.
- Preemption.

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Dodd-Frank Act
Title XIV

- Mortgage Originator Compensation.
- Anti-Steering.
- Escrow Accounts.
- Appraisal Practices.
- Ability to Repay and Qualified Mortgage.

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Dodd-Frank Act
Title XIV

- Risk Retention and Qualified Residential Mortgage.
- Prepayment Penalties.
- High Cost Loans.
- Disclosures.

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What is the CFPB?

- What does it do?
- Who runs the show?

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Dodd-Frank Act

- Who is covered?
- Who is not covered?

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"Non-Mortgage" Goodies:

1. Policy on *ex parte* communications in rule making
2. State notice to CFPB of administrative action
3. Disclosure by CFPB
4. Non-Depository Covered Persons

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Non-Depository Covered Persons

- CFPB to define "larger participants" originating, brokering or servicing consumer purpose mortgage loans.
- CFPB then to require reports from and supervise larger participants.

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Non-Depository Covered Persons

- Notice and Request for Comment published June 29, 2011.
- Initial Rule due July 21, 2012.

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Preemption – Alternative Mortgage Transaction Parity Act

- June 27, 2011 CFPB Bulletin 11-1 presents options and promises further guidance.
- Interim final rule published July 22, 2011 to preserve preemption of state alternative mortgage prohibitions and restrictions.

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HMDA

- 13 new data fields.
- No rule yet.
- No deadline for regulation but new data reporting will not be required until the first January 1 occurring 9 months after issuance of final regulation.

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Mortgage Originators

- Prohibits compensating MOs on any term or condition other than loan amount.
- MO must not receive compensation from consumer and any other person.

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Mortgage Originators

- **Anti Steering:**
  - Impermissible for MO to steer consumer to a product resulting in greater compensation for MO.
  - MO must present multiple offers to consumer.

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Different from TILA

- No rule yet but have rule under TILA.
- Dodd-Frank Act:
  - Holds individual MOs liable.
  - “Mortgage originator” includes person who represents to public, through advertising or other communication means, that person can or will provide any of listed services.

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Proposed Rule – Escrows and HPML Thresholds

- Implements amendments made by Dodd-Frank.
- Comments were due May 2, 2011.

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Proposed Rule – Escrows and HPML Thresholds

- Requires disclosures for all mortgage loans with escrow.
- Requires disclosures when no escrow or when escrow cancelled.
- Extends minimum period for mandatory escrow accounts from 1-5 years.

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Appraisal Rule

- Compliance mandatory April 1, 2011.
- Implements section 129E of TILA, as enacted by Dodd-Frank.
- Applicable to all consumer credit transactions secured by a consumer's principal dwelling.

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Appraisal Rule

Regulates five major issues relative to valuations/appraisals

1. **<u>Valuation of consumer's principal dwelling</u> - prohibits influence or coercion relative to valuation and mischaracterization of value.**

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Appraisal Rule

2. <u>Conflicts of interest</u> – Person preparing valuation or providing valuation management functions must not have direct or indirect interest in property or transaction for which valuation performed (exceptions from this restriction for employees and affiliates of creditor based on creditor size).

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Appraisal Rule

3. Prohibits a creditor from extending credit based on a valuation if creditor knows a violation of coercion/misrepresentation or conflict of interest provision has occurred relative to valuation.

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Appraisal Rule

4. Customary and reasonable compensation – creditors and their agents must compensate fee appraisers at rate that is customary and reasonable for comparable services performed in same geographic market.

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Appraisal Rule

5. Mandatory reporting of material failure to comply with USPAP or other state/federal ethical or professional requirements.

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Ability to Repay

- Lender must not make a loan without a reasonable and good faith determination based on verified and documented information that consumer has reasonable ability to repay the loan, including taxes, insurance and assessments.
- Exceptions for:
  - “Qualified Mortgage”
  - Certain balloons.
  - Certain streamline refis.

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Proposed Regulation – Ability to Repay

- Proposed regulation sets forth ability to repay criteria and qualified mortgage definition.
- Comments were due July 22, 2011.
- Final rule will be issued by Consumer Financial Protection Bureau – like in 1Q 2012.

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Determination of Ability to Repay

Consider and verify:

1. Current or reasonably expected income;
2. Status of employment if rely on employment income;

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Determination of Ability to Repay

3. Monthly payment based on fully indexed rate and amortizing payments that are substantially equal;

4. Monthly payment on any simultaneous loan creditor knows or has reason to know will be made;

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Determination of Ability to Repay

5. Monthly payment for mortgage-related obligations;
6. Current debt obligations;
7. Monthly DTI ratio or residual income; and
8. Credit history.

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Qualified Mortgage

- Proposal sets forth two alternatives relative to qualified mortgages.
  - Alternative 1: Safe harbor – Creditor complies with ability to repay requirement if loan is QM.
  - Alternative 2: Presumption of compliance – Creditor is presumed to comply with ability to repay requirement if loan is QM

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Proposed Regulation – Ability to Repay: Qualified Mortgage

- No negative amortization.
- No interest only.
- No balloon payment (except in certain circumstances).
- Term of 30 years or less.
- Underwriting decision based on fully amortizing payment schedule to include taxes, insurance, and other assessments (at highest possible rate for 1st 5 years after consummation).

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Proposed Regulation – Ability to Repay: Qualified Mortgage

- 3% "points and fees" limit on loans of $75,000 or greater
- Points and fees for loans of less than $75,000 tiered alternatives

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Proposed Regulation – Ability to Repay: Qualified Mortgage

- As proposed, points and fees:
  - Includes all direct and indirect compensation to LO, including LO that is creditor in table-funded transaction (will include transaction specific fees paid to LO employees).
  - Includes prepayment penalties – new loan and refinance if by same creditor, servicer or affiliate of either.
  - Excludes FHA MIP, VA Funding fee, insurance/guaranty fees for government program.
  - Excludes PMI under certain conditions.

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Proposed Regulation – Ability to Repay: Qualified Mortgage

- May exclude *bona fide* discount points if certain conditions are met.
- Uses HOEPA points and fees definition.
- Proposed rule amends this definition.

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Proposed Regulation – Prepayment Penalty

- Rule proposed with comments due July 22, 2011.
- Any consumer credit transaction secured by dwelling must not include a prepayment penalty unless specific criteria met.

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Proposed Regulation – Prepayment Penalty

- If permitted, “3-2-1”
- If creditor offers covered transaction with prepayment penalty, must also offer alternative covered transaction without a prepayment penalty.

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Proposed Regulation – Risk Retention and QRM

- Dodd-Frank imposes credit risk retention requirements for securitizers.
- Proposed rule jointly issued by OCC, FRB, FDIC, SEC, FHFA and HUD to implement risk-retention.
- Comments were due by August 1, 2011.

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Proposed Regulation – Risk Retention and QRM

- Generally – securitizer required to retain not less than 5% of credit risk of assets collateralizing asset-backed securities.
- Exemption from 5% risk retention for asset-backed securities collateralized exclusively by qualified residential mortgages.

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What is a Qualified Residential Mortgage (QRM)?

- Closed end credit transaction to purchase or refinance 1-to-4 family property (at least one unit must be principal dwelling of borrower) that meets all of the eligibility criteria. Does not include construction loans, reverse mortgage loan, temporary or "bridge loans," timeshare plans.
- Does not include government loans.

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Eligibility Criteria

- 1st Mortgage
- No piggy backs
- ≤ 30-year term
- Borrower is not in default on any debts.
- No neg am
- 2/6 ARM caps
- No prepayment penalty
- Points and fees of 3% or less
- DTI limits (Housing 28% / Total 36%)
- LTV Limits (70%-80%)

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ATTORNEYS AT LAW

High-Cost Loan Thresholds

- Reduces APR and points and fees thresholds.
- Uses APOR instead of treasury securities for APR threshold.
- Adds third threshold – prepayment penalties.
- No proposed regs yet.

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Disclosures

- Combined RESPA/TILA (Last version: Sept. 12, 2011).
- Periodic Statements.
- Updated Home Buying Information Booklet.
- More.

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ATTORNEYS AT LAW

PINYON BANK
4321 Random Boulevard • Somecity, NM 54321

DATE ISSUED 10/17/2011 **LOAN ID #** 1330172608
Your interest rate, points, and lender credits can change unless you lock the interest rate. All other estimated closing costs expire on **10/31/2011** at 3:00 p.m. MDT.

Loan Estimate

APPLICANTS James White and Jane Johnson
PROPERTY 456 Avenue A, Anytown, NM 12345

LOAN TERM 30 years
PURPOSE Purchase
PRODUCT Fixed Rate
LOAN TYPE ☒ Conventional ☐ FHA ☐ VA ☐ ________

Loan Terms		Can this amount increase after closing?
Loan Amount	$162,000	**NO**
Interest Rate	3.875%	**NO**
Monthly Principal & Interest *See Projected Payments Below for Your Total Monthly Payment*	$761.79	**NO**
		Does the loan have these features?
Prepayment Penalty		**NO**
Balloon Payment		**NO**

Projected Payments

Payment Calculation	Years 1-7	Years 8-30
Principal & Interest	$761.79	$761.79
Mortgage Insurance	+ 82	—
Estimated Taxes & Insurance *Amount Can Increase Over Time*	+ 206	+ 206
Estimated Total Monthly Payment	$1,050	$968

Escrow Information for Estimated Taxes & Insurance	$206 a month	☒ Escrow. Your monthly payment includes your taxes and insurance. ☐ No escrow. You must pay your taxes and insurance separately from your loan payments.

Closing Costs

Estimated Cash to Close	$16,054	Includes $6,689 in estimated settlement costs. See details on page 2.

Visit **www.consumerfinance.gov/futureurl** for general information and tools.

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PAGE 2 • LOAN ID # 1330172608

Calculating Settlement Costs

A. Origination Charges	$1,802
.25 Points %	$405
Application Fee	$100
Processing Fee	$200
Document Preparation Fee	$167
Underwriting Fee	$400
Wire Transfer Fee	$30
Verification Fee	$500

B. Services You Cannot Shop For	$672
Flood Determination Fee	$20
Tax Status Research Fee	$110
Flood Monitoring Fee	$32
Tax Monitoring Fee	$75
Appraisal Fee	$405
Credit Report Fee	$30

C. Services You Can Shop For	$4,215
Pest Inspection Fee	$135
Survey Fee	$65
Title – Insurance Binder	$700
Title – Search	$1,261
Title – Lender's Policy	$535
Title – Owner's Policy (optional)	$1,017
Settlement Agent Fee	$502

Calculation	
A + B + C	$6,689
Lender Credits	– $0
Estimated Settlement Costs	**$6,689**

Calculating Cash to Close

D. Taxes and Other Government Fees	$85
Transfer Taxes	$0
Recording Fees	$85
Other Taxes and Government Fees	$0

E. Prepaids	$867
Property Taxes (0 months)	$0
Homeowner's Insurance Premium (6 months)	$605
Mortgage Insurance Premium (0 months)	$0
Prepaid Interest ($17.44 per day for 15 days @ 3.875%)	$262

F. Initial Escrow Payment at Closing		
		$413
Taxes & Assessments	$105.30 per month for 2 mo.	$211
Homeowner's Insurance	$100.83 per month for 2 mo.	$202
Mortgage Insurance	$0 per month for 0 mo.	$0
Flood Insurance	$0 per month for 0 mo.	$0
HOA/Condo/Co-op	$0 per month for 0 mo.	$0

Limits on Increases: *Generally, charges in A and Transfer Taxes in D cannot increase, and the total of the charges in B, C, and Recording Fees in D cannot increase by more than 10%. We will notify you if a change causes an increase above these limits.*

Calculation	
Estimated Settlement Costs (A + B + C – Lender Credits)	$6,689
D + E + F	$1,365
Down Payment/Funds from Borrower	$18,000
Deposit	– $10,000
Cash to Borrower	– $0
Seller Credits	– $0
Other Credits and Adjustments	– $0
Closing Costs to be Financed	– $0
Estimated Cash to Close	**$16,054**

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FRANZÉN AND SALZANO, P.C.
ATTORNEYS AT LAW

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PHONE 555-123-4444
EMAIL joesmith@pinyonbank.com
NMLS ID 676698

CREDITOR Pinyon Bank
NMLS ID 898897

LOAN ID # 1330172608

Additional Information About This Loan

Comparisons	Use these measures to compare this loan with other loans.	
In 5 Years	$57,316	Total you will have paid in principal, interest, mortgage insurance, and fees.
	$15,773	Principal you will have paid off.
Annual Percentage Rate (APR)	4.31%	This is not your interest rate. This rate expresses your costs over the loan term.
Total Interest Percentage (TIP)	69.3%	This rate is the total amount of interest that you will pay over the loan term as a percentage of your loan amount.
Lender Cost of Funds (LCF)	0.86%	The rate the lender pays to borrow money to lend you.

Other Considerations

Late Payment If your payment is more than 15 days late, we will charge a late fee of 5% of the monthly principal and interest payment.

Servicing
- ☐ We intend to service your loan. You will make your payments to us.
- ☒ We intend to transfer servicing of your loan.

Assumption If you sell or transfer your house to another person, we
- ☐ will allow, under certain conditions, this person to assume this loan on the original terms.
- ☒ will not allow this person to assume this loan on the original terms.

Appraisals We will promptly give you a copy of any written property appraisals or valuations you pay for, even if the loan does not close.

Refinance We do not guarantee that you will be able to refinance your loan to lower your interest rate and payments in the future.

Verify Receipt

You do not have to accept this loan because you received this disclosure, signed a loan application, or sign below.

Applicant Signature Date

Co-Applicant Signature Date

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FRANZÉN AND SALZANO, P.C.
ATTORNEYS AT LAW

YUCCA BANK
4321 Random Boulevard • Somecity, NM 54321

DATE ISSUED 10/17/2011 **LOAN ID #** 1330172608
Your interest rate, points, and lender credits can change unless you lock the interest rate. All other estimated closing costs expire on **10/31/2011** at 3:00 p.m. MDT.

Loan Estimate

APPLICANTS James White and Jane Johnson
PROPERTY 456 Avenue A, Anytown, NM 12345

LOAN TERM 30 years
PURPOSE Purchase
PRODUCT 3/3 Adjustable Rate
LOAN TYPE ☒ Conventional ☐ FHA ☐ VA ☐ ___________

Loan Terms		Can this amount increase after closing?
Loan Amount	$162,000	**NO**
Interest Rate	3.5% for 3 years	**YES** • Adjusts **every 3 years** starting in year 4 • Can go **as high as 6%** in year 7 • See **AIR table on page 2** for details
Monthly Principal & Interest *See Projected Payments Below for Your Total Monthly Payment*	$727.46	**YES** • Adjusts **every 3 years** starting in year 4 • Can go **as high as $947** in year 7
		Does the loan have these features?
Prepayment Penalty		**NO**
Balloon Payment		**NO**

Projected Payments				
Payment Calculation	**Years 1-3**	**Years 4-6**	**Years 7-9**	**Years 10-30**
Principal & Interest	$727.46	$707 min $904 max	$707 min $947 max	$707 min $947 max
Mortgage Insurance	+ 82	+ 82	+ 82	—
Estimated Taxes & Insurance *Amount Can Increase Over Time*	+ 0	+ 0	+ 0	+ 0
Estimated Total Monthly Payment	$809	$789–$986	$789–$1,029	$707–$947
Escrow Information for Estimated Taxes & Insurance	$212 a month	☐ Escrow. Your monthly payment includes your taxes and insurance. ☒ No escrow. You must pay your taxes and insurance separately from your loan payments.		

Closing Costs		
Estimated Cash to Close	$15,039	Includes $6,080 in estimated settlement costs. See details on page 2.

Visit **www.consumerfinance.gov/futureurl** for general information and tools.

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PAGE 2 • LOAN ID # 1330172608

Calculating Settlement Costs

A. Origination Charges	$1,305
.25 Points %	$405
Processing Fee	$100
Underwriting Fee	$600
Verification Fee	$200

B. Services You Cannot Shop For	$475
Credit Report Fee	$5
Appraisal Fee	$425
Tax Status Research Fee	$30
Flood Determination Fee	$15

C. Services You Can Shop For	$4,300
Survey Fee	$75
Pest Inspection Fee	$125
Settlement Agent Fee	$473
Title – Search	$800
Title – Examination	$1,377
Title – Lender's Policy	$500
Title – Owner's Policy (optional)	$950

Calculation	
A + B + C	$6,080
Lender Credits	– $0
Estimated Settlement Costs	**$6,080**

Calculating Cash to Close

D. Taxes and Other Government Fees	$85
Transfer Taxes	$0
Recording Fees	$85
Other Taxes and Government Fees	$0

E. Prepaids	$874
Property Taxes (0 months)	$0
Homeowner's Insurance Premium (6 months)	$638
Mortgage Insurance Premium (0 months)	$0
Prepaid Interest ($15.75 per day for 15 days @ 3.50%)	$236

F. Initial Escrow Payment at Closing			$0
Taxes & Assessments	$0	per month for 0 mo.	$0
Homeowner's Insurance	$0	per month for 0 mo.	$0
Mortgage Insurance	$0	per month for 0 mo.	$0
Flood Insurance	$0	per month for 0 mo.	$0
HOA/Condo/Co-op	$0	per month for 0 mo.	$0

Limits on Increases: *Generally, charges in A and Transfer Taxes in D cannot increase, and the total of the charges in B, C, and Recording Fees in D cannot increase by more than 10%. We will notify you if a change causes an increase above these limits.*

Calculation	
Estimated Settlement Costs (A + B + C – Lender Credits)	$6,080
D + E + F	$959
Down Payment/Funds from Borrower	$18,000
Deposit	– $10,000
Cash to Borrower	– $0
Seller Credits	– $0
Other Credits and Adjustments	– $0
Closing Costs to be Financed	– $0
Estimated Cash to Close	**$15,039**

Adjustable Interest Rate (AIR) Table

Index + Margin	MTA + 3%
Initial Interest Rate	3.5%
Minimum/Maximum Interest Rate	3.25% / 6%
Limits on Interest Rate Changes	
First Change	2%
Subsequent Changes	2%
Change Frequency	
First Change	Beginning of 37th month
Subsequent Changes	Every 36th month after first change

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EMAIL joesmith@yuccabank.com
NMLS ID 767698

CREDITOR Yucca Bank
NMLS ID 989897

LOAN ID # 1330172608

Additional Information About This Loan

Comparisons	**Use these measures to compare this loan with other loans.**	
In 5 Years	$54,153	Total you will have paid in principal, interest, mortgage insurance, and fees.
	$16,950	Principal you will have paid off.
Annual Percentage Rate (APR)	3.69%	This is not your interest rate. This rate expresses your costs over the loan term.
Total Interest Percentage (TIP)	57.5%	This rate is the total amount of interest that you will pay over the loan term as a percentage of your loan amount.
Lender Cost of Funds (LCF)	1.04%	The rate the lender pays to borrow money to lend you.

Other Considerations

Late Payment If your payment is more than 15 days late, we will charge a late fee of 5% of the monthly principal and interest payment.

Servicing
- ☐ We intend to service your loan. You will make your payments to us.
- ☒ We intend to transfer servicing of your loan.

Assumption If you sell or transfer your house to another person, we
- ☐ will allow, under certain conditions, this person to assume this loan on the original terms.
- ☒ will not allow this person to assume this loan on the original terms.

Appraisals We will promptly give you a copy of any written property appraisals or valuations you pay for, even if the loan does not close.

Refinance We do not guarantee that you will be able to refinance your loan to lower your interest rate and payments in the future.

Verify Receipt

You do not have to accept this loan because you received this disclosure, signed a loan application, or sign below.

Applicant Signature Date

Co-Applicant Signature Date

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Questions?

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Reducing Litigation and Regulatory Enforcement Risk by Prudent Review of Servicing Policies and Procedures

Franzen and Salzano, P.C.
40 Technology Parkway South, Suite 202
Norcross, Georgia 30092
(770) 248-2881

Comprehensive Audit Procedure

- Violation of Certain State Licensing Requirements
  - **Identify activities of employees who communicate in writing or orally with consumers.**
  - **Analyze whether activity constitutes licensable activity in relevant states.**
  - **Mortgage lender/broker and mortgage loan originator – “negotiate”.**
  - **Debt collector/credit services organization.**

Comprehensive Audit Procedure

- Unauthorized Practice of Law
  - **Identify activities which may constitute practice of law by non-lawyers.**
  - **Demand Letters.**
  - **Pre-foreclosure activity.**
  - **Drafting loan modifications without attorney oversight.**
  - **Evictions.**
  - **Bankruptcy.**
  - **Closing Modifications – witness only closings.**

Comprehensive Audit Procedure

- Unauthorized Fee Splitting
  - **Identify payment for activities which may constitute violation of RESPA, State Bar Ethical Standards, or state law.**

Comprehensive Audit Procedure

- Drafting and Executing Affidavits
  - **Require personal knowledge of facts.**
  - **Don’t just sign a form.**
  - **Watch the dates – “effective date” vs. actual date signed.**
  - **Never sign a document with blanks.**
  - **Review facts/file before executing.**
  - **Execute in front of a notary (literally!)**
  - **No incentives for number of documents or speedy execution.**

Comprehensive Audit Procedure

- **Violation of Requirements of State Foreclosure Laws**
  - **New - local registration requirements.**
  - **Quirks in certain jurisdictions within state.**
  - **Issues with legal description - check, and check again!**
  - **Improper/late notice to IRS/State Revenue Agency.**
  - **Late HUD Occupancy Notice to Borrower.**
  - **Identify and document proper party to foreclose.**
  - **Execute and file required assignments before foreclosure/deed recorded.**
  - **Possession of original note/security deed or comply with applicable state law re: lost notes.**
  - **Calculation of foreclosure bids - check and re-check!**
  - **Drafting/executing foreclosure deeds prior to sale.**
  - **MERS compliant.**

Comprehensive Audit Procedure

- Loss Mitigation Simultaneously with Foreclosure
  - **Who's on first?**
  - **Accepting reinstatement/modification and continuing foreclosure.**
  - **Single point of contact.**
  - **Toll free number.**
  - **2d/3d Look program for all mod denials.**

Comprehensive Audit Procedure

- Payment Application
  - **Ensure no multiple late fees for same delinquency.**
  - **Review suspense account procedures; application of non-conforming payments.**
  - **Apply to interest, principal, then other charges unless state law provides otherwise.**

Comprehensive Audit Procedure

- Fees Properly Charged
  - **In compliance with state laws and documents.**
  - **Reasonable.**

Comprehensive Audit Procedure

- Force-placed Insurance
  - **Reasonable price in relation to claims.**
  - **Not with affiliate.**

Comprehensive Audit Procedure

- Property Valuation
  - **BPO not more frequently than annually unless GSE or to facilitate non-f/c remedy.**
  - **Reasonable fee.**

Comprehensive Audit Procedure

- Violation of the Bankruptcy Automatic Stay
  - **Check status frequently.**
  - **Filing claim - identifying the proper claimant.**

Comprehensive Audit Procedure

- Violation of Serviceman’s Civil Relief Act of 2003
  - **Check status frequently.**

Comprehensive Audit Procedure

- Addressing Consumer Complaints
  - **Establish protocol and dedicated group.**
  - **Document, document, document.**
  - **Servicer and third party providers.**

Comprehensive Audit Procedure

- Violation of Fair Debt Collection Practices Act
  - **Letters**
    - **Review before signing.**
    - **Wet/electronic/no signature.**
  - **Oral Communications**
    - **Message on phones.**

Comprehensive Audit Procedure

- Violation of State Eviction Laws
  - **Dealing with the repo man.**
  - **Protect yourself with appropriate agreements/indemnities/insurance.**

Comprehensive Audit Procedure

- Violation of HAMP, MHA, HARP, HAFA, UF, etc.
  - **New cause of action.**
  - **Procedures?**
  - **Dedicated team?**

Comprehensive Audit Procedure

- Violation of State Laws Requiring Communication in Consumer’s Native Language
  - **Interpreters?**

Comprehensive Audit Procedure

- Communication with Visually/Hearing Impaired
  - **Accommodations?**

Comprehensive Audit Procedure

- Violation of State and Federal Laws Regarding Monitoring and Recording Calls
  - **Verbal notice to participants including employees.**
  - **Visual notice to employees.**
  - **Employee Handbooks.**

Comprehensive Audit Procedure

- Violation of Servicing Agreements
  - **Fulfilling contractual requirements.**

Comprehensive Audit Procedure

- Violation of State and Federal Privacy Laws
  - **Employees talk.**
  - **Employees take files home.**
  - **Employees work from home electronically.**
  - **Off-shore outsourcing.**
  - **Protecting consumer’s personal information – truncating ssn.**

Comprehensive Audit Procedure

- Mortgage Fraud
  - **Short sale fraud.**

Comprehensive Audit Procedure

- Law Changes and Implementation
  - **Track changes.**
  - **Document implementation.**

Comprehensive Audit Procedure

- Policies/Procedures and Training
  - **Document, document, document.**

Comprehensive Audit Procedure

- Paperless Offices
  - **Really**????

Comprehensive Audit Procedure

- HR policies/Procedures
  - **Handbook.**
  - **Memos.**

Comprehensive Audit Procedure

- IT/System Review
  - **Document**

Comprehensive Audit Procedure

- Review of Third Party Providers
  - **Periodic reviews to ensure compliance with state and federal laws and servicer's requirements, and properly licensed.**
  - **Termination of non-compliant providers.**
  - **Track sanctions.**

Comprehensive Audit Procedure

- Do It All Again Next Year

Disparate impact claims on the way out under the Fair Housing Act

Christopher Willis
Partner and Chair of the Fair Lending Task Force
Ballard Spahr LLP, Atlanta

In late February, the Supreme Court will hear argument on a case of extraordinary importance to the housing and mortgage lending industries. *Magner v. Gallagher* will allow the Court to decide whether "disparate impact" claims can be brought under the Fair Housing Act, and I believe that the Court will say "no." The reason is simple: the plain language of the statute does not provide for such claims.

By way of background, there are several federal statutes that prohibit discrimination in various contexts, like Title VII of the Civil Rights Act of 1964 and the Age Discrimination in Employment Act ("ADEA"). Some provisions of those statutes make it illegal to engage in *intentional* discrimination against someone because of their race, gender or age. This is called "disparate treatment." But other provisions of those statutes also prohibit *disparate impact* discrimination. This refers to a practice that may have been undertaken with no discriminatory intent, but which impacts people in a disproportionate way because of race or some other protected status.

The difference between the two types of provisions carries enormous importance. It's one thing for companies to understand that they cannot engage in intentional discrimination, but avoiding disparate impact claims is much harder, because it requires complex statistical analysis to determine whether such an impact exists, and if so, why.

The starting point -- and I believe ending point -- of the Supreme Court's analysis in *Magner* will be the language of the Fair Housing Act itself, and particularly section 804(a) of the Act. That section provides that it is a violation of the Act "[t]o refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin."

The language requires an intentional act of discrimination, because it uses a series of active words to denote the discriminatory conduct it prohibits -- refusing to sell or rent a dwelling, and refusing to negotiate a sale or rental. Even the catch-all language -- to "otherwise make available or deny" a dwelling -- speaks to an intentional act of denying housing "because of" a protected characteristic.

But since the Supreme Court has already considered disparate impact claims under other federal statutes, we need to look at the language that the Court found to create such claims. In doing that, we need to bear in mind that both Title VII and the ADEA have two relevant provisions. Since they are similar to each other, I use the Title VII language for this discussion.

The first provision in Title VII, section 703(a)(1), prohibits the following: "to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin." This provision uses a series of active words: to fail or refuse to hire, or to discharge a person because of race or another characteristic. And the catch-all language, "otherwise to discriminate," is similarly active. The Supreme Court has held that this language creates liability *only for acts of intentional discrimination*.

By contrast, section 703(a)(2) makes it unlawful "to limit, segregate, or classify ... employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin." This is the language that the Supreme Court has interpreted as giving rise to disparate impact liability. Unlike the provision we just discussed, section 703(a)(2) contains much more passive-sounding prohibited acts, because it reaches conduct that would "tend to deprive" someone of an employment opportunity or would "otherwise adversely affect his status as an employee."

The ultimate issue, then, is whether the language of the Fair Housing Act is more like the "intentional discrimination" provision from Title VII, or more like the "disparate impact" provision. A comparison of the language answers that question clearly: the Fair Housing Act is much more similar to the disparate treatment language in Title VII. Most importantly, the Fair Housing Act does not use the critical phrases from Title VII prohibiting conduct that may "tend to deprive" an individual of housing or "adversely affect" the ability to obtain housing. Faced with this language, and in light of its earlier decisions, I believe that the Supreme Court will find an absence of Congressional intent to prohibit conduct that has a disparate impact under the Fair Housing Act. And having reached that conclusion on the statute's language, all of the other issues like legislative history or HUD's administrative interpretation of the Act will fall aside, because the interpretation of a statute ends with the statute's text when its meaning is clear. That is the reason why I think that *Magner* will be decided in a way that prohibits disparate impact claims.

New Consumer Law Whistleblower Provisions

- Section 1057 of Dodd-Frank amended Sarbanes Oxley's retaliation protections relating to "opposition claims" filed with the Department of Labor ("DOL") to include protection for whistleblowers who allege violations of consumer protection laws subject to enforcement by the Consumer Financial Protection Bureau
- Protects employees from:
  - providing or attempting or causing to provide information to an employer or government agency relating to a violation of certain consumer laws
  - testifying or intending to testify in, or filing, instituting or causing to be filed or instituted, any proceeding under any federal consumer financial law (TILA, RESPA, FCRA, ECOA, etc.)
  - objecting to, or refusing to participate in any activity the employee reasonably believes violates any laws subject to the CFPB's jurisdiction
- Dodd-Frank brings such individuals into the same anti-retaliation provisions applicable to securities whistleblowers under Sarbanes-Oxley, as expanded by Dodd-Frank
- Same 180-day limitations period and DOL filing procedure applies to these claims as to "opposition" claims under Sarbanes-Oxley
- CFPB public statement soliciting whistleblowers on December 15, 2011 (Bulletin 2011-05)

Ballard Spahr LLP

DODD-FRANK ACT REGULATORY UPDATE

Paul S. Pilecki
Kilpatrick Townsend & Stockton LLP
Washington, D.C.

David T. Bloom
SunTrust Banks, Inc.
Atlanta, Georgia

Dodd-Frank Act Regulatory Update

Georgia Bar Banking and Finance Law Program

February 17, 2012

Atlanta, GA

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David T. Bloom
SVP & Deputy General Counsel
SunTrust Banks, Inc.
Atlanta, GA

I. Overview of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203; 124 Stat. 1376 (Jul. 21, 2010))

A. Principal Issues Addressed

1. Supervision and regulation of financial entities that present systemic risk

2. Establishment of a mechanism to resolve the failures of large financial institutions with minimal disruption to the financial system

3. Imposes new requirements on the over-the-counter derivatives markets by regulating swap dealers, increasing transparency, improving pricing, and reducing risk through swaps clearing

4. Establishment of the Bureau of Consumer Financial Protection ("CFPB") to regulate the offering of credit and deposit products to individuals

5. Elimination of the Office of Thrift Supervision ("OTS") and redistribution of banking agency regulatory authority

6. Imposes substantial new regulatory measures on credit rating agencies

7. Imposes new regulatory requirements on investment advisers, hedge funds, and private equity firms

8. Prohibits insured depository institutions, bank holding companies, and their affiliates from engaging in short-term proprietary trading, and owning, sponsoring, or having certain relationships with a hedge fund or a private equity fund

9. Imposes new conditions in the areas of corporate governance, executive compensation, securities disclosures, and public company accounting regulation

B. Effective date—unless otherwise provided, the effective date is July 22, 2010, the day after enactment.

II. Modified Regulatory Agency Structure and Responsibilities

A. Financial Stability Oversight Council ("FSOC")

1. Voting Members—Treasury Secretary (Chairperson), Federal Reserve Board Chairman, Comptroller, CFPB Director, SEC Chairman, FDIC Chairman, CFTC Chairman, FHFA Director, and an independent member with insurance expertise (§ 111). Nonvoting advisory members representing state regulators among others are also designated.

2. The FSOC is authorized to identify systemically important nonbank financial companies and activities, financial market utilities (*See* Proposed Rule, "Authority to Designate Financial Market Utilities as Systemically Important," FSOC, 76 Federal Register 17,047 (Mar. 28, 2011)), and payment, clearance, and settlement activities.

3. Purposes and Responsibilities (§ 112)

a. Identify risks to financial stability, promote market discipline, and respond to emerging threats to U.S. financial markets;

b. Monitor the financial services marketplace in order to identify potential threats to the financial stability of the United States;

c. Require the FRB to supervise nonbank financial companies that may pose risks to the financial stability of the United States;

d. FSOC may issue recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards for a financial activity or practice conducted by bank holding companies or nonbank financial companies under their respective jurisdictions, if the FSOC determines that the conduct of the activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities (§ 120); and

d. For other enumerated purposes.

4. A bank holding company would not be regarded as systemically important and subject to enhanced standards (§§ 115 and 165) unless it has $50 billion or more of assets.

B. <u>Federal Reserve Board ("FRB")</u>

1. May establish enhanced standards applicable to systemically significant institutions and issue risk management standards for the payment, clearing, and settlement activities of certain financial market utilities (*See* Proposed Rule, "Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies," FRB, 77 Federal Register 594 (Jan. 5, 2012); Final Rule, "Capital Plans," FRB, 76 Federal Register 74,6311 (Dec.1, 2011); Final Rule, "Resolution Plans Required," FRB, 76 Federal Register 67,323 (Nov. 1, 2011); Proposed Rule, "Financial Market Utilities," 76 Federal Register 18,445 (Apr. 4, 2011));

2. Authorized to conduct an examination of a nonbank financial company for the sole purpose of determining whether it should supervise the nonbank financial company (*See* Proposed Rule, "Definitions of 'Predominantly Engaged in Financial Activities' and 'Significant' Nonbank Financial Company and Bank Holding Company," FRB, 76 Federal Register 7,731 (Feb. 11, 2011));

3. Assumed OTS powers over thrift holding companies and their nondepository institution subsidiaries and assumes rulemaking authority related to transactions with affiliates, insider lending, and antitying (*See* Interim Rule, "Availability of Information, Public Observation of Meetings, Procedure, Practice for Hearings, and Post-Employment Restrictions for Senior Examiners; Savings and Loan Holding Companies," FRB, 76 Federal Register 56,508 (Sep. 13, 2011); Notice of Intent and Request for Comment, "Continued Application of Regulations to Savings and Loan Holding Companies," FRB, 76 Federal Register 43,953 (Jul. 22, 2011); Notice of Intent and Request for Comments, "Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies," FRB, 76 Federal Register 22,662 (Apr. 22, 2011))

4. Expanded authority to examine, issue regulations, or take other supervisory action on all subsidiaries of a bank holding company, including functionally regulated subsidiaries (§§ 604, 605);

5. Will have authority over "supervised securities holding companies" (§ 618) (*See* Proposed Rule, "Supervised Securities Holding Company Registration," 76 Federal Register 54,717 (Sep. 2, 2011));

6. Required to collect assessments from holding companies with more than $50 billion of assets and regulated nonbank financial companies to cover the estimated expenses of supervising such entities (§ 318);

7. Restricted in making loans under its emergency lending authority under section 13 of the Federal Reserve Act (§ 1101);

8. The President is required to designate a Vice Chairman for Supervision who is required to develop policy recommendations regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the FRB, and oversee the supervision and regulation of such firms (§ 1108).

C. Office of the Comptroller of the Currency ("OCC")

1. Assumed OTS powers over federal thrifts and authority to issue rules for state-chartered thrifts. (*See* Joint Notice, "List of Office of Thrift Supervision Regulations to Be Enforced by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act," OCC and FDIC, 76 Federal Register 39,246 (Jul. 6, 2011))

D. Federal Deposit Insurance Corporation

1. Assumed OTS supervisory powers over state chartered thrifts. (*See* Joint Notice, above)

2. To complement the early resolution plan requirement, the FDIC adopted a rule that requires each insured depository institution with $50 billion or more in total assets to submit periodically to the FDIC a contingent plan for the resolution by the FDIC, as receiver, of such institution under the Federal Deposit Insurance Act (''FDI Act'') in the event of the institution's failure. (*See* Final Rule, "Resolution Plans Required for Insured Depository Institutions with $50 Billion or More in Total Assets," FDIC, 77 Federal Register 3,075 (Jan. 23, 2012))

E. Bureau of Consumer Financial Protection

1. The CFPB is established as an independent entity within the Federal Reserve System to regulate the offering and provision of consumer financial products or services under the federal consumer financial laws.

a. The FRB does not have authority over the actions of the CFPB or the personnel of the CFPB.

b. The CFPB is authorized to employ attorneys, compliance examiners, compliance supervision analysts, economists, statisticians, and other employees as may be deemed necessary to conduct the business of the CFPB.

c. The CFPB established specific functional units for research, community affairs, collecting and tracking complaints, fair lending and equal opportunity, financial education, financial protection for older Americans, and an ombudsman function.

2. Scope of Authority for Financial Products. The term “financial product or service” means-

a. Extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit (other than solely extending commercial credit to a person who originates consumer credit transactions);

b. Extending or brokering leases of personal or real property that are the functional equivalent of purchase finance arrangements;

c. Providing real estate settlement services (subject to exclusions), or performing appraisals of real estate or personal property;

d. Engaging in deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds or any financial instrument for use by or on behalf of a consumer;

e. Selling, providing, or issuing stored value or payment instruments, except that, in the case of a sale of, or transaction to reload, stored value, only if the seller exercises substantial control over the terms or conditions of the stored value provided to the consumer;

f. Providing check cashing, check collection, or check guaranty services;

g. Providing payments or other financial data processing products or services to a consumer by any technological means, including processing or storing financial or banking data for any payment instrument, or through any payments system or network used for processing payments data, including payments made through an online banking system or mobile telecommunications network, except for a merchant, retailer, or seller of any nonfinancial good or a provider of access to a host server to a person for purposes of enabling that person to establish and maintain a website;

h. Providing financial advisory services (other than services relating to securities provided by a person regulated by the SEC[1] or a person regulated by a State securities commission, but only to the extent that such person acts in a regulated capacity) to consumers on individual financial matters or relating to proprietary financial products or services (other than by publishing any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation), including (I) providing credit counseling to any consumer; and (II) providing services to assist a consumer with debt management or debt settlement, modifying the terms of any extension of credit, or avoiding foreclosure;

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[1] A broker-dealer, an investment adviser, a registered mutual fund, a securities exchange, a transfer agent, and a municipal securities dealer, among others are all “persons regulated by the [SEC].”

i. Collecting, analyzing, maintaining, or providing consumer report information or other account information, including information relating to the credit history of consumers, used or expected to be used in connection, with any decision regarding the offering or provision of a consumer financial product or service, subject to exceptions;

j. Collecting debt related to any consumer financial product or service; and

k. Any other financial product or service, if the CFPB finds that the financial product or service is (I) entered into or conducted as a subterfuge or with a purpose to evade any federal consumer financial law; or (II) permissible for a bank or for a financial holding company to offer or to provide under any provision of a federal law or regulation applicable to a bank or a financial holding company, and has, or likely will have, a material impact on consumers.

l. The term “financial product or service” does not include the business of insurance or “electronic conduit services” (generally, electronic data transmission, data storage, or payments).

3. “Covered Person.” The CFPB has authority over any person that engages in offering or providing a “financial product or service” to a consumer, including any affiliate of a covered person if the affiliate acts as a “service provider.”

4. The CFPB has rulemaking authority over “federal consumer financial laws” and is authorized to issue orders and guidance, and take enforcement action as necessary to implement those laws (§ 1022) (*See* Notice, “Streamlining Inherited Regulations,” CFPB, 76 Federal Register 75,825 (Dec. 5, 2011); Interim Final Rules Transferring Authority to CFPB effective December 30, 2011, *e.g.,* “Mortgage Acts and Practices-Advertising (Regulation N); Mortgage Assistance Relief Services (Regulation O),” CFPB, 76 Federal Register 78,130 (Dec. 16, 2011)). The CFPB will not have rulemaking authority over the Community Reinvestment Act or the Expedited Funds Availability Act.

a. The CFPB is required to consult with the appropriate prudential regulators or other federal agencies prior to proposing a rule and during the comment process regarding consistency with prudential, market, or systemic objectives.

b. On the petition of a member agency of the FSOC, the FSOC may set aside a final regulation, in whole or in part, prescribed by the CFPB, if the FSOC decides, under specified procedures, that the regulation or provision would put the safety and soundness of the U.S. banking system or the stability of the U.S. financial system at risk. (§ 1023)

5. The CFPB has examination and supervisory authority over nondepository institution providers of consumer financial products (§ 1024) and services and,

with respect to consumer financial laws, insured depository institutions with assets of more than $10 billion and their affiliates (§ 1025). The banking agencies will continue to examine and supervise compliance with federal consumer financial laws with respect to insured depository institutions with assets of $10 billion or less, subject to coordination with the CFPB (§ 1026).

F. Office of Financial Research ("OFR") (§§ 151-156)

1. Established within Treasury under a Director appointed by the President for a six-year term.

2. Purpose—support the FSOC in fulfilling its purposes and duties by collecting data on behalf of the FSOC, and providing such data to the FSOC and member agencies; performing applied research and essential long-term research; developing tools for risk measurement and monitoring; and performing other related services (§ 153).

3. During the first two years, the OFR will be funded by an allocation of FRB funds necessary to cover the operations of the OFR. Thereafter, Treasury will establish an assessment schedule, including the assessment base and rates, applicable to bank holding companies with total consolidated assets of $50 billion or greater and nonbank financial companies supervised by the FRB to collect assessments equal to the total expenses of the OFR (§ 155) (*See* Proposed Rule, "Assessment of Fees on Large Bank Holding Companies and Nonbank Financial Companies Supervised by the Federal Reserve Board to Cover the Expenses of the Financial Research Fund," Treasury, 77 Federal Register 35 (Jan. 3, 2012)).

III. Deposit Insurance Reforms – Sections 331-336; 343

A. Deposit insurance premiums will be based on an institution's average consolidated total assets minus its average tangible equity during the assessment period, rather than its deposit base. In the case of an insured depository institution that is a custodial bank (as defined by the FDIC, based on factors including the percentage of total revenues generated by custodial businesses and the level of assets under custody) or a banker's bank, an amount that the FDIC determines is necessary to establish assessments for a custodial bank or a banker's bank.

B. The FDIC is given flexibility in its dividend policy so that assessments for deposit insurance purposes are not procyclical.

C. The reserve ratio of the Deposit Insurance Fund may not be less than 1.35 percent of the estimated amount of insured deposits or the new assessment base. The upper limit of 1.5 percent on the reserve ratio is removed. The FDIC is required to take such steps as may be necessary for the reserve ratio of the Deposit Insurance Fund to reach 1.35 percent of estimated insured deposits by September 30, 2020. In setting the assessments necessary to meet the minimum reserve ratio requirement, the FDIC must offset the effect of meeting the minimum on insured depository institutions with total consolidated assets of less than $10 billion. In other words, banks with assets of $10 billion or more will pay the premiums necessary to bring the reserve ratio from the current minimum of 1.15 percent to 1.35 percent. (*See* Final Rule, "Assessments, Large Bank Pricing," FDIC, 76 Federal Register 10,672 (Feb. 25, 2011); Final Rule, "Designated Reserve Ratio," FDIC, 75 Federal Register 79,286 (Dec. 20, 2010); Proposed Rule, "Assessment Dividends, Assessment Rates and Designated Reserve Ratio," FDIC, 75 Federal Register 66,272 (Oct. 27, 2010))

D. The standard maximum insured deposit amount is increased permanently to $250,000 per depositor at each insured institution. The amount applies retroactively to institutions for which a receiver was appointed between January and October 2008. (*See* Final Rule, "Deposit Insurance Regulations; Permanent Increase in Standard Coverage Amount; Advertisement of Membership; International Banking; Foreign Banks," Final Rule, 75 Federal Register 49,363 (Aug. 13, 2010))

E. A non interest-bearing transaction account will be fully insured and will not be taken into account when computing the net amount due to such depositor. This provision has the effect of continuing the TAG program on a mandatory basis even if a bank opted out from participation. However, Dodd-Frank does not provide for separate deposit premiums as is the case for TAG. Effective date: December 31, 2010 until December 31, 2012. (*See* Final Rule, "Deposit Insurance Regulations; Unlimited Coverage for Noninterest-Bearing Transaction Accounts," FDIC, 75 Federal Register 69,577 (Nov. 15, 2010); Final Rule, "Deposit Insurance Regulations; Unlimited Coverage for Noninterest-Bearing Transaction Accounts; Inclusion of Interest on Lawyers Trust Accounts," FDIC, 76 Federal Register 4,813 (Jan. 27, 2011))

F. Orderly Liquidation Authority—Title II. (*See* Interim Final Rule, "Orderly Liquidation Authority Provisions of the [DFA]," FDIC, 76 Federal Register 4,207 (Jan. 25, 2011))

IV. New Regulatory Restrictions, Limitations, and Other Changes

A. <u>Capital Requirements – Sections 171, 606, 616</u>

1. A financial holding company ("FHC") must be well capitalized and well managed as a condition of engaging in expanded financial activities.

2. The FRB is authorized to issue regulations imposing capital requirements on bank holding companies. The FRB is required to "seek" to make such requirements countercyclical allowing for decreases in requirements during times of economic contraction.

3. Collins Amendment. The banking agencies are required to set capital requirements for insured institutions and holding companies with the existing minimum capital ratios applicable to depository institutions serving as a floor. (*See* Final Rule, "Risk-Based Capital Standards: Advanced Capital Adequacy Framework—Basel II; Establishment of a Risk-Based Capital Floor," OCC, FRB, and FDIC, 76 Federal Register 37,620 (Jun. 28, 2011))

a. Debt and equity instruments issued by a holding company that would not qualify as capital for a bank but issued prior to May 19, 2010 will be phased out for institutions that have $15 billion or more of assets. The phase out will commence on January 1, 2013 and run for three years.

b. A holding company that had total consolidated assets of less than $15 billion as of December 31, 2009 may continue to include trust preferred securities ("TRUPS") issued before May 19, 2010 in Tier 1 capital. Preferred stock issued under TARP continues status as Tier 1 capital.

c. Bank holding company subsidiaries of foreign banking organizations that have relied on SR 01-1 have a five-year deferred effective date before the requirements apply.

d. The holding company capital requirements will not apply to bank holding companies subject to the FRB Small Bank Holding Company Policy Statement ($500 million or less of assets).

e. Subject to recommendations of the FSOC, the banking agencies are required to develop capital requirements that address the risks that the activities of a banking organization pose to the institution as well as public and private stakeholders in the event of adverse performance, disruption, or failure of the institution or the activity. The rules should address the risks arising from (i) significant volumes of activity in derivatives, securitized products purchased and sold, financial guarantees purchased and sold, securities borrowing and lending, and repurchase agreements and reverse repurchase agreements; (ii) concentrations in assets for which values are based on models rather than cost or prices derived from liquid markets; and (iii) concentrations in market share for any activity that would substantially disrupt financial markets if the institution was forced to cease the activity unexpectedly. (*See* Proposed Rule, "Risk-Based Capital Rules: Market Risk," OCC, FRB, and FDIC, 76 Federal Register 1,890 (Jan. 11, 2011))

4. The banking agencies are also required to "seek" to make capital requirements countercyclical allowing for decreases in requirements during times of economic contraction.

5. Source of Financial Strength. A holding company is required to serve as a source of financial strength, i.e., the ability to provide financial assistance in the event of the financial distress of the insured institution, to an insured institution subsidiary.[2] Effective date: July 21, 2011, with regulations to be issued by July 21, 2012.

[2] The requirement also applies to a company that controls an insured institution that is not the subsidiary of a holding company. Because a company that has control of an insured institution would be a bank or thrift holding company, this requirement serves no purpose.

B. Transactions with Affiliates – Section 608

1. Any investment fund advised by a bank or an affiliate will be an "affiliate" for purposes of Section 23A of the Federal Reserve Act. Previously, certain funds had to be "sponsored and advised" by the bank or an affiliate.

2. Definition of "covered transaction"

a. Clarified to treat a repurchase agreement as an extension of credit rather than as a purchase of assets.

b. Expanded to include a borrowing or lending of securities to the extent the transaction causes a bank or subsidiary to have credit exposure to an affiliate. Will be subject to the collateral requirement.

c. Expanded to include a derivative transaction with an affiliate to the extent the transaction causes the bank or subsidiary to have credit exposure to the affiliate. Will be subject to the collateral requirement.

d. A "covered transaction" will include a loan secured by "debt obligations" of an affiliate in addition to loans secured by "securities" issued by an affiliate.

3. The FRB will continue to have authority to issue "orders" as may be necessary to administer and carry out the purposes of Section 23A, but it will no longer have authority to issue orders to grant exemptions on its own. Exemptions for relationships and transactions must be granted by regulation.

a. The FRB must notify the FDIC of a finding that a proposed exemption is in the public interest and consistent with the purposes of Section 23A.

b. The FDIC will have 60 days to object in writing to the proposed exemption on the basis that it determined that the exemption would present an unacceptable risk to the Deposit Insurance Fund.

c. The OCC may exempt a transaction of a national bank by order with the concurrence of the FDIC.

d. The FRB may exempt a transaction of a state member bank and the FDIC may exempt a transaction of a state nonmember bank by order if the FRB and the FDIC jointly find that the exemption is in the public interest and the FDIC finds that the exemption does not present an unacceptable risk to the Deposit Insurance Fund.

e. The FRB must also receive a written no-objection from the FDIC in order to grant an exemption or exclusion under Section 23B.

4. The FRB is authorized to issue regulations or interpretations concerning the extent to which a netting arrangement with an affiliate may be taken into account in determining the amount of a covered transaction and whether a transaction is fully collateralized. Any interpretations issued with respect to an individual institution must be issued jointly with the appropriate federal banking agency for the institution.

5. Section 609 subjects transactions between a bank and a "financial subsidiary" to the individual affiliate amount limitation (10 percent of capital and surplus). However, only transactions entered into on or after July 21, 2010 will be subject to the 10 percent limit.

6. Effective date: July 21, 2012.

C. Limits on Purchase of Assets from Insiders – Section 615

1. In order for a bank to purchase an asset from or sell an asset to an insider (executive officer, director, principal shareholder, or one of their related interests), the transaction must be on market terms and, if the transaction represents more than 10 percent of the capital of the bank, the board of the bank, excluding interested parties, must approve the transaction in advance. This provision replaces existing Section 22(d) of the Federal Reserve Act concerning certain transactions with directors.

2. The FRB may adopt rules to implement this provision in consultation with the OCC and FDIC.

3. Effective date: July 21, 2011.

D. Lending Limits for Derivatives – Sections 610, 611, 614

1. The definition of "loans and extensions of credit" in Section 84 of the National Bank Act is amended to include credit exposure arising from a derivative transaction[3], repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction. Effective date: July 21, 2012.

2. Amends the FDI Act to condition the ability of a state insured bank to engage in a derivative transaction on whether the law on lending limits of the chartering state takes into consideration credit exposure on derivatives transactions. Effective date: January 21, 2013.

3. Credit exposure on a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing

[3] A "derivative transaction" includes any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

transaction will be subject to the lending limit applicable to loans to insiders under Regulation O. Effective date: July 21, 2012.

E. De Novo Branching – Section 613

A state or national bank may establish a branch in any state if a state bank located in that state is permitted to establish the branch. Effective date: July 22, 2010.

F. Payment of Interest on Demand Deposits – Section 627

The prohibitions against payment of interest on demand deposits were repealed effective July 21, 2011. Thus, banks and thrifts may pay interest on corporate transaction accounts. (*See* Final Rule, "Prohibition Against Payment of Interest on Demand Deposits," FRB, 76 Federal Register 42,015 (Jul. 18, 2011); Final Rule, "Interest on Deposits; Deposit Insurance Coverage," FDIC, 76 Federal Register 41,392 (Jul. 14, 2011))

G. "Volcker Rule" – Section 619

1. Under new Section 13 of the BHC Act, subject to exceptions, a bank, a bank holding company, a foreign bank, a subsidiary or an affiliate of a bank, bank holding company, or foreign bank (all are "banking entities"[4]),[5] will not be permitted to engage in "proprietary trading" or acquire retain any equity, partnership, or other ownership interest in, or sponsor a "hedge fund" or a "private equity fund."

2. Generally, the prohibition will be effective no later than July 21, 2012. Implementation of the provisions requires completion of a study by the FSOC on proprietary trading and hedge and private equity sponsorship and investment by banking entities (*See* "Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds," FSOC (Jan. 2011)) and the issuance of regulations by the banking agencies jointly for banks, the FRB, the SEC, and the CFTC (*See* Proposed Rule, "Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds," OCC, FRB, FDIC, and SEC, 76 Federal Register 68,846 (Nov. 7, 2011); CFTC also issued a Proposed Rule, which was not yet published as of January 27, 2012). The regulations are required to address additional capital requirements related to holding ownership interests and sponsoring hedge funds and private equity funds.

3. Transition Period. A transition period of two years is provided with the possibility of obtaining extensions.

[4] An exception is provided for trust companies that accept deposits only in a fiduciary capacity and that meet certain other conditions and limits on activities.
[5] The Volcker Rule also applies to nonbank systemically important financial institutions supervised by the FRB. Such institutions are defined in section 102 and will be designated by the FSOC.

a. A banking entity must bring its activities and investments into compliance not later than two years after the effective date. The FRB may grant up to three one-year extensions, so long as an extension is consistent with the Volcker Rule and is not detrimental to the public interest.

b. Illiquid Funds. The FRB may grant an extension of the transition period to a banking entity to the extent necessary to fulfill a contractual obligation that was in effect on May 1, 2010. During the extension, the banking entity may take or retain its ownership interest in or otherwise provide additional capital to an illiquid fund. The FRB may grant one extension that may not exceed five years. A banking entity may not engage in any prohibited fund activity after the earlier of the date on which the contractual obligation to invest in the illiquid fund terminates and the date on which extensions granted by the FRB expire.

c. The FRB adopted rules to implement the transition periods (*See* Final Rule, "Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities," FRB, 76 Federal Register 8,265 (Feb. 14, 2011)).

4. Key Definitions

a. "Proprietary trading" means engaging as a principal for the trading account of the banking entity in any transaction to purchase or sell or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative or contract, or any other security or financial instrument designated by regulations ("securities and other instruments").

b. "Trading account" means any account used for acquiring or taking positions in securities and other instruments principally for the purpose of selling in the near-term (or otherwise with the intent to resell in order to profit from short-term price movements).

c. "Hedge fund" and "private equity fund" mean an issuer that would be an "investment company" but for the exceptions in sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940.

d. "Illiquid fund" means a hedge fund or private equity fund that, as of May 1, 2010, was principally invested in, or was invested and contractually committed to invest principally in, illiquid assets such as portfolio companies, real estate investments, and venture capital investments and makes all investments under, and consistent with, an investment strategy to invest principally in illiquid assets. In adopting rules, the FRB must consider the terms of investment for the fund, contractual obligations, and the ability of the fund to divest of assets, and other factors that it determines to be appropriate.

d. "Sponsor" means to serve as a general partner, managing member, or trustee of a fund; to select a majority of the directors or management of a fund; or share with a fund the same name or a variation of the same name.

5. Permitted Activities. The agencies are authorized by Section 619 to permit banking entities to engage in the following activities:

a. Purchase and sale of U.S. Government, Agency, and GSE obligations, and obligations of any state or political subdivision;

b. Purchase and sale of securities and other instruments in connection with underwriting and market-making activities to the extent designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties;

c. Hedging activities related to individual or aggregated positions, contracts, or other holdings of the banking entity designed to reduce the specific risks related to the position;

d. Purchase and sale of securities and other instruments on behalf of a customer;

e. Holding an investment in a Small Business Investment Company, a public welfare investment, or a qualified rehabilitation expenditure investment;

f. Insurance company investing activity;

g. Organizing and offering a private equity or hedge fund if the banking entity provides bona fide trust, fiduciary, or investment advisory services and the fund is organized and offered only in connection with the provision of those services and only to persons that are customers of such services of the banking entity ("Fiduciary Fund").

i. The banking entity may serve as a general partner, managing member, or trustee of the Fiduciary Fund, and otherwise control the Fund, its management, and its expenses.

ii. The banking entity may hold only a de minimis investment in a Fiduciary Fund that is not more than 3 percent of the total ownership interests of the Fund. The aggregate of all interests in such funds of a banking entity may not exceed 3 percent of the Tier 1 capital of the banking entity.

iii. A banking entity may provide a Fiduciary Fund with initial startup equity but it must actively seek unaffiliated investors to reduce or dilute its investment to 3 percent or less than the ownership interests of the Fund within one year from the date of establishment of the fund (an extension of up to two years may be available).

iv. In calculating compliance with any capital requirements under regulations implementing the Volcker Rule, a banking entity must deduct the outstanding amount of any Fiduciary Fund investments, including retained earnings, from the assets and tangible equity of the banking entity. The amount of the deductions must increase commensurate with the leverage of the Fund.

v. A banking entity and its affiliates may not enter into a "covered transaction" (as defined under Regulation W) with a Fiduciary Fund that is organized and offered, by the banking entity. Such transactions are also prohibited for a hedge or private equity fund controlled by the banking entity's fund. Transactions between a banking entity and a Fiduciary Fund will be subject to Section 23B of the Federal Reserve Act.

vi. A banking entity may not guarantee the obligations or the performance of a Fiduciary Fund.

vii. A banking entity may not share the same name or variation of the same name with a Fiduciary Fund.

viii. Among persons affiliated with a banking entity, only the directors or employees of the banking entity who are directly engaged in providing investment advisory or other services to the Fiduciary Fund may take or retain an ownership interest in the Fund.

ix. The banking entity must provide a disclosure in writing to prospective and actual investors in a Fiduciary Fund that any losses in the Fund are borne solely by investors in the Fund;

h. Trading that takes place entirely outside the United States and the banking entity is not controlled by a banking entity that is organized under U.S. law;

i. The acquisition of an ownership interest in, or the sponsorship of, a hedge fund or a private equity fund by a banking entity solely outside of the United States, provided that no ownership interest in the fund is offered for sale or sold to a U.S. resident and that the banking entity is not controlled by a banking entity that is organized under U.S. law; and

j. Other activities determined by the federal banking agencies, the SEC, and the CFTC that would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.

6. Limitations and Conditions on Permitted Activities.

    a. A transaction or activity will not be permitted if it would (i) involve or result in a material conflict of interest between the banking entity and its customers or counterparties, (ii) result in a material exposure of the banking entity to high-risk assets or high-risk trading strategies, (iii) pose a threat to the safety and soundness of the banking entity, or (iv) pose a threat to the financial stability of the United States.

    b. The agencies may impose additional capital requirements, quantitative limits, and diversification requirements on the permitted activities if the agencies determine that the conditions are appropriate to protect the safety and soundness of the banking entities engaged in such activities.

    c. The regulations adopted by the agencies must include requirements related to internal controls and recordkeeping in order to ensure compliance.

7. Conditions Specific to Hedge Fund and Private Equity Fund Activities

    a. Prohibition on Covered Transactions. The prohibition on entering into covered transactions with Fiduciary Funds extends to a private equity or hedge fund that is advised, managed, or sponsored, by a banking entity. Section 23B of the Federal Reserve Act will apply to the banking entity and its affiliates and their transactions with a fund that the banking entity advises, manages, sponsors, organizes, or offers.

    b. Prime Brokerage Transactions. The FRB may permit a banking entity to enter into any prime brokerage transaction with any hedge fund or private equity fund in which a fund managed, sponsored, or advised by the banking entity has an ownership interest if the banking entity is in compliance with all of the conditions related to its Fiduciary Funds.

8. Override Provisions

    a. The prohibitions and restrictions of the Volcker Rule override any provision of law that authorizes an activity that is otherwise prohibited or limited by the Volcker Rule.

    b. Nothing in the Volcker Rule may be construed to limit or restrict the ability of a banking entity to sell or securitize loans in a manner otherwise permitted by law.

    c. The Volcker Rule may not be construed to limit the powers of federal agencies and state regulatory authorities to act under otherwise applicable provisions of law.

H. Issues in Approval of Applications

1. Agencies must consider whether an acquisition or merger proposal will have an adverse effect on the stability of the U.S. financial system. § 604(d), (e), (f).

2. Establishes a nationwide concentration cap of 10 percent of the aggregate consolidated liabilities of all financial companies at the end of the calendar year preceding the transaction. § 622

3. The resulting bank in an interstate acquisition must be well capitalized and well managed and a bank holding company must be well managed and well capitalized in order to complete an interstate acquisition. § 607.

4. An interstate bank merger or holding company acquisition is subject to a concentration cap of 10 percent of the total amount of deposits of all depository institutions in the United States. § 623.

5. A financial holding company must obtain prior FRB approval for any acquisition of a nonbank company with more than $10 billion in assets. A filing under the Hart-Scott-Rodino Act would be required even though the transaction would be subject to FRB approval. § 604(e).

6. Limits imposed on charter conversions of a bank that is subject to a banking agency enforcement action. § 612.

7. The FRB in considering an application by a foreign bank to establish a U.S. office and the SEC in considering whether to permit a foreign person or an affiliate of a foreign person to register as a U.S. broker or dealer must consider, for a foreign bank or broker-dealer that presents a risk to the stability of United States financial system, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk.

I. No Use of Ratings – Sections 939 and 939A

1. Amends the FDI Act and the National Bank Act to delete the terms “investment grade” and “credit rating” and substitutes standards of creditworthiness established or issued by the applicable agency. (*See* Proposed Rule, “Alternatives to the Use of External Credit Ratings in the Regulations of the OCC,” 76 Federal Register 73,526 (Nov. 29, 2011) (Correction, 76 Federal Register 76,095 (Dec. 9, 2011)); Proposed Guidance, “Guidance on Due Diligence Requirements in Determining Whether Investment Securities Are Eligible for Investment,” 76 Federal Register 73,777 (Nov. 29, 2011); Proposed Rule, “Permissible Investments for Federal and State Savings Associations: Corporate Debt Securities,” FDIC, 76 Federal Register 78,086 (Dec., 15, 2011))

2. The agencies proposed to incorporate into proposed market risk capital rules certain alternative methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings (*See* Proposed Rule, "Risk-Based Capital Guidelines: Market Risk; Alternatives to Credit Ratings for Debt and Securitization Positions," OCC, FRB, and FDIC, 76 Federal Register 79,380 (Dec. 21, 2011); Proposed Rule, "Alternatives to the Use of Credit Ratings in the Risk-Based Capital Guidelines of the Federal Banking Agencies," OCC, FRB, and FDIC, 75 Federal Register 52,283 (Aug. 25, 2010))

J. Risk Committees and Stress Tests – Section 165

1. Publicly traded bank holding companies with $10 billion or more in assets will be required to have a risk committee of the board of directors; the FRB may require publicly traded bank holding companies with less than $10 billion in assets to have a risk committee.

2. A risk committee will be responsible for the oversight of the enterprise-wide risk management practices of the bank holding company and include the number of independent directors as the FRB may determine appropriate, based on the nature of operations, size of assets, and other appropriate criteria related to the bank holding company; and include at least one risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms.

3. The FRB is required to issue final rules not later than July 21, 2012, to take effect not later than October 21, 2013.

4. A nonbank financial company supervised by the FRB and a bank holding company with more than $50 billion of assets will be required to conduct semiannual stress tests. All other financial companies that have total consolidated assets of more than $10 billion and are regulated by a primary Federal financial regulatory agency must conduct annual stress tests and publish the results. (*See* Proposed Rule, "Annual Stress Test," OCC, 77 Federal Register 3,408 (Jan. 24, 2012); Proposed Rule, "Annual Stress Test," FDIC 77 Federal Register 3,166 (Jan.23, 2012))

5. A stress test will generally provide for at least 3 different sets of conditions, including baseline, adverse, and severely adverse.

K. Executive Compensation – Section 956

1. Requires the agencies to prohibit incentive-based payment arrangements, or any feature of any such arrangement, at a covered financial institution that the agencies determine encourages inappropriate risks by a financial institution by providing excessive compensation or that could lead to material financial loss.

2. A covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive based compensation arrangements

sufficient to determine whether the structure provides "excessive compensation, fees, or benefits" or "could lead to material financial loss" to the institution.

3. The agencies issued a proposed rule that would require the reporting of incentive-based compensation arrangements by a covered financial institution and prohibit incentive-based compensation arrangements at a covered financial institution that provides excessive compensation or that could expose the institution to inappropriate risks that could lead to material financial loss. (*See* Proposed Rule, "Incentive-Based Compensation Arrangements," OCC, FRB, FDIC, FHFA, and NCUA, 76 Federal Register 21,170 (Apr. 14, 2011))

L. Asset-Backed Securities

1. Conflicts of Interest -- Section 621

a. An underwriter, placement agent, initial purchaser, or sponsor (and their affiliates) of an asset-backed security ("ABS") may not for one year after the first closing of the sale of the ABS engage in a transaction that involves or results in a material conflict of interest with respect to any investor in a transaction arising out of such activity.

b. The prohibition would not apply to hedging activity, purchases and sales of ABS made under, and consistent with, the role of an underwriter, placement agent, initial purchaser or sponsor to provide liquidity for the ABS or bona fide market-making in the security.

2. Risk Retention – Section 941

a. The SEC and the banking agencies are required to issue regulations to require a "securitizer"[6] to retain an economic interest in a portion of the credit risk for any asset that the securitizer transfers, sells, or conveys to a third party through an ABS. (*See* Proposed Rule, "Credit Risk Retention," OCC, FRB, FDIC, FHFA, SEC, and HUD, 76 Federal Register 24,090 (Apr. 29, 2011))

b. The SEC, the banking agencies, HUD, and FHA are required to issue regulations to require a securitizer to retain an economic interest in a portion of the credit risk for any residential mortgage that the securitizer transfers, sells, or conveys to a third party through an ABS.

c. Standards to Be Incorporated in Regulations

i. A securitizer will be prohibited from hedging or otherwise transferring the retained credit risk;

[6] "Securitizer" means an issuer of an ABS or a person who organizes and initiates an ABS transaction by selling or transferring assets to the issuer

ii. A securitizer will be required to retain not less than five percent of the credit risk for any asset that is not a "qualified residential mortgage"[7] or less than five percent of the credit risk for non-qualified mortgage assets if the originator[8] of the asset meets prescribed underwriting standards;

iii. Permissible forms and minimum duration of risk retention;

iv. Apply to all securitizers, including nondepository institutions;

v. Regulations related to commercial mortgages will also address the effect of a third-party purchaser of a first loss position, adequate underwriting standards, and adequate representations and warranties and related enforcement mechanisms;

vi. Appropriate standards for risk retention related to CDOs and similar instruments;

vii. Total or partial exemptions in the public interest and for the protection of investors, for U.S. government or agency backed ABS,[9] and for state or political subdivision backed ABS;

viii. Allocation of risk retention between a securitizer and an originator in the case of a securitizer that purchases assets from an originator; and

ix. Asset classes with separate rules for securitizers that will include underwriting standards for loans within the asset classes.

d. Exemptions. Any exemptions must help ensure high quality underwriting standards for the securitizers and originators of assets for ABS and encourage appropriate risk management practices by securitizers and originators, improve the access of consumers and business to credit on reasonable terms, or otherwise be in the public interest for the protection of investors.

e. The agencies are required to establish an exemption from the risk retention requirements for "qualified residential mortgages" taking into account underwriting and product features that historical loan performance indicate result in a lower risk of default, such as documentation, verification of income, payments to income, insurance, and prohibiting or restricting the use of balloon payments, negative amortization, prepayment

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[7] No risk retention is required if all of the assets collateralizing an ABS are qualified residential mortgages. A securitizer will be required to retain a portion of the credit risk of qualified residential mortgages included in a mixed pool of assets.
[8] "Originator" means a person who through the extension of credit or otherwise creates a financial asset that collateralizes an ABS and sells an asset to a securitizer.
[9] For this purpose, Fannie Mae and Freddie Mac are not U.S. government agencies.

penalties, interest-only payments, and other features that demonstrate a higher risk of borrower default.[10]

f. Effective date of regulations—one year after publication of final regulations for residential mortgages and two years after publication of final regulations for all other classes of ABS.

3. The SEC is required to adopt rules for disclosures for ABS that facilitate comparison of securities in similar asset classes and disclose asset-level or loan-level data. (§ 942)

4. The SEC is required to adopt regulations regarding the use of representations and warranties in the market for ABS and to disclose fulfilled and unfulfilled repurchase requests so that investors may identify originators with clear underwriting deficiencies (§ 943) and require an issuer of an ABS to perform, and disclose, a review of the assets underlying the ABS (§ 945).

5. The exemption from registration under the Securities Act of 1933 for certain ABS is removed. (§ 944)

V. Consumer Regulatory Changes

A. Prohibited Acts – Sections 1031, 1036

1. The CFPB may act to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.

a. "Unfair" — the act or practice causes or is likely to cause substantial injury to consumers that is not reasonably avoidable and the substantial injury is not outweighed by countervailing benefits to consumers or to competition.

b. "Abusive"— the act or practice materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or takes unreasonable advantage of a lack of understanding of the consumer of the material risks, costs, or conditions of the product or service, the inability of the consumer to protect his own interests in selecting or using a product or service, or the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

2. It is unlawful for a covered person or service provider to offer or provide to a consumer any financial product or service not in conformity with federal

[10] The definition of "qualified residential mortgage" will be no broader than the definition of "qualified mortgage" under section 129C(c)(2) of the Truth in Lending Act.

consumer financial law; commit an act or omission in violation of federal consumer financial law; to engage in any unfair, deceptive, or abusive act or practice; to fail to or refuse to permit access to or copying of records; to establish or maintain records; or make or provide reports to the CFPB.

B. Pre-Emption – Title X, Subtitle D (Sections 1041-1048)

1. Relation of Consumer Financial Protection Act of 2010 ("Title X") to State Law – Section 1041

a. A state law may be overridden by Title X only if the provision of state law is inconsistent with Title X and then only to the extent of the inconsistency. A state law is not inconsistent with Title X if the protection afforded to consumers is greater than the protection under Title X. The CFPB may make a determination regarding the inconsistency of a state law on its own motion or in response to a petition.

b. The CFPB must issue a notice of proposed rulemaking when a majority of states have enacted a resolution in support of establishing or modifying a consumer regulation by the CFPB.

2. State Enforcement Powers – Section 1042

a. A state may bring a civil action in a state or federal court in the state that has jurisdiction over the defendant to enforce Title X or any rules issued under Title X. Actions against national banks and federal thrifts are limited to enforcement of regulations issued under Title X.

b. The state attorney general or regulator must give notice to the CFPB prior to filing a complaint to enforce Title X or an applicable rule by providing a complete copy of the complaint and a written description of the action. The CFPB may intervene, remove the action to federal court (if applicable), be heard on all matters, and appeal any order or judgment.

3. Contracts entered into prior to July 21, 2010 that relied on a pre-emption regulation, order, guidance, or interpretation issued by the OCC or OTS remain valid for institutions regulated by the OCC and OTS as well as their subsidiaries. (§ 1043)

4. State Law Preemption Standard for National Banks and Federal Branches – Section 1044

a. State consumer financial laws are preempted only if

i. Application of the law would have a discriminatory effect on national banks in comparison with the effect of the law on a state bank;

ii. The state law prevents or significantly interferes with the exercise by the national bank of its powers under the standard in *Barnett Bank* as determined by the OCC or a court on a case-by-case basis; or

iii. The state consumer financial law is preempted by federal law other than Title X.

b. Dodd-Frank expressly states that Title X does not occupy the field in any area of state law.

c. No OCC preemption rule or order may be interpreted or applied to invalidate the provision of the state consumer financial law unless substantial evidence made on the record of the proceeding supports that the preemption finding was made in accordance with the standard of *Barnett Bank*.

d. The OCC is required to conduct a formal review of its preemption determinations at two five-year intervals following issuance of the determination.

e. State consumer financial laws expressly apply to a subsidiary or affiliate of a national bank (other than a national bank) to the same extent that the state consumer financial law applies to any person subject to the state law.

f. Title X does not affect the authority of a national bank to charge interest under section 85 of the National Bank Act.

5. Visitorial Powers. Dodd-Frank adopts the decision in *Cuomo v. Clearing House Association* so that no provision relating to visitorial powers or that otherwise limits or restricts the visitorial authority to which any national bank is subject may be construed as limiting or restricting the authority of any attorney general of any state to bring an action against a national bank in a court to enforce an applicable law and to seek relief as authorized. (§ 1047)

6. Effective date: July 21, 2011.

C. <u>Reasonable Interchange Transaction Fees – Section 1075</u>

The FRB issued regulations regarding any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction. The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction must be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. The regulations will not apply to any issuer that, together with its affiliates, has assets of less than $10 billion. (*See* Interim Final Rule and Final Rule, "Debit Card Interchange Fees and Routing," 76 Federal Register 43,478 (Jul. 20, 2011))

D. Credit Card Complaints

Section 1013(b)(3)(C) requires the CFPB to report annually to Congress information and analysis about complaint numbers, types, and, when applicable, resolution. CFPB issued a proposed policy statement that addresses its proactive disclosure of credit card complaint data it receives from consumers under the terms of the Consumer Financial Protection Act of 2010. The proposed policy statement sets forth the CFPB's proposed initial disclosure of credit card complaint data. It also identifies additional ways that the CFPB may disclose credit card complaint data but as to which the CFPB will conduct further study before finalizing its position. (*See* Proposed Policy Statement, "Disclosure of Certain Credit Card Complaint Data," CFPB, 76 Federal Register 76,628 (Dec. 8, 2011))

E. Mortgage Loan Originations – Title XIV ("Mortgage Reform and Anti-Predatory Lending Act")

1. Title XIV includes provisions that are designed to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive. Effective Date: Regulations must be issued no later than January 21, 2013 and the rules must be effective within 12 months after issuance.

2. Duty of Care. Each mortgage originator must be qualified and, when required, registered and licensed as a mortgage originator and include on all loan documents any unique identifier of the mortgage originator provided by the Nationwide Mortgage Licensing System and Registry. The CFPB will prescribe regulations requiring banks to establish and maintain procedures reasonably designed to assure and monitor compliance by banks, their subsidiaries, and their employees.

3. Yield-Spread Premiums. For any residential mortgage loan, no mortgage originator may receive from any person and no person may pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal).

4. Restructuring of Financing Origination Fee. For any mortgage loan, a mortgage originator may not receive from any person other than the consumer and no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator may pay a mortgage originator any origination fee or charge except bona fide third party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator.

5. Steering. The CFPB will prescribe regulations to prohibit

a. Mortgage originators from steering any consumer to a residential mortgage loan that (i) the consumer lacks a reasonable ability to repay or

(ii) has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms);

b. Mortgage originators from steering any consumer from a residential mortgage loan for which the consumer is qualified that is a “qualified mortgage” to a residential mortgage loan that is not a qualified mortgage;

c. Abusive or unfair lending practices that promote disparities among consumers of equal creditworthiness but of different race, ethnicity, gender, or age; and

d. Mortgage originators from (i) mischaracterizing the credit history of a consumer or the residential mortgage loans available to a consumer; (ii) mischaracterizing or suborning the mischaracterization of the appraised value of the property securing the extension of credit; or (iii) if unable to suggest, offer, or recommend to a consumer a loan that is not more expensive than a loan for which the consumer qualifies, discouraging a consumer from seeking a residential mortgage loan secured by a consumer’s principal dwelling from another mortgage originator.

6. Ability to Repay. No creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments. (*See* Proposed Rule, “Regulation Z; Truth in Lending,” FRB, 76 Federal Register 27,390 (May 11, 2011))

a. A determination of a consumer’s ability to repay a residential mortgage loan must include consideration of the consumer’s credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer’s equity in the dwelling or real property that secures repayment of the loan.

b. A creditor must determine the ability of the consumer to repay using a payment schedule that fully amortizes the loan over the term of the loan.

c. A creditor making a residential mortgage loan must verify amounts of income or assets relied on to determine repayment ability, including expected income or assets, by reviewing the consumer’s Form W–2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer’s income or assets.

d. A consumer's ability to repay a variable rate residential mortgage loan that allows or requires the consumer to defer the repayment of any principal or interest, the creditor must use a fully amortizing repayment schedule.

7. Qualified Mortgages. Exempt from certain requirements and have certain safe harbors available. The term "qualified mortgage" means any residential mortgage loan—

a. For which the regular periodic payments for the loan may not (I) result in an increase of the principal balance; or (II) subject to exceptions, allow the consumer to defer repayment of principal;

b. The terms of which do not result in a balloon payment (a scheduled payment that is more than twice as large as the average of earlier scheduled payments);

c. For which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented;

d. In the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

e. In the case of an adjustable rate loan, for which the underwriting is based on the maximum rate permitted under the loan during the first 5 years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

f. That complies with any guidelines or regulations established by the CFPB relating to ratios of total monthly debt-to-monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the CFPB may determine relevant;

g. For which the total points and fees payable in connection with the loan do not exceed 3 percent of the total loan amount;

h. For which the term of the loan does not exceed 30 years, subject to exceptions, such as in high-cost areas; and

i. In the case of a reverse mortgage, a reverse mortgage which meets the standards for a qualified mortgage, as set by rules issued by the CFPB.

8. Appraisals. Dodd-Frank includes provisions on appraiser independence, appraisal portability, appraiser compensation, registration requirements, and limits on automated valuation models.

9. Escrow Requirements. A lender will be required to establish an escrow account for certain closed-end consumer credit secured by a first lien on a principal dwelling for payment of taxes, hazard insurance, flood insurance, mortgage insurance, and any other required periodic payments or premiums. This requirement will generally apply to high-rate loans or otherwise as required by law.

VI. Derivatives – Title VII

A. Push Out of Swap Activities – Section 716

1. General rule—No “federal assistance” may be provided to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity. The effect is that a banking organization must conduct its swaps activities, with certain exceptions, through a non-depository institution affiliate.

2. “Federal assistance” means the use of advances from a Federal Reserve credit facility, federal deposit insurance or guarantees for the purpose of (i) making any loan to, or purchasing any stock, equity interest, or debt obligation of, any swaps entity; (ii) purchasing the assets of any swaps entity; (iii) guaranteeing any loan or debt issuance of any swaps entity; or (iv) entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.

3. A bank may be a “major swaps participant” but not a “swaps dealer.” A bank that engages in swaps activities that are limited to hedging and risk mitigation and swaps involving rates or reference assets that are permissible for investment by a national bank[11] will be permitted to retain those activities in the bank. As a practical matter, a bank would have to establish a separate affiliate for swaps activities if it is a swaps dealer and only for swaps that reference bank impermissible assets.

4. Effective date: Two years following the date on which Title VII is effective, which is July 16, 2011 (*See* Final Order, “Effective Date of Swap Regulation,” CFTC, 76 Federal Register 42,508 (Jul. 19, 2011); Notice of Proposed Amendment, “Effective Date of Swap Regulation,” CFTC, 76 Federal Register 65,999 (Oct. 25, 2011)). A federal banking agency may permit a bank up to 24 months to conform activities that require registration as a swaps entity with an extension of an additional year possible.

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[11] Acting as a swaps entity for a credit default swap will not be considered a bank permissible activity unless cleared by a derivatives clearing organization.

5. The prudential regulators are required to issue rules setting minimum standards for swaps and security-based swaps activities conducted by banks and bank holding companies.

6. The entities described as eligible for exemptions for activities that may stay in a bank are "insured depository institutions," which would not include uninsured U.S. branches and agencies of foreign banks. The agencies appear to have sufficient rulemaking authority to make the same exemptions available to branches and agencies under the principles of national treatment and equality of competitive opportunity.

B. Other Swaps Concepts Affecting Financial Institutions--(§§ 721; 722; 723; 725(g); 763)

1. Swap Dealers and Major Swap Participants will be required to register with the CFTC. Security-Based Swap Dealers and Major Security-Based Swap Participants will have to register with the SEC. (*See* Final Rule, "Registration of Swap Dealers and Major Swap Participants," CFTC, 77 Federal Register 2,613 (Jan. 19, 2012))

2. Dealers and Major Participants will be subject to new regulations including margin requirements, capital requirements, and business conduct standards. (*See* Proposed Rule, "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 76 Federal Register 23,732 (Apr. 28, 2011); Proposed Rule, "Capital Requirements of Swap Dealers and Major Swap Participants," CFTC, 76 Federal Register 27,802 (May 12, 2011); Proposed Rule, "Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties," CFTC, 75 Federal Register 80,638 (Dec. 22, 2010) (Final Rule issued by CFTC but not published in Federal Register as of January 27, 2012); Proposed Rule, "Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants," CFTC, 75 Federal Register 71,397 (Nov. 23, 2010))

3. Most financial institutions are expected to be subject to mandatory clearing and trade execution requirements. The CFTC and SEC are required to consider whether to exclude certain smaller financial institutions with total assets of $10 billion or less.

4. All market participants, including financial institutions, will be subject to new swap data reporting and real-time transaction reporting designed to enhance swap market transparency and pricing. (*See* Final Rule, "Swap Data Recordkeeping and Reporting Requirements, CFTC, 77 Federal Register 2,136 (Jan. 13, 2012); Final Rule, "Real-Time Public Reporting of Swap Transaction Data," CFTC, 77 Federal Register 1,182 (Jan. 9, 2012); Interim Final Rule, "Reporting Certain Post-Enactment Swap Transactions," CFTC, 75 Federal Register 78,892 (Dec. 17, 2010))

C. Key Terms

1. "Swap"—A swap is broadly defined as any agreement, contract, or transaction based on an underlying financial product or the occurrence or non-occurrence of an event relating to a financial product, including interest rate swaps, foreign exchange swaps, credit default swaps, and commodity swaps. Title VII includes foreign exchange forwards and swaps within the definition of "swap." Treasury is authorized to make a written determination that foreign exchange swaps and forwards should not be regulated as "swaps" under the DFA. In April 2011, Treasury issued a proposed determination that would exempt foreign exchange forwards and swaps for all purposes other than the swap reporting and business conduct rules (*See* Request for Comments, "Determination of Foreign Exchange Swaps and Forwards," Treasury, 75 Federal Register 66,426 (Oct. 28, 2010)). The definition of "swap" excludes a number of products including (i) sales of a nonfinancial commodity or security for deferred shipment or delivery so long as it is intended to be physically settled, (ii) options on securities, (iii) forwards on securities, (iv) any note, bond, or evidence of indebtedness which is a security, and (v) identified banking products such as certificates of deposit.

2. "Security-Based Swap" – A swap that is based on (i) an index that is a narrow-based security index; (ii) a single security or loan, or (iii) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index provided that the event relates to the financial statements, condition, or obligations of the issuer.

3. "Major Swap Participant" – A person who is not a "swap dealer" and (i) maintains a substantial position in swaps for any of the major swap categories (excluding positions held for hedging commercial risk or risk of an employee benefit plan); (ii) has outstanding swap counterparty exposure that could have serious adverse effects on the financial stability of the United States; or (iii) is a highly leveraged financial entity that that maintains a substantial position in any major swap category.

4. "Major Security-Based Swap Participant" – A person who is not a "security-based swap dealer" and (i) maintains a substantial position in security-based swaps for any of the major security-based swap categories (excluding positions held for hedging commercial risk or risk of an employee benefit plan); (ii) has outstanding security-based swap counterparty exposure that could have serious adverse effects on the financial stability of the United States; or (iii) is a highly leveraged financial entity that that maintains a substantial position in any major security-based swap category.

5. "Swap Dealer" – Any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties for its own account; or (iv) engages in any activity causing the person to be commonly known as a dealer or market maker in swaps. A bank will not be

considered a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan to that customer or its dealing activities are less than a de minimis level established by the CFTC and the SEC.

6. “Security-Based Swap Dealer” – Any person who (i) holds itself out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties for its own account; or (iv) engages in any activity causing the person to be commonly known as a dealer or market maker in security-based swaps. Excludes an entity engaged in a de minimis level of security-based swap dealing activity to be established by the CFTC and SEC.

(*See* Proposed Rule, “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant,’ and ‘Eligible Contract Participant,’” CFTC and SEC, 75 Federal Register 80,174 (Dec. 21, 2010); Proposed Rule, “Further Definition of ‘Swap,’ ‘Security-Based Swap,’ and ‘Security-Based Swap Agreement’; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,” CFTC and SEC, 76 Federal Register 29,818 (May 23, 2011))

D. <u>Retail Foreign Exchange Transactions – Section 742</u>

1. A U. S. financial institution may not enter into, or offer to enter into, certain types of foreign exchange transactions described in section 2(c)(2)(B)(i)(I) of the Commodity Exchange Act with a retail customer except under a rule or regulation of a Federal regulatory agency allowing the transaction under such terms and conditions as the Federal regulatory agency prescribes (a “retail forex rule”).

2. Section 2(c)(2)(B)(i)(I) includes “an agreement, contract, or transaction in foreign currency that … is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)).” A Federal regulatory agency’s retail forex rule must treat similarly all such futures and options and all agreements, contracts, or transactions that are functionally or economically similar to such futures and options. (*See* Proposed Rule, “Retail Foreign Exchange Transactions,” FRB, 76 Federal Register 46,652 (Aug. 3, 2011); Final Rule, “Retail Foreign Exchange Transactions,” OCC, 75 Federal Register 41,375 (Jul. 14, 2011); Final Rule, “Retail Foreign Exchange Transactions,” FDIC, 76 Federal Register 40,779 (Jul., 2011))

VII. Public Company Issues

A. <u>Compensation – Sections 951 to 953</u>

1. “Say-on-Pay” – All pubic companies must give shareholders a non-binding vote to approve executive compensation at least once every three years. At least once every six years, shareholders must be given the opportunity to vote on how

often they want to vote on executive compensation – every one, two or three years. Applies to first annual meeting at least six months after July 21, 2010. (§ 951)

2. Golden Parachute Compensation – Proxy solicitation material for a business combination must clearly describe compensation to be paid to named executive officers as a result of the transaction. Unless previously approved under a "say-on-pay" vote, golden parachute compensation must be subject to a non-binding shareholder vote at the time the transaction is approved. (§ 951)

3. Compensation Committee Independence – Listed companies must have a compensation committee that meets independence requirements similar to those for audit committees under the Sarbanes-Oxley Act. Directors who receive consulting, advisory or other compensatory fees or who are affiliates of the company will not be independent. The SEC has one year to adopt rules to address listing requirements related to compensation committees. (§ 952)

4. Compensation Consultants – Dodd-Frank gives compensation committees the authority to engage consultants, legal counsel and other advisors, provides the committee with responsibility for overseeing their work, and requires companies to provide the committee with appropriate funding. The committee may engage a consultant, legal counsel or other advisor only after taking into account certain factors that may affect independence. (§ 952)

5. Compensation Disclosures

a. Use of Compensation Consultants – Companies must disclose in their annual meeting proxy statement whether the compensation committee retained and obtained the advice of a compensation consultant and whether the consultant's work raised any conflict of interest. (§ 952)

b. Pay vs. Performance – Companies must show the relationship between executive compensation actually paid and the financial performance of the company. This disclosure must appear in the annual meeting proxy statement. (§ 953(a))

c. Relative Pay – Companies must disclose the median of annual total compensation of all employees, excluding the CEO, and the ratio of such amount to the annual compensation of the CEO. (§ 953(b))

d. Hedging – Companies must disclose in the annual meeting proxy statement whether employees and directors are permitted to hedge against any decrease in the value of company shares granted as compensation or held by the individual. (§ 955)

6. Claw-back Policies – Listed companies must adopt a claw-back policy for the recovery of incentive-based compensation that is based on financial information

reported under the securities laws when there is an accounting restatement. SEC rulemaking is required. (§ 954)

B. Corporate Governance – Sections 971-973

1. Voting by Brokers – Brokers prohibited from exercising discretionary voting on the election of directors, executive compensation, and any other significant matter the SEC determines by rule. The say-on-pay proposal would be a non-routine matter on which brokers may not exercise discretionary voting. (§ 957)

2. Proxy Access – Authorizes the SEC to adopt rules and regulations regarding the obligation of a company to include in the company's proxy materials shareholder nominees for director. (§ 971)

3. Disclosure Regarding Chairman and CEO Structure – Companies must disclose in the proxy statement for the annual meeting the reasons why the company has chosen the same person to serve as chairman and CEO or why it has chosen different persons. (§ 972)

SUMMARIES OF FDIC LITIGATION AGAINST FORMER DIRECTORS & OFFICERS

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Summaries of FDIC Litigation Against Former Directors & Officers

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This is a compilation of selected posts from BankBryanCave.com.
You can access all of the links and other posts referred to herein at www.bankbryancave.com.

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FDIC as Receiver of Heritage Community Bank v. Saphir, et al., Filed Nov. 1, 2010

FDIC Files Lawsuit Against Directors and Officers of Failed Illinois Bank

Wednesday, November 3, 2010

Written by Bard Brockman

The FDIC filed a lawsuit against directors and officers of Heritage Community Bank (Glenwood, Ill.), which was taken into FDIC receivership in early February 2009. The FDIC lawsuit was filed in federal court in Chicago on November 1, 2010, and it is the FDIC's second suit against directors or officers of failed institutions since the advent of the current real estate recession. For a copy of the complaint, click here.

The FDIC's case theory revolves around the bank's commercial real estate ("CRE") lending program. The lawsuit alleges that the directors and officers failed to protect the bank from the "substantial inherent risks of large-scale CRE lending," by:

- routinely financing CRE projects without any meaningful analysis or adequate appraisals;
- repeatedly making loans with excessive loan-to-value ratios; and
- failing to properly evaluate the creditworthiness of CRE borrowers and guarantors.

One unique factual allegation in the lawsuit is that the bank routinely drew down interest reserves from specific loans and recorded it as income. That practice, the FDIC alleged, generated phony profits, which the bank used to justify "substantial dividends" to the holding company and "generous incentive compensation" to its senior management.

The lawsuit asserts three distinct sets of claims – one set against the bank's directors; a second set against the directors and officers on the bank's loan committee; and a third set against the bank's chief financial officer.

Claims Against Directors

The FDIC alleged that the directors had breached their duties under both federal law (FIRREA) and state law by:

- failing to establish and enforce lending policies, including limits on CRE concentrations and limits on speculative or high-LTV projects;
- failing to establish sufficient reserves for loan losses and maintaining adequate capital; and
- failing to ensure that the bank had sufficient, capable personnel to undertake and administer the CRE lending program.

Claims Against Directors and Officers on Loan Committee

The FDIC similarly alleged that the members of the loan committee had violated FIRREA and state law duties by:

- failing to enforce prudent lending policies;
- failing to make informed decisions about loans they approved; and
- failing to ensure that approved loans were properly monitored.

Claims Against Chief Financial Officer

The FDIC alleged that the bank's CFO was grossly negligent (in violation of FIRREA), was negligent under state law, and breached his fiduciary duties to the bank under state law, by:

- failing to ensure that the bank's ALLL reserves were sufficient in the face of negative indicators, including an increasing number of distressed CRE credits;
- failing to ensure that the bank maintained sufficient capital to cushion against high-risk CRE loan losses; and
- improperly advising the board to approve dividends to the holding company and incentive compensation awards to senior management.

This lawsuit against the directors and officers of Heritage Community Bank is expected to start a small wave of D&O suits. The FDIC recently announced that it expects to file actions against 70 directors and officers of failed institutions. More suits are certainly on the way, and we will continue to update BankBryanCave.com with additional D&O litigation information.

FDIC as Receiver of Integrity Bank of Alpharetta, GA v. Skow, et al., Filed Jan. 14, 2011

FDIC Files Lawsuit Against Directors and Officers of Failed Integrity Bank
Friday, January 21, 2011
Written by Bard Brockman

The FDIC filed its third lawsuit against selected former directors and officers of a failed financial institution on January 14, 2010. The defendants in the lawsuit are certain former directors and officers of Integrity Bank (Alpharetta, Ga.), which the FDIC placed into receivership on August 29, 2008. The complaint, which was filed in the U.S. District Court for the Northern District of Georgia, asserts claims for negligence, gross negligence and breach of fiduciary duty.

The central theme of the complaint is that the defendants served on the bank's Director Loan Committee, and in that capacity they pursued an "unsustainable growth strategy designed to exploit the then-expanding 'bubble' in the residential and commercial real estate market." Directors who did not serve on that committee were not sued. The FDIC alleged a variety of misdeeds by the defendants, including the following:

- the adoption of a loan policy that set a lending limit in excess of the statutory legal lending limit;
- the abdication of the credit and lending functions to a Senior Lender who was compensated based on the volume of loan originations, without regard to the quality of the credit; and
- an over-concentration in speculative ADC loans that ultimately represented nearly 80% of the bank's total loan portfolio

However, the more than $70 million in damages alleged focus on twenty-one (21) specific ADC loans approved by, or subject to the oversight of, the Director Loan Committee.

There are three interesting side notes that are not apparent from a reading of the FDIC's complaint. First, in April 2010, federal prosecutors indicted two former executives of Integrity Bank (including one of the director defendants in the FDIC civil suit) on charges of conspiracy, bribery, bank fraud and securities fraud. In public statements following the indictments, the prosecutors alleged that these executives had conspired with a major borrower to essentially "rob the bank from the inside." However, the losses alleged in the Complaint do not involve the borrower involved in the fraud loses. It will be interesting to see if the other director defendants point to that alleged criminal conduct as the true proximate cause of the bank's failure.

The second notable item is that one of the former Integrity Bank directors sued by the FDIC, Jack S. Murphy, is the current chairman of the Georgia Senate Banking Committee. It does not appear that Sen. Murphy has any plans to resign his chairmanship, and he has received strong public support from fellow Republicans in the Georgia Senate.

The third item worth noting is that while there are numerous allegations of negligence, it is alleged that virtually every specific loan involved a loan to one borrower or specific loan to value limitation.

FDIC as Receiver of 1st Centennial Bank v. Appleton, et al., Filed Jan. 14, 2011

FDIC Files Fourth Lawsuit Against Former Bank Directors and Officers
Friday, January 21, 2011
Written by Bard Brockman

On January 14, 2010, the FDIC filed its fourth lawsuit against former directors and officers of a failed financial institution. The defendants in this action are the former directors and the former VP of Real Estate Construction for 1st Centennial Bank (Redlands, Cal.), which was put into receivership on January 23, 2009.

The FDIC's complaint asserts state law claims for negligence, breach of fiduciary duty, and breach of the directors' duty to supervise. It also asserts a claim under FIRREA for gross negligence. The complaint focuses on 16 specific loan losses, and it seeks damages in the minimum amount of $26.8 million flowing from those bad loans.

The crux of the FDIC's lawsuit is that the 1st Centennial defendants "recklessly implemented an unsustainable business model pursuing rapid asset growth concentrated in high-risk loans in commercial real estate without having adequate credit administration and loan underwriting policies and practices to manage the risk." Even after the local real estate market had softened significantly, the FDIC alleged, the defendants did not take steps to curtail the bank's lending , carefully monitor the existing loan portfolio, or seek to minimize loan losses. By the end of 2008, the percentage of Acquisition, Development and Construction loans to total capital had increased to 1,264%, more than ten times the regulatory guidance.

Another central theme of the FDIC's lawsuit is that the bank's CEO, Chief Credit Officer and VP of Real Estate Construction were all unqualified to carry out their duties and responsibilities to the bank. This does not necessarily present the other director defendants with a defense, however, as the FDIC has specifically alleged the board did not adequately supervise the bank's management.

FDIC as Receiver of Corn Belt Bank and Trust Company v. Stark, et al., Filed Mar. 1, 2011

FDIC Sues Former Directors and Officers of Corn Belt Bank & Trust

Tuesday, March 22, 2011

Written by Bard Brockman

The FDIC filed its fifth lawsuit against former officers of directors of a failed banking institution on March 1, 2011. The defendants are four members of the Loan Committee for Corn Belt Bank & Trust (Pittsfield, Illinois). Three of the defendants were directors (one of whom as bank president), and the fourth defendant was Corn Belt's Senior VP of Lending. See a copy of the FDIC's complaint.

The FDIC seeks to recover damages for five failed loans to borrowers in the truck leasing business. According to the FDIC's complaint, Corn Belt's internal loan review specifically warned the defendants about the following weaknesses in the loans: (i) they provided 100% financing to a start-up company; (ii) the borrower was outside the bank's geographical footprint; (iii) the loans would be secured by semi-tractors and other rolling stock; and (iv) the guarantees covered only a small portion of the debt. The FDIC also alleges that the defendants knew or should have known that: (i) the loan terms did not require the borrower to make an equity contribution; (ii) the borrower had inadequate cash flow; (iii) the debt service coverage ratios were insufficient; (iv) the credit request relied only on forward-looking financial statements; and (v) the loans allowed the borrower to make draws in excess of the amount required to purchase semi-tractors.

Among the noteworthy allegations in the FDIC's complaint is that the president and chief lending officer closed a $1.8 million loan, despite the fact that it had not been approved by the Loan Committee. The FDIC is equally critical of the Loan Committee on this extension of credit. Once the Loan Committee learned that the loan had been closed, the FDIC alleges, it did not object or question the officers who had extended the unauthorized credit.

The FDIC asserted claims against all defendants for negligence (under Illinois law) and gross negligence (under FIRREA) for approving the failed loans, which the FDIC contends resulted in loan losses to Corn Belt of approximately $10.4 million. The FDIC asserted similar claims against the former president and chief lending officer for making the unauthorized loan, and for failing to properly administer loans and protect the bank's security interest in collateral.

This is the FDIC's first lawsuit that focuses on commercial lending practices outside of the real estate arena, and it serves to put the banking community on notice that the FDIC is not singularly focused on failed real estate loans.

FDIC as Receiver for Washington Mutual Bank v. Killinger, et al., Filed Mar. 16, 2011

FDIC Sues Three Former Washington Mutual Executives and Their Wives

Friday, April 1, 2011

Written by Jake Bielema

On March 16, 2011, the FDIC brought suit in the United States District Court in Seattle against three top executives of the failed Washington Mutual Bank, alleging that those executives' "gross negligence and breaches of fiduciary duty" caused WaMu to lose "billions of dollars." In a further sign that the FDIC intends to be aggressive in such matters, the FDIC named as defendants two of the executives' wives, alleging that they improperly received transfers of property before and after WaMu's September 2008 failure.

The lawsuit represents the sixth lawsuit to date filed by the FDIC against former directors and/or officers of failed banks following the recent economic downturn. It is significant because WaMu represented the largest bank failure in U.S. history, with assets that stood at more than $300 billion dollars when it failed.

The complaint does not set a specific amount of damages sought, but the damages could well exceed $900 million. The complaint generally alleges that the executives focused on short term gains to increase their own compensation, and disregarded the best interests of the institution for the longer term. Specifically, the complaint alleges that the bank's home loans division recklessly made billions of dollars of loans which were highly risky, single family residential loans, which dramatically heightened the risk profile of the loans held in WaMu's portfolio. The complaint alleges that this high concentration in high risk residential loans, positioned the bank such that it would be impossible for it to survive what characterized as "the inevitable decline in the overrated housing market."

There have also been reports that the FDIC reached an agreement with WaMu's outside directors for a payment of $125 million to settle all potential claims. If these reports are in fact accurate, it is interesting that the settlement amount was negotiated and finalized without the initiation of any litigation.

Finally, the FDIC has made it clear that it will be pursuing more of these types of claims. The FDIC's Professional Liability Lawsuits page shows that the FDIC's Board has approved lawsuits against 158 individual directors and officers of failed banks, while filed lawsuits only name 40 individual defendants so far. Thus, it would appear that far more litigation is on the way.

FDIC as Receiver for Wheatland Bank v. Spangler, et al., Filed May 5, 2011

FDIC Sues Former Directors and Officers of Wheatland Bank
Thursday, May 19, 2011
Written by Bard Brockman

The FDIC filed its seventh D&O lawsuit since the beginning of the current economic downturn. The complaint was filed against the former directors and officers of Wheatland Bank of Naperville, Illinois. See a copy of the FDIC's complaint.

The FDIC's theory about the ultimate failure of Wheatland Bank has a ring of familiarity to it by now. It contends that the bank pursued rapid asset growth concentrated on high-risk commercial real estate (CRE) loans, without implementing adequate loan underwriting and credit administration practices to manage the risk. The FDIC also alleges that the bank routinely violated its loan policies, approved loans that had little chance of repayment, and repeatedly ignored regulators' warnings about its risk lending practices.

The complaint asserts two primary case theories. First, it alleges that the members of the bank's Loan Committee (which included two non-director officers) approved high-risk insider loans to "favored shareholders or borrowers" without adequate analysis or collateral, and failed to pursue the borrowers or guarantors after those loans went into default. The FDIC asserts alternative claims against the Loan Committee defendants for gross negligence (under FIRREA), negligence, breach of fiduciary, and breach of loyalty for the more than $22 million of losses caused by eight loan defaults.

Second, the FDIC asserts negligence and gross negligence claims against the director defendants for their failure to properly supervise the operations of the bank. Specifically, the FDIC alleges that the director defendants permitted management to violate the bank's business plan and loans policies; that they failed to select and retain competent management; and that they failed to exercise independent judgment in evaluating the actions and competency of management.

This second set of claims is perhaps the most intriguing. It signals that the FDIC is not concentrating solely on the directors and officers who comprise the loan committee. Instead, the FDIC will seek to hold directors liable for alleged breaches in connection with their ultimate role in supervising the management and operations of the bank.

FDIC as Receiver of IndyMac Bank, F.S.B. v. Perry, Filed Jul. 6, 2011

[FDIC Sues Former IndyMac CEO for Over $600 Million]

Monday, August 1, 2011
Written by Bard Brockman

On July 6, 2011, the FDIC filed a civil complaint against Michael Perry, the former chief executive officer of IndyMac Bank, F.S.B. ("IndyMac"). A copy of the complaint is available here. The lawsuit is the FDIC's eighth lawsuit against directors or officers of failed banks in the current economic downturn, and it comes a little more than one year after its first D&O lawsuit (against four senior officers of IndyMac's home builders division).

In its complaint against Mr. Perry, the FDIC chronicles IndyMac's meteoric rise as an independent mortgage lender. For instance, between 2000 and 2006, IndyMac increased its mortgage loan production from approximately $10 billion to almost $92 billion, most of which was sold in the secondary market. According to the complaint, IndyMac's principal mortgage product was a high-risk "Alt-A" loan, which was typically marketed to borrowers with less than full documentation, lower credit scores and higher loan-to-value ratios.

The crux of the FDIC's complaint is that Mr. Perry neglected to comply with his duties as CEO, and that he presided over IndyMac's aggressive generation of residential loans at a time when he knew the secondary market was volatile and uncertain. When IndyMac could not profitably sell those loans in the secondary market, it transferred the loans to its internal "Hold for Investment" portfolio. The mortgage loans generated in the six-month period between April and October 2007 alone resulted in more than $600 million of liquidated losses for the bank. The FDIC believes that IndyMac suffered additional losses for loans generated in 2008, but it has not determined the amount of those losses just yet.

To support its contention that Mr. Perry knew that the secondary market for residential loans was rapidly deteriorating, the FDIC quotes from dozens of Mr. Perry's e-mails dating back to 2004. It also cites several unhelpful admissions that Mr. Perry allegedly made in internal e-mails after the bursting of the real estate bubble (e.g., "we were idiots, absolute idiots to allow ourselves to do 80/20 piggybacks at the tail end of a long run in housing . . .").

Before its failure, IndyMac grew to be the nation's second largest mortgage lender and the seventh largest S&L association. The FDIC seems determined to make many of the key players at IndyMac answer for that very public failure.

FDIC as Receiver of Haven Trust Bank v. Briscoe, Filed Jul. 14, 2011

FDIC Sues Former Directors and Officers of Haven Trust Bank

Monday, July 18, 2011

Written by Bard Brockman

The FDIC filed its ninth lawsuit against directors or officers of failed financial institutions since the onset of the current economic downturn. On July 14th, the FDIC filed a civil complaint against the directors and three senior officers of Haven Trust Bank (Duluth, Ga.), which was placed into receivership in December 2008. The FDIC estimates the failure of Haven Trust Bank will cost the Federal Deposit Insurance Fund approximately $248 million. We have posted a copy of the complaint.

Some of the core allegations in the FDIC's complaint are very familiar by now. The FDIC alleges that the Haven Trust defendants implemented an unsustainable business model focused on rapid asset growth heavily concentrated in high-risk commercial real estate ("CRE") loans. It further contends that the defendants failed to maintain adequate internal controls, loan underwriting policies, and sufficient credit administration procedures necessary to oversee and manage the operations of the bank. The FDIC alleges that the defendants continued to pursue an aggressive CRE lending strategy throughout most of 2008, after regulators had cautioned them about the bank's poor asset quality and rapidly deteriorating capital ratios.

The unique allegations in the complaint center on the influence the FDIC contends was exercised by two of the directors, R.C. Patel and Mike Patel, who collectively owned a controlling interest in the bank. Specifically, the FDIC contends that the bank made numerous imprudent insider loans (exceeding $7 million) to the Patels or their relatives, all for the Patels' personal benefit. The FDIC also alleges that despite the bank's rapidly declining capital-to-asset ratios, the defendant directors authorized dividend payments to the bank holding company in the months prior to the receivership.

The FDIC's complaint asserts state law claims for negligence and breach of fiduciary duty, and an additional claim for gross negligence under FIRREA. The total amount of the damages sought is estimated to exceed $40 million.

FDIC as Receiver of Michigan Heritage Bank v. Cuttle, Filed Aug. 8, 2011

FDIC Files Lawsuit Against Former Senior Loan Officer

Monday, October 10, 2011

Written by Bard Brockman

On August 8, 2011, the FDIC filed a lawsuit against Timothy J. Cuttle, the former Senior Loan Officer of Michigan Heritage Bank, which was placed into receivership in April 2009. A copy of the FDIC's complaint is available here. Although the FDIC has included loan officers among the defendants in some of its prior D&O lawsuits, this is the first time in the current litigation cycle that the FDIC has targeted its claims against a single loan officer.

The FDIC's focus on the Senior Loan Officer is likely largely attributable to the Bank's detailed written Lending Policy, which assigned strict and specific responsibilities to the Bank's loan officers. According to the FDIC's complaint, the Senior Loan Officer violated the Lending Policy, as well as prudent lending practices, in connection with eleven (11) commercial loans, which resulted in losses in excess of $8.2 million. The complaint asserts state law claims for negligence and breach of fiduciary duty, and a gross negligence claim under FIRREA, for the following types of misconduct:

- causing the Bank to approve and fund loans based on inadequate collateral;
- causing the Bank to approve and fund loans based on inadequate, incomplete, in accurate or unrealistic appraisals;
- failing to adequately inspect real estate taken as collateral;

- causing the Bank to approve and fund loans without requiring adequate sources of repayment;
- causing the Bank to approve and fund loans without adequately analyzing debt service coverage ratios and the borrowers' abilities to perform on the loans;
- failing to ensure that loans closed according to the terms approved; and
- causing the Bank to approve and fund CRE loans in which the project equity contribution from the borrower was not evaluated or was inadequate.

Although the FDIC targets the Senior Loan Officer, the lawsuit makes clear that the loans at issue were approved by a Senior Loan Committee, and in a few instances, by the Bank's board of directors. So why has the FDIC seemingly departed from its prior practice and not sued the Senior Loan Committee or the directors in this case?

The complaint offers clues to two possible explanations.

First, for many of the loans at issue, the FDIC alleges that the Senior Loan Officer withheld key information from the Senior Loan Committee and the board, and that the Bank would not have approved the loans had that information been disclosed.

Second, and perhaps more importantly, the complaint reveals that the Bank eventually demoted the officer and removed him from the Senior Loan Committee in May 2007 – two years before the Bank's failure. He eventually left the Bank's employ. That affirmative disciplinary action may have spared the Senior Loan Committee and the board of directors from being named as co-defendants in the lawsuit.

FDIC as Receiver of The Columbian Bank and Trust Co. v. McCaffree, Filed Aug. 9, 2011

FDIC Sues Directors of Columbian Bank and Trust

Tuesday, October 11, 2011

Written by Bard Brockman

In the second of three D&O lawsuits filed on successive days in August, the FDIC sued six former directors of Columbian Bank and Trust (Topeka, KS), which was placed into receivership in August 2008. A copy of the FDIC's complaint is available here.

The FDIC's complaint alleges that Columbian embarked on an aggressive commercial and CRE lending program in 2003 to drive up the Bank's revenues. In furtherance of this lending program, the FDIC contends, Columbian incentivized its loan officers to generate loans, at the expense of credit quality. The FDIC further alleges that this "uncontrolled" lending campaign, combined with the defendants' several other failures — most notably, the failure to heed regulators' warnings and to follow the Bank's own loan policies – caused the 40-year-old Columbian Bank to collapse in just five years.

The complaint focuses on losses resulting from loans to twelve sets of borrowers. The FDIC is seeking to hold the former directors for the total amount of those loan losses, which is over $52 million.

Aside from the FDIC's contention that the loans at issue violated the Bank's loan policy and were the product of a negligent underwriting and approval process, the loans bear few common characteristics. In one example, the FDIC alleges that Columbian made a series of loans ($18 million in total) to a newly-formed LLC to purchase and rehab a commercial office building in Kansas City that had no signed leases or tenants. Columbian apparently never prepared a DSC or cash flow analysis on the project; nor did it obtain financial statements on the borrower or its guarantors. The project failed, and the Bank ultimately suffered losses of nearly $8 million.

The FDIC's complaint presents two case theories: (1) that the defendants were negligent and/or breached their fiduciary duty with respect to approval of the failed loans; and (2) that the defendants were negligent and/or breached their fiduciary duty in connection with their failure to properly supervise the Bank's officers and employees. These two case theories are presented in the context of claims for gross negligence (under FIRREA), negligence under state law, and breach of fiduciary duty under state law.

Perhaps the most interesting aspect of the FDIC's complaint is the allegation that the six defendants, along with "other culpable former directors," constituted a majority of the Bank's board. This clearly suggests that the FDIC has elected not to sue all of the former Columbian directors, despite its assertion that they are "culpable" for the Bank's failure.

Why the FDIC has chosen not to sue other former directors of Columbian is not clear from the complaint. One possible explanation is that the defendant directors all served on the Director's Loan Committee and that the other former directors did not. This does not seem plausible, however, since Columbian's own loan policy invests ultimate responsible for all lending activities with the full board. Other possible explanations could be that the non-defendant directors did not vote for the loan loss transactions at issue in the complaint, or that they voiced concern with Columbian's aggressive lending strategy. Regardless of the reason they were omitted from the complaint, we view this as an encouraging sign that the FDIC will not automatically seek to attach liability to any and every person who served as a director of a failed banking institution.

FDIC as Receiver for Cooperative Bank v. Rippy, Filed Aug. 10, 2011

FDIC Sues Former Directors and Officers of Cooperative Bank
Wednesday, October 12, 2011
Written by Bard Brockman

On August 10, 2011, the FDIC sued nine former directors and officers of Cooperative Bank (Wilmington, NC), which was placed into receivership in June 2009. A copy of the FDIC's complaint is available here.

In its complaint, the FDIC alleges that the board and senior management of Cooperative Bank instituted a strategy in 2001 to grow from the Bank's assets from $443 million to $1 billion by the end of 2005. The Bank did not meet that goal, but the board and senior management reaffirmed the goal to become a $1 billion bank, and pursued an aggressive growth plan in furtherance of that goal. That aggressive growth plan, the FDIC alleges, caused the Bank to become over-concentrated in acquisition, development and construction ("ADC") loans. Furthermore, the FDIC contends, the defendants "failed to manage the inherent risks associated" with the aggressive growth strategy. Specifically, the director defendants permitted a lax loan approval process that did not include a formal loan committee to review an analyze loans; instead, the Bank relied on various levels of loan approval authority, which were routinely violated. State and federal regulators repeatedly warned Cooperative's management about the risks associated with its high concentration in speculative loans and weaknesses in its lending function, but the FDIC states those warnings were ignored.

The FDIC's complaint seeks approximately $34.5 million of damages on negligence and breach of fiduciary duty theories. The alleged damages flow from two types of loan losses.

The first set of losses resulted from Cooperative's "Lot Loan Program," in which the Bank provided credit to borrowers to buy vacant lots for the purported purpose of eventually building vacation homes in developments along the North Carolina coast. In reality, the FDIC alleges, Cooperative provided lot loans to out-of-state, speculative buyers (many of whom intended to "flip" the lots) on artificially-inflated appraisals.

The Lot Loan program was particularly ill-advised, the FDIC contends, because the Bank's senior management acknowledged from the start that the lot loans would not be profitable for the Bank. The senior managers viewed the Lot Loan Program as a "loss leader," which would put the Bank in a better position to provide construction financing when the buyers were ready to build.

In the course of setting up the Lot Loan Program, the Bank's senior management represented to the Bank's ALCO Committee that the lot loans would be limited to a 90% loan-to-value ratio, and that payments would not be interest-only (which had been a concern of the regulators). Even at 90% LTV, the lot loans violated the Bank's own Loan

Policy, which allowed only a 65% LTV limit for raw land and a 75% LTV limit for land development. To make matters worse, the lot loans were no-equity loans, with interest-only payments, and the majority of the lot loans were "stated income" (no-document) loans.

Cooperative's board learned about the high-risk Lot Loan Program at a board meeting on July 17, 2007, and specifically determined that the lot loans did not comply with the Bank's Loan Policy. Nevertheless, the board took no corrective action, and the Bank continued to make risk lot loans for several more months. The FDIC is seeking to recover damages of nearly $10 million against the Bank's senior management – the president and EVP for mortgage lending – for the lot loans extended before the July 17, 2007 board meeting. It is also seeking to hold the senior managers and all of the directors liable for approximately $4.5 million of losses on lot loans extended after that July 17, 2007 board meeting.

In addition, the FDIC is seeking to damages of over $20 million for losses suffered on nine commercial real estate loans. The key allegations with respect to these losses is that the director defendants approved these loans without any formal loan review or evaluation process. Instead, the Bank's president called individual directors and secured telephonic approval until he had enough votes to approve a loan. The director defendants did not have copies of the loan files or any other presentations to evaluate the loan when they purportedly approved them by telephone.

FDIC as Receiver for Silverton National Bank, N.A. v. Bryan, Filed Aug. 22, 2011

FDIC Sues Directors and Officers of Silverton Bank

Wednesday, September 14, 2011

Written by Bard Brockman and Rob Klingler

On August 22, 2011, the FDIC filed a complaint in the U.S. District Court for the Northern District of Georgia against the former directors and executive officers of Silverton Bank, N.A. Silverton was declared insolvent and placed into FDIC receivership on May 1, 2009.

Silverton, formerly known as The Banker's Bank, was not a traditional banking institution. It provided correspondent and clearinghouse services, among other financial services, to community banks only. Silverton was owned by investor banks, and its board was comprised entirely of experienced community bankers.

The FDIC's account of Silverton's failure contains many of the same hallmark allegations present in its prior D&O lawsuits:

- overly-aggressive growth goals;
- compensation that incentivized loan production regardless of asset quality;
- expansion of lending into unfamiliar geographic markets;
- heavy focus on risky CRE and ADC lending;
- significant weaknesses in loan underwriting and credit administration;
- ignored warnings from state and federal banking regulators; and
- complete disregard of deteriorating economic conditions.

As it has done in prior lawsuits, the FDIC has identified several failed credit transactions that it contends are examples of negligence, gross and a breach of fiduciary duty by the directors or officers who approved them. In total, the FDIC seeks damages in excess of $61 million for fifteen (15) specific credit transactions.

Although it contains some familiar allegations and case themes, the FDIC's complaint against the Silverton D&Os is unique, both in substance and tone. For the first time in the current downturn, the FDIC seeks to hold directors liable for instances of what it describes as "corporate waste." Specifically, the complaint recites several examples of Silverton's "extravagant spending" while the economy was in decline, including: (i) the purchase of two corporate aircraft for the bank holding company; (ii) the construction of a new airplane hangar for the holding company on leased property; (iii) the construction of a "lavish" new office building, which Silverton occupied 20 months before the expiration of its then-current lease. The FDIC alleges that the directors who authorized these specific expenditures are liable for more than $10 million of "corporate waste."

The tenor of the FDIC's allegations against the Silverton D&Os is more strident than in its prior lawsuits. The FDIC is particularly critical of the Silverton board, which was comprised of CEOs or presidents of other community banks. That experience and specialized knowledge, the FDIC contends, imposed a heightened duty on the directors to discharge the duties owed to the bank.

Bryan Cave banking partner Walt Moeling, who represented Silverton in connection with certain regulatory matters, has a different perspective on the immediate cause of Silverton's failure. The Atlanta Journal-Constitution interviewed Walt about Silverton's failure. Here is an excerpt from that article:

> Ultimately, Moeling said, Silverton failed not because of its lending or spending, but because it is structured differently than most banks.
>
> As a bank for banks, Silverton's services included clearing checks, offering short-term investments for banks' cash, financing new bank startups and divvying up and selling parts of loans – known as "participations" – that were too large for any single bank to handle.
>
> To fund its operations, Moeling said, Silverton depended on member banks' cash deposits in their check-clearing accounts and short-term investments. For each member, those accounts often totaled millions of dollars – well above the FDIC's deposit guarantee of $250,000.
>
> When rumors of Silverton's troubles surfaced in early 2009, a modern-day run on the bank occurred. Member banks pulled out their money and turned to the Federal Reserve to clear their checks and hold their cash.
>
> "Once the cracks began to appear, the member banks felt that they couldn't have uninsured deposits," Moeling said. Silverton "went from very liquid to out of cash, very, very fast."

Finally, the FDIC's complaint is also unique in that it includes a direct claim against the primary and excess D&O insurance carriers. The facts giving rise to that claim are interesting. According to the complaint, Silverton paid the premium for a primary D&O policy with Chubb. Chubb forwarded a Binder that referenced several endorsements, including a Regulatory Exclusion, which would operate to exclude from coverage any claims brought by federal or state regulators. However, when the D&O Policy was issued about one month later, it did not include contain a Regulatory Exclusion endorsement. One month later, on the very afternoon that Silverton was closed and the FDIC was appointed as receiver, Chubb's underwriting officer forwarded the Regulatory Exclusion, which he claimed had been omitted from the policy in error. When the FDIC later asserted a civil demand under the D&O policy, Chubb denied coverage due to the Regulatory Exclusion. As part of its complaint, the FDIC is asserting a claim for declaratory relief against Chubb and the excess carrier, Westchester, to have the court determine whether the Regulatory Exclusion is part of the D&O policies.

FDIC as Receiver for First National Bank of Nevada v. Dorris, Filed Aug. 23, 2011

Recent Settlement Indicates FDIC's Focus on D&O Insurance
Monday, October 10, 2011
Written by Jake Bielema

A recent negotiated settlement in an FDIC failed bank lawsuit, which has as its sole focus potentially available funds under a D&O policy, and in fact assigns claims under that policy to the FDIC, further suggests that the FDIC's real focus in failed bank litigation is on proceeds that may be available under D&O policies, as opposed to the personal assets of former directors and former officers.

The First National Bank of Nevada ("FNB Nevada") failed on July 25, 2008, less than thirty days after First National Bank of Arizona ("FNB Arizona") was merged with an into FNB Nevada. On August 23, 2011, the FDIC filed an action in the District of Arizona against the former CEO and Vice Chairman of the Bank's holding company as well as of both FNB Nevada and FNB Arizona and additionally against the holding company's Executive Vice President ("EVP"), who was also the EVP of FNB Nevada and FNB Arizona. There was nothing remarkable about the FDIC's complaint, which basically alleged negligence and gross negligence in lending, primarily at FNB Arizona, which allegedly resulted in millions of dollars of bad loans that ultimately contributed to the Bank's failure.

What is remarkable about the FNB Nevada case is that shortly after the complaint was filed, on September 2, 2011, the FDIC and the two named defendants jointly filed a Motion for Entry of Judgment which would in effect settle all of the FDIC's claims against the two named defendants. In the proposed settlement contemplated by the Motion for Entry of Judgment, each of the individuals consented to the entry against them of separate judgments in the amount of $20 million. Notably, however, those amounts were to be paid only through what the FDIC is able to recover from the D&O carrier, Catlin, which had denied coverage and refused to defend the FDIC's claims on behalf of the named defendants. The settlement specifically provides that the FDIC will not pursue any aspect of the judgment against the named defendants individually, and will limit its efforts at recovery to its claims for wrongful denial of coverage against the D&O carrier.

This settlement no doubt had some appeal to the two named defendants, in that it, if approved, it will result in a full release of any and all claims against them individually, as well as an agreement not to pursue any aspect of the agreed upon judgment from them individually. However, the insurance company is likely to take the position that the settlement, which was entered into without development of any actual evidence or proof that either of the named defendants engaged in any kind of actionable wrong-doing, was collusive and was entered into without any rational analysis, and solely at the expense of the carrier. The response to that, however, is likely to be that the D&O carrier should not now be heard to criticize the manner and extent to which the FDIC's claims were analyzed or defended, after it refused to provide any coverage under the policy or to provide any defense to the named defendants.

In any event, it is yet another indication that the FDIC's primary focus in the failed bank litigation is the proceeds of directors and officer liability policies, not the personal assets of former officers and directors of failed institutions.

FDIC as Receiver for Alpha Bank v. Blackwell, Filed Oct. 7, 2011

FDIC Sues Former Directors and Officers of Alpha Bank & Trust
Wednesday, October 12, 2011
Written by Bard Brockman

On October 7, 2011, the FDIC filed a complaint against the former directors and senior officers of Alpha Bank & Trust (Alpharetta, Ga.), which was put into receivership on October 24, 2008. A copy of the FDIC's complaint is available here. Alpha Bank & Trust ("Alpha" or the "Bank") opened in May 2006 and operated for only thirty (30) months. Nevertheless, the FDIC estimates that the failure of Alpha will cause the Deposit Insurance Fund to lose $214.5 million.

According to the complaint, Alpha embarked on an aggressive growth strategy that focused on making risky loans in the acquisition, development and construction (“ADC”) and commercial real estate (“CRE”) sectors. The complaint also alleges that the Bank incentivized loans officers to generate loans, regardless of credit quality or loan performance, and that the Bank either disregarded or rejected warnings from regulators and third-party loan review consultants.

The complaint seeks to recover $23.92 million in damages directly tied to losses suffered on thirteen separate bad credits. The defendants were all members of the Director’s Loan Committee, and according to the complaint, they each voted to approve one or more of the subject loans. Their alleged failures and omissions included the following:

- failure to follow the Bank’s existing loan policies;
- failure to inform themselves and each other about the true nature and condition of the Bank’s loan portfolio;
- failure to adopt and enforce prudent underwriting procedures and appropriate loan-to-value ratios;
- approving loans to borrowers who were or who should have been known to be not creditworthy;
- approving loans to be made on an unsecured or under-secured basis;
- approving loans made on the basis of inadequate or non-existent appraisals;

- causing or permitting loans to be made without properly and promptly perfecting security interests in the loan collateral; and
- failure to exercise their duties to manage and supervise the affairs of the Bank in a safe, sound and prudent manner.

The complaint asserts a state law claim for negligence and a claim for gross negligence under FIRREA. Interestingly, the FDIC does not assert a separate state law claim for breach of fiduciary duty, even though it has consistently pled that claim in nearly every other D&O lawsuit to date.

FDIC as Receiver for Mutual Bank v. Mahajan, Filed Oct. 25, 2011

FDIC Sues Former Directors, Officers and Outside Counsel of Mutual Bank

Friday, November 11, 2011

Written by Bard Brockman

The FDIC sued the former directors and two former officers of Mutual Bank (Homewood, Illinois), along with Mutual Bank's outside law firm, on October 25, 2011. Mutual Bank was placed into FDIC receivership in July 2009, and its failure currently is estimated to cost the Deposit Insurance Fund $775 million. A copy of the FDIC's complaint is available here.

One of the unique aspects of this lawsuit is the FDIC's allegations of corporate waste. For example, the FDIC alleges that the directors approved a $250,000 payment for sponsorship of a "bank function." The bank function was actually the wedding of one of the directors, who was also the chairman's and principal shareholder's son. In another example, the FDIC alleges that the directors allowed $495,000 of Bank funds to be used to make payments to another director for his wife's defense of a Medicare fraud case. In yet another example, the FDIC alleges that the directors permitted roughly $300,000 of Bank funds to be used to fund travel to an unnecessary directors' meeting in Monte Carlo. In total, the FDIC is seeking to recover at least $1.09 million from the directors who approved the wasteful transactions.

The FDIC is also suing the directors for their approval of $10.5 million of illegal dividend payments in 2007 and 2008, at a time when the Bank was hemorrhaging and under severe regulatory criticism. The dividends were paid to the bank holding company, which in turn paid them to the shareholders, with 95% of the dividends being paid to the controlling family, which had four members on the Bank board.

The bulk of the FDIC's complaint is devoted to its claims against the directors and senior officer defendants for approval of twelve loans that resulted in losses of over $115 million for the Bank. As a backdrop for those claims, the FDIC describes a litany of the Bank's operational deficiencies and failures, including: (i) a "dangerous" concentration in CRE and ADC loans; (ii) a failure to maintain a proper credit administration staff; (iii) an inappropriate reliance on outside mortgage brokers to structure and facilitate large loans; (iv) a failure to establish procedures to ensure compliance with the Bank's loan policy and prudent lending practices; (v) an inability to generate timely and accurate financial reports; (vi) a routine disregard of the Bank's loan policy; and (vii) an arrogant disregard of bank regulators and their criticisms.

Most of the bad loans were for purchase or refurbishing of existing hotel properties, and most of them were made after the commercial real estate market had started to decline and collateral values had plummeted. In one example, in February 2008, the director and officers defendants approved a loan for nearly $29 million to a limited liability company to renovate a hotel in south Florida. Approximately $20 million of the loan was used to refinance a prior loan that was already in default. The Bank disbursed the funds without first obtaining formal approval by the loan committee. Furthermore, at the time of the loan, the borrower had not received the required construction permits. The Bank failed to monitor the project, and it disbursed construction draws on sham purchase orders. In the end, the FDIC alleges, the estimated losses attributable to this loan are in excess of $16 million, plus interest.

Finally, the FDIC also asserts claims for legal malpractice, breach of fiduciary duty, and aiding and abetting against the Bank's primary outside counsel (who was also a director) and his law firm. In short, the FDIC alleges the Bank's lawyer was aware of the regulators' warnings about the Bank's overconcentration in out-of-area projects; its poor underwriting practices; its inability or unwillingness to monitor and control large loans; and its overconcentration in the hotel industry. Despite that knowledge, the FDIC alleges, the lawyer and his firm actively facilitated "massive" loans to developers that they knew or should have known would inflict huge losses on the Bank. The FDIC also alleges that the lawyer and his firm failed to counsel the Bank on the illegality of the $10.5 million of dividend payments to the holding company. In total, the FDIC is seeking $79 million in damages against the lawyer and his firm, plus a disgorgement of the more than $3 million of legal fees paid to the firm between January 2007 and April 2009.

FDIC as Receiver for Westsound Bank v. Johnson, Filed Nov. 18, 2011

FDIC Sues Former Directors and Officers of Westsound Bank

Tuesday, January 24, 2012

Written by Bard Brockman

In mid-November 2011, the FDIC filed a complaint against eleven former directors and officers of Westsound Bank (Bremerton, WA), which was closed in May 2009. The lawsuit is the FDIC's seventeenth action against former D&Os of failed banking institutions since the advent of the Great Recession. A copy of the FDIC's complaint is available here.

The FDIC's core allegations resemble those asserted in its prior D&O lawsuits. Specifically, it alleges that the Westsound board embarked on a "reckless" business strategy focused on high-risk ADC and CRE lending. The FDIC further contends that the board and the Directors Loan Committee ("DLC"): (i) failed to properly manage and supervise the bank's lending function; (ii) approved loans in violation of and without regard to the bank's loan policy; (iii) ignored regulators' warnings about excessive loan concentrations and lax oversight of the lending function; and (iv) approved additional loans and loan renewals and advances to mask non-performing credits.

The FDIC seeks to recover damages in excess of $15 million on claims for gross negligence (under FIRREA), and state law claims for negligence and breach of fiduciary duty. Its alleged damages are tied to 35 specific credits, including seven ADC/CRE loans, and seven other loans to insiders allegedly made without board approval in violation of Reg. O.

The most interesting loan losses arise from 21 loans made to members of the local Russian/Ukranian community. These loans were among 142 "fraudulent" loans originated by a single loan officer, who the FDIC alleges colluded with a non-bank employee, Aleksandr Kravchenko, to bring loans to the bank. According to the complaint, Mr. Kravchenko frequently purchased properties, and then would find a straw buyer to obtain the loan to buy the property and fund construction of a spec home. Mr. Kravchenko, through his construction company, often received a "development fee" of $10,000 – $15,000 from the loan proceeds, although no work was performed for the fee.

The FDIC contends that, under the bank's loan policy, these loans should have been considered by the Directors' Loan Committee ("DLC"). Instead, these loans were approved through an automated (and easily manipulated) process reserved for loans intended to be sold into the secondary market. Most of the loans provided 100% financing, and many were based on stated-income or incomplete and questionable financial information. Additionally, the appraisals used to support automated approval were based upon an "as-built" valuation, even where the proposed borrower had not submitted building plans. Furthermore, the loan officer who originated the loans earned more than $1 million in commissions alone, including commissions on renewals of non-performing loans, in less than two years. The FDIC alleges that regulators warned the board that the bank's lending function, and specifically the protocol that allowed the loan officer to obtain approval of the questionable credits, was "malfunctioning." It further alleges that the board did not address the problem in a timely fashion, allowing the loan officer to extend credit on the 21 “fraudulent” loans for which the FDIC is now seeking to recover damages.

FDIC as Receiver for Bank of Asheville v. Greenwood, Filed Dec. 29, 2011

FDIC Files Suit Against Former Directors of The Bank of Asheville
Wednesday, January 25, 2012
Written by Jake Bielema

On December 29, 2011, the FDIC filed suit against seven former directors of the Bank of Asheville in the Western District of North Carolina seeking to recover over $6.8 million in losses suffered by the bank prior to receivership. All of the directors named as defendants were members of the bank’s Loan Committee, the committee responsible “for the amplification, implementation and administration of the loan policy” and “management of the lending function”. The Complaint cites 30 specific commercial real estate and business loans approved by the defendants between June 26, 2007 and December 24, 2009 as causing loss to the bank and those loans form the subject matter of the Complaint. A copy of the FDIC’s complaint is available here.

In the Complaint, the FDIC as Receiver essentially cites the Bank’s rapid growth strategy concentrated in what it characterizes as “higher risk, speculative commercial real estate loans”. The Complaint alleges that the defendants had virtually no previous banking or commercial real estate lending experience, failed to implement even the most basic prudent lending controls, and neglected to adequately supervise inexperienced and under qualified lending personnel. The complaint further alleges that the defendants failed to heed warnings by State and Federal regulators as well as outside auditors of the increasing risk associated with the bank's highly concentrated commercial real estate loan portfolio. The complaint alleges that once those risks began to manifest themselves, the defendants "took actions that masked the bank's mounting problems" by approving additional loss loans and renewing and making additional advances on other non-performing loans, as well as replenishing interest reserves which allowed borrowers to pay interest with more borrowed funds.

The Asheville suit brings to 18 the total number of lawsuits the FDIC has now filed against directors and/or officers of failed banks. What is most notable about the complaint is the absence of any particularly compelling allegation of wrongdoing, such as self dealing or personal enrichment, and the relatively small amount of the losses sought. The Asheville suit appears to be the clearest example yet of a suit that is based almost solely upon allegations of negligence relating to rapid growth and over concentration in commercial real estate, a fact pattern that was prevalent at hundreds of community banks during the real estate boom years. The Asheville suit may signify that the FDIC is becoming more aggressive in deciding which bank failures merit lawsuits, or it may signal that the FDIC believed it needed to file a lawsuit in order to get the attention of a D&O carrier. Based on the number of lawsuits that the FDIC has authorized, it is clear that there will be many more lawsuits to come against former directors and officers of failed banks.

FDIC as Receiver for R-G Premier Bank of Puerto Rico v. Galán-Alvarez, Filed Jan. 18, 2012

FDIC Sues Former Directors and Officers of R-G Premier Bank

Thursday, January 26, 2012

Written by Bard Brockman

On January 18, 2012, the FDIC filed a complaint against former directors and officers of R-G Premier Bank of Puerto Rico, which was closed and put into receivership on April 30, 2010. A copy of the FDIC's complaint is available here.

The roots of R-G Premier's failure, the FDIC contends, can be traced to the 2001 strategic decision to increase its commercial real estate lending. According to the complaint, the board of directors appointed a new Chief Lending Officer, Victor Irizarry, and it structured the Bank to give Irizarry "free rein" to make commercial real estate loans. Among the board's alleged failings was its decision to give Irizarry supervisory control of the Bank's credit risk management department. This reporting structure, the FDIC alleges, effectively squelched the credit risk personnel from voicing any concerns about the underwriting of loans or creditworthiness of borrowers. Internal audits and banking regulators both warned that the credit risk management function should be segregated from the loan department, but the board ignored those warnings.

The FDIC further alleges that the board itself essentially turned a "blind eye" to the Bank's lending function. Specifically, the FDIC alleges that the board failed to institute effective loan reviews, which in turn "undermined its own ability to monitor the health and quality of its rapidly expanding commercial loan portfolio." The board's failure to institute appropriate procedures and controls, combined with its resistance to recommended reform, resulted in the Bank's extension of over $350 million in loans that a "prudent banker should have known would probably never be repaid."

The FDIC asserts two claims for gross negligence against the D&O defendants. First, it asserts a claim against the director defendants (except for the advisory directors) for their grossly negligent failure to adequately supervise the Bank's lending function. And second, it alleges a claim for gross negligence arising from the approval of risky and imprudent loans by the officers and directors, including the advisory directors who voted for those loans. The FDIC prays for damages in excess of $257 million for loan losses arising from 77 specific failed credits.

ALLOWANCE FOR LOAN AND LEASE LOSSES

Jamie Hood
Porter Keadle Moore, LLP
Atlanta, Georgia

Porter Keadle Moore, LLP
Professional Service with a Personal Touch

Allowance for Loan and Lease Losses

February 17, 2012

2006 Interagency Policy Statement Highlights

- Issued to ensure consistency with GAAP and supervisory guidance.
- The allowance does not apply to:
  - Loans carried at fair value,
  - Loans held for sale,
  - Off-balance sheet credit exposures* (e.g. financial instruments such as off-balance sheet loan commitments, standby letters of credit, and guarantees).

* reserve in other liabilities with an offset in other expenses

2006 Interagency Policy Statement Highlights

- Allowance calculation <u>must be institution specific</u> and not based on standard benchmark loss percentages (i.e. 15% substandard and 50% doubtful).

Components of ALLL

Impaired Loans - Specific Reserves

Classified Loans - General Reserve

General Loan Pools - General Reserve

Impaired Loans

- A loan is **impaired** when it is probable that a creditor will be unable to collect all amounts due according to the contractual term of the loan agreement, which includes both the contractual interest and principal payments.
- ASC does not specify how to identify impaired loans and directs the creditor to apply its normal loan review/identification procedures in making that judgment.

Example of Impairment Analysis

Example Bank						
Impaired Loans						
	Recorded					
	Investment	PV of Expected	FV of	NRV of	Specific	
Borrower	in the Loan *	Payments	Loan	Collateral	Allowance	
Smith	1,000,000			1,200,000	-	1
Jones	2,500,000			2,000,000	500,000	2
Brown	1,500,000			1,800,000	-	1
Total	**5,000,000**				**500,000**	

1 $0 impairment loss. Cannot include in General Reserve (FAS 5) calculation. No ALLL required.

2 Impairment loss identified. Charge off for a collateral dependent loan, specific reserve for others.

* Recorded Investment in the Loan takes into account write-downs and does not include any valuation allowance.

General Reserve

- Need to quantify the reasons for making the adjustments.
- Must reflect both historical and environmental factors.
- If an institution's historical loss experience is minimal, the allowances under General Reserve must be supported based on qualitative or environmental factors and/or peer data.

Example of General Reserve Analysis

Example Bank					
Allowance for Loan and Lease Losses					
	Loan	Historical	Subjective	Total	
	Balance	Charge offs	Factors	Reserve %	Allowance
General Allowance:					
1-4 Family Revolving Open - end	215,646	0.25%	0.50%	0.75%	1,617
1-4 Family 1st Lien Closed	185,200	0.25%	0.50%	0.75%	1,389
Construction & Land Development & Other Land					
1-4 Family Residential	18,259,758	0.33%	0.50%	0.83%	151,556
Other Construction and Land	62,554,338	0.33%	0.50%	0.83%	519,201
Nonfarm, Nonresidential					
Owner Occupied	3,873,120	0.25%	0.50%	0.75%	29,048
Not Owner Occupied	9,699,503	0.25%	0.50%	0.75%	72,746
1-4 Family 2nd Lien Closed	6,290	0.25%	0.50%	0.75%	47
Commercial and Industrial Loans	3,613,024	0.33%	0.50%	0.83%	29,988
Other Consumer Loans	1,593,121	0.33%	0.50%	0.83%	13,223
Total General Allowance	100,000,000				818,816
Classified Loans	2,000,000				250,000
Specific Reserves on Impaired Loans	5,000,000				500,000
Total	107,000,000				1,568,816

Example of General Reserve Analysis

Example Bank			
Summary of Qualitative and Environmental Factors			
	Grade	Impact	
Changes in lending policies and procedures	3	0.0%	
Changes in economic and business conditions	4	0.1%	
Changes in the nature and volume of the loan portfolio	3	0.0%	
Changes in lending management and staff	3	0.0%	
Changes in problem loans	4	0.1%	
Changes in the quality of the loan review system	3	0.0%	
Changes in collateral values in general	4	0.1%	
Existence, effect and changes in concentrations	4	0.1%	
Other external factors	4	0.1%	
Total change due to qualitative and environmental factors		0.5%	
Each of these factors is monitored on a quarterly basis and are rated based on the following scale:			
	Grade	Impact	
Current environmental factor significantly improved compared to historical period	1	-0.2%	
Current environmental factor improved compared to historical period	2	-0.1%	
Current environmental factor the same compared to historical period	3	0.0%	
Current environmental factor declined compared to historical period	4	0.1%	
Current environmental factor significantly declined compared to historical period	5	0.2%	

Future of Allowance & Impairment

- Part of financial instruments project
- FASB and IASB trying to cooperate but have differing objectives
- FASB objective is to cover losses now
- IASB objective is to recognize the estimated losses over the life of the asset as a yield adjustment
- Most recent proposal is an attempt to reconcile and satisfy both objectives

Allowance - Impairment

- Three "buckets"
  - The good bucket
  - The bad bucket
  - The impaired bucket
- Alternatives for the good bucket
  - 12 months expected based on current information
  - Expected losses over life of loans recognized over the life of the loans
  - 12 months expected that does not change; add or subtract current changes but never lower than original expectation

Jamie Hood, CPA Audit Manager

- Joined PKM in 2003
- Graduate of Georgia Southern University
- 8 years of Bank Audit Experience
- Extensive practice in auditing community banks and publicly traded companies
- Member
  - American Institute of Certified Public Accountants
  - Georgia Society of Certified Public Accountants

Troubled Debt Restructurings

February 17, 2012

What is it?

- **310-40-15-5** A restructuring of debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.
- However, not all modifications of loan terms result in a TDR. If the modified terms are consistent with market conditions and representative of terms the borrow could obtain in the open market, the restructured loan is not categorized as a TDR.

Why do we care?

- If a modification meets the definition of a TDR, it also meets the definition of an impaired loan and must be accounted for as such in accordance with ASC 310-40 (FAS 114). **Why?**
- A loan is **impaired** when it is probable that a creditor will be unable to collect all amounts due according to the contractual term of the loan agreement, which includes both the contractual interest and principal payments.

Why do we care?

- TDRs are a current "Hot Topic" and microscopic scrutiny by regulators and auditors.
- Regulatory criticism often includes the need for improvement.
- Auditors are responsible for obtaining an understanding of the extent to which the company is modifying the terms of loans and the nature of the modifications in order to plan the audit; identifying the internal controls that management has implemented to ensure that TDRs are identified and accounted for as impaired loans.

What are the sources of guidance?

ACCOUNTING

- ASC 310 *Receivables* (FAS 114)
  - Troubled Debt Restructurings by Creditors 310-40
- Accounting Standards Update No. 2011-02

REGULATORY

- OCC Bank Accounting and Advisory Series 2010 Q&A

AUDIT

- SAS 57 and AU 342 for guidance on auditing accounting estimates

How to Identify?

- When evaluating whether a restructuring constitutes a TDR, the creditor must separately conclude that both of the following exist:
  - 1) The creditor granted a concession
  - 2) The debtor is experiencing financial difficulties
- The amendments to ASC 310 clarify the guidance on a creditor's evaluation of whether it has granted a concession and provides examples of financial difficulty.

Examples of a Concession

- ▲If a debtor does not otherwise have access to funds at a market rate for debt with similar risk characteristics as the restructured debt, the restructuring may indicate the creditor has granted a concession.
  - Concession stems from an agreement between the creditor and the debtor or is imposed by law or court
  - Concession is granted when creditor attempts to protect as much of its investment as possible

Examples of a Concession

- ▲Reduction of the stated interest rate for the remaining original life of the debt
- ▲Extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk
- ▲Reduction of the face amount or maturity amount of the debt as stated in the agreement
- ▲Reduction of accrued interest

Troubled Debt Restructurings

- A temporary or permanent increase in the contractual interest rate does not preclude the restructuring from being a TDR. The new interest rate (although higher) may be considered a concession because the new rate could still be below market for new debt with similar risk.
- However, a restructuring that results in a delay in payment that is insignificant is not a concession. The amendments include examples illustrating the assessment of whether a restructuring ‘s delay is insignificant.

Examples of Financial Difficulties

- The debtor is currently in payment default on any of its debt, or it is probable the debtor will be in default on any of its debt in the foreseeable future
- The debtor has declared or is in the process of declaring bankruptcy
- The debtor’s cash flows will be insufficient to service any of its debt in accordance with the contractual terms of the existing agreement for the foreseeable future

Accounting for TDRs

- "Generally accepted accounting principles require a creditor to measure loan impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. However, as a practical expedient, a creditor is permitted to measure loan impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent."

Footnote disclosure highlights

Troubled Debt Restructurings that Subsequently Defaulted	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Residential-Prime			
Residential – Subprime			
Consumer – Other			
Finance Leases			
Troubled Debt Restructurings that Subsequently Defaulted	**Number of Contracts**	**Recorded Investment**	**Recorded Investment**
Residential-Prime			
Residential – Subprime			
Consumer – Other			
Finance Leases			

Disclosures - ASC 2011-02

- Public Entities: Effective for first interim or annual periods beginning on or after June 15, 2011.
- Nonpublic Entities: Effective for annual periods ending after December 15, 2012, including interim periods within those annual periods.
  - As a result of adopting the amendments in ASU No. 2011-2, Company X reassessed all restructurings that occurred on or after the beginning of the current fiscal year (January 1, 2011) for identification as troubled debt restructurings. Company X identified as TDRs certain receivables for which the ALL had previously been measured under a general allowance for credit losses methodology. Upon identifying those receivables as troubled debt restructurings, Company X identified them as impaired under the guidance in Section 310-10-35.

Disclosures – ASC 2011-02, continued

- The amendments in ASU No. 2011-02 require prospective application of the impairment measurement guidance in Section 310-10-35 for those receivables newly identified as impaired. At the end of the first interim period of adoption (September 30, 2011), the recorded investment in receivables for which the allowance for credit losses was previously measured under a general allowance for credit losses methodology and are now impaired under Section 310-10-35 was $58.8 million, and the allowance for credit losses associated with those receivables, on the basis of a current evaluation of loss, was $7.2 million.

RECENT BANKING LAW CASES

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RECENT BANKING LAW CASES

ICLE Banking and Finance Law
February 17, 2012

By

Gerald L. Blanchard
Bryan Cave, LLP

BRYAN CAVE

BASIC LEGAL PRINCIPLES

Mistakes were made.

Someone else should pay.

BRYAN CAVE

CONTRACT CLAIMS

- True meeting of the minds
- Good faith and fair dealing
- Oral agreements
- Duress
- Statute of frauds
- Estoppel

BRYAN CAVE

TORT CLAIMS

- Breach of fiduciary duty
- Fraudulent or negligent misrepresentation
- Negligent loan administration
- Tortious interference with contractual affairs

BRYAN CAVE

Baxter v. Fairfield Financial Services, Inc., 307 GA App 286, 704 SE2d 423 (2011).

BRYAN CAVE

GUARANTORS TO BANK: -YOU MISLED US

In suit by lender against Guarantors, the Guarantors claimed that they were fraudulently induced to sign the Guaranties based on alleged statements made by a loan officer about the creditworthiness of the borrower. According to the Guarantors, the loan officer told them the company's two principals "were the Bank's strongest borrowers," "were loved at the Bank," and "were good people to do business with." Guarantors pled a cause of action based on fraud.

BRYAN CAVE

BANK TO GUARANTORS -WE DON'T BELIEVE YOU ACTUALLY RELIED ON THAT STATEMENT!

There existed no fiduciary relationship between the bank and guarantors that would have obligated the Bank to provide them with accurate advice. Absent a special relationship there could be no reasonable reliance on the loan officer's statement. Moreover, where the statements in question involve general commendations or opinion a party is obligated to make their own investigation in order to ascertain the truth.

BRYAN CAVE

JIG Real Estate, LLC v. Countrywide Home Loans, Inc., 289 Ga 488, 712 SE2d 820 (Ga 2011)

BRYAN CAVE

FORECLOSURE RESCISSION

JIG Real Estate, was the high bidder at a foreclosure sale held by Countrywide Home Loans. Countrywide sought to rescind the sale based upon OCGA 9-13-172.1

BRYAN CAVE

RESCISSION CONT.

Rescission is authorized where:

(i) The sale was not conducted according to law;

(ii) The default was cured prior ot the sale;

(iii) The borrower and lender have agreed to cancel the sale based upon an enforceable promise by the borrower to cure the default.

BRYAN CAVE

RESCISSION CONT.

Georgia Supreme Court held that the rescission statute was not void for vagueness.

BRYAN CAVE

Decision One Mortgage Company, LLC v. Victor Warren Properties, Inc., Case No. A10A0247 (Ga. App. June 14, 2010).

BRYAN CAVE

THE PRICE REAL WAS TO GOOD TO BE TRUE

Decision One conducted a nonjudicial foreclosure sale at which Warren Properties was the high bidder. Before leaving the courthouse steps, Warren Properties paid the funds and Decision One gave a receipt. Several weeks later, Decision One returned the funds to Warren Properties purporting to rescind the sale. Warren Properties demanded performance and sued alternatively for damages and specific performance. Decision One defended that its calculation of the opening bid had been a mistake and asked the court to invoke its equitable power to grant relief. The trial court granted Warren Properties' motion and ordered Decision One to deliver the deed.

BRYAN CAVE

FORECLOSURE PRICE CONT.

The Court of Appeals rejected Decision One's mistake argument under the general rule that "equity does not operate to rescind a contract based upon a unilateral mistake 'where the party claiming mistake, by exercising reasonable diligence, could have discovered the truth.'"

BRYAN CAVE

DuBarton Enterprises, LLC v. Appalachian Community Bank, 304 Ga App 273, 695 SE2d 748 (Ga App 2010)

BRYAN CAVE

DUTY TO NEGOTIATE?

- Dubarton defaulted on its loan from Appalachian, which began foreclosure proceedings. Dubarton, alleging negligence and fraud, filed suit to enjoin the foreclosure. The trial court denied relief. On appeal, among other claims, Dubarton argued the fraudulent failure by the bank to enter into another loan agreement to fund satisfaction of the defaulted loan.

BRYAN CAVE

DUTY TO NEGOTIATE?

The Court of Appeals, rejected this contention. The bank had the right under the security deed to foreclose, rendering irrelevant any subsequent actions by the bank that made more difficult the debtor's repaying the loan. Held: the bank owed no duty to the borrower to renegotiate the terms of the loan or to enter into a problem loan workout.

BRYAN CAVE

Farm Credit Of Northwest Florida, ACA V. Easom Peanut Company, et al., 2011 WL 4057786 (Ga APP 2011).

BRYAN CAVE

PEANUT PRIORITY

Peanut growers were not paid by peanut broker. Lender asserted priority claim to proceeds from the sale of the peanuts. Growers requested that lender's claim be subordinated based upon bad faith. The absence of good faith in the conduct of a secured party is a consideration which, if sufficiently established by the evidence, may result in a reordering of the priorities set forth in the UCC.

PEANUTS CONT.

J.E. Golden Farms alleged that Fidelity told it that as soon as its peanuts were delivered, Farm Credit would issue a check for payment. J.E. Golden Farms contacted Rick Bitner of Farm Credit in Tallahassee to verify Fidelity's statement. Bitner allegedly confirmed that Fidelity had a line of credit, that Fidelity's account was in good standing, and that upon receipt of the paperwork for the peanuts, Farm Credit would issue payment directly to J.E. Golden Farms.

Kensington Partners, LLC V. Beal Bank Nevada, 2011 WL 3131044 (Ga App 2011)

BRYAN CAVE

ASSIGNMENT IS NOT A MYSTERY WORD

Beal Bank sued on a note and guaranty it acquired by assignment from the FDIC acting as receiver for BankFirst. The borrower and guarantors appealed from an entry of summary judgment against them in the amount of $6,977,750 arguing that there was no evidence of a valid assignment.

BRYAN CAVE

ASSIGNMENT CONT.

- Although the appellants concede that the affidavits establish that the FDIC assigned the note to Beal Bank, they claim that Beal Bank has not shown that the assignment was valid because there is no evidence that BankFirst had failed or that the FDIC was appointed receiver of BankFirst.

BRYAN CAVE

ASSIGNMENT CONT.

- The evidence submitted includes an affidavit providing that Beal Bank acquired the note and deed for valuable consideration by assignment from the FDIC as receiver of BankFirst; the written assignment of the deed from the FDIC to Beal Bank, which repeatedly identifies the FDIC as receiver for BankFirst; and a Note Allonge attached to the promissory note, identifying Beal Bank as the assignee and the FDIC as receiver for BankFirst.

BRYAN CAVE

ASSIGNMENT CONT.

- Guarantors also argued that the individual guaranties were not assigned along with the collateral documents. Unfortunately for them the assignment of the deed included all other loan documents relating to the loan. Further, under Georgia law, the assignment of the underlying promissory note operates as an assignment of any related guaranty.

BRYAN CAVE

ASSIGNMENT CONT.

- Finally, he guarantors argued that there were questions of fact about the amount of debt actually owing. Bank presented evidence to rebut this argument, including the entire payment history of the loan.

BRYAN CAVE

<u>REL Development, Inc. v. BB&T</u>, 699 SE2d 779 (Ga 2010)

BRYAN CAVE

Sue or Foreclose

Borrower defaulted on over $4 million in loans and the lender commenced foreclosure proceedings for an August, 2008 sale. At the borrower's request the lender pulled the foreclosure ad to provide the borrower with time to sell the property. The borrower was unable to do and the lender, instead of recommencing foreclosure, simply sued the borrower and guarantors.

BRYAN CAVE

Sue or Foreclose

The value of the real property collateral dropped dramatically after the foreclosure was called off. The obligors argued that the lender should have been required to have mitigate its damages by continuing with the foreclosure in order to maximize its recovery and reducing the amount of the deficiency.

BRYAN CAVE

Sue or Foreclose

"The fatal flaw in this argument is that the Bank had no obligation to pursue foreclosure proceedings but was fully authorized by both the law and the debt instruments to pursue only lawsuits against the debtors and guarantors to recover the debts."

BRYAN CAVE

See also River Farm LLC v. SunTrust Bank, 699 SE2d 771 (Ga 2010)

BRYAN CAVE

Whooping Creek Construction, LLC V. Bartow County Bank, 310 Ga App 690, 713 SE2D 871 (Ga App 2011).

BRYAN CAVE

BOUNCED CHECK

- Whooping Creek Construction, LLC ("WCC") sued bank after check it received for grading work bounced. Trial court entered summary judgment for the bank. WCC had been hired by DDH Construction which in turn had been hired by Gavin Garrett, LLC, Garret had been hired by the general contractor.

BRYAN CAVE

BOUNCED CHECK CONT.

- The GC issued payment to Gavin Garrett, including the money owed to WCC and Garrett transferred the money to DDH Construction, which then sent WCC a check for $60,452. WCC deposited the check at McIntosh Bank and sent to Bartow County Bank. Bartow returned the item and placed a hold on DDH's account after which it transferred the funds back into Garrett's account so it could exercise setoff rights due to a default under another loan.

BRYAN CAVE

BOUNCED CHECK CONT.

- WCC argued that the bank was liable for conversion because the Bank had actual knowledge that the funds that passed through the accounts of Gavin Garrett and DDH were intended to discharge a debt owed to WCC.

BOUNCED CHECK CONT.

"Where the right of set-off against a depositor exists, that right has application only to general deposit funds, which are commingled with other funds on deposit with the bank, and not to receipts which are designated as trust funds *or are received by the bank with knowledge that they are intended to discharge a particular obligation, such that they partake of the character of trust funds."* Summary judgment for bank reversed.

<u>Thomas v. Bank of America Corp</u>., 309 Ga App 778, 711 SE2d 371 (GA App 2011)

BRYAN CAVE

DEBT CANCELLATION PRODUCTS

- For 95 cents per $100 of outstanding balance on a credit card account, Credit Protection Plus provides for the cancellation of the account balance or suspension of the minimum payment due if certain specified events—such as job loss, illness, or death—occur. Being employed is a requirement for some of the Credit Protection Plus components. But because the components are bundled, a customer who purchases Credit Protection Plus must purchase all components, including those components for which she is ineligible.

BRYAN CAVE

DEBT CANCELLATION CONT.

- Thomas alleged: (1) that the defendants committed insurance fraud by falsely representing that all of the bundled components of Credit Protection Plus would be available to her; (2) that the defendants violated the Georgia Insurance Code by failing to quote the premium rates for the bundled components separately so that she could purchase them separately; (3) that the defendants violated the Georgia Insurance Code by charging premiums that exceeded the premium rates on file with the Georgia Insurance Commissioner.

DEBT CANCELLATION

Debt cancellation is a banking product and not insurance.

Mannato v. SunTrust Bank, 308 Ga App 691, 708 SE2d 611 (Ga App 2011)

BRYAN CAVE

SHAREHOLDER RIGHTS

On March 27, 2008, Mannato asked SunTrust to pursue legal claims against its officers and directors for breach of fiduciary duty in connection with the housing market collapse. On August 19, 2008, SunTrust's board of directors responded to Mannato's request in writing and rejected it.

BRYAN CAVE

SHAREHOLDER RIGHTS

The board explained that it created a special committee and retained independent counsel to investigate Mannato's claims. Based on this investigation, SunTrust determined that the allegations of breach of fiduciary duty were "without basis in fact" and that "the best interests of the Company would not be served by commencing litigation."

BRYAN CAVE

SHAREHOLDER RIGHTS

- "On September 24, 2008, Mannato, in his capacity as a shareholder of SunTrust, demanded access to SunTrust's books and records for inspection and copying. SunTrust's counsel denied this request, in part, because Mannato owned less than two percent of SunTrust's shares and was therefore not entitled to inspect its records and books under OCGA § 14–2–1602(e) and SunTrust's bylaws."

BRYAN CAVE

SHAREHOLDER RIGHTS

- Court rejected Mannato's claims. The statutory restriction specifically abrogates any common law rights he may have had as a shareholder to inspect SunTrust's books and records.

BRYAN CAVE

State Bar of Georgia Unauthorized Practice of Law Advisory Opinion No. 2010-1

QUESTION PRESENTED: Assuming no traverse has been filed by any party in a garnishment action, is the completion, execution and filing of an answer in the garnishment action by a non-attorney employee of the garnishee considered the unlicensed practice of law?

BRYAN CAVE

Garnishments Cont.

SUMMARY ANSWER: A nonlawyer who answers for a garnishee other than himself in a legal proceeding pending with a Georgia court of record is engaged in the unlicensed practice of law. Approved by the Ga Supreme Court on September 12, 2011.

BRYAN CAVE

Garnishments Cont.

A properly served garnishee is bound to file an answer with the appropriate court. If the answer is not filed, the garnishee faces a default judgment. The inescapable conclusion is that a garnishment action is a legal proceeding. That being the case, the Committee examines who is permitted to file an answer to a legal proceeding that is pending with a Georgia court.

BRYAN CAVE

Garnishments Cont.

As far as corporate self-representation, in Georgia, only a licensed attorney is authorized to represent a corporation in a proceeding in a court of record, including any proceeding that may be transferred to a court of record from a court not of record

BRYAN CAVE

Bank of America Corp. v. Ronald, et al., 2011 WL 3690047 (Cal App 2001)

BRYAN CAVE

COUNTRYWIDE

- By 2005, Countrywide was the largest mortgage lender in the United States, originating over $490 billion in loans in that year alone. Plaintiff alleged that Countrywide's founder and CEO, Angelo Mozilo determined that Countrywide could not sustain its business "unless it used its size and large market share in California to systematically create false and inflated property appraisals throughout California.

BRYAN CAVE

COUNTRYWIDE

Plaintiff alleged that Countrywide then used these false property valuations to induce Plaintiffs and other borrowers into ever-larger loans on increasingly risky terms." Mozilo purportedly knew "these loans were unsustainable for Countrywide and the borrowers and to a certainty would result in a crash that would destroy the equity invested by Plaintiffs and other Countrywide borrowers."

BRYAN CAVE

COUNTRYWIDE CONT

Mozilo and others at Countrywide then allegedly "hatched a plan to 'pool' the foregoing mortgages and sell the pools for inflated value. Rapidly, these two intertwined schemes grew into a brazen plan to disregard underwriting standards and fraudulently inflate property values ... in order to take business from legitimate mortgage providers, and moved on to massive securities fraud hand-in-hand with concealment from, and deception of, Plaintiffs and other mortgagees on an unprecedented scale."

BRYAN CAVE

COUNTRYWIDE CONT.

Countrywide had a duty to "disclose to each borrower, including each Plaintiff herein, that the mortgage being offered to the Plaintiff was, in fact, part of a massive fraud that Countrywide knew would result in the loss of the equity invested by Plaintiff in his home and in severe impairment to Plaintiff's credit rating." Countrywide's fraudulent scheme "*destroyed California home values county-by-county and then State-wide.*"

BRYAN CAVE

COUNTRYWIDE CONT.

Court in dismissing claim found that even if the allegations were true "..we conclude that while Countrywide had a duty to refrain from committing fraud, it had no independent duty to disclose to its borrowers its alleged intent to defraud its investors by selling them mortgage pools at inflated values."

BRYAN CAVE

Paul v. Home Bank, 2011 WL 3443484 (Ind App 2011)

BRYAN CAVE

Read the Loan Documents

Plaintiffs were party to two loans (the "Superior" and the "Subordinate" loans) with separate guaranties. Guarantors argued that the integration clause found in the signed guaranties for the Superior Loan had an integration clause that negated the Subordinate Loan Guaranty.

BRYAN CAVE

Read the Loan Documents

"The Loan Documents constitute the complete and exclusive statement of all agreements among Borrower, Bank, and Guarantor. The Loan Documents replace and supersede all prior written and oral agreements by and among Borrower, Bank, and Guarantor and no representation, warranty, condition, commitment, or other statement will have any force or effect whatsoever unless contained in the Loan Documents."

BRYAN CAVE

Read the Loan Documents

The Superior Loan guaranty referenced the loan number for the Superior Loan. The Subordinate Loan guaranty referenced the loan number for the Subordinate Loan. Thus, the Superior Loan and the Subordinate Loan were two entirely separate contractual transactions, and the integration clause in the Superior Guaranty integrated only those agreements that were part of the negotiations directly leading to the Superior Loan.

BRYAN CAVE

Read the Loan Documents

Guarantors remained liable for the Subordinate Loan once the Superior Loan had been paid in full.

BRYAN CAVE

Read the Loan Documents

- "..it is undisputed that the Appellants are physicians and embarked upon a sophisticated business venture, namely hotel investment. Moreover, the Appellants cannot now complain because they failed to read the Superior Guaranty or seek the advice of legal counsel before signing the Superior Guaranty."

BRYAN CAVE

<u>Bank of America v. Narula</u>, 2011 WL 3209849 (Kan App 2011)

BRYAN CAVE

FRAUD

BofA sought to foreclose on a commercial office building. Borrowers counterclaimed for breach of contract, fraud, breach of fiduciary duty and negligent misrepresentation. The trial court awarded the Narulas $793,997 in compensatory damages and $750,000 in punitive damages against BofA.

FRAUD

The trial found that the Narulas had a long-standing, close relationship with Bank of America. From 1993 until May 2001, the Narulas' principal personal banker, known as a “Relationship Manager,” was Charles Wooten, a banker for Bank of America. He met with the Narulas many times and gave them advice on various personal and business financial matters such as working capital lines of credit, management of accounts receivable, creditworthiness of customers, and the Narulas' investment accounts.

FRAUD

The evidence showed that Bank of America handled both the Narulas' business needs and their personal investment funds. Bank of America repeatedly promoted itself to the Narulas as their "Trusted Financial Advisor." Bank of America wanted the Narulas to rely on it for its advice and counsel. The Narulas, for their part, relied heavily on Bank of America as their "Trusted Financial Advisor" in their personal and business affairs, and Bank of America knew that the Narulas were relying on them for financial advice.

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FRAUD

In 1998, Promotional Resources, the Narulas' business, was outgrowing its office space. Wooten, the BofA loan officer, suggested to the Narulas that they should consider constructing their own building. Wooten told the Narulas that the building could be an important part of their estate plan and could serve as a source of income during their retirement. Wooten even suggested the building site.

BRYAN CAVE

FRAUD

The Narulas liked Wooten's idea but told him that they had no experience in constructing a building or how to finance it. Wooten explained that they should not worry because Bank of America would hold their hand through the entire process. Borrower said "fine" so long as the permanent financing once the construction was finished was on a fixed rate.

BRYAN CAVE

FRAUD

BofA sold the borrower a swap in order to fix the rate. "The Swap Agreement was a nonnegotiable, lengthy, pre-printed form in small print that was not shown to the Narulas before signing nor was it explained to them during closing…in his first personal visit to the Narulas in August 2001, Bank of America Officer Dennis Nicely concluded that the Narulas had no idea as to how the Swap Agreement worked."

BRYAN CAVE

FRAUD

BofA required the borrower to sign various Modification and Extension Agreements, one of which deleted the bank's obligation to convert the construction loan to a permanent loan. The borrower was unable to move the loan and as a condition for another Modification the Narulas were required to begin liquidating personal assets. Eventually the bank demanded payment on the loan as well as the termination fee on the swap which at that point amounted to over $180,000.

BRYAN CAVE

FRAUD

The trial court concluded the Bank deceptively removed the provision requiring the bank to make a Permanent Loan to the Narulas under the Second Modification and Extension Agreement. The trial court further found that the Narulas had no idea what was meant by the sentence, "Section 2.2 of the Loan Agreement is hereby deleted in its entirety." Section 2.2 of the Loan Agreement dealt with Bank of America's obligation to make the Permanent Loan.

BRYAN CAVE

We enjoy being able to say that whatever problem a banker may have, we have a lawyer who has worked on a similar problem for a banker!
The members of our financial institutions group offer clients across the United States a broad spectrum of practical experience and legal knowledge of the governance, structure and regulation of financial institutions.

We emphasize hands-on experience. Our team includes numerous 25-year+ veterans of banking law, many of whom have prior real world experience as investment bankers, regulators, bank officers and CPA's who formerly audited banks.

Our broad experience, coupled with our innovative solutions and our long standing ties to regulators, trade associations and service providers, make us an invaluable asset to our clients

BRYAN CAVE

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BRYAN CAVE

Role of Lawyers in the Interaction Between Bank Clients and the Government

Moderator
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Overview

I. Discussion of contexts in which regulators and bank lawyers work together

II. The regulators will discuss their missions and how they see things

III. Question and answer

ALSTON+BIRD LLP

FDIC

Department of Banking & Finance "Safeguarding Georgia's Financial Services"

KILPATRICK TOWNSEND ATTORNEYS AT LAW

Contexts

- Interpretative guidance – bank lawyers regularly seek interpretive guidance from regulators with respect to applicable law, regulations and policies.
- Transaction applications and related discussions – bank lawyers represent their clients in connection with applications to merge banks, raise capital, open branches, etc. Such applications also involve a continuous dialogue that often begins pre-filing and that can extend on past closing.
- Examination findings and relates issues – regulators regularly examine banks and the findings of their exams and other related issues are often discussed with bank counsel.

Contexts

- Enforcement actions – regulators in their supervisory capacity often ask the banks they regulate to agree to various enforcement actions or seek to have them involuntarily imposed. Bank lawyers negotiate with the regulators with respect to such actions and represent the banks in connection with their implementation.
- Post-closing – when a bank closes, bank lawyers represent the former officers and directors of banks in connection with post-closing investigation and other legal matters.

Federal Deposit Insurance Corporation

- **Mission** is to maintain stability and public confidence in the nation's financial system by:
  - insuring deposits,
  - examining and supervising financial institutions for safety and soundness and consumer protection, and
  - managing receiverships.
- **Vision** is to be a recognized leader in promoting sound public policies, addressing risks in the nation's financial system, and carrying out its insurance, supervisory, consumer protection, and receivership management responsibilities.

Georgia Department of Banking and Finance

- **Mission** is to promote safe, sound, competitive financial services in Georgia through innovative, responsive regulation and supervision.
- **Vision** is to be the best financial services industry regulator in the country – Progressive. Proactive. Service-Oriented.
- **Motto** is: “Safeguarding Georgia’s Financial Services”

ALSTON+BIRD LLP FDIC Department of Banking & Finance "Safeguarding Georgia's Financial Services" KILPATRICK TOWNSEND ATTORNEYS AT LAW

Attorney-Client Privilege

- The attorney-client privilege generally applies to banks just like it does to any other corporation.
- Meaning, banks may refuse the disclosure of confidential communications with bank counsel.
- The privilege is designed to foster frank, open, and uninhibited discourse between attorney and client so that the client's legal needs are competently addressed.
- The attorney-client privilege may be raised during any type of legal proceeding, civil, criminal, or administrative, and at any time during those proceedings, pre-trial, during trial, or post-trial.

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Attorney-Client Privilege

- Prior to 2006, there was a conflict between the regulators' desire for full, unfettered access to all institution information and the banks' desire to retain the attorney-client privilege with respect to information that the banks provided to their regulators and that was later sought by third parties.
- As a result, in 2006, Congress passed 12 U.S.C. § 1828(x)(1) which provides that there is no waiver of the attorney-client privilege, under federal or state law, when a bank provides privileged materials to a federal or state bank regulator.

Attorney-Client Privilege

- Section 1828(x)(1) clearly applies to the Federal Reserve, FDIC, OCC and state regulators, like the Georgia Department of Banking & Finance.
- However, the Consumer Financial Protection Bureau is not a "federal banking agency," as defined in the statute, and thus not expressly covered by it.
- Nevertheless, pursuant to a January 4, 2012 CFPB bulletin, the CFPB has taken the position that it can demand attorney-client privileged documents from its supervised institutions without the privilege being waived as to third parties.

Attorney-Client Privilege

- Issues can arise when a bank is closed because the privilege runs with the bank.
- Thus, when a bank goes into FDIC receivership, the FDIC succeeds to the privilege and is able to waive it.
- This is one of the main drivers for officers and directors retaining personal counsel when failure becomes a risk. Their personal counsel can advise them about personal liability and related issues. If that is done, communications between those individuals and that separate counsel will be privileged.

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Exclusion & Sanction of Lawyers

- Pursuant to 12 C.F.R. Part 308, the federal banking regulators have provided rules of procedure in administrative proceedings before them. These rules include provisions that allow the FDIC and other federal bank regulators to exclude and otherwise sanction lawyers.
- Similar rules would apply in traditional courts for proceedings there involving the federal banking regulators and any state regulatory proceeding handled in such a forum.
- There are no specific statutes or rules that would expressly permit the exclusion or sanction of bank counsel outside of administrative or litigation proceedings.

Thomas Dujenski

REGIONAL DIRECTOR FOR THE DIVISION OF SUPERVISION AND CONSUMER PROTECTION'S ATLANTA REGION

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Thomas Dujenski was appointed Regional Director of the Atlanta Region in April 2010 and has served with the FDIC for over 27 years. The Atlanta Region covers the following states: Alabama, Florida, Georgia, North Carolina, South Carolina, Virginia, and West Virginia. As Regional Director, Mr. Dujenski directs the supervision of 1,028 insured depository institutions with assets totaling nearly $1.3 Trillion. Prior to this appointment, Mr. Dujenski served as Regional Director in the Dallas Region and as Deputy Regional Director in the Kansas City Region. Other management positions that Mr. Dujenski has held include Assistant Regional Director, Field Office Supervisor, Review Examiner, and Senior Bank Examiner. Mr. Dujenski also served in the Washington Office on several long-term assignments.

Mr. Dujenski graduated from State University of New York, Fredonia, New York, with a Bachelors degree in Business Administration - Finance; earned a Masters degree from Saint Bonaventure University, Saint Bonaventure, New York; and, graduated with distinction from Stonier Graduate School of Banking, University of Delaware. He is also a graduate of the Federal Executive Institute.

Kevin Hagler

DEPUTY COMMISSIONER FOR SUPERVISION

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Commissioner Braswell appointed Kevin Hagler as the Deputy Commissioner for Supervision on August 1, 2008. In this position, Kevin is responsible for regulatory supervision of the State's 200 State chartered Banks, and 60 State chartered credit unions, with a staff of 63 examiners.

Kevin began his career with the Department in 1997. He progressed through the examiner ranks and became a Supervisory Examiner in 2002 in District 1 (Northwest District). In 2003, Kevin was appointed to the position of District Director in District 1, where he assumed field regulatory and supervisory responsibilities for the financial institutions in the District.

Prior to joining the Department, Kevin started his career by working for Altus Bank before taking a position with The Bank of Mobile. In 1994, he moved to Atlanta to work for Trust Company Bank (SunTrust Bank) in the Factoring Division, and later worked in the In-Store Banking Division as an Assistant Manager. Kevin is a graduate of Auburn University with a degree in Finance and is a Certified Examination Manager.

John Henrie

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John Henrie presently serves as Deputy Regional Director overseeing risk management activities of the Atlanta Regional Office. Prior to this assignment, he served as an Assistant Regional Director for banks principally located in South Georgia and Supervisor for the Atlanta Field Office which covers banks located in North Georgia, including the Atlanta Metro Area. Prior to coming to Georgia, he served as the Chief of the Divisions of Supervision and Consumer Protection's Risk Management and Application Section in Washington, DC where he provided support to senior Division management, regional office staff, and other Division offices in matters relating to the examination and supervision of financial institutions. Mr. Henrie has also served as a case manager in the Boston Regional Office and as a Review Examiner in the Risk Management and Applications Section. He started his FDIC career as a bank examiner in the Concord, NH field office, in 1987.

Mr. Henris is a graduate of Brigham Young University and of the Stonier Graduate School of Banking.

Mark Kanaly

ALSTON+BIRD LLP

Mark Kanaly is a Partner in the firm's Financial Services & Products Group, focusing on the representation of banks and other financial institutions, as well as real estate investment vehicles, such as REITs. He assists these companies with private and public securities offerings, mergers and acquisitions, underwritings, corporate formations and restructurings, recapitalizations, corporate governance and a host of related complex regulatory issues.

In the current economic cycle, Mr. Kanaly has worked on some of the most innovative and recognized banking and real estate transactions in the country. In addition, he has counseled a host of distressed financial institutions and their boards of directors, as they have grappled with the challenges posed by the current financial and real estate environment.

Mr. Kanaly is a nationally recognized speaker on banking and real estate investment topics and his comments are regularly covered in the banking, real estate and general business press. He is a regular contributor to banking and real estate periodicals and industry conferences.

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James Stevens

James Stevens provides general corporate and bank regulatory advice to clients. Mr. Stevens has substantial experience in the representation of public and private companies and financial institutions in mergers and acquisitions, securities offerings and regulatory reporting and compliance. He also advises clients with respect to controlling and non-controlling equity investments.

Mr. Stevens was recognized as a 2009 "40 Under 40 Up and Comer" by the *Atlanta Business Chronicle*, has been selected as a Georgia "Rising Star" by *SuperLawyers* magazine every year since 2006, and was a member of the 2007-2008 Leadership Buckhead Program. Mr. Stevens is a member of the *Order of the Coif*, and during law school was Managing Editor of the *Georgia Law Review*.

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EMERGING PAYMENTS: PAYMENTS ISSUES – WHAT IS MONEY?
CONTINUED DEVELOPMENT OF PAYMENT SYSTEMS INCLUDING RELOADABLE CARDS AND CELL PHONES

Judith E. Rinearson
Bryan Cave, LLP
New York, New York

Emerging Payments:
Payments Issues - What is Money?

"Continued Development of Payment Systems including Reloadable Cards and Cell Phones"

Judith Rinearson
Georgia Bar Association – 2012 Banking Law Program
February 17, 2012

BRYAN CAVE
A Broader Perspective℠

Panel Agenda

- **Judie Rinearson**, Bryan Cave – Introductions; "What are Prepaid, Emerging and Mobile Payments?"
- **Cherie Fuzzell**, President, Firstview LLC
- **Steve Doctor,** Senior Vice President, Chief Operating Officer, Chief Financial Officer, Chexar
- **Judie Rinearson,** Bryan Cave - Legal Issues; Federal and State laws; Banks' roles; Risks and Benefits
- **Questions & Answers**
- **Concluding Thoughts**

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Judith Rinearson

Part I:

What are Prepaid, Emerging and Mobile Payments?

Payment Products

Three basic structures for payment products:

- Pay Later: Credit Cards; 30-day bill pay; lines of credit; charge cards; payday lending
- Pay Now: Cash (though some say cash is also "pay before"); checks; debit.
- Pay Before: Traveler's checks; money orders; tokens; prepaid cards

Emerging Payments

- Prepaid - "Pay before"
  - Payroll
  - General Purpose Reloadable
- Emerging & Mobile - "All of the above"
  - Credit, Debit and Prepaid Payments
  - Person-to-person
  - Loads
  - eWallets

Prepaid Cards: One size does NOT fit all

Retail Gift Cards – Payroll Cards – General Purpose Reloadable (GPR) cards - Teen Cards – Travel Cards – Mall Cards – Government Benefit Cards – Reward and Promotional Cards – Health Spending Account Cards -- and More

- Some are one-time transitory products that are thrown away when used up. Others allow for reloading and longer term relationships.
- Some are entirely anonymous. Others are imprinted with customer names and can be renewed every 2-3 years
- Some provide cash access at ATMs. Many do not allow for cash redemption.
- Some are pre-denominated in fixed dollar amounts. Others are loaded with value up to the level requested by the purchaser.

*It **is** clear that prepaid cards provide an important and necessary source of financial services to millions of underbanked and underserved consumers.*

Closed Loop -- Open Loop

Closed Loop vs Open Loop Gift Cards

Closed Loop "Store Gift Cards"

- Essentially a plastic version of a paper gift certificate
- Issuer is the retailer that accepts the card
- Runs on merchant's POS system – clerk usually knows immediately balance on card. There is NO Bank involved. (usually)

Open Loop "General Use Cards"

- Essentially a prepaid Visa, MasterCard, American Express or Discover Card useable where each brand is accepted
- Runs on existing credit card POS system – clerk only knows if a purchase is approved or declined; clerk does not know the balance.
- Can also access ATMs with a PIN
- There is ALWAYs a Bank involved (usually)

Open Loop – Branding

- Cards branded with a leading "acceptance mark" (American Express, Discover, MasterCard, Visa and PIN Networks such as NYCE, Star, Pulse, Interlink, etc)
- Value is maintained on a host computer system
- Uses existing payment network infrastructure for ATM and POS – anywhere network brand is accepted

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Prepaid – Payroll and General Purpose Reloadable

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General Purpose Reloadable and Payroll Cards – How they work

- Bank-issued – payment network branded
- If sold at POS: temporary non-reloadable anonymous card
- If issued through an employer: employee provides data
- Customer Identification: via online or telephone, cardholders provide name, address, SSN, DOB. Verified. Screened against known names and addresses (including IP addresses and telephone numbers.
- Limits usually between $5,000 - $10,000; load and spending velocity limits; Back-end monitoring
- Reg E; FDIC insurance; Durbin Amendment; FinCEN Regs

Categories of Prepaid Cards

BY FUNCTIONALITY
- Closed Loop - Purchasing Only (Retail Gift Cards)
- Closed Loop – Purchasing and cash (University Cards)
- Open Loop – PIN Based Only Card – PIN purchases and ATMs
- Open Loop – Purchasing Only Cards
- Open Loop – PIN + Purchasing Cards

BY FUNDING SOURCE
- Consumer funded
- Government funded
- Corporate funded

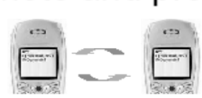
Emerging Payments

- What are they ?
  - USUALLY - - Same as existing payments but with a different "form factor"
    - Mobile Payments
    - Virtual Payments
    - eWallets
    - Contactless payments
  - USUALLY – underlying the form, is a Visa, MasterCard, Amex or Discover payment product – just with a different access device

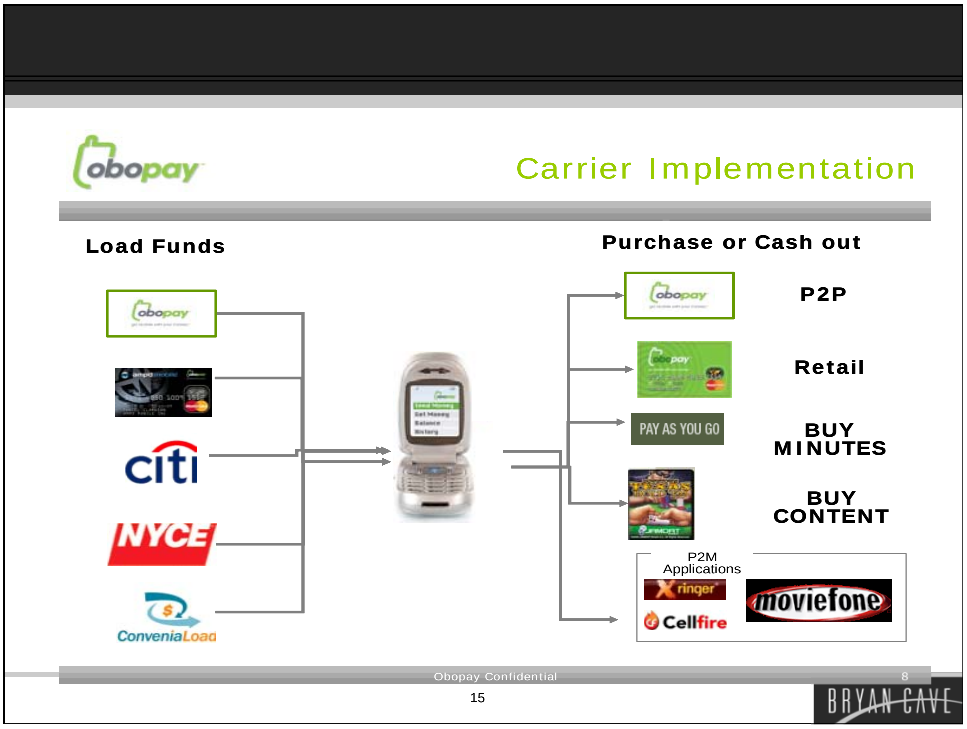
2007 Prepaid Card Expo

Mobile Payments Overview

Technology solutions are being developed for both remote and proximity payments.



Type of Mobile Payment	Remote Payments	Proximity Payments
How it works	Customer sends request through mobile phone, followed by verification process	Device in mobile phone acknowledge at POS terminal, and transacation is completed
Supporting Technologies	SMS (Short Message Services)	NFC (Near-Field Communication) and RFID (Radio Frequency ID)
Primary Focus of Technology	Security	Convenience
Case Studies	PayPal Mobile; Obopay	ViVOpay (ViVOtech); Mobile J/Speedy (JCB)


obopay
Carrier Implementation
Load Funds
Purchase or Cash out
P2P
Retail
PAY AS YOU GO
BUY MINUTES
BUY CONTENT
P2M Applications
ringer
Cellfire
moviefone
citi
NYCE
ConveniaLoad
Obopay Confidential
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Google wallet
What is Google Wallet?
How it works
Where it works
Get Google Wallet ›
FAQ
Help
We're building a better wallet.
Save time and money by shopping with Google Wallet — a smart, virtual wallet that stores your payment cards, offers, and more on your phone and online.
Make your phone your wallet
The Google Wallet mobile app securely stores your credit cards and offers on your phone. When you check out at brick-and-mortar stores that accept Google Wallet, you can pay and redeem offers quickly just by tapping your phone at the point of sale.
How it works in-store ›
Carry your wallet on the web
The Google Wallet online service stores your credit cards in the cloud. When you checkout at online merchants that accept Google Wallet, you can quickly pay by signing into your Google Wallet account.
How it works online ›
Google Checkout is transitioning to Google Wallet.
Start
Citrix XenApp - ...
5 Citrix
Outlook Web A...
Microsoft Pow...
Documents
Google Walle...
7:36 PM

Prepaid & Emerging Payments

- Hearing from the experts
  - –Cherie Fuzzell, First View Financial
  - –Steve Doctor, Chexar

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Judith Rinearson

Part II:

The Legal Issues:

- Federal & State Laws
- Banks' Roles
- Risks and Benefits

Basic Payment laws

- Federal
  - Consumer protection (Reg Z credit; Reg E for debit and prepaid; CARD Act; CFPB
  - Anti-Money Laundering (BSA/USA PATRIOT; Prepaid access rules; OFAC); Cross-Border restrictions
  - Dodd Frank – Durbin Amendment (interchange, exclusivity and routing rules; Remittances; CFPB
  - Bank regulations – OCC; FDIC; FRB; FFIEC
- State
  - Consumer protection
  - Abandoned Property
  - State money transmitter licensing

How prepaid payments are regulated

- Federal Laws: Electronic Funds Transfer Act & Reg E
  - **Regulation E extended to Payroll Cards – July 1, 2007**
  - **Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD Act") Signed into law May 22, 2009; effective generally in August 2010; amends the EFTA**
  - Gift Card Amendment covers both "open-loop" and "closed-loop" gift cards, codes and devices.
    - No Expiration Dates on Gift Cards prior to 5 years
    - No Monthly service fees on Gift Cards until after 12 months of inactivity
    - Disclosure requirements
    - Exemptions for reloadable non-gift cards; loyalty, award and promotional cards; admission tickets to events and venues; paper based products.
  - Continued compliance challenges for card issuers balancing Card Act against state law.
    - Only pre-empted less protective state laws

How prepaid payments are regulated

Federal Laws: FinCEN – Prepaid Access Regulations

- On July 26, 2011, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued Final Regulations on Prepaid Access.
- Replaces "stored value" with "prepaid access" and defines a number of new terms including:
  - Prepaid access (access to funds paid in advance, and retrievable through an electronic device or vehicle).
  - Prepaid program.
  - Provider of prepaid access.
  - Seller of prepaid access.
  - Closed loop prepaid access.

- Providers and Sellers must obtain identifying information about customers and verify their identities; file suspicious activity reports; implement effective AML compliance programs; and more.

FinCEN's Prepaid Access Rules

- **FIRST, a program is NOT a covered "prepaid program" if it meets one of these 3 GENERAL exemptions:**
  - Provides closed loop prepaid access to funds of up to $2,000 maximum value in any day; OR
  - Provides prepaid access solely to funds provided by a federal, state, local or other government agency; OR
  - Provides prepaid access solely to funds from pre-tax flexible spending arrangements for health and dependent care expenses, or from Health Reimbursement Arrangements.
  -
- *NOTE: Closed loop prepaid access is "[p]repaid access to funds or the value of funds that can be used only for goods or services in transactions involving a defined merchant or location (or set of locations), such as a specific retailer or retail chain, a college campus, or a subway system."*

FinCEN's Prepaid Access Rules

- **SECOND, a program is NOT a covered "prepaid program" if it meets one of these 2 LIMITED exemptions:**

- Provides prepaid access solely to employment benefits, incentives, wages or salaries; OR
- Provides "open loop" prepaid access solely to funds not to exceed $1,000 maximum value, and from which no more than $1,000 can be initially or subsequently loaded, used, or withdrawn on any day.

- **PROVIDED that it *does not permit:***
- Funds or value to be transmitted internationally.
- Transfers between or among users within the program.
- Reloads from non-depository sources.

FinCEN's Prepaid Access Rules

- A Provider is the participant within a prepaid program that agrees to serve as the principal conduit for access to information from its fellow program participants. The participants in each prepaid access program must determine a single participant to serve as the provider of prepaid access.

- A Seller is any person that receives funds or the value of funds in exchange for an initial or subsequent loading of prepaid access, if that person:
- Sells prepaid access *offered under a prepaid program that can be used before verification of customer identification; OR*
- Sells *any prepaid access in excess of $10,000 to any person during any one day, and has not implemented policies and procedures reasonably adapted to prevent such a sale.*

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FinCEN's Prepaid Access Rules

- Providers and Sellers are Money Services Businesses (MSBs). They must establish procedures to:
- Obtain identifying information about a person who obtains prepaid access *under a prepaid program, and*
- Verify the identity of that person.

- Identifying information includes: name, address, date of birth, and identification number.

- Sellers must *also establish procedures to obtain identifying information about a person who obtains any kind(s) of prepaid access to funds that exceeds $10,000 during any one day, and verify that person's identity.*

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FinCEN's Prepaid Access Rules

- Each Provider and Seller must also:
- Develop, implement and maintain an AML compliance program.
- File reports of suspicious activity.
- Comply with reporting, recordkeeping and other rules applicable to MSBs generally.

- In addition, Providers must also:
- Register as an MSB with FinCEN.
- Maintain access to transactional records.

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FinCEN's Prepaid Access Rules

- **Bank Centered Programs:**
- FinCEN FAQs have confirmed that "bank-centered programs," controlled by a bank issuer, are outside the scope of these regulations. *Regulations for banks and MSBs are "mutually exclusive."*
- Difficult position for banks:
- Bank regulators want banks to be "in control."
- Law enforcement wants program managers to register as Providers.
- If a bank's program manager registers: is that an acknowledgment that the bank is NOT in control?
- Latest input from one bank examiner (speaking unofficially): would prefer registration for program managers so that both are regulated.

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FinCEN Notice of Proposed Rule-Making : Cross border transportation Reporting

- Expands scope of cross-border reporting requirements
- Adds "tangible prepaid access device" to the list of other monetary instruments that must be reported at the U.S. border >$10,000.
- "*Tangible prepaid access device" is defined as "any physical item that can be transported, mailed, or shipped into or out of the United States and the use of which is dedicated to obtaining access to prepaid funds or the value of funds by the possessor in any manner without regard to whom the prepaid access is issued."*
- Includes (i) general use prepaid cards, (ii) payroll cards, (iii) government benefits cards, and (iv) store gift cards, etc.
- Excludes (i) credit cards and debit cards, (ii) codes and PINs, and items like computers or Web-enabled cell phones, or (iii) other devices that are not dedicated to accessing specific prepaid funds.
- Also excludes cross-border transportation of prepaid cards by businesses shipping inventory to sales agents

Dodd-Frank: The "Durbin Amendment"

Dodd-Frank Act : the "Durbin Amendment" and the CFPB

- Huge law – sweeping changes to financial services and banking in the US
- Seeking to avoid another "meltdown" and "too big to fail" entities
- Hedge Funds; Wall Street Transparency; non-bank financial services; insurance; swaps; asset-backed securities; investor protections;
- Areas with Major impact on prepaid and emerging payments:
  - Consumer Financial Protection Bureau
  - Durbin Amendment – Interchange and Routing
  - Remittances

The Durbin Amendment

- Interchange Restrictions and Routing Restrictions: The "Durbin Amendment" – favored by Merchants
  - Impacts certain debit and prepaid cards – *not credit cards*
  - Restricts interchange to 21 cents plus a multiplier:
    - \$50 = 24.5¢ [21¢ + 2.5¢ (\$50 x .05 /100) + 1 ¢ fraud adjustment]
    - \$500 = 47¢ [21 ¢ + 25¢ (\$500 x.05 /100) + 1 ¢ fraud adjustment]]
  - Also for routing transactions, requires at least 2 unaffiliated networks on each card

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Durbin Amendment: 3 Exemptions

(1) Exempt if the issuer together with its affiliates have **assets of less than \$10 billion --- OR**

(2) Exempt if it is a debit or prepaid card provided to a person pursuant to a **federal, state or local government administered payment program** where the holder can *ONLY access funds from such program. But Exclusion can be lost if "provisos" not met:*

- one year after the effective date a fee for an overdraft (including a fee assessed for a shortage of funds or for a transaction processed for an amount exceeding the account balance) **may be** charged; or a fee imposed by the issuer for the first ATM withdrawal per month from an ATM that is part of the issuer's designated ATM network **may be** charged.

(3) AND a "**general purpose reloadable card**" exemption….

1 more exclusion œ 3 Party Systems" œAmerican Express & Discover

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Durbin Amendment: The reloadable general use prepaid card exemption

Exempt if it is a "reloadable general use prepaid card" that is

- **(i) Not issued or approved for use to access or debit any account held by or for the benefit of the cardholder** (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis)
- (ii) Reloadable and not marketed or labeled as a gift card or gift certificate; and
- ***(iii) The card is the only means of access to the underlying funds, except when all remaining funds are provided to the cardholder in a single transaction*.**" Restricts convenience checks, bill pay or remittance via ACH, "because certain reloadable prepaid cards are virtually identical in function to debit cards"

Same additional "provisos" apply as with government administered cards: no overdraft fees; 1 free ATM transaction each month.

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Durbin Amendment Update: The reloadable general use prepaid card exemption

- September 9: Fed issued "Frequently Asked Questions about General-Use Prepaid Cards and Circumvention and Evasion" (FAQs).
  - Some helpful insights – such as "convenience checks payable to the cardholder" do not violate "sole means of access" obligation.
  - **But "sole means of access" still stands - bill-pay and FSA restrictions still a concern**.
- Still talk of Congressional or even legislative action regarding the new "sole means of access" requirement.
- Was effective October 1st
- Banks must self-certify to Visa and MasterCard regarding eligibility for the exemption.

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Post Durbin fall-out

- Prices NOT lower. Electronic Payment Coalition Survey shows "no consumer benefit" from lowered "swipe fees". *http://bit.ly/wAeQb8* -
- However, merchants learn that cost of accepting debit and prepaid has INCREASED for small dollar transactions. *http://aol.it/tGbOv8*
  - WSJ: Visa & MasterCard have eliminated discounts on small transactions
  - Coffee shops estimate a 35% increase in interchange on transactions less than $10
  - Consumers now asked to pay with cash.
- "Sole means of access" limitation – *criticized by Barney Frank and Spencer Bachus*

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Routing and Exclusivity

Primary change: Two Unaffiliated networks per prepaid access device with 4-party systems

Also: Prohibited exclusivity arrangements by networks.

- A payment card network "may not restrict or otherwise limit an issuer's ability to contract with any other payment card network that may process an electronic debit transaction involving the issuer's debit cards."

Voluntary exclusive arrangements - -

- **Prohibited** even if there is no contractual rule or restriction.

Non-reloadable Open Loop Gift Cards

- Difficulty: Only one signature network per card
  - No PIN network, no addresses for sending PINs
  - Board urged to exempt such cards entirely
- Decision: No exemption. Instead, more time to figure it out
  - April 1, 2013

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Routing and Exclusivity

- Applies to ALL debit and general-use prepaid cards (Interchange exemptions don't apply here)
- Other "form factors"? Mobile phones? Fobs?
  - Routing restrictions still apply
  - Supplemental access device connected with a card - must also comply.
- Not Covered:
  - Three-party systems, ATMs

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Effective Dates

- Interchange requirements – October 1, 2011
- Exclusivity for Payment Networks - October 1, 2011
- Routing and Exclusivity generally for issuers - April 1, 2012
- Routing and Exclusivity for HSA / FSA / HRA cards (those using transaction substantiation systems) – April 1, 2013
- Prepaid Card issuers – generally April 1, 2013
  - Non-reloadable sold before April 1, 2013 exempt
  - For reloadable cards sold and reloaded prior to April 1, 2013, the effective date for routing rules is May 1, 2013;
  - For reloadable cards sold prior to April 1, 2013 and reloaded on or April 1, 2013, the effective date for routing rules is 30 days after the date of reloading

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Consumer Financial Protection Bureau (CFPB)

•The Consumer Financial Protection Bureau ("CFPB") is a new Consumer Protection Agency for financial services.

•For the first time, there will be a federal regulator over both banks AND certain non-bank financial institutions, such as payday lenders, check-cashers and mortgage brokers.

•The scope of CFPB powers is broad and includes selling, providing or issuing "stored value."

- •Conventional Wisdom: CFPB would have power to regulate non-banks ONLY after a "confirmed Director" is in place.
- •Recess Appointment of Richard Cordray has raised questions: Was Congress in recess? Was Cordray "confirmed" by the Senate? Does it make a difference?

Consumer Financial Protection Bureau (CFPB)

Meetings with the CFPB re: Prepaid - -

- •Yes, prepaid is on their radar screens
- •Consumer groups are urging more regulation
- •CFPB regulators are actively purchasing and using prepaid cards in order to understand the products better
- •Prepaid is not their first priority – which are:
  - •Mortgage brokering and servicing
  - •Payday lending
  - •Private student lending
- •*But it is still a priority*
- •Collecting data from industry, consumers and consumer groups.

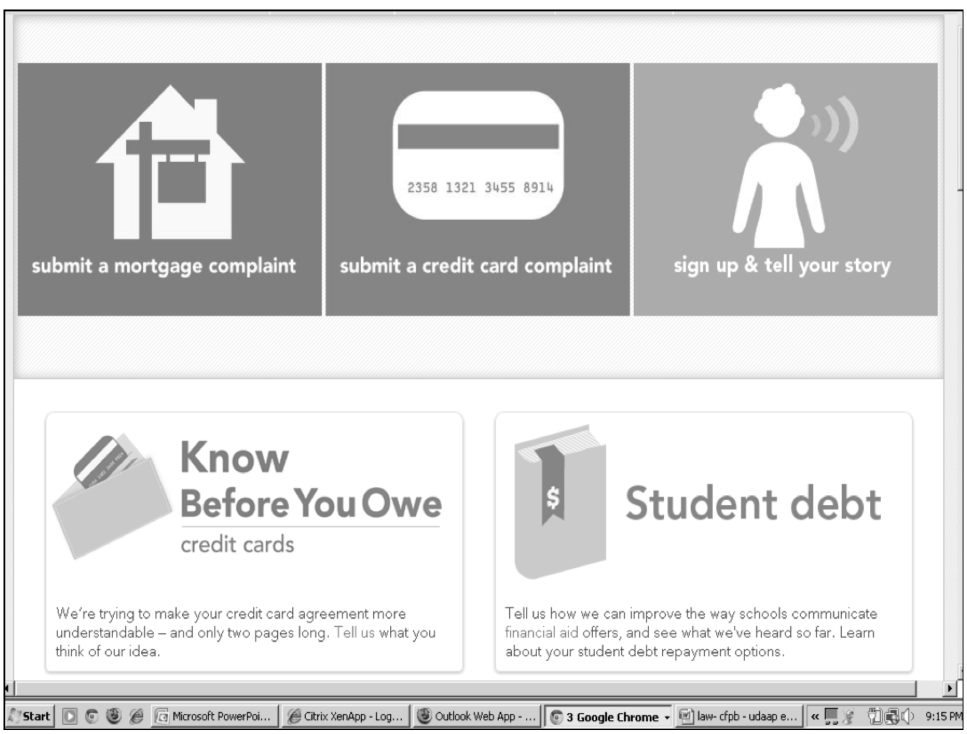
October speech: CFPB will decide what is "fair" for consumers…

Consumer Financial Protection Bureau (CFPB)

Credit cards – Blue print for Emerging Payments?

Disclosures
- easily compared – easy to read
- "Schumer Box"

Complaints
- Important role in CFPB process
- Beginning with "external" customer complaints to ALL sources
- Collecting Complaints and "stories" on the CFPB website and via Twitter, Email;



Consumer Financial Protection Bureau (CFPB)

Reasons for heightened concern.

- CFPB empowered to prohibit a *covered person or service provider* from committing or engaging in an unfair, deceptive or abusive act or practice.
- "Abusive" is a new and generally untested legal standard
- CFPB collects data (such as complaints) or does research.
- Three critical powers
  - Examination of covered entities
  - Rulemaking
  - Enforcement
- Mission: To make markets for consumer financial services "work for America." See www.cfpb.gov

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Consumer Financial Protection Bureau (CFPB)

Lessons from Payday Lenders

Lessons from the payday lending industry:

- "Field Hearings" in Birmingham, AL (with little advance notice) – inviting comments from public, industry and community leaders
- More Field Hearings expected – perhaps on a monthly basis
- Requests for data from industry
- Expecting proposed regulations and active investigations

"We will begin dealing face-to-face with payday lenders, mortgage servicers, mortgage originators, private student lenders, and other firms that often compete with banks but have largely escaped any meaningful federal oversight," Cordray said

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"Abusive" – How UDAP becomes UDAAP…

- UDAP: unfair or deceptive acts or practices
  - There must be a representation, omission, or practice that is likely to mislead.
  - The act or practice must be considered from the perspective of the reasonable consumer.
  - The representation, omission, or practice must be a material one.
- UDAAP: unfair, deceptive, or *abusive* acts or practices. Abusive: materially interferes with the ability of a consumer to understand a term or condition or takes unreasonable advantage of:
  - A lack of understanding on the part of the consumer of the material risks, costs, or conditions
  - The inability of the consumer to protect his or her own interests
  - The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

The additional "abusive" standard…

- **"Amorphous" and "Subjective"**
- **Can be "technically legal" but still "abusive."**
- **Exam Manual – Indicators of Problems:**
  - **Is profitability dependent on penalty fees?**
  - **Terms subject to change at discretion at any time?**
  - **Is there a high rate of fees that are routinely "reversed"?**
  - **Does the pricing structure make total costs hard to understand?**
  - **Is there a penalty to terminate the product with loss of benefits?**
  - **Is there a fee or cost just to access balances or consumer data?**
  - **Is the product targeted to higher risk populations, such as:**
    - **Students, Elderly, Minority populations**
    - **Low income, on public assistance, low credit scores**

The CFPB & Emerging Payments

- CFPB has begun examinations of banks with more than $10 billion in assets and has also begun requesting data regarding prepaid card programs.
- Examiners are (i) assessing the inherent risks of the payment products and (ii) reviewing what is being done to mitigate those risks.
- *Prepaid card issuers and marketers may wish to use the Exam manual to have a risk assessment performed of their products – for each step of the products' life cycle.*
- *Anticipate scrutiny of complaints – focus on resolving recurring consumer problems asap.*

It's going to happen. Be ready.

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Dodd-Frank & Remittances

Dodd-Frank Act Section 1073

- "Remittance transfer" is an "electronic ... transfer of funds requested by a sender located in any State to **a designated recipient [in a foreign country] that is initiated by a remittance transfer provider ..."**
- EXCLUSION: Small-value transactions, less than $15.
- "Remittance transfer provider" is "**any person or financial institution that provides remittance transfers for a consumer in the normal course of its business, whether or not the consumer holds an account with such person or financial institution."**
- Applies to remittances to foreign countries r**equested by a consumer and initiated by a remittance transfer provider.**
- **Regulates Disclosures for sender and recipients; error resolution.**

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State Laws and Payment Rules

Important State Laws:

- Consumer protection laws (preemption limited)
- Abandoned property laws (impact on revenues)
- Non-bank money transmitter licensing laws

Rules:

- Visa/MasterCard payment network rules;
- National Automated Clearing House Assn (NACHA) and ACH rules.

Emerging Payments – How regulated?

Existing Laws Apply – the same for this as other form factors

- State laws
  - Abandoned Property
  - "Money transmitter" Licensing
  - Consumer protection – Fair advertising laws
- Federal laws
  - Dodd-Frank – Durbin & CFPB
  - Reg E – CARD Act
  - Privacy, GLBA and FCC
  - Anti-money laundering laws
  - Banking and deposit-taking

A word about Money Transmitter Licensing laws

- Genesis: "Safety and soundness" of non-bank –issuers (Banks are generally exempt)
- Regulates non-bank entities that receive and hold consumer funds, with promise of making funds available later – or sending funds elsewhere.
- Money Order and Travelers Cheque issuers; Remittance companies
- 48 states have enacted such laws, which usually require:
  - Minimum capitalization ($50,000-$1 million) and bonding
  - Background checks on principals
  - Holding of 100% consumer funds in "permissible investments"
  - Regular reports; annual renewal filings; fees; audits
  - No restrictions on other lines of business – thousands are licensed
- Difficult to get but still a "poor man's bank license"

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A word about Money Transmitter Licensing laws

- "Disintermediation" of banks...
  - Paypal , Google, American Express
- But even worse – state banks at a disadvantage
  - Uniform Money Services Agreement – NCCUSL
  - Exempt only "if it does not issue, sell, or provide payment instruments or stored value through an authorized delegate who is not a bank."
    - 9 States: Alaska, Arkansas, Idaho, Maine, New Jersey, North Dakota, Vermont, Washington, Wyoming
  - Exempts banks only if it is a national bank or a state bank chartered or authorized to do business in their OWN state; out of state, state banks not exempt:
    - Alabama, Colorado, Mississippi, Nevada, Oregon, Utah

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A word about Money Transmitter Licensing laws

- Cost – at least 2 years and $250,000
- Ongoing compliance, renewals, fees - -
- At least one full-time licensing employee
- And a full time AML Compliance officer
- Risks - - -
  - Doing money transmission business without a license – federal crime 18 USC § 1960
  - States increasingly penalizing non-banks $10-$100,000
  - Subject to audit and supervision

These laws allow Western Union, Moneygram, Paypal, and Google to do payments business without a banking partner.

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Prepaid and Emerging Payments: Where do banks fit?

- One MUST have a bank for:
  - Access to the Visa and MasterCard payment networks
  - Amex and Discover – less clear
- One MUST have a bank for:
  - Access to ACH payments
  - Access to ATMs

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Prepaid and Emerging Payments: Where do banks fit?

- Advantages to banks - - -
  - Access to new customer base
  - Source of new deposits
    - But are these "brokered deposits"?
      - Third party source
      - But exclusions for any bank agent whose "primary purpose" is <u>not</u> the placement of funds with depository institutions.
  - Source of new fee income
  - Cutting edge; focus on the future

Prepaid and Emerging Payments: Where do banks fit?

- Risks to banks - -

(1) Banks that don't understand the risks can be taken advantage of

- Fraudulent Payroll Card programs
- Sleazy marketing programs
- Multi-level marketers
- International payments
- Cards legally purchased or acquired, but then used to load illegal funds
  - Stolen credit cards used to buy gift cards

Prepaid and Emerging Payments: Where do banks fit?

(3) Abandoned property liability
- As the "holder" of funds, primary liability to escheat unclaimed funds
- Liability may remain with the bank, even if funds transferred

(4) Compliance obligations – AML; CARD act and consumer protection; Class action risks; privacy and data security

(5) Third party risks – lack of controls
- Bank has contract with cardholders – ultimate obligor
- Bank must control terms, pricing, features
- Regulators scrutinize closely

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Prepaid and Emerging Payments: Where do banks fit?

(6) Anti-money laundering risks
- Knowing your customer
- Knowing your customer's customers
- CIP on the front end of the transaction
- Transaction monitoring on the back end

Bottom Line: These can be genuinely good "win-win" products, for the bank, its customers, its vendors. But *if it sounds too good to be true, it probably is.*

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Prepaid and Emerging Payments: Risks & Benefits

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AML Risks and Criminal Activity

National AML Threat Assessment 2007

- Closed loop gift cards: exchanging cash for cards/Use as alternative currency
- Open (and closed) loop gift cards: Money laundering through bulk card acquisition and resale
- Payroll cards: Fraudulent businesses could use to pay terrorists or launder money
- Remittance cards: Provides anonymous cross-border access to funds for purchases or cash
- Provides anonymous cross-border access to funds for purchases or cash

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Regulatory and Compliance Risks

- Bank regulations
- Anti-money laundering regulations
- Remittance laws s
- Consumer protections laws – state and federal
- Abandoned property law
- Money transmitter licensing laws
- Data security and privacy
- Litigation – class actions; patent litigation

Benefits

- New customers
- New revenue streams
- Reducing costs for businesses and governments
- Efficient and speedy transactions
- Convenience
- Accessible payments to the underbanked and underserved

Electronic and Prepaid Payments are Growing….

From the Federal Reserve 2010 Payments study…

- While prepaid cards had the lowest transaction volume of all noncash payments at 6 billion, these transactions represented the fastest growing payment type, increasing 21.5 percent annually from 2006 to 2009
- 20 billion more electronic payments were made in 2009 than in 2006, which represented a 9.3 percent annual increase and accounted for close to 80 percent of noncash payments.
- Yet, with 27.5 billion checks still being written, almost half of which are consumer-to-business transactions, much opportunity lies ahead.

Prepaid Cards Provide Solutions to Consumers—*Center for Financial Service Innovation (CFSI)*

- "Our findings give evidence about the potential of prepaid cards to enhance families' financial well-being."
- "Interviewees saw the cards as a useful tool, a way to escape the high fees imposed by banks and check-cashing companies"
- "Most customers felt the costs associated with prepaid are fair and lower than what they would incur if they used a check casher or checking account."
- *A Tool for Getting By or Getting Ahead: Consumers Views On Prepaid Cards (2009)*

Conclusion

Prepaid cards and Emerging Payments

- Provide important and critical benefits
  - For consumers
  - For banks
  - For businesses and governments
  - For law enforcement

To succeed, you need:

- Knowledgeable and experienced staff and business partners
- Solid, up-to-date technology and flexible systems
- Need a vision to know what consumers will want and the ability to anticipate legal, regulatory and business changes
- A culture of compliance and fairness

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For more information….

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APPENDIX

INSTITUTE OF CONTINUING LEGAL EDUCATION IN GEORGIA
BOARD OF TRUSTEES

The State Bar of Georgia and the Law Schools of The University of Georgia, Emory University and Mercer University established the Institute of Continuing Legal Education in Georgia in August 1965. In 1984, Georgia State University College of Law was added to the consortium, and in 2005, John Marshall Law School was added. The purpose of the Institute is to provide an outstanding continuing legal education program so that members of the legal profession are afforded a means of enhancing their skills and keeping abreast of developments of the law. The Institute is governed by a Board of Trustees composed of twenty-eight members consisting of the Immediate Past President, the President, the President-elect, the Secretary, and the Treasurer, all of the State Bar of Georgia; the President, President-elect and the Immediate Past President of the Young Lawyers Division; nine members to be appointed by the President of the State Bar of Georgia, each for a term of three years (the President has three appointments each year); two representatives of each of the participating law schools; and the Immediate Past Chairperson of the Institute. The Immediate Past President of the State Bar of Georgia serves as Chairperson of the Board of Trustees of the Institute.

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Revised: 10/19/11

GEORGIA MANDATORY CLE FACT SHEET

- Every "active" attorney in Georgia must attend 12 "approved" CLE hours of instruction annually, with one of the CLE hours being in the area of legal ethics and one of the CLE hours being in the area of professionalism. Furthermore, any attorney who appears as sole or lead counsel in the Superior or State Courts of Georgia in any contested civil case or in the trial of a criminal case in 1990 or in any subsequent calendar year, must complete for such year a minimum of three hours of continuing legal education activity in the area of trial practice. These trial practice hours are included in, and not in addition to, the 12 hour requirement. ICLE is an "accredited" provider of "approved" CLE instruction.

- Excess creditable CLE hours (i.e., over 12) earned in one CY may be carried over into the next succeeding CY. Excess ethics and professionalism credits may be carried over for two years. Excess trial practice hours may be carried over for one year.

- A portion of your ICLE name tag is your **ATTENDANCE CONFIRMATION** which indicates the program name, date, amount paid, CLE hours (including ethics, professionalism and trial practice, if any) and should be retained for your personal CLE and tax records. **DO NOT SEND THIS CARD TO THE COMMISSION!**

- ICLE will electronically transmit computerized CLE attendance records directly into the Official State Bar Membership computer records for recording on the attendee's Bar record. **Attendees at ICLE programs need do nothing more as their attendance will be recorded in their Bar record.**

- The Commission on Continuing Lawyer Competency staff will mail a prescribed affidavit form to each active attorney at the end of the year. The form will show the CLE courses attended and the number of credit hours that are entered in the Bar records. Each attorney will swear or affirm that the CLE credits claimed on the affidavit were **ACTUALLY ATTENDED. Attorneys who are late attending or have to leave a seminar for a period of time will have to strike the CLE hours shown on the affidavit and enter the hours actually attended and claimed; or inform the ICLE staff at the seminar to reduce the hours in the ICLE records before transmitting the credit hours in the ICLE record!**

- If the affidavit is correct, the member need only sign the form confirming actual attendance and return it to the Commission.

- If the affidavit is incorrect, the member should enter the corrections, sign the form, and return it to the Commission.

- Do not mail anything to the Commission other than the affidavit. No receipts or other evidence of attendance are required to support the affidavit unless requested by the Commission.

- Should you need CLE credit in a state other than Georgia, please inquire as to the procedure at the registration desk. ICLE does not guarantee credit in any state other than Georgia.

- Any questions concerning attendance credit at ICLE seminars should be directed to Linda Howard Toll Free: 1-800-422-0893 x306; Athens Area: 706-369-5664 x306; Atlanta Area: 770-466-0886 x306

TO: ICLE Seminar Attendee

Thank you for attending this seminar. We hope that these program materials will provide a great initial reference and resource for you in the particular subject matter area. There is a chance, however, that you might find an error(s) in these materials, like a wrong case citation or a typographical mistake that results in an obvious misstatement of black-letter law, such as an incorrect length for the applicable statute of limitations.

In an effort to make them as correct as possible, should you discover a significant substantive error(s), please note it (them) on the Errata Sheet below. Then, please detach the sheet and mail it to **ICLE, P.O. Box 1885, Athens, GA 30603-1885 or fax it to (706) 369-5899.** We will collect all the errata sheets and, after a reasonable time mail a correction to all seminar attendees and those attorneys who have ordered the book. Should you have a different legal interpretation or opinion from the author's, the appropriate way to address this is by giving him or her a call, which by the very nature of our seminars is always welcome.

Thank you for your help. It is truly appreciated.

- -

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