FDIC Issues Recent FIL on Overdraft Protection Programs

The federal banking regulators have placed a particular amount of focus on overdraft payment programs. In 2005, Joint Guidance on Overdraft Protection Programs was issued (FIL-11-2005), and then on November 12, 2009, The Federal Reserve Board amended Regulation E. On August 11, 2010, the FDIC issued a Financial Institution Letter (FIL-47-2010) relative to overdraft payment programs and consumer protection. The Summary of the FIL provides that, “[t]he FDIC expects the institutions it supervises to closely monitor and oversee any overdraft payment programs they offer to consumers. Such oversight should include appropriate measures to mitigate risks, incorporating the best practices outlined in the 2005 Joint Guidance on Overdraft Protection Programs, and effective management of third-party arrangements. Management should be especially vigilant with respect to product over-use that may harm consumers, rather than providing them the protection against occasional errors or funds shortfalls for which the programs were intended.” The FDIC does clarify, however, that ad hoc overdraft payments made as an accommodation are not the focus of this guidance, nor are linked lines of credit. (FIL 47-2010, Supplemental Information). The Supplemental Information attached to the FIL-47-2010 provides that the FDIC is concerned about the risks posed by automated overdraft payment programs and includes a list of actions regarding automated overdraft payment programs that the FDIC expects its supervised institutions to take. The list of actions includes: ensuring ongoing and regular board and management oversight of program features and operation (Appropriate steps include an annual review of an overdraft program’s features.); review of marketing, disclosure, and implementation of such programs to minimize potential consumer confusion and promote responsible use; train staff to explain program features and other choices; prominently distinguish account balances from any available overdraft coverage amounts; monitor programs for excessive or chronic customer use, and if a customer overdraws his or her account on more than six occasions where a fee is charged in a rolling twelve-month period, undertake meaningful and effective follow-up action (Examples given of follow-up action include contacting the customer to discuss less costly alternatives, and giving the customer a reasonable opportunity to decide whether to continue fee based overdraft coverage or choose another available alternative.); institute appropriate daily limits on customer costs; consider providing information to consumers about how to access free or low-cost financial education workshops or individualized counseling to learn how to more effectively manage personal finances; review check-clearing procedures to ensure they operate in a manner that avoids maximizing customer overdrafts and related fees through the clearing order; and monitor and, where necessary, mitigate credit, legal, reputational, safety and soundness, and other risks, as appropriate. FIL-47-2010, Supplemental Information, Supervisory Expectations.

The Supplemental Information to the FIL also references the new Regulation E Requirements, which took effect on July 1, 2010. The FDIC explains that in complying with the Regulation E requirements, “institutions should not attempt to steer frequent users of fee-based overdraft products to opt in to these programs while obscuring the availability of alternatives.” Further, the FIL supplemental materials explain that, “any steering activity with respect to credit products raises potential legal issues, including fair lending, and concerns about unfair and deceptive acts or practices, among others, and will be closely scrutinized.” FIL-47-2010, Supplemental Information, Regulation E Requirements. The FDIC also goes on to explain that overdraft payment programs will
Comparison of Commercial Lending Authority Among Charters

The enactment of the Dodd-Frank Act has caused many financial institutions to reevaluate their charter to determine if it will continue to meet their needs going forward. One factor that an institution may consider is the ability of the charter to make commercial loans. In general, commercial bank charters are not required to have a minimum amount of residential mortgage loans, and thus, don’t have the restrictions limiting the amount of commercial loans that can be made as a percentage of their assets. Remember, however, that the focus of the discussion is about the ability to have a certain mix of loans, and there are many other factors that may come into play that may limit an institution’s ability to make commercial loans such as capital levels, concentration risk issues, loan-to-one borrower limitations, and others.

State-chartered Savings and Loan Associations are limited by the Qualified Thrift Lender Test (“QTL”), which requires that an association’s qualified thrift investments equal or exceed 65 percent of the savings association’s portfolio assets, and the savings association’s qualified thrift investments continue to equal or exceed 65 percent of the savings association’s portfolio assets on a monthly average basis in 9 out of every 12 months. (HOLA Section (m))(12 U.S.C. 1464). There are additional limitations for savings and loan associations. State-chartered savings and loan associations, according to La. R.S. 6:822(b)(i), are limited in the amount of nonresidential (commercial) real estate loans, which shall not exceed forty percent of its assets. In addition, for commercial loans that are unsecured or secured by something other than real estate, such as UCC-9 security interests in equipment or inventory, a savings and loan association is limited in that the aggregate amount of such loans shall not exceed ten percent of the assets of the association. (La. R.S. 6:822(2)(r)). Thus, a state chartered savings and loan association is limited as to how many commercial loans it can make. In comparison, federal savings associations are subject to a twenty percent limitation for non-real estate commercial loans. The LBA has raised this issue with the Office of Financial Institutions and has asked that they consider allowing state chartered savings associations to have the same lending authority as federal savings associations for unsecured or non-real estate secured commercial loans. (20% of assets).

Federally-chartered savings associations (including Federal Savings Banks) are similarly limited by the QTL Test as discussed earlier for state savings and loan associations. In addition, the Federal Home Owners Loan Act limits the amount of commercial and other loans that a Federal savings association can make to not exceed 20 percent of the total assets of the association. Such loans may be secured or unsecured loans for commercial, corporate, business, or agricultural purposes. Also, amounts in excess of 10 percent of such total assets may be used only for small business loans, as that term is defined by the Director of OTS. (HOLA Section (5)(c)(2)(A)). Federally-chartered savings associations are also limited by the amount of nonresidential real estate loans that can be made to an aggregate amount of 400 percent of the association’s capital, as determined under subsection (t), with an exception to this limitation where permitted by the Director. (HOLA Section 5(c)(2)(B)).

State-chartered savings banks are required to qualify as a QTL by maintaining the sixty percent asset test of the Internal Revenue Code of 1968 and any subsequent amendments. (La. R.S. 6:1140). This is referred to as the Domestic Building and Loan Association Test or DBLA test (IRS regulation 26 CFR Section 301.7701-13A). The 60 percent assets test requires that at least 60 percent of a DBLA’s assets must consist of assets that thrifts normally hold, except for consumer loans that are not educational loans. The DBLA test does not include mortgage loans originated and sold into the secondary market and subsidiary investments. As to the remaining 40 percent of assets not used to meet the QTL qualifications, the state savings bank should have some flexibility to make commercial real estate secured loans and unsecured loans according to La. R.S. 6:1222(8). Section 1222(8) provides that a savings bank may loan funds subject to the limitations imposed by existing law, through secured or unsecured loans for business, corporate, commercial, or agricultural purposes. Further, Section 1136(A) of the Louisiana State Savings Bank Act of 1990 (“LSSB Act”) gives the state savings bank charter some parity as to powers with banks operating under the laws of Louisiana. The parity provision is however subject to the regulations of the
commissioner, and must be consistent with the policy and purposes with the LSSB Act.

In conclusion, the ability to make commercial loans is just one factor that an institution may want to consider when evaluating the utility of a charter. The analysis will depend on your business plan and determining which charter provides the features that best fit your needs.

**7th Circuit Decision in Vainisi v. Commissioner Stands**

Since the IRS failed to request cert in the case of *Vainisi v. Commissioner* (the TEFRA interest disallowance case for S corporation and QSub banks) following the 7th Circuit Court of Appeals’ decision in March, the decision stands as final on the issue. As you may recall, the 7th Circuit held that the clear language of the statute should apply in this case, which is that a sub S bank (regardless of whether it is a parent or subsidiary of another S corp and therefore, a QSub) is not subject to the application of IRC section 291, 20% interest disallowance rule on its qualified tax-exempt obligations (QTEOs) after three years of S status.

The issue in the case, which had been the subject of IRS audits, proposed regulation and litigation over the last few years, was essentially whether Congress intended the application of the TEFRA interest disallowance rules as interpreted by the IRS. According to the IRS, even though Section 1363(b)(4)) clearly states that the interest disallowance provision of Section 291 (the “TEFRA haircut”) should not apply to an S corporation with a C history after three years, Congress did not intend that S corporation banks be excluded from the TEFRA haircut after three years of S status. The court gave very little deference to the Tax Court’s reasoning and pretty much dismissed the IRS’s proposed regulation as an attempt to reflect Congress’ intent or to “correct” the anomalous result created with respect to S banks by the language of Section 1363(b)(4)).

Even though the IRS did not request review by the U.S. Supreme Court, it is still unclear what their next steps would be. No statement has been issued on whether the IRS intends to seek a “legislative fix” to the “perceived” problem with the statute or whether guidance reflecting the application of the rule as interpreted by the 7th Circuit will be issued. It is important that while the Service is contemplating its next steps, it should withdraw its 2006 proposed regulation, whose validity even the 7th Circuit questioned, and also issue guidance as quickly as possible outlining steps that taxpayers who have been taking the TEFRA haircut should follow in order to receive their refunds. View the Appeals Court decision. (Source: ABA Subchapter S News, September 24, 2010)

**Louisiana Attorney General Issues Opinion on Judicial Sales Under Writ of Fieri Facia**

The Louisiana Attorney General on August 30, 2010 released opinion number 10-0161 addressing a question raised by a local government marshal. The question raised was whether the seizing creditor or a representative have to be present on the date of the scheduled sale in order to conduct the sale. The opinion referred to La. Code of Civil Procedure article 2338(B), which provides that, “[i]f the seizing creditor is not present or represented at the sale, the property shall not be sold for less than the amount necessary to fully satisfy his writ plus the costs.” The opinion further explained that it is not necessary for the seizing creditor to be present or represented at the sale in order for the sale to proceed; however, the property cannot be sold for less than the amount necessary to fully satisfy the writ plus the costs if the seizing creditor is neither present nor represented at the sale. View AGO 10-0161.

**Louisiana Attorney General Issues Opinion on Applicability of Small Succession Law Changes**

The Louisiana Attorney General released Opinion Number 10-0086 on August 27, 2010 addressing the applicability of the changes to the small succession law. The opinion provides that the change in the definition of small succession made by Act 81 of the 2009 Louisiana Regular Legislative Session, which permits the use of the affidavit procedure to administer a small succession valued up to $75,000, is applicable only to those persons deceased on or after January 1, 2010. The Attorney
General opinion explains that the provisions of Act 81 became effective on June 18, 2009, except for one provision: the change in the law concerning the definition of a small succession. Prior law considered a small succession to be the succession of a person who dies leaving property valued at $50,000 or less, while under Act 81, the aggregate value of a small succession was increased from $50,000 to $75,000 or less. Further, the Attorney General opinion explains that Act 81 does not create a time period in which the affidavit procedure may not be used. Rather, the opinion explains that the small succession by affidavit procedure may be used to administer an estate qualifying as a small succession, where the deceased person dies intestate, no matter the date of death, where the affidavit complies with the formalities imposed by law, and all other requirements of law are met. It is also explained in the opinion that the provisions of Act 81 are not limited solely to those persons deceased after January 1, 2010. It is explained that with one exception, all the provisions of Act 81 are applicable to those persons deceased prior to and on and after January 1, 2010, and that the one exception is the change in the law increasing the value of the small succession to $75,000, as it is here that the date of January 1, 2010 is of import. It is the Attorney General’s opinion that this change in the law, which permits the use of the affidavit procedure to administer a small succession valued up to $75,000, is applicable only to those persons deceased on and after January 1, 2010. View AGO 10-0086.

Federal District Court in California Holds That Bank’s Processing Practices Are in Violation
On August 10, 2010, a federal district court in the Northern District of California issued a ninety page findings of fact and conclusions of law in which it ordered Wells Fargo to pay $203 million to customers who, according to the court, were charged improper overdraft fees. The decision focused on whether the bank’s high-to-low posting practice was “unfair” under the California Business and Professions Code and whether that practice was “fraudulent” under that same Code (Section 17200). The Court seemed to focus on the shift by the bank to a high-to-low posting practice. The court also focused on the bank’s practice of commingling debit-card transactions with checks and ACH transactions in the posting process. Once commingled, these transactions were posted together in high-to-low order. (See page 66, line21 of the decision). Read the decision.

Note Holder Held to Have No Cause of Action Against Surviving Spouse of Note Maker
The Louisiana Court of Appeal for the Fifth Circuit issued a decision on an appeal of an exception of no cause of action and improper joinder of parties in which it held that no privity of contract existed, sufficient to sustain a cause of action by a note holder against a note maker’s surviving spouse. The case arose when a note holder brought a legal action to recover the unpaid balance of a note from the surviving spouse of the note maker. The other issue involved in this case had to do with the plaintiff’s failure to join the succession representative for the estate of the note maker. The Fifth Circuit explained that the trial judge should have allowed the plaintiff time within which to amend his petition. The appellate court remanded the matter to the trial court to allow the plaintiff an opportunity to amend his petition in order to remove the grounds for the objection of improper joinder of parties. Young v. Branch, 10-81 (La.App. 5 Cir. 5/25/10) 40 So.3d 1097.

Settlement Agreement on Note Held Enforceable
The Louisiana Court of Appeal for the Fifth Circuit decided a case where a bank as holder of a note brought a legal action against the maker of the note to recover the remainder of unpaid principal balance plus interest. The parties reached an agreement and entered into a receipt and release agreement in which the borrower agreed to pay a sum of money and sign a new promissory note, which would be payable in full in two years. It was also agreed that the borrower would execute an assignment, assigning his interest in an LLC to the bank. After execution of the agreement, the borrower paid the agreed sum of money, but never signed the new promissory note and never executed the assignment as agreed. The bank sought the borrower’s signature on the note and assignment, but he refused to sign. The bank then brought a motion to enforce settlement agreement. The trial court found that the maker of the note intended to settle the matter having
signed a release and receipt agreement and having paid the agreed sum to the bank. The trial court ordered the borrower to sign the note and security agreement. The matter was appealed. On appeal, the court looked to La. Civil Code articles 3071 and 3072 relative to compromises. Further, the court held that the trial court did not err in finding that this exchange satisfied the two essential elements of the compromise: a mutual intent to end the litigation and reciprocal concessions. The court further explained that the party seeking rescission of a settlement agreement bears the burden of proving its invalidity. The trial court found that the borrower failed to meet his burden to prove that the agreement was invalid and the appellate court could not find that the district court was wrong in its finding.

*Hancock Bank of Louisiana v. Holmes*, 09-1094 (La.App. 5 Cir. 5/25/10) 40 So.3d 1131.

### 2010 Bank Counsel Conference: A Conference on Banking Law and Regulations for Bankers and Bank Counsel

The 2010 LBA Bank Counsel Conference is scheduled for November 11 and 12 in New Orleans. This conference should be called the Banking Legal and Regulatory Developments Conference because these are the subjects discussed and it is not restricted to lawyers. In fact, many bankers, including CEO’s & compliance officers, regularly attend the conference. The conference focuses on current changes in state and federal laws that have occurred or that have become more timely during the past year. In addition, the conference includes presentations on current bank regulations. For example, this year there will be a panel discussion titled, “What Lenders Want Their Title Attorneys to Know about RESPA.” Here is a run-down of other topics that are scheduled to be presented this year: State Legislative Update; Secured Lending Update and Agriculture Lending Update; Bankruptcy Law Developments; UCC-9 Security Interests Recent Developments; Electronic Discovery-Proactive Policies and Responding to Requests; and a Panel Discussion on What Bankers Expect From Their Legal Counsel, and that is just what is to be presented on Thursday. On Friday we have presentations scheduled on: the Oil Spill and Drilling Moratorium and the Banking Industry Legal Issues; Procedural Pitfalls of Executory Process, Seizures, and the Rights of Keepers; the Dodd-Frank Wall Street Reform and Consumer Protection Act; Certificates of Insurance and Lenders’ Collateral; an Ethics Primer for Business Lawyers; and Attorney Professionalism. As you can see, we have scheduled a broad variety of topics reflecting the many issues bankers and bank counsel are currently facing. View the full brochure and registration information.

*Note: The information contained in this LBA Legal Bulletin is not intended to constitute, and should not be received as, legal advice. Please consult with your counsel for more detailed information applicable to your institution.*