Message from the Chair

This edition of the Banking Law Committee Journal includes four articles on a wide range of topics. Howard Eisenhardt of BuckleySandler has contributed a fascinating piece on the deposit insurance treatment of IOLTA accounts, while Sara Emley and Manley Williams of the same firm offer their insights and perspective on the Federal Reserve's proposed regulation implementing the ability-to-pay provisions of the CARD Act. Puzzled by preemption after Dodd-Frank? Robert Cook and Timothy Meredith of Hudson Cook explain how Dodd-Frank alters the preemption landscape for federally chartered real estate lenders. And last, but not least, Schiff Hardin's Lori Buerger tells how well-prepared bidders can take advantage of exciting opportunities to buy small failed banks from the FDIC. I look forward to seeing these distinguished writers and many other Banking Committee members at our Spring Meeting in Boston, April 14th through 16th!

Sally Miller
Chair, Banking Law Committee
smiller@iib.org

Featured Articles

Lawyers’ Trust Accounts Benefit From Unlimited Deposit Insurance
Howard Eisenhardt

The financial crisis that began in September 2008 and resulted in many bank failures caused some lawyers to reconsider the rules applicable to trust accounts. While frequent users of trust accounts are probably familiar with relevant developments during the financial crisis, other attorneys may benefit from a bit of background on these accounts.

When lawyers receive funds of clients, they must hold the funds separate from their own funds, and typically use trust accounts for this purpose. Client funds can include financial settlements or advance legal fees, for example. The funds of multiple clients can be held together in a single trust account, which is a fiduciary account. Combining the funds of multiple clients is customary if the net interest on the money would not be enough to compensate for the costs of maintaining separate accounts for the clients.

Who's Entitled to a Credit Card? Perspectives on the Fed's Independent Ability to Pay Amendment
Sara Emley and Manley Williams

Note: On March 18, 2011 the Federal Reserve Board adopted the amendments to Regulation Z discussed in the article below generally as proposed. For more information see: http://www.federalreserve.gov/newsevents/press/bcreg/20110318b.htm.

Americans are devoted to credit cards, as evidenced by the nearly $800 billion in credit card debt and other revolving credit outstanding at...
year-end 2010. More than half of all US households have credit card debt. But our fixation on credit has led to some hard landings recently, with credit card delinquencies rising more than 150% from 2006 to 2009. As delinquencies triggered late payments, increased interest rates, and over-the-limit fees, the contractual rate and fee provisions in credit card agreements became a rallying point for public protest and media attention. Among the outcomes of a Congressional focus on credit card practices was the Credit Card Accountability Responsibility and Disclosure Act of 2009 (known as the CARD Act), which President Obama signed on May 22, 2009.

Real Estate Lending Preemption After Dodd-Frank
Robert A. Cook and Timothy P. Meredith

In the aftermath of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Act"), national banks and federally chartered savings banks have been concerned about the Act's impact on federal preemption of state laws with respect to consumer financial services transactions. In assessing this impact, many have overlooked the fact that, while Dodd-Frank effects a sea change for most existing preemption rules, it made only one change to the preemption rules for real estate lending transactions: the Act increases the level of scrutiny courts give to the Office of the Comptroller of the Currency's ("OCC" or "Comptroller") real estate lending regulations. Although this change is not nearly as comprehensive as the changes Dodd-Frank made to other preemption rules, it does introduce an element of uncertainty to the real estate lending preemption analysis. Further, as a practical matter, banks should consider that in the current environment, the Comptroller is likely to be a far more less aggressive advocate of preemption than it has been in the past.

FDIC-Assisted Transactions: Target Sizes Shrink, but Opportunities Remain Large
Lorraine M. Buerger

It's no surprise that the tally of bank failures continues to mount. As the first quarter of 2011 draws to a close, the total number of bank failures during the current cycle of turmoil in the banking industry has topped 350. According to the Federal Deposit Insurance Corporation ("FDIC"), last year's 157 bank failures was the highest number since 1992.

Last year is predicted by many (including the FDIC itself) to represent the high point in the ongoing wave of bank failures. However, with more than 850 banks remaining on the FDIC's list of problem institutions as of the most recently-published FDIC Quarterly Banking Profile, the pace of failures in 2011 is most likely to abate only slightly from the peak.
Lawyers’ Trust Accounts Benefit From Unlimited Deposit Insurance

by

Howard Eisenhardt, Counsel
BuckleySandler LLP

The financial crisis that began in September 2008 and resulted in many bank failures caused some lawyers to reconsider the rules applicable to trust accounts. While frequent users of trust accounts are probably familiar with relevant developments during the financial crisis, other attorneys may benefit from a bit of background on these accounts.

When lawyers receive funds of clients, they must hold the funds separate from their own funds, and typically use trust accounts for this purpose. Client funds can include financial settlements or advance legal fees, for example. The funds of multiple clients can be held together in a single trust account, which is a fiduciary account. Combining the funds of multiple clients is customary if the net interest on the money would not be enough to compensate for the costs of maintaining separate accounts for the clients.

If a lawyer holds large sums for a single client, a specific trust account is usually established so the funds can earn interest for the client. Frequently, however, the amount of money a lawyer is holding for his client is either small or only to be held for a short time. Separate trust accounts may be impractical in this situation because the amount of interest earned would be less than the costs incurred to maintain the accounts. Traditionally, when client funds are pooled in trust accounts, they earned no interest because attorneys are not ethically permitted to derive a monetary benefit from funds belonging to their clients.

State laws and Supreme Court Rules created Interest on Lawyers Trust Accounts (“IOLTA”). IOLTA accounts were allowed to earn interest which is paid to the state IOLTA Program to fund charitable causes. IOLTA accounts must be held in financial institutions with FDIC insurance and must be capable of being withdrawn without delay. Mishandling IOLTA funds, such as by using the funds for improper purposes or failing to keep required records, can result in disciplinary action against a lawyer.

The interest on IOLTA accounts is used to benefit low-income persons and provide legal assistance to the poor. As stated on the IOLTA.org website, “at no cost to lawyers or their clients, interest from lawyer trust accounts is pooled to provide civil legal aid to the poor and support improvements to the justice system.” Significant funds are generated by IOLTA accounts; one estimate of 2007 IOLTA is $212 million nationally. The California State Bar reported $12.2 million in IOLTA grants in 2008.

Despite the charitable purposes to which trust account interest is put, IOLTA Programs have faced legal challenges. Among other things, claims have been made that the taking of the interest earned violates the Compensation Clause of the Fifth Amendment and that the requirement that the client funds be placed in such an account was an illegal taking.
In *Brown et al. v. Legal Foundation of Washington, et al.*, 271 F.3d 835 (2003), the United States Supreme Court held that under the Fifth Amendment, the taking must be for public use and just compensation must be paid to the owner. The Court made it clear that the success of the IOLTA programs in providing legal services to the needy qualified the distribution of the funds as a public use. The Court further held that there was no violation of the Just Compensation clause because the owner had no pecuniary loss.

In the midst of the global financial crisis in November 2008, the FDIC created the Transaction Account Guarantee Program (TAG), which included (among other measures designed to boost confidence in the banking system) a provision for unlimited insurance coverage for non-interest bearing deposit transaction accounts. The TAG Program included IOLTA accounts. That provision was originally set to expire on December 31, 2009 and was extended by the FDIC until December 31, 2010.

President Obama signed the Dodd Frank Wall Street Reform and Consumer Protection Act into law on July 21, 2010. Dodd Frank extended unlimited FDIC insurance for non-interest bearing accounts until December 31, 2012, but through an oversight, it did not extend the unlimited coverage to IOLTA accounts. As a result, lawyers had to consider whether to deposit trust funds totaling more than the FDIC-insured limit in IOLTA accounts and face the consequences of possible bank failure, or alternatively, whether to potentially violate state ethics rules and use non-interest bearing accounts for the deposit of large sums to take advantage of unlimited deposit insurance. Either alternative had potentially unhappy consequences for lawyers, their clients, and IOLTA Programs.

The ethics rules of most bar associations further complicated the issue. A December 2010 ABA press release noted that lawyers must deposit client funds into IOLTA accounts in 42 states and the District of Columbia. In seven other states, lawyers may opt-out of participation in IOLTA accounts, and participation is voluntary in one state and in the U.S. Virgin Islands.

With the deadline of December 31, 2010 for the expiration of unlimited FDIC insurance for IOLTA accounts looming, the American Bar Association lobbied successfully for an amendment to include IOLTA accounts in the definition of “non-interest bearing” transaction accounts. President Obama signed H.R. 6398 on December 29, 2010, extending unlimited deposit insurance for IOLTA accounts through December 31, 2012. Thereafter, on January 18, 2011, the FDIC announced a rule redefining non-interest bearing transaction accounts to include IOLTA accounts, with the effect that IOLTA accounts are now insured without limit until December 31, 2012.

The legal change is good news for lawyers with IOLTA accounts, who might have had to withdraw funds from an account when it reached the otherwise-applicable deposit limits, or create multiple accounts to avoid balances higher than such limits. The ability to keep trust funds together in a single account also reduces required recordkeeping for lawyers and allows interest to continue to be earned for IOLTA Programs.
Not later than February 28, 2011, banks offering noninterest-bearing transaction accounts, including IOLTA accounts, must post a notice in their main and branch offices and on their websites, as follows:

All funds in a “noninterest-bearing transaction account” are insured in full by the Federal Deposit Insurance Corporation from December 31, 2010, through December 31, 2012. This temporary unlimited coverage is in addition to, and separate from, the coverage of at least $250,000 available to depositors under the FDIC’s general deposit insurance rules. The term “noninterest-bearing transaction account” includes a traditional checking account or demand deposit account on which the insured depository institution pays no interest. It also includes Interest on Lawyers Trust Accounts (“IOLTAs”). It does not include other accounts, such as traditional checking or demand deposit accounts that may earn interest, NOW accounts, and money-market deposit accounts.

For those wishing to delve further into the operation, regulation and uses of IOLTA accounts, the following are useful sources of information:

http://www.abanet.org/legalservices/iolta/ioltback.html

http://www.iolta.org/

http://www.law.cornell.edu/supct/html/01-1325.ZS.html

ABOUT THE AUTHOR: Howard A. Eisenhardt is Counsel in the Washington DC office of BuckleySandler LLP. He advises financial services companies on regulatory compliance and enterprise risk management, data security and privacy laws, information security, data protection, data security breaches, regulatory exams, and solicitation management. He was previously Director of Privacy at Key Bank, Chief Privacy Officer at Charter One Bank, N.A, and Chief Corporate Counsel for Charter One Bank. Mr. Eisenhardt is a Certified Information Privacy Professional (CIPP) and a Certified Anti-Money Laundering Specialist (CAMS). He may be reached at heisenhardt@buckleysandler.com
WHO’S ENTITLED TO A CREDIT CARD?
PERSPECTIVES ON THE FED’S INDEPENDENT ABILITY TO PAY AMENDMENT

by
Sara Emley, Partner
and
Manley Williams, Partner

BuckleySandler LLP

Note: On March 18, 2011 the Federal Reserve Board adopted the amendments to Regulation Z discussed in the article below generally as proposed. For more information see: http://www.federalreserve.gov/newsevents/press/bcreg/20110318b.htm.

Americans are devoted to credit cards,¹ as evidenced by the nearly $800 billion in credit card debt and other revolving credit outstanding at year-end 2010.² More than half of all US households have credit card debt. But our fixation on credit has led to some hard landings recently, with credit card delinquencies rising more than 150% from 2006 to 2009.³ As delinquencies triggered late payments, increased interest rates, and over-the-limit fees, the contractual rate and fee provisions in credit card agreements became a rallying point for public protest and media attention. Among the outcomes of a Congressional focus on credit card practices was the Credit Card Accountability Responsibility and Disclosure Act of 2009 (known as the CARD Act), which President Obama signed on May 22, 2009.⁴

The CARD Act mandated increased disclosures about changes to annual percentage rates on cards, and limited the conditions for increased APRs on existing balances. It also added new restrictions on the timing and content of billing statements. Significantly, it required card issuers to consider the consumer’s ability to repay the debt and prohibited extending credit to consumers under age 21 who can neither demonstrate an independent means of repaying the credit nor obtain a co-signer over age 21 with the ability to repay the debt. These last changes, referred to

¹The increasing role of credit card debt as part of consumers’ overall financial pictures is not limited to the United States. A recent study of Canadians who filed bankruptcy found that the average debt of bankruptcy filers increased 17% between 2008 and 2010, with the largest increase accounted for by credit card debt. See Madhavi Acharya & Tom Yew, “Portrait of a bankrupt,” The Spec.com, February 28, 2011 (online at http://www.thespec.com/news/world/article/494129--portrait-of-a-bankrupt-male-41-married-with-4-credit-card, viewed March 8, 2011).
as the “ability to pay” requirements, are among the matters covered by a still-pending Federal Reserve Board rule-making, and are the subject of this article.

CARD Act reforms have been both applauded and criticized. Media and consumer observers have pointed out what they see as the numerous loopholes, while consumer advocate-in-chief Elizabeth Warren announced on the first anniversary of the CARD Act that consumers now have better information and fewer surprises. Meanwhile, card issuers and representatives of the retail industry have criticized the ability to pay requirements, claiming that they will curtail credit availability to large segments of the population. Perhaps unwilling to wait for the effects of regulatory fixes, consumers have reduced their credit card debt by double digits since the height of the recession, but some experts believe these reductions will prove temporary and an improving economy will cause credit card debt to rise again.

Regardless of whether CARD Act reforms prove to have a salutary effect, those responsible for implementing them will be hard at work interpreting the law and communicating the new norms. This may be particularly challenging with respect to the ability to pay provision.

The Federal Reserve Board implements and interprets ability to pay under Regulation Z, implementing the Truth in Lending Act (TILA). On February 22, 2010, the Fed adopted a regulation to implement the ability to pay rule and other provisions of the CARD Act. However, in November, the Fed issued another proposed rule covering ability to pay, explaining that it had “become aware that clarification is needed to resolve confusion regarding how institutions comply” with these and other aspects of the new CARD Act rules, including in particular the extent to which ability to pay requirements apply to consumers not under the age of

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8 15 USC §1601 et seq.

9 75 FR 7658 (February 22, 2010).
The comment period ended on January 3, 2011, but the Fed has not yet issued the rule in final form.

The amendment would require card issuers to consider the independent ability to pay of every applicant for individual credit, regardless of his or her age. Adoption of the amendment would mean that card issuers could not rely on “spousal” or “household” income when considering whether to extend credit to adults 21 or older, unless the spouses are joint applicants on the account or the spouse applying alone lives in a community property state. Card issuers fear they could not issue individual credit cards to applicants without adequate income or assets, even if those applicants have access to spousal income or assets sufficient to make the account payments.

Response to the Fed’s proposal shows the credit and retail industries to be united in their opposition and the consumer advocacy community nearly as united in support. Retail credit card issuers say the proposed amendments will “shut[] off credit availability to wide swaths of the population,”11 while creditors claim the greatest negative fallout will be felt by women not working outside the home who are less likely to be able to obtain individual credit.12

The CARD Act added new ability to pay requirements in TILA Section 150,13 requiring credit card issuers to consider the ability of a consumer to repay before opening an account. Section 150 applies to all consumers.

A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.

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10 75 FR 67458, 67473 (November 2, 2010).
Under TILA Section 127(c)(8), credit card accounts may not be opened for applicants under 21 unless the applicant has submitted an application co-signed by a joint obligor aged 21 or older with means to repay the debt, or the application reflects the consumer’s independent means of repaying the obligation.

Despite the fact that only TILA Section 127(c)(8) requires consideration of a consumer’s “independent” ability to repay the debt and that section only applies when the consumer is younger than 21, the Fed’s amendment would require card issuers to consider the independent ability to pay of an applicant for individual credit, regardless of his or her age. Retailers and bank card issuers say the requirement for independent income will both reduce their ability to extend credit and cause them to be sued for discrimination. The financial community made these arguments in dozens of comment letters on the Fed’s proposal, noting that the CARD Act’s ability to pay language was specifically intended to protect young consumers from starting out life with significant debt loads, unless they already had means to repay. Applying this standard to adults with access to household or spousal income is inappropriate in their view, because many cardholders use household income rather than their personal independent income to repay debts. The appropriate test for determining an over-21 consumer’s ability to pay should be access to income, rather than actual ownership of income.

The Fed’s suggestion that joint accounts are an effective alternative to individual accounts in which the credit underwriting is based on household income is unpalatable to both credit-issuers and consumer advocates. With joint credit, both account holders are fully responsible for repayment. If one of the joint account holders has no independent income, or a much smaller income than the other, and the relationship ends or the account holders stop cooperating on debt payments, the non-working person will be just as liable for the debt as the income-earning account holder. For this reason, some non-working persons, even spouses, may not want joint credit – preferring not to obligate themselves for debts knowing that they have no independent income.

14 A link to the public comments received is here: http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=R%2D1393&doc_ver=1&ShowAll=Yes
Retailers also point to the practical difficulty of opening joint credit accounts when both applicants are not present to apply. Macy’s says joint applications are not practical when stay-at-home spouses shop for the household, because joint applicants are not typically together in the store when the credit application is submitted. At Macy’s and its sister store, Bloomingdales, most credit cards issued are applied for at point-of-sale in the store.15

Adam Levin, co-founder of Credit.com and a former New Jersey consumer affairs official, is also skeptical of joint credit: “I don’t know if it’s ever really good to combine credit. I think it’s a natural tendency that couples want to do it as part of the process of bringing themselves closer together. But I think that couples must always maintain separate credit files because death, illness or divorce requires that each member of the couple be able to stand on his or her own two feet.”16 Consumer advocates note that consumers individually obligated for debt and unable to access household income for the payments will be in a worse position than if they had never obtained the credit. The National Consumer Law Center, a vocal proponent of this view, therefore wants card issuers to be required to verify the income of applicants for individual credit.17

In addition to parsing the statutory language of TILA and the CARD Act, and their separate age-based standards on ability to pay, responses to the Fed’s proposal invoke a variety of public policy considerations. Creditors claim that non-working women (what some retailers describe as their “core customers”) will be net losers if the amendment is adopted, with far less ability to obtain independent credit. A credit squeeze for women without an independent income could continue throughout a woman’s life in the case of divorce or death of her husband because a divorced or widowed woman without an individual credit history may be unable to re-establish credit.

Creditors also fear the amended rule will guarantee lawsuits. Their concern is that evaluating independent income is contrary to the Equal Credit Opportunity Act and implementing Regulation B, both of which were intended to promote credit for non-working applicants (primarily women) who might have trouble getting credit in their own names. Card issuers do not want to attempt to evaluate applicants’ individual incomes while simultaneously raising their risk of noncompliance with Regulation B.

In addition to women, opponents of the amendment identify military families and the retired as potential victims of the Fed’s ability to pay proposal. Spouses of military members are less likely than spouses of non-military to work outside the home according to USAA, an insurer for military families, so they would be disproportionately affected by a requirement that they demonstrate independent income to get credit cards. Moreover, spouses of military personnel serving abroad would be unable to apply for joint credit because the absent service member would be unavailable to sign a credit application. Retailer Macy’s asks the Fed: “Does the Board contend that Congress intended to prohibit them from applying for credit cards until their spouse’s/partner’s return to this country to complete a joint application? Are they expected to put their lives and the lives of their children on hold?”

Macy’s also anticipates the amendment would deprive non-working military spouses of the discounts offered to branded card users. The retailer claims it would be “unfortunate to deny such discounts to an unemployed spouse.”

A broad theme running through many of the financial industry’s comment letters is the potential damage to the economic recovery that may result from implementation of the independent ability to pay amendment. Bank of America noted that adoption would result in an overall contraction in credit card availability.

With the battle lines drawn between the credit and consumer advocacy communities on the ability to pay issue, some members of Congress are once again getting involved. Two female

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18 Macy’s letter, p. 2.
19 Macy’s letter, p. 5.
20 In its comment letter on the proposed amendment (Letter from Stacie E. McGinn to Board of Governors of the Federal Reserve System, January 3, 2011), Bank of America cited tests showing that more than 10% of applications that pass today would not pass under the ability to pay calculation of the proposed rules. Bank of America letter, p. 2.
members of Congress who worked on CARD Act language and the ability to pay requirements recently called upon the Fed to revise its proposed amendment, siding with the credit community in concluding that “stay-at-home moms” and other adults “without certifiable income” might be unjustly denied credit.21

In a credit-centric economy, most consumers use credit cards, even those who do not earn wages. The Federal Reserve Bank of Boston reported that 78% of consumers (176.8 million Americans) owned a credit card in January 2010.22 More than 80% of the student population has credit cards, according to Sallie Mae.23 Yet the civilian labor force participation is closer to 65% or 66%.24 Obviously, many consumers without independent income are using credit cards. The banking and card-issuing industries accept (and rely upon) the reality that some of their customers pay their accounts with funds of others, including spouses, partners, and parents. These creditors grant credit to some individuals based on credit histories that reflect access to funds rather than individual income. Not surprisingly, card issuers promote credit availability. The Fed’s proposed requirement for demonstrable independent income on the part of every card holder, on the other hand, is a “significant – and potentially dangerous – set-back” which was unintended by Congress when it enacted the CARD Act.25

23 “How Undergraduate Students Use Credit Cards,” Sallie Mae, April 2009.
About the Authors:

**Sara Emley** is a Partner of BuckleySandler LLP. She advises financial services firms on regulatory and other legal issues applicable to investment advisers, investment companies, broker-dealers and credit card issuers. Ms. Emley also advises financial services firms on compliance with ERISA and other laws and regulations applicable to retirement accounts, and assists clients in filings with regulators. She represents clients in examinations, investigations and proceedings brought by the Securities & Exchange Commission and self-regulatory organizations. Ms. Emley was Note Editor of the Duke Law Journal. Prior to entering private practice, she served as a law clerk for Chief Judge Stephanie Seymour, United States Court of Appeals for the Tenth Circuit. She may be reached at semley@buckleysandler.com.

**Manley Williams** is a partner of BuckleySandler LLP. Her practice focuses on retail financial services, with an emphasis on consumer protection and the specialized regulatory provisions applicable to major credit card issuers, credit reporting agencies, and debt collection agencies. Ms. Williams was previously a staff attorney in the Legal Division and the Division of Consumer and Community Affairs at the Federal Reserve Board in Washington, DC, where she worked with Regulations Z (Truth in Lending), B (Equal Credit Opportunity), C (Home Mortgage Disclosure), X (Real Estate Settlement Procedures), and CC (Availability of Funds and Collection of Checks), as well as with monetary policy and community development issues. Ms. Williams graduated from Harvard Law School. She may be reached at mwilliams@buckleysandler.com
Real Estate Lending Preemption After Dodd-Frank
By
Robert A. Cook and Timothy P. Meredith, Hudson Cook, LLP

In the aftermath of the Dodd-Frank Wall Street Reform and Consumer Protection Act1 (“Dodd-Frank” or the “Act”), national banks and federally chartered savings banks2 have been concerned about the Act’s impact on federal preemption of state laws with respect to consumer financial services transactions. In assessing this impact, many have overlooked the fact that, while Dodd-Frank effects a sea change for most existing preemption rules, it made only one change to the preemption rules for real estate lending transactions: the Act increases the level of scrutiny courts give to the Office of the Comptroller of the Currency’s (“OCC” or “Comptroller”) real estate lending regulations. Although this change is not nearly as comprehensive as the changes Dodd-Frank made to other preemption rules, it does introduce an element of uncertainty to the real estate lending preemption analysis. Further, as a practical matter, banks should consider that in the current environment, the Comptroller is likely to be a far more less aggressive advocate of preemption than it has been in the past.

Section 1044 of Dodd-Frank creates a new express preemption standard that is effective on the designated transfer date, July 21, 2011.3 Under the new standard, a state law affecting a consumer financial services transaction is preempted if (1) the law discriminates against a national bank (as compared to a state bank chartered in the state), (2) the law is preempted under the “Barnett” standard,4 or (3) the law is preempted by Federal law “other than Title LXII.” “Title LXII” refers to Title LXII of the Revised Statutes of the United States5, commonly known

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1 Pub. L. 111-203.

2 Under Dodd-Frank, the lending authority of federal savings banks will be subject to the same preemption standards that apply to national bank lending powers. Dodd-Frank Act § 1046. Dodd-Frank is not entirely clear on how this will work. However, it appears that federal savings banks will be treated the same as national banks after these provisions of Dodd-Frank become effective. Section 312 of Dodd-Frank transfers to the Federal Reserve Board and the Office of the Comptroller of the Currency, respectively, the functions of the Office of Thrift Supervision as regulator of savings and loan holding companies and federal thrift institutions, respectively.

3 Dodd-Frank Act § 1048.


5 See Dodd-Frank Act § 1044(a).
as the National Bank Act and generally found at 12 U.S.C. 21 et seq. The real estate lending authority for national banks resides in 12 U.S.C. § 371. Section 371 is part of the Federal Reserve Act, even though it is located in the midst of provisions that are part of the National Bank Act. The OCC’s current real estate lending rules, found in 12 CFR Part 34, are based on the real estate lending authority located in 12 U.S.C. § 371, not Title LXII. Consequently, preemption questions that arise in connection with a federally chartered bank’s real estate lending authority need not be analyzed under Dodd-Frank’s new “discrimination” test or the Barnett standard. Further, real estate lending preemption is not subject to the same procedural hurdles under Dodd-Frank that limit how and when the OCC may issue preemption determinations in connection with state laws that affect other consumer financial transactions. For example, the OCC may only issue preemption determinations in connection with laws found in Title LXII on a “case-by-case basis” and any preemption determinations based on Title LXII must be supported by “substantial evidence”. In addition, preemption determinations under Title LXII may only be issued after consultation with the Bureau of Consumer Financial Protection, and the Comptroller may not delegate the authority to staff to make such determinations. Rather, the determination must be issued by the Comptroller. These procedural hurdles do not apply to Part 34 or any future real estate lending preemption determinations issued under 12 U.S.C. § 371.

Nevertheless, Dodd-Frank changes the landscape for real estate lending in one very important way. Part 34 and any new regulations or preemption determinations the Comptroller issues under 12 U.S.C. § 371 will be subject to greater scrutiny by the courts. Dodd-Frank lowered the level of “deference” a court must give to any OCC preemption determination or regulation, including those issued under 12 U.S.C. 371. Before Dodd-Frank, courts applied “Chevron deference” to the OCC’s preemption determinations. Under the Chevron standard, first established by the U.S. Supreme Court in *Chevron U.S.A. v. NRDC*, 467 U.S. 837 (1984), if the intent of Congress is not clear from the face of the federal statute at issue, a court will defer

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6 The annotations at 12 U.S.C. § 21 provide a listing of the provisions in Title 12 of the United States Code that comprise Title LXII of the Revised Statutes of the United States. Note that several sections within 12 U.S.C. §§ 21 et. seq. are not part of Title LXII.

7 See 69 FR 1904, 1907, FN 18 and surrounding text (January 13, 2004).

8 Dodd-Frank Act § 1044 to be codified at Title LXII of the Revised Statutes of the United States §5136B(b)(3).

9 Dodd-Frank Act § 1044 to be codified at Title LXII of the Revised Statutes of the United States §5136B(e).

10 Dodd-Frank Act § 1044 to be codified at Title LXII of the Revised Statutes of the United States §5136B(b)(3)(B) and §5136B(b)(6).

11 Dodd-Frank Act § 1044 to be codified at Title LXII of the Revised Statutes of the United States §5136B(b)(5)(A).
to an agency’s interpretation of the statute if the agency’s interpretation is based on a “permissible construction” of the statute:

If the statute is silent or ambiguous with respect to the specific question, the issue for the court is whether the agency's answer is based on a permissible construction of the statute."

Thus, in the past the Comptroller did not necessarily need to reach the right answer, or even the best answer when deciding whether a federal law preempted a state consumer financial law. As long as there was any ambiguity in the federal statute, the Comptroller’s interpretation simply had to be one permissible way to construe the federal statute.

Under Dodd-Frank, courts must apply the following new standard when asked to review an OCC preemption determination, including the rules in 12 CFR Part 34:

(A) Preemption.--A court reviewing any determinations made by the Comptroller regarding preemption of a State law by this title or section 24 of the Federal Reserve Act (12 U.S.C. 371) shall assess the validity of such determinations, depending upon the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision.¹²

Therefore, the rules in Part 34 will be subject to more stringent judicial review under Dodd-Frank than they were under the Chevron standard. Courts will have to consider the thoroughness of the OCC’s considerations, the validity of the OCC’s reasoning and whether the preemption determination at issue is consistent with other valid OCC determinations, as well as any other factors the court finds important. Thus, while the preemption rules in Part 34 (or any real estate lending regulations issued under 12 U.S.C. 371 prospectively) need not pass muster under Dodd-Frank’s procedural hurdles, a court must still find them to be well reasoned, consistent and persuasive.

Even if national banks or federal savings banks are comfortable that Part 34 will survive this heightened judicial scrutiny, banks may still have practical concerns about relying on the broad preemption found in Part 34. Although the Obama Administration has yet to appoint a new Comptroller, it is unlikely, given Congress’ roll-back of preemption in Dodd-Frank, that the next Comptroller will be aggressive on the issue of federal preemption. The OCC may back down from its historical practice of filing amicus briefs and providing other assistance to national banks in preemption cases. It is even possible that the new Comptroller could pursue more sweeping measures, like rewriting Part 34 to dilute its strong preemption authority.

¹² Dodd-Frank Act § 1044 to be codified at Title LXII of the Revised Statutes of the United States §5136B(b)(5)(A).
In conclusion, national banks and federal savings banks continue to enjoy a strong preemption foundation in connection with real estate lending. Part 34 supports the notion that real estate lending by national banks and federal savings banks is largely a matter of federal law and that most the state consumer financial laws would not apply. However, after the designated transfer date, courts will assess the validity of an OCC preemption determination under a much more stringent standard. In addition, banks should not count on the OCC to continue in its adopted role as preemption’s champion.
FDIC-Assisted Transactions:
Target Sizes Shrink, but Opportunities Remain Large

By Lorraine M. Buerger
Schiff Hardin LLP*

It’s no surprise that the tally of bank failures continues to mount. As the first quarter of 2011 draws to a close, the total number of bank failures during the current cycle of turmoil in the banking industry has topped 350. According to the Federal Deposit Insurance Corporation (“FDIC”), last year’s 157 bank failures was the highest number since 1992.

Last year is predicted by many (including the FDIC itself\(^1\)) to represent the high point in the ongoing wave of bank failures. However, with more than 850 banks remaining on the FDIC’s list of problem institutions as of the most recently-published FDIC Quarterly Banking Profile, the pace of failures in 2011 is most likely to abate only slightly from the peak.

However, while the number of failed banks is expected to remain high, the amount of assets held by failed banks has significantly declined. The size of the banks placed into FDIC receivership has steadily decreased during the current cycle. Total assets of the 157 bank failures during 2010 were $90 billion, representing a dramatic decrease from the $169 billion in assets held by the 140 banks that failed during 2009. The fact that bank failures now tend to be smaller institutions is not unexpected, in light of the tremendous difficulty that smaller banks currently face when seeking fresh capital, particularly when attempting to raise capital pursuant to a mandate from regulators.

\(^1\) “... the FDIC has been predicting that 2010 will be the high water mark for bank implosions. ‘Going forward, the FDIC looks to see fewer failures,’ agency spokesman Greg Hernandez said.” The Washington Post, Dec. 28, 2010.
These trends combine to spell ongoing opportunity for willing and qualified buyers, including for community banks for whom failed bank targets with smaller asset bases are highly attractive and uniquely suitable targets.

In addition, these opportunities are made even more noteworthy by the fact that such smaller targets, with fewer assets and less expansive franchises, in some instances will fail to attract significant bidding interest during the FDIC’s pre-failure marketing efforts conducted by its Franchise Marketing organization. The result is likely to be potentially more attractive transaction economics for savvy bidders that recognize the opportunity the assets of smaller failed banks can represent.

**Successfully Buying the Assets of a Smaller Failed Bank**

Bidders for all failed bank assets face the constraints and limitations necessitated by the FDIC’s Franchise Marketing process, including tight timing, rigorous confidentiality obligations and limited opportunities for on-site due diligence (loan reviews). Bidders for smaller failed bank targets can improve their prospects for a successful outcome by utilizing several techniques:

- With a smaller asset base, there is reduced margin for error, so the deepest possible understanding of the credit portfolio is key to success. With a smaller portfolio to review, bidders have an opportunity to extract more value from the limited on-site diligence window. Rather than conducting a spot check of random files or reviewing only the largest credits, bidders should: (a) maximize their on-site diligence window (*i.e.*, request the largest allowable on-site team for the longest window of time), and (b) expand review to as many credit files as possible, focusing on the commercial loans, lines
of credit and largest residential loans and HELOCs. The greater a bidding team’s knowledge of the credit portfolio, the more bidding power it commands.

- Local bidders always have an inherent advantage, because they know the local community, the competitive dynamics and the real estate market and in some instances may even have knowledge of individual borrowers. Whenever possible, bidders should maximize that advantage by conducting diligence on an open bank basis, as early as possible in the process. By remaining well-informed regarding publicly-available, formal regulatory actions (Consent Orders and Written Agreements) against local competitors, potential bidders can seek out or create open-bank diligence opportunities.

- Unlike bidders that may be interested in (or at least considering) failed bank targets of various sizes in multiple states, community bank bidders for smaller targets often are interested in a single target that represents a carefully-selected, well-understood, and in some cases ideal addition to the bidder’s existing franchise. In such instances, skillful bidding is imperative. Hopeful bidders should heighten their chances of success by conducting “moot bidding” exercises. The bidder should conduct on-line diligence and prepare (but not submit) bids for failed bank targets failing prior to the bidder’s true strategic target. The results of this exercise will sharpen the skills of the bidder’s diligence team, and provide invaluable experience for the team responsible for drafting the bid. By studying the economics of the moot bid against the ultimate winning bid, the team will dramatically improve its likelihood of success for the team’s eventual target.

- Smaller asset bases, for which more comprehensive diligence of the credit portfolio is possible, invite strategic consideration of non-loss-share transactions. Although highly disfavored for failed banks with larger asset bases (notably, the
overwhelming majority of failed bank deals since 2008 have been structured to include loss sharing with the FDIC), the trend toward ever-decreasing failed bank asset bases makes non-loss-share deals less risky. Even if bidders strongly prefer the protection of loss sharing with the FDIC, the bidding team should at minimum consider the possibility that non-loss-share bids might be submitted by other bidders. The FDIC highly encourages submission of multiple bids. In light of the opportunity to submit bids of different types (e.g., with and without loss share protection), bidders should at least consider the strategic possibilities available.

**Continued Process Changes**

Simultaneous with the steady pace of Friday evening failed bank closures, the FDIC continues to refine its process for receiverships, consistent with its goal of minimizing costs to the insurance fund. The result is a process that is dynamic and in an ongoing state of change. Remaining well-informed about the FDIC’s process is another key to being a successful buyer in FDIC-assisted transactions. However, bidders for smaller targets are often disadvantaged by not having previous experience with FDIC-assisted transactions, and being unfamiliar with the FDIC’s process.

For example, the FDIC recently introduced its latest iteration (Version 3.01) of the Purchase and Assumption Agreement (the “P&A”) pursuant to which failed bank assets are purchased. With Version 3.01, the FDIC has eliminated the former “With Loss Share” and “No Loss Share” versions of the P&A. A single version is now used for all Whole Bank transactions, and the exhibits including loss share terms and conditions (Exhibits 4.15A and 4.15B) are attached or excluded, based on the final terms of the transaction. In addition, the latest version is noteworthy for being the FDIC’s most extensive “clean-up” of the P&A to date. Experienced
bidders know that dozens of the changes to the document are merely cosmetic, making the document more internally consistent. Distinguishing between the cosmetic and substantive revisions can be a challenge for less experienced bidders, including those likely to focus on smaller failed bank targets.

In conclusion, although failed bank targets are expected to generally be smaller in the year ahead, they will be numerous and represent significant opportunities for well-prepared bidders. Bidders for targets of all sizes can best prepare for success by approaching the bidding process strategically, and taking steps to familiarize themselves as much as possible with the FDIC’s process for failed-bank transactions.

* Lorraine (Lori) M. Buerger is an attorney at Schiff Hardin, LLP and member of the firm’s Financial Institutions Client services Group. Lori’s practice concentration is on corporate transactions, with a particular focus on banking regulation and FDIC-assisted transactions. Prior to joining the firm, Lori spent 15 years representing corporations in the areas of regulatory/legislative affairs. She can be contacted at lbuerger@schiffhardin.com.

For more information regarding the fundamentals of acting as bidder in FDIC-assisted transactions, see the author’s earlier article in the ABA Banking Law Committee Journal, October 2010.

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