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Attorneys

Kenneth F. Ehrlich

Matthew D. Hanaghan

Michael K. Krebs

Practice Areas

Corporate and Transactions

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1. Final FDIC Policy Restricts Private Investors in Failed Bank Acquisitions

The FDIC has adopted a final policy statement that will apply to private equity investors who participate in the acquisition of banking assets in receivership. The final Statement of Policy on the Acquisition of Failed Insured Depository Institutions approved on August 26 provides guidance to prospective investors about the standards they will be expected to meet in order to qualify to bid on a failed institution. The final policy statement incorporates a number of significant changes compared to the policy statement that was originally proposed in July. Those changes include, for example, refining the description of the types of investors covered, lowering the capital standard that the resulting institution must commit to maintain after the acquisition, and clarifying the circumstances in which a cross-support obligation would apply. The final policy statement eliminates the proposed source of strength provisions which would have required any holding company serving as an investment vehicle to enter into an agreement to sell equity or otherwise raise capital, if necessary, to support the resulting bank. The FDIC Board of Directors may waive one or more provisions of the policy statement if it determines that such a waiver is in the best interests of the Deposit Insurance Fund, and that the goals and objectives of the policy statement can be accomplished by other means.

Nutter Notes: The policy statement imposes significant burdens on bidders for failed banks that are backed by private equity investors and may to a certain extent dampen the interest that some investors have in funding acquisitions of failed banks. Although some of the requirements in the policy statement as originally *proposed have been softened and the source of strength requirement has been eliminated, many of the proposed restrictions on private equity investors have been retained in the final policy statement. The prescribed minimum capital commitment has been revised to provide for a level of initial capitalization sufficient to establish a ratio of Tier 1 common equity to total assets of at least 10% throughout the first 3 years after the acquisition, down from a Tier 1 leverage ratio of not less than 15% in the original proposal. The original proposal also included a cross-guarantee provision that would have required a holding company or bank that acquires a failed bank and that also holds majority investments in one or more other FDIC insured banks to pledge to the FDIC its proportionate interests in each such bank to pay for any losses to the Deposit Insurance Fund resulting from the failure of any such other bank. Under the final policy statement, the pledge will only be required from investors owning 80% or more of two or more banks or thrifts. The final policy statement retains limits on transactions with affiliates, continuity of ownership requirements and other restrictions on private equity investors largely unchanged from those originally proposed.*

2. Guidance Issued on ALLL for Junior Lien Mortgage Loans

The FDIC has issued guidance for estimating credit losses on groups of loans with similar risk characteristics, particularly loans secured by junior liens on residential properties in areas where there have been declines in the value of such properties. A financial institution letter (FIL-43-2009) issued on August 3 advises banks that, when estimating credit losses on such groups of loans, an institution should consider its historical loss experience on the group, adjusted for changes in trends, conditions, and other relevant factors in the current economic environment that affect repayment of the loans in the group as of the allowance evaluation date. According to the guidance, after determining the appropriate historical loss rate for each group of junior lien loans with similar risk characteristics, management should consider those current qualitative or environmental factors that are likely to cause the estimated credit losses on these loans as of the evaluation date for the allowance for loan and lease losses (ALLL) to differ from the group's historical loss experience. The FDIC cautions that failure to timely recognize estimated credit losses could delay appropriate loss mitigation activity, such as restructuring junior lien loans to more affordable payments or reducing principal on the loans to facilitate refinancing.

Nutter Notes: The Interagency Policy Statement on the Allowance for Loan and Lease Losses, issued in revised form by the federal banking agencies in December 2006, requires each depository institution to develop, maintain, and document a comprehensive, systematic, and consistently applied process for determining the amounts of the ALLL. The FDIC's August 3 guidance reminds institutions that an appropriate ALLL covers estimated credit losses on individually evaluated loans that are determined to be impaired and on groups of loans with similar risk characteristics that are collectively evaluated for impairment. The August 3 guidance also advises institutions that the factors that are likely to cause the estimated credit losses on junior lien loans to differ from a group's historical loss experience include changes in the repayment status of the junior lien borrowers' loans secured by more senior liens on the same properties, changes in the value of the underlying real estate collateral, including the extent to which senior lien loan balances or the combined balances exceed the value of the underlying real estate, and the institution's policies regarding the initiation of foreclosure on junior lien loans and bidding by more senior lienholders. According to the guidance, FDIC examiners will continue to evaluate the effectiveness of an institution's loss mitigation strategies for loans as part of their assessment of the institution's overall financial condition.

3. FFIEC Warns Loan Servicers about Conflicts Arising in Loan Modifications

The member agencies of the Federal Financial Institutions Examination Council (FFIEC) have jointly issued a statement entitled Support for Responsible Loss Mitigation Activities that addresses conflicts of interest that can arise in the context of loan modification decisions. The statement released on August 6 reiterates the agencies' continued support for loan loss mitigation activities designed to preserve homeownership, including programs designed to achieve sustainable mortgage obligations regardless of lien position. The statement is directed in particular at institutions that are servicing both first and subordinate lien loans secured by the same residential real estate. Such servicers may be faced with potential conflicts of interest when making loan modification decisions because a loan modification may affect the priority or prospects for recovery of all lienholders on the mortgaged property. The August 6 statement reminds loan servicers that they have a duty to act in the best interests of the owners or investors in serviced residential mortgage loans and in accordance with the terms of applicable contractual arrangements.

Nutter Notes: A servicer's decision to alter the terms of a loan that is not anticipated to produce a greater recovery to owners or investors in the mortgage loan, regardless of any potential effect on other lienholders, may constitute a breach of the duties the servicer owes to the owners or investors, according to the agencies' guidance. The federal banking agencies issued statements in April 2007 and again in September 2007 encouraging financial institutions and any other entities that service mortgage loans to work with borrowers on strategies to mitigate loan losses while preserving homeownership, consistent with safe and sound lending practices. The agencies' August 6 guidance coincides with recent Treasury Department announcements that its Making Home Affordable loan modification program is on pace to assist between 3 and 4 million homeowners over the next 3 years and that Treasury will provide additional incentive payments for Making Home Affordable program participants that conduct loan modifications in areas where home price declines have hit the hardest.

4. Massachusetts Revises Data Security Requirements and Postpones Compliance Deadline

The Office of Consumer Affairs and Business Regulation (OCABR) has revised Massachusetts' new information security regulation. The amendments to the Standards for the Protection of Personal Information of Residents of the Commonwealth (201 C.M.R. 17.00) announced on August 17 include an extension of the compliance deadline until March 1, 2010. The new information security requirements would have become effective on January 1, 2010. The regulation requires all businesses, regardless of location, that maintain personal information about Massachusetts residents to develop and implement an information security program that is consistent with the standards in the new law and regulations. Depository institutions are not exempt from the Massachusetts regulation, which includes minimum security standards that are more strict than those set forth in the federal banking agencies' Interagency Guidelines Establishing Information Security Standards. The amendments modify previously issued requirements to evaluate and monitor compliance by third-party service providers, to conduct an inventory of records containing protected personal information, and to impose limits on collection of and access to protected personal information. The revised computer system security rules are now applicable only to the extent that they are "technically feasible." Prior to the amendment, the technical feasibility condition only applied to certain encryption requirements. In its press release, OCABR said that the August 17 changes are meant to “reinforce flexibility in compliance by small businesses.”

Nutter Notes: The revised rule requires that a business must oversee service providers by “taking reasonable steps to select and retain” those service providers that are capable of maintaining appropriate security measures, and contractually requiring such vendors to maintain appropriate security measures. It appears that contracts entered into before March 1, 2010 will be grandfathered until March 1, 2012, and thereafter must be amended to include certain security requirements, but there is some ambiguity in the revised regulation about the application of the rule to contracts entered into before March 1, 2010. The revised regulations define the term “service provider” to mean any person that receives, maintains, processes or otherwise has access to protected personal information through its provision of services directly to a person that is subject to the information security standards. The amended regulation no longer expressly requires businesses and individuals to specifically identify all paper and electronic records that contain protected personal information, or to immediately prohibit terminated employees from accessing personal information physically or electronically. Rules requiring that businesses limit the amount of personal information collected, and limit employees who have access to the information and the time such information is retained to that which is reasonably necessary have also been eliminated. Nevertheless, those security measures may still be reasonably necessary to safeguard protected personal information based on the nature of the business of the person obligated to comply with the security standards.

5. Other Developments: SEC Advisory on ALLL and Transaction Account Guarantee

- SEC Sends Letter to Public Banking Companies About ALLL Disclosures

The Securities and Exchange Commission sent substantially identical letters in August to chief financial officers of certain publicly-held banking companies identifying disclosure issues they may wish to consider in preparing public disclosure about the manner in which they account for ALLL. The letter suggests that the current economic environment may require institutions to reassess whether the information upon which accounting decisions are based remains accurate.

Nutter Notes: The letter recommends that institutions reconfirm or reevaluate their accounting for ALLL, and reevaluate the Management’s Discussion and Analysis disclosure in SEC reports. The letter includes examples of common suggestions the SEC has provided to financial institutions on Management’s Discussion and Analysis disclosures about ALLL.

- FDIC Extends the Transaction Account Guarantee Program

The FDIC approved an extension of the Transaction Account Guarantee component of the Temporary Liquidity Guarantee Program on August 26. The program will be extended for 6 months until June 30, 2010. Each insured depository institution that participates in the extended program will be subject to increased fees during the extension period.

Nutter Notes: Each institution that is currently participating in the program, which guarantees unlimited deposits in qualifying noninterest-bearing transaction accounts, will have an opportunity to opt out of the extension. Each participant must also review and update its disclosure postings and notices to accurately reflect whether it is participating in the extension.

Nutter Bank Report

Nutter Bank Report is a monthly electronic publication of the Banking and Financial Services Group of the law firm of Nutter McClennen & Fish LLP. Chambers and Partners, the international law firm rating service, has ranked Nutter's Banking and Financial Services practice among the top banking practices in the nation. The 2009 Chambers and Partners review says that a "real strength of this practice is its strong partners and . . . excellent team work." Clients praised Nutter banking lawyers as "practical, efficient and smart." Visit the U.S. rankings at ChambersandPartners.com. The Nutter Bank Report is edited by Matthew D. Hanaghan. Assistance in the preparation of this issue was provided by Lisa M. Jentzen. The information in this publication is not legal advice. For further information, contact:

Kenneth F. Ehrlich
kehrlich@nutter.com
Tel: (617) 439-2989

Michael K. Krebs
mkrebs@nutter.com
Tel: (617) 439-2288